



REPUBLIC OF KOSOVO
OFFICE OF THE AUDITOR GENERAL

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AUDIT REPORT
ON THE FINANCIAL STATEMENTS OF THE MINISTRY OF
LOCAL GOVERNMENT ADMINISTRATION
FOR THE YEAR ENDED 31 DECEMBER 2013

Prishtina, June 2014

The Office of the Auditor General (OAG) undertakes both Regularity and Performance Audits. The Auditor General Lage Olofsson, is the head of the Office of Auditor General, which employs around 145 staff. The Auditor General and the Office of the Auditor General shall be independent and certifies around 90 Annual Financial Statements each year, while undertaking other forms of audits.

Our Mission is to “Contribute to sound financial management in public administration”. We shall perform quality audits in line with internationally recognized public sector auditing standards and good European practices. We shall build confidence in the spending of public funds. We shall play an active role in securing taxpayers’ and other stakeholders’ interests in enhancing public accountability’

The reports produced by the Office of the Auditor General directly promote accountability as they provide a base for holding managers’ of individual budget organisations to account.

The Auditor General has decided on the audit opinion and report on the Annual Financial Statements of the Ministry of Local Government Administration in consultation with the Assistant Auditor General, Ibrahim Gjylderen, who supervised the audit.

The opinion and report issued are a result of the audit carried out under the management of the Audit Director, Vlora Mehmeti, supported by Jusuf Kryeziu (team leader), Igballe Halili and Aida Podrimaj.

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Executive Summary

Introduction

This report summarises the key findings from our audit of the 2013 Annual Financial Statements of the Ministry of Local Government and Administration, which determine the Opinion given by the Auditor General. I would like to thank the Minister of the Ministry of Local Government Administration and his team for their assistance during the audit process.

The examination of the 2013 financial statements was undertaken in accordance with the internationally recognised Public Sector auditing standards (ISSAIs) issued by INTOSAI. Our approach included such tests and procedures as we deemed necessary to arrive at an opinion on the financial statements. The approach taken is set out in our Audit Planning Memorandum dated 04/10/2013.

Our audit focus has been on:

- the Annual Financial Statements –compliance with the reporting framework and the significant issues highlighted in the Audit Planning Memorandum;
- the response to our 2012 and earlier recommendations; and
- the Financial Management and Internal Control of Ministry of Local Government and Administration (including budget execution and management).

The level of work undertaken by the Office of Auditor General to complete the 2013 audit is a direct reflection of the quality of the internal controls implemented by management.

Opinion

Annex I explains the different types of Opinions applied by the Office of Auditor General. The Auditor General's opinion is:

In our opinion, the financial statements present <i>a true and fair view</i> in all material aspects (ISSAI 200 Unmodified Opinion).

Overall Conclusion

Our overall conclusion based on the detailed sections of this report is that:

The internal control system of the Ministry of Local Government and Administration has been properly designed and has functioned well with the exception of some cases which should be taken into account in order not to lower the internal control credibility.

Our conclusion relating to Financial Management and Control is that a slight progress has been marked since 2012 in the area of management of expenditures through procurement procedures. Notwithstanding this, Ministry of Local Government and Administration should increase the level of control in the area of budget planning and execution for the Capital Investments category in order to ensure increase of efficiency and infrastructure of local government. For this purpose, enhanced cooperation with municipalities is more than indispensable.

In addition, the review of controls is necessary in the process of the oversight of capital projects by the ministry, management of debts and assets.

The audit recommendations' aim to support the Management in improving financial controls and increasing other aspects of operational activities. We considered the responses to our 2012 recommendations. Our overall conclusion is that Ministry has made progress relating to the implementation of prior year recommendations in the area of expenditures. However, our tests have pointed out that same deficiencies are evident in some areas and concrete actions should be taken in order to eliminate them.

Our main recommendations to the Minister of Ministry of Local Government and Administration are as follows:

- Further engagement to fully address our recommendations. The fact that some recommendations have been repeated from one year to the other is particularly concerning. The Minister should analyse well all recommendations given and should take measures for their full addressing;
- Analyse the reasons behind the low level of the budget execution regarding capital investments, as well as to eliminate weaknesses at the planning stage or at the budget execution stage;
- Ensure the creation of a transparent internal environment in the procurement management, starting from the preparation of a good procurement plan, initiation of procedures to the supervision of contracts. Minister should also increase the level of cooperation with respective municipalities at the planning stage in order to prepare a good procurement plan; and
- Put in place an internal functional system on the debt management in order not to burden the upcoming fiscal year with prior year liabilities and put in place controls for asset management to ensure that Ministry maintains / updates the asset register every year.

Minister's response - 2013 audit

The Minister has agreed with our audit findings and committed himself to address the recommendations given.

1 Audit Scope and methodology

It is the responsibility of Ministry of Local Government and Administration (MLGA) to prepare financial statements under the International Public Sector Accounting Standards (IPSAS) for 'Financial Reporting under the Cash Basis for Accounting' and other specific requirements. The Office of the Auditor General (OAG) is responsible for carrying out a Regularity Audit which involves the examination and evaluation of the Annual Financial Statement (AFS) and other financial records and expression of opinions on:

- Whether the AFS give a true and fair view of the accounts and financial affairs for the audit period;
- Whether the financial records, systems and transactions comply with applicable laws and regulations;
- The appropriateness of internal controls and internal audit functions; and
- All matters arising from or relating to the audit.

We have considered the extent to which management controls can be relied upon when determining the overall testing required to provide the necessary level of evidence to support the Auditor General's opinion and the focus of our compliance audit.

The following sections provide a more detailed summary of our audit findings with emphasis on observations and recommendations in each area of review. An assessment of Management Responses to recommendations made in 2012 is at Annex II.

For completeness, we have included issues identified at the interim audit where they remain relevant. Our findings are defined as:

High Priority - issues which may result in a material weakness in internal control and where action will offer the potential for improvements to the efficiency and effectiveness of internal controls; and

Medium Priority - issues which may not result in a material weakness but where action will also offer the potential for improvements to the efficiency and effectiveness of internal controls.

Our procedures included a review of the internal controls and accounting systems and procedures only to the extent considered necessary for the effective performance of the audit. Audit findings should not be regarded as representing a comprehensive statement of all the weaknesses which exist, or all improvements which could be made to the systems and procedures operated. Findings considered low priority will be reported separately to finance staff.

2 Annual Financial Statements and Other External Reporting Obligations

Overall Conclusion

Our review of the AFS considers both compliance with the reporting framework and the quality and accuracy of the information recorded in the financial statements. We also consider the Declaration made by the Chief Administrative Officer and Chief Financial Officer when the draft AFS are submitted to the Government.

The declaration regarding presentation of the AFS incorporates a number of assertions relating to compliance with the reporting framework and the quality of information within the financial statements. A number of the declarations are intended to provide assurance to the Government that all relevant information has been provided to ensure that a comprehensive audit can be undertaken.

MLGA has managed to submit all reports required under the applicable legal framework in time. The AFS have met all International Public Sector Accounting Standards (IPSAS) for „Financial Reporting under the Cash Basis for Accounting“ and the Financial Rule 03/2013. They provided complete and accurate information on events and presented transactions.

2.1 Audit Opinion

Unmodified Opinion¹

In our opinion, the financial statements present *a true and fair view* in all material aspects **(ISSAI 200 Unmodified Opinion)**.

¹ The term “Unmodified Opinion” is equivalent to the term “Unqualified Opinion” used in previous version of the Annual Report. The new terminology is in accordance with new INTOSAI standards (ISSAI 200). For more information, refer to Annex I.

2.2 Compliance with AFS reporting requirements

Description

The Annual Financial Statements are required to comply with a specified reporting framework. We considered:

- Compliance with MoF Rule no. 03/2013 – on annual financial statements of budget organisations; and
- Requirements of LPFMA no. 03/ L-048.

We have no issues to raise on these matters. Taking into account the above - the Declaration made by Chief Administrative Officer and Chief Financial Officer, are considered to be true and fair.

Recommendations

We have no recommendations in this area.

2.3 Compliance with other external reporting requirements

Description

Other than producing AFS, MLGA is required to address external reporting obligations such as:

- Budget request;
- Quarterly reports including nine month financial statements in time;
- Action plan for the addressing of audit recommendations;
- Preliminary and final procurement plan in time;
- Outstanding debts report; and
- Progress report on capital projects in the amount of over €10,000 are submitted to MoF.

We have no issues to raise on these matters. MLGA has complied with external reporting requirements in the appropriate quality and by adhering to timelines.

Recommendations

We have no recommendations in this area.

3 Prior Year Recommendations

Overall Conclusion

Ever since the acceptance of our 2012 recommendations in July 2013, MLGA has undertaken measures to address the concerns raised. There is progress relating to the addressing of recommendations, but there still remain some issues to be addressed.

Description

Our Audit Report on the 2012 AFS resulted in 11 recommendations. MLGA prepared an Action Plan to ensure that all recommendations would be addressed within a specified period.

By the end of our 2013 audit, five (5) recommendations have been fully addressed; three (3) were partially addressed; and three (3) have not been addressed yet. For a more thorough description of the recommendations and how they are addressed, see Annex II.

Recommendations

Issue 1 - Addressing Prior Year Audit Recommendations - High Priority

Finding Prior year recommendations have not been fully addressed, in particular those related to procurement and asset management.

Risk The continued weakness of internal controls in key financial systems has resulted in:

- Continuous inefficiency in budget planning and execution, particularly in capitals, and
- Deficiency in adhering to the expenditure procedures and their categorisation.

Recommendation 1 The Minister should ensure that measures set forth in the action plan on the areas with emphasised deficiencies are constantly reviewed and monitored in order to ensure that they are fully addressed by the accountable staff members.

4 Financial Management and Control

Overall Conclusion

Our audit approach is focused on understanding and evaluating the actions taken by management to secure effective financial management and control and the results of this actions. For individual financial systems we seek to identify the level at which actual controls operate.

This may, for example, be monitoring activity undertaken by senior management or lower level operational controls. We consider whether controls are well designed, have been implemented as planned and operate effectively. This requires an assessment of structures, processes and accountability lines introduced by management including the role undertaken by Internal Audit and Audit Committee.

Our overall conclusion is that MLGA has designed proper internal control system; however it was not fully implemented in all cases. Further improvements are needed in the areas of budget management and procurement procedures. Further on, particular attention should be paid to debts management. This requires an assessment of structures, processes and accountability lines introduced by management.

4.1 Budget Planning and Execution

Description

We have considered the source of budget funds for the MLGA, spending of funds by economic categories and revenues collected. This is highlighted in the following tables:

Table 1 Sources of budget Funds - outturn against the budget (in €)

Description	Initial Budget	Final Budget ²	2013 Outturn	2012 Outturn	2011 Outturn
Sources of Funds	5,993,623	6,138,693	4,919,403	5,792,704	7,680,745
Government Grant - Budget	5,993,623	5,992,002	4,877,197	5,752,550	7,679,345
External Donations	-	146,691	42,206	40,154	1,400

² Final budget – the budget approved by the assembly which was subsequently adjusted for by the Ministry of Finance.

The final budget, compared with the initial budget, is higher as a result of external donations. This increase occurred following the budget review and is in line with Government decisions.

In 2013, MLGA executed 80% of the final budget or €4,919,403, this is a lower level than in the previous year (2012). The budget execution remains at an unsatisfactory level, and explanations for the current position are detailed below.

Table 2. Spending of funds by economic categories - outturn against the budget (in €)

Description	Initial Budget	Final Budget	2013 Outturn	2012 Outturn	2011 Outturn
Spending of funds broken down by economic categories	5,993,623	6,138,693	4,919,403	5,792,704	7,680,745
Wages and Salaries	756,746	734,546	666,931	696,535	726,375
Goods and Services	306,054	539,898	390,365	649,265	413,051
Utilities	30,000	30,000	25,724	23,401	37,661
Subsidies and Transfers	437,249	477,319	468,125	390,063	408,164
Capital Investments	4,300,000	4,356,930	3,368,258	4,033,440	6,095,493
Reserves (if any)	163,574 ³				

Explanations for changes in budget categories are given below:

The final budget in proportion to the initial budget for Wages and Salaries was decreased by 2.9%, whilst the budget outturn for this category was about 90%.

The final budget of Goods and Services category, compared to initial budget, was increased by €233,844. All movements were done based on the Government decisions. The 2013 budget outturn for this category is about 73%.

Budget for Subsidies and Transfers during the year has increased by €40, 070 or expressed in percentage by 9%. MLGA had a good budget outturn in this category, about 98%.

The budget for Capital Investments has increased during the year by €56,930, whilst only 77% of budget for this category was executed. . The public investments programme includes,

³ Initial budget in the category of reserves was €163,574. Of this amount, there were €85,547 means allocated in the category of Goods and Services, whilst the amount of €78,000€ were transferred in accordance with the government decision in the budget of Administrative Office of North Mitrovica, for the payment of hazard to the officers of AONM.

under the initial budget, three (3) ongoing projects from previous year and two (2) new projects for 2013.

MLGA has also received grants from external donators in the amount of €146,691, out of which €42,206 were spent during 2013.

Recommendations

Issue 2 - Budget Execution - High Priority

Finding Budget execution was not at the expected level. Notwithstanding the budget increase during 2013, MLGA did not manage to entirely execute its budget for this year. When expressed in percentage, the budget was executed by 80%, a low execution was notable especially in the categories of capital investment and goods and services. According to MLGA, such low execution of 2013 was due to Public Review Board failure to review the complaints of economic operations on three projects.

Risk Low budget execution may result in a failure to meet the organisation's overall objectives. Low budget execution, in particular for capital investments dedicated to the increase of local government efficiency, puts the local economic development at risk and may lead to setbacks in the local administration reform. Failure to comply with the expenditures plan may result in the decrease of MLGA efficiency.

Recommendation 2 The Minister should conduct a systematic assessment of the reasons behind the low level of overall budget execution, and eliminate weaknesses either at the budget planning stage or at implementation stage.

Issue 3 - Budget Execution in the last quarter - High Priority

Finding The largest part of the capital investments budget was executed in the last quarter of the year and in particular in the last month of the year. Out of €3,368,258 of the total expenditures executed in 2013, €2,336,203 was executed in the last quarter. Out of this €1,714,473 or over 50% were executed only in the last month (December/2013).

Risk This carries the risk that numerous payments are made in the last quarter and in particular in the last month, which may avoid the appropriate controls.

Recommendation 3 The Minister should ensure a systematic monitoring of budget performance on a monthly basis in order to improve it, and should also identify and address barriers to plan budget execution levels.

4.2 Expenditures

4.2.1 Procurement

Description

In the beginning of 2013, the MLGA planned expenditures through procurement in the amount of €140,506, while by the end of 2013 it executed expenditures through the procurement process in the amount of €627,103. Of them, €448,159 were executed in the category of capital investments, whilst €178,944 were executed for goods and services.

There are some cases when aspects of procurement processes were not adhered to over which controls were not applied, but generally there is progress in this aspect compared to previous year.

Our audit tests on procurement procedures identified the following issues.

Recommendation

Issue 4 -Weaknesses in Procurement Planning - High Priority

Finding Procurement activities for Goods and Services in the amount of €91,346 were foreseen in the procurement plan, whilst €178,994 was executed. Procurement activities in the amount of €49,160 were foreseen for capital investments, whilst €448,159 was executed. The total amount of procurement expenditures which were not planned in the procurement plan is €486,597. The largest portion of this amount was executed for funding capital projects in municipalities. These shortcomings are due to improper cooperation with municipalities during preparation phase of the procurement plan.

In addition, while examining the sample "Supply with Equipment and Information Technology" the procurement activity in the amount of €56,929 was executed, whilst planning for this supply was €39,160.

Risk Failure to identify needs for goods and services in time and failure to determine the approximate amount of contract may lead to processing of expenditures not in accordance with the applicable rules. They may also bring MLGA into difficulties by entering into new unplanned liabilities and thus putting the achievement of objectives foreseen by law at risk.

Recommendation 4 The Minister should ensure that needs for goods and services and capital investments are identified in time and the approximate value of expenditures is determined in order to reduce risks/ departure from legal rules.

Moreover, Minister should increase the level of cooperation with respective municipalities at the planning stage in order to conduct identification of needs in time and have a good planning of procurement expenditures.

Issue 5 - Signing of contracts without the commitment of funds and categorisation of expenditures in inadequate economic categories - High Priority

Finding Signing of contract "Supply with IT equipment" in the amount of €56,929 mentioned above was entered into without the commitment of funds. The commitment was initially done from the category of subsidies for public entities. Then the commitment was cancelled, and following the signing of the contract, another commitment was made from the category of goods and services.

In regard to capital investments, payments of capital transfers for public entities in the amount of €211,840 were not categorised under the adequate code (33100 capital transfers for public entities. They were categorised under other capitals. In addition, in the contract "Supply with IT equipment", the individual values of two IT equipments supplied were over €1,000. These have been recorded in the economic 13503 code - other equipment under €1,000. They should have been recorded as capital outlays under the 31650 code.

Risk Entering into a contract without committed funds is in contradiction to the applicable legislation and it may bring MLGA into financial difficulties when entering into new liabilities under lack of full information. Whilst registration into inadequate codes may lead to the loss of reliability on the quality of information reported, by overestimating one category and underestimating another category of expenditures.

Recommendation 5 The Minister should ensure that controls are enhanced before signing the contract in order to ensure that funds are committed from the adequate category and that, while getting processed, payments are registered according to the codes in the accounting plan.

Issue 6 - Insufficient supervision for capital investment projects - High priority

Finding The supervision of capital investment projects was insufficient and this should be developed further. Almost every year, MLGA has been funding capital projects in municipalities. These are regulated based on a Memorandum of Understanding (MoU) between MLGA and Municipalities. We have identified the following issues:

MLGA and Municipality of Skënderaj have entered into a MoU for funding the project "Construction of Administrative Facility of Municipal Assembly of Skënderaj" in the amount of €350,000 for 2013.

According to the MoU, the Oversight Body is appointed by Municipality. MLGA engaged two engineers of the relevant field to supervise (monitor) the process. But they report (supervise) only based on the report described by the Municipality's oversight body.

Risk MLGA's insufficient supervision of co-funding projects may lead to avoidance of responsibility, accountability and transparency. Moreover, when the oversight body is comprised of only one person, taking into account that the project contains a variety construction works, may result in inefficient monitoring.

Recommendation 6 The Minister should ensure mechanisms of cooperation are strengthened and that ongoing oversight during the capital projects funded by MLGA is enhanced in order to increase responsibility and accountability at a higher level.

Issue 7 - Modification of Memorandum of Understanding - High priority

Finding On 05.07.2013, MLGA had entered into a MoU with the Ministry of Community and Returns (hereinafter MCR) and Municipality of Novobërdë for co-funding of project "Paving the road in asphalt in the village Kufc e Epërme, Municipality of Novobërdë". MoU set forth obligations of each party involved, where MLGA would contribute with the amount of €155,000, MCR with €50,000 and the Municipality with €5,000. In the meantime, MLGA had entered into another MoU for paving the pavement on the same street in the amount of €40,000, contributed by MLGA.

According to MoU, MCR will pay the first instalments, after the submission of progress payments (work reports) on the completed works by the contracted company.

Notwithstanding the MoU and the fact that MCR had committed the amount due for payment (according to written MLGA confirmations), MLGA has, on 06.12.2013, taken over the responsibility to pay the MCR liabilities with the reasoning of having committed funds for the contracted amount.

The progress payment, which MLGA committed to pay (including the MCR obligation), was €106,197. Out of which, the Municipality's liability was €5,000. MLGA paid just €62,197 and the other part in the amount of €39,000 was carried forward for payment in 2014.

Risk Modification of the MoU, in terms of payment at the end of the fiscal year may have a mutual financial negative effect, for both MCR and MLGA. MCR may have not managed to spend the funds in the amount of €50,000 for 2013, despite the fact that they were committed for the concerned project. Whilst the amount of €39,000 carried forward from MLGA to be paid in the upcoming year has resulted with increased outstanding liabilities (see sub chapter 4.4 Handling of debts).

Recommendation 7 The Minister should ensure that MoU is fully adhered to in order to eliminate repetition of same shortcomings in the future. In case there is a need for the modification of MoU, all eventual financial implications for all parties involved in the co-financing should be taken into account.

Issue 8 – Poor planning of blueprinting services needs- High priority

Finding MLGA conducted procurement procedures for the activity “Blueprinting services for roads, water supply, atmospheric sewage and waste sewage”. Following the completion of procurement procedures, MLGA contracted the Economic Operator (EO) having offered the lowest price in total for four blueprints. , We have found that MLGA had only one of the four contracted services executed , which is the road blueprint.

We have compared prices of the winning EO and prices of other bidders for each blueprint and found that the cost of road project delivered from the winning EO was €8,890. The same project would have cost €5,556 if it that been executed by the other eligible operator.

Whilst, prices offered by winning EO for the blueprints of water supply and sewage, which were not used by MLGA, were convenient.

Risk Improper planning of MLGA’s real needs and failure to use most convenient offers on blueprint for water supply and sewage increases the risk that money is irrationally used.

Recommendation 8 The Minister should ensure that, prior to the initiation of procurement procedures, appropriate analyses are made relating to real needs of MLGA in order to achieve the set objectives at a reasonable cost.

4.2.2 Non Procurement Expenditure

Description

These expenditures include all purchases that do not need procurement procedures, such as; utilities, expenses for official trips, representation expenses and other expenses.

Recommendations

We have no recommendations in this area

4.2.3 Remunerations (Wages and Salaries)

Description

Wages and Salaries are paid through a centralised system. Controls operated by MLGA relate to payroll authorisation, an analysis of variances and different reconciliations. For 2013, MLGA planned €734,546 in the category of Wages and Salaries, whilst it executed €666,931, or 90%.

We have identified weaknesses in the control systems, which have enabled the inclusion of allowances dedicated to civil servants for a part of the Minister's cabinet who are not civil servants. These payments are eliminated completely at the beginning of 2014.

Recommendations

We have no recommendations in this area.

4.2.4 Subsidies and Transfers

Description

The budget for the Subsidies and Transfers category for 2013 was €477,319, whilst expenditures for 2013 were €468,125 or 98%.

Almost every year, MLGA allocates funds for the Subsidies and Transfers category to finance municipalities. MLGA has issued Regulation no. 03/2013 on Allocation of Financial funds from the economic category of subsidies and transfers, and enters into special Memorandum of Understanding for each project (subsidy).

In this category, we tested 11 samples (payments) selected from the Treasury records, the amount was €149,799. As a result, MLGA seems to have has a functional system for the management of Subsidies and Transfers in general.

Recommendations

We have no recommendations in this area.

4.3 Assets and liabilities

4.3.1 Capital and non capital assets

Description

The amount of capital assets (over €1,000) disclosed in AFS was €4,815,020, whilst the amount of non capital assets (under €1,000) was €559,159. Assets were disclosed in AFS according to their net amount.

Recommendations

Issue 9 – Shortcomings in assets management - Medium Priority

Finding MLGA has established the Stocktaking Committee and the Assets evaluation committee. However, these committees have not carried out their duties and responsibilities as expected, namely they did neither conduct the stocktaking nor evaluate assets.

MLGA has the overall asset register in place, but it is not complete.

Risk Lack of stocktaking, evaluation and complete recording of assets increases the risk for their loss or misuse.

Recommendation 9 The Minister should ensure that assets are managed according to legal requirements in order to prevent them from loss or misuse. To this end, the inventory and valuation of assets should be carried out each year.

4.4 Handling of debts

Description

MLGA has disclosed the outstanding liabilities in Annual Financial Statements for 2013 in accordance with Financial Rule for Annual Financial Reporting. The amount of disclosed liabilities is €148,865. These liabilities are carried forward to be paid in 2014.

Recommendations

Issue 10 – Increased outstanding liabilities – High Priority

Finding Outstanding liabilities for 2013 have considerably increased compared to the end of 2012. Outstanding liabilities disclosed in 2012 AFS were in the amount of €3,200, whilst 2013 liabilities were in the amount of €148,865. Out of which, 90% belong to outstanding liabilities for capital investments.

Outstanding liabilities for capital investments were a result of failure to plan capital projects in time. We have reported the related shortcomings in the chapters above. Meanwhile, lack of budget for certain categories was the reason for a number of unpaid liabilities for goods and services in the amount of €4,100.

Risk Increase of outstanding liabilities indicates an inefficient management of public funds for the fiscal year, and also impact the upcoming year's budget. In addition, entering into liabilities in absence of budget may result in the inability to pay.

Recommendation 10 The Minister should analyse the reasons behind the increase of liabilities and ensure that capital projects activities are planned in time in order that liabilities will not burden the upcoming year's budget. In addition it should be ensured that there is sufficient budget prior to initiating the supply with goods and services.

5 Internal Audit System

Description

The Internal Audit System is a key part of internal control.. We consider the scope of internal audit work and the activity of the audit committee. In addition, we review actions taken by senior management as a result of the work carried out by Internal Audit and the Audit Committee.

MLGA has established the Internal Audit Unit consisting of an internal audit director and two internal auditors (one of the officers has been engaged at the beginning of 2014).

MLGA has also established an Audit Committee consisting of three members. In addition, the committee has approved the Audit Committee Statute in accordance with Law on Internal Audit.

The Internal Audit Unit (IAU) has drafted the annual audit plan for 2013 foreseeing to conduct five (5) regular audits and audits on request. During 2013, this unit conducted four (4) regular audits and three (3) audits on request, whilst it had not conducted the audit on “capital investment management system” as was foreseen in the plan. Internal audit reports have resulted in findings and recommendations.

IAU has quarterly and annually prepared reports on its work and activities. In addition, it submitted quarterly reports to CHU/IA.

During the year, the committee has had, in general, three (3) regular meetings, where quarterly reports of IAU, strategic plan and other issues relating to internal audit were discussed at.

Recommendations

Issue 11 - Prioritisation of audits based on the risk assessment - High Priority

Finding The Internal Audit Unit has carried out most of the planned audits; however, this unit did not manage to conduct the audit “capital investment management system” as foreseen in the plan. In doing so, it did not manage to support the MLGA Management on the functioning of controls in the area of capital investment management.

Risk The IAU failure to completely implement its programme reduces the assurance provided to the Management relating to the functioning of controls in the management of procurements expenditures (capital investments). This may result in unidentified weaknesses and ongoing inefficient practices.

Recommendation 11 The Minister should work with IAU Director to ensure that sufficient assurance is provided by IAU regarding the functioning of controls in the areas where risks are assessed to be high. In the upcoming years, accomplishment of IAU planned activities are monitored by Audit Committee every two months and proactive actions should be taken in order that departures from the plan are addressed in due time.

Annex I: Explanation of the different types of opinion applied by the OAG

(extract from ISSAI 200)

Form of opinion

147. The auditor should express **an unmodified opinion** if it is concluded that the financial statements are prepared, in all material respects, in accordance with the applicable financial framework.

If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor should modify the opinion in the auditor's report in accordance with the section on "Determining the type of modification to the auditor's opinion".

148. If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor should discuss the matter with the management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, determine whether it is necessary to modify the audit opinion.

Modifications to the opinion in the auditor's report

151. The auditor should modify the opinion in the auditor's report if it is concluded that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or if the auditor was unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. Auditors may issue three types of modified opinions: a qualified opinion, an adverse opinion and a disclaimer of opinion.

Determining the type of modification to the auditor's opinion

152. The decision regarding which type of modified opinion is appropriate depends upon:

- The nature of the matter giving rise to the modification – that is, whether the financial statements are materially misstated or, in the event that it was impossible to obtain sufficient appropriate audit evidence, may be materially misstated; and
- The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

153. The auditor should express a **qualified opinion if**: (1) having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or (2) the auditor was unable to obtain sufficient appropriate audit evidence on which to base an opinion, but concludes that the effects on the financial statements of any undetected misstatements could be material but not pervasive.

154. The auditor should express an **adverse opinion if**, having obtained sufficient appropriate audit evidence, the auditor concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

155. The auditor should **disclaim an opinion if**, having been unable to obtain sufficient appropriate audit evidence on which to base the opinion, the auditor concludes that the effects on the financial statements of any undetected misstatements could be both material and pervasive. If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the audit scope that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor should request that management remove the limitation.

156. If expressing a modified audit opinion, the auditor should also modify the heading to correspond with the type of opinion expressed. ISSAI 1705¹⁹ provides additional guidance on the specific language to use when expressing a modified opinion and describing the auditor's responsibility. It also includes illustrative examples of reports.

Emphasis of Matter paragraphs and Other Matters paragraphs in the auditor's report

157. If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that is of such importance that it is fundamental to their understanding of the financial statements, but there is sufficient appropriate evidence that the matter is not materially misstated in the financial statements, the auditor should include an Emphasis of Matter paragraph in the auditor's report. Emphasis of Matter paragraphs should only refer to information presented or disclosed in the financial statements.

158. An Emphasis of Matter paragraph should:

- be included immediately after the opinion;
- use the Heading “Emphasis of Matter” or another appropriate heading;
- include a clear reference to the matter being emphasised and indicate where the relevant disclosures that fully describe the matter can be found in the financial statements; and
- indicate that the auditor’s opinion is not modified in respect of the matter emphasised.

159. If the auditor considers it necessary to communicate a matter, other than those that are presented or disclosed in the financial statements, which, in the auditor’s judgement, is relevant to users’ understanding of the audit, the auditor’s responsibilities or the auditor’s report, and provided this is not prohibited by law or regulation, this should be done in a paragraph with the heading “Other Matter,” or another appropriate heading. This paragraph should appear immediately after the opinion and any Emphasis of Matter paragraph.

Annex II: Prior year recommendations

Audit Component	Recommendation given	Recommendation fully addressed	Partly addressed	Not addressed
Prior year recommendations (2011)	The management should ensure that the action plan clearly determines a timeline for the addressing of recommendations with the accountable staff members identified - and with initial focus in the areas of significant importance.	X		
4.2 Budget planning and execution	<p>Issue - Improper budget execution - High priority</p> <p>The management should systematically address reasons for the reduction of budget execution in 2012 and determine practical options for its improvement and profiles of expenditures throughout the year. This may include:</p> <p>Work with municipalities to ensure that every possible deficiency in the procurement processes was avoided;</p> <p>Work with other budget organisations to enable to impact in the procurement processes in order to promote more concise processes which do reduce time delays and possibility for remarks in processes;</p> <p>Proactive monitoring of possible levels of expenditures at the level of sub categories, interrelation with MoF to return funds which are not expected to be used;</p> <p>Review of processes of budget planning to ensure that they are sustainable.</p> <p>Issue - Registration of expenditures in incorrect codes - Priority - Other</p> <p>The management should ensure that controls are applied in order to ensure that expenditures planned for subsidies and transfers are spent only in these areas.</p>		X	

<p>4.4 Expenditures 4.4.1 Procurement</p>	<p>Issue - Funding of municipal projects with deficiencies - Priority - Important MLGA management should preliminary ensure the commitment of budget funds for municipalities in order that projects agreed with an agreement are executed in line with contracts signed and are in time. MLGA should put in place effective monitoring to ensure that municipality cash flow is in accordance with project requirements and to ensure that municipalities cannot enter into contracts prior to signing a formal Memorandum of Understanding.</p> <p>Issue - Delays in the execution of works - Priority - Important The management should identify the causers for delays in the execution of projects and take actions to ensure that projects are completed within the expected timelines. Penalties should be implemented where needed to support this process.</p> <p>Issue - Modification of the lot in the invoice from the report of acceptance of goods - Priority - Other The management should increase enhanced supervision controls in the process to ensure that items accepted are the ones required and invoiced.</p> <p>Issue - Execution of payment despite that contract specifications were not complied with - Priority - Other The management should review reasons why a payment was made without complying with the contract requirements in order to ensure that this situation is not repeated.</p>	<p>X</p> <p>X</p> <p>X</p> <p>X</p>	<p>X</p>	
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4.4.2 Other expenditures	<p>Issue - Deficiencies in controls relating to official trips - Priority - Important</p> <p>Official trips should be funded if they are supported by a strong cause of the official work which justifies the purpose of the trip. Regulations to specify MLGA obligations towards the staff involved in official trips that are not MLGA staff should be approved. Controls dealing with advances should be reviewed and increase their level where needed.</p>		X	
4.4.4 Subsidies and transfers	<p>Issue - Non compliance with agreements for subsidies - Priority - Other</p> <p>The management should review the existing controls dealing with subsidies, and determine whether additional actions may be undertaken to ensure the achievement of the agreed action - this may involve payments in stages reflecting the acceptance of required reports, etc.</p>			X
4.5 Assets 4.5.1 Capital and non capital assets	<p>Issue - Incomplete assets register - Priority - Important</p> <p>The management should ensure that assets registers are formally reconciled in the stocktaking report and that all information are incorporated within the register or were maintained separately as required.</p>			X
5 Internal audit system	<p>Issue - Failing to report in time to CHU/IA</p> <p>IAU should put the emphasis on the submission of reports to CHU/IA in time, namely 15 days following the end of the quarter.</p>	X		