



REPUBLIC OF KOSOVA
OFFICE OF THE AUDITOR GENERAL

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AUDIT REPORT
ON THE FINANCIAL STATEMENTS OF THE CIVIL AVIATION
AUTHORITY FOR
THE YEAR ENDED 31 DECEMBER 2014

Pristina, June 2015

The Office of the Auditor General undertakes both Regularity and Performance Audits. The Acting Auditor General is the head of the Office of the 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 Acting Auditor General has decided on the audit opinion and report on the Annual Financial Statements of the Civil Aviation Authority 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, Zukë Zuka, supported by Valbona Tolaj (Team Leader) and Hysen Boqolli (member).

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Executive Summary

Introduction

This report summarises the key findings from our audit of the 2014 Annual Financial Statements of Civil Aviation Authority which determine the Opinion given by the Acting Auditor General. I would like to thank the Director General of Civil Aviation Authority and his team for their assistance during the audit process.

The examination of the 2014 financial statements was undertaken in accordance with the internationally recognised Public Sector auditing standards (ISSAIs). 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 September 2014.

Our audit focus has been on:



The level of work undertaken by the Office of the Auditor General to complete the 2014 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 the Auditor General.

The Auditor General's opinion is:

Unmodified Opinion

In our opinion the Annual Financial Statements *present a true and fair view* in all material aspects **(ISSAI 200/1700 Unmodified Opinion)**.

Overall Conclusion

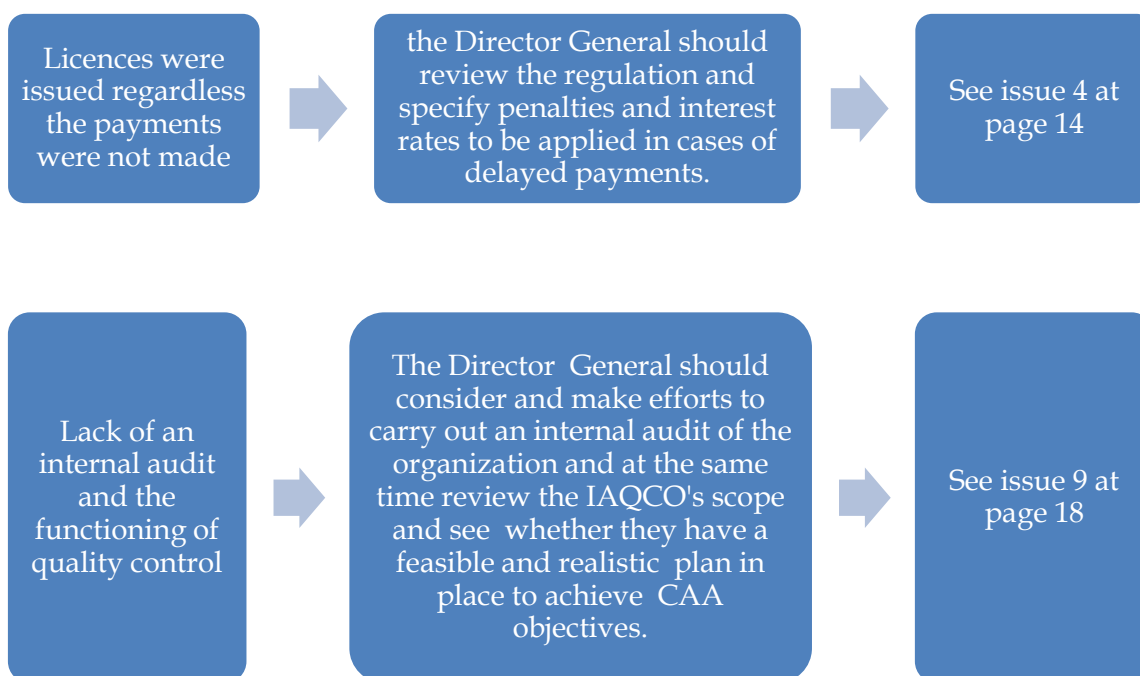
Based on details presented in each section of this report, our overall conclusion is that:

We were able to obtain assurance from effective operation of managerial controls in a number of areas, but we identified several weaknesses in areas of financial management. Weaknesses are explained in more details in the body of this report.

Audit recommendations are intended to support the Management of the Civil Aviation Authority in improving their financial controls and operational activities. We considered the response to our 2013 recommendation, which has been implemented.

We discussed the quality of financial reporting by the Civil Aviation Authority, our findings as well as Financial Management and Control in the main body of this report.

Our key conclusions and recommendations are:



Director General's response – audit 2014

Detailed audit findings and conclusions highlighted in this report have been taken into consideration by the Director General. The Director General has agreed on all issues presented in this report.

1 Audit Scope and Methodology

It is the responsibility of the Civil Aviation Authority (CAA) to prepare Annual Financial Statements (AFS) 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 AFS and other financial records and expression of:

- 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 (AG) opinion. Management activities also determine the focus of our compliance audit and good governance audit which do not directly impact on the opinion.

Our audit approach to governance is focused on evaluating the actions taken by management to secure effective Financial Management and Control and the results thereof in efficiently delivering high quality operational outputs. 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 Committees as well as inbuilt system controls.

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 how the Management have addressed recommendations made in the report of 2013 may be found in 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.

Findings considered of low priority will be reported separately to finance staff.

Our procedures included a review of the internal controls and accounting systems and associated substantive testing 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.

2 Annual Financial Statements and other External Reporting Obligations

Introduction

Our review of the AFS considers compliance with the reporting framework as well as the quality and accuracy of the information recorded in the financial statements. We also consider the Declaration made by the Chief Executive Officer (CEO) and Chief Financial Officer (CFO) 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 Annual Financial Statements (AFS). 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.

Overall Conclusion

We have determined an unmodified opinion; the quality of the AFS was generally good. AFS have fully met all IPSAS requirements for Financial Reporting under the Cash Basis for Accounting and Financial Rule no. 03/2013. They provide accurate and complete information on events and transactions presented. All other reporting obligations not related to the AFS were fully met.

2.1 Audit Opinion

The Auditor General's Opinion is:

Unmodified Opinion

In our opinion the Annual Financial Statements *present a true and fair view* in all material aspects **(ISSAI 200/1700 Unmodified Opinion)**.

2.2 Compliance with AFS and other reporting requirements

Description

AFS are required to comply with a specified reporting framework and other reporting requirements. We considered:

- Compliance with the Financial Rule no. 03/2013 on AFS of budget organisations;
- Requirements of LPFMA no. 03/ L-048 as amended and supplemented;
- Requirements of Rule 01/2013/MoF – Spending of public money and MoF Rule no. 02/2013 on the Management of Budget Organizations’ Non-Financial Assets;

In the context of AFS we have no issues to raise on these matters.

3 Prior Year Recommendations

Overall Conclusion

CAA implemented the recommendation given in the 2013 audit report.

Description

Our Audit Report on the 2013 AFS of CAA resulted in one key recommendation. During 2014, CAA implemented the recommendation given in 2013. For a more thorough description of the recommendation and how it is addressed, see Annex II.

Recommendations

We have no recommendations in this area.

4 Governance

Overall conclusion

The CAA Management has designed a good system of internal control and financial management. Effective controls have ensured that budget management meets the principles of proper financial management with the exception of a number of weaknesses highlighted in this report.

CAA addressed key aspects of the governance framework. Self-assessment is prepared and submitted on time where specific components of financial management and control are presented. Nevertheless we have raised issues regarding inadequate reporting in self assessment.

While the budget execution is at an appropriate level we found that classification of expenditures should be improved. On the other hand, with exception to the application for license fees, controls over revenues were good. Controls over procurement and expenditure were adequate. The key areas where improvements are most needed are segregation of duties, staff promotion and handling of special services contracts.

4.1 Good Governance

Description

Management implemented a number of internal controls to ensure that financial systems are operating properly. It is important that they include appropriate reporting to management to enable an effective and timely response to operational problems identified, with the exception of a number of weaknesses mentioned in this report.

Issue 1 – Preparation of the report on self assessment and internal control– Medium Priority

Finding The self-assessment questionnaire for the Financial Management and Control system completed by CAA presented the operation situation of the Board of Directors and of the Audit Committee which currently do not exist in the organization¹.

Risk Preparation of the self-assessment report with incorrect information reflects weaknesses or incompliance in reporting.

Recommendation 1 The Director General of CAA should ensure that the self assessment and reporting process is based on the real situation by considering it as a part of its efforts towards further development of the Financial Management and Control system.

Issue 2 – Segregation of duties – Medium Priority

Finding Regulation no. 02-2013 on “Management of non-financial assets” specifies that the duties of the assets officer and the Receipt/Logistics officer cannot be performed by the same officer. However, Assets Officer holds both the position of Receipts/Logistics and of the Depot Officer.

Risk Performance of duties of two different related positions risks the functioning of internal control, reporting as well as the responsibility for the position.

Recommendation 2 The Director General should ensure that the duties of the Assets and Receipts/Logistics Officers are separated and performed by different officers.

¹ The CAA Board of Directors’ mandate expired in September 2013, whilst CAA has not established the IAU and the Audit Committee.

4.2 Budget Planning and Execution

Description

We have considered the sources of budgetary funds for CAA, spending of funds by economic categories and revenues collected for the Kosovo Budget. This is highlighted in the following tables:

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

Description	Initial Budget	Final Budget ²	2014 Outturn	2013 Outturn	2012 Outturn
Sources of Funds	783,000	841,375	822,116	729,460	731,568
Government Grant -Budget	783,000	841,375	822,116	729,460	731,568

The final budget is by €58,375 higher than the initial budget. The AAC's budget is funded by the government grant.

In 2014, CAA used 98% of the final budget or €841,375, an improvement of 13% compared to 2013. The budget was executed at a satisfactory level.

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

Description	Initial Budget	Final Budget	2014 Outturn	2013 Outturn	2012 Outturn
Spending of funds broken down by economic categories	783,000	841,375	822,116	729,460	731,568
Wages and Salaries	492,508	594,457	594,457	459,035	379,386
Goods and Services	274,330	235,856	220,039	258,700	339,108
Utilities	16,162	11,062	7,619	11,725	13,074

Explanations for changes in budget categories are given below:

- The increase in budget for Wages and Salaries by €101,979 is a result of the salary increase of 25% based on Government decision no. 01/176; and
- Budget cuts in Goods and Services by €38,473 and in Utilities by €5,100 are as a result of the implementation of the Government Decision No. 07/172 as saving measure where 15% of the budget for these categories was cut.

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

Issue 3 – Recording the payment with an inadequate code – Medium Priority

Finding A payment of €1,769 for the supply of IT (Laptop, computer and printer) is recorded in the economic code 13610 - office supply whilst should be recorded in 13503 - computers (less than 1000 euro).

Risk Failure to classify expenditures according to the chart of accounts set by the Treasury may result in incorrect presentation of expenditures.

Recommendation 3 The Director General of CAA should provide additional controls within the payments sector so that expenditures are classified and recorded in accordance with the approved chart of accounts.

Tabela 3. Own Source Revenues collected – outturn against budget (in €)

Description	Initial Budget	Final Budget	2014 Receipts	2013 Receipts	2012 Receipts
Own source revenues	1,500,000	1,500,000	1,368,556	1,656,541	1,498,150
Total	1,500,000	1,500,000	1,368,556	1,656,541	1,498,150

Compared to the planning, revenues were 9% less, whilst compared to 2013 revenues decreased by around 17%. This is a result of the reduced number of passengers by 14% and the reduction of the traffic during 2014 due to termination of flights by an airline in October 2013.

4.3 Own source revenues

Description

CAA's revenue main sources are the passenger safety fee and the license/certificate fee. The passengers' safety fee for passengers travelling on commercial flights from Kosovo is defined by Regulation 2008/7, whilst the license/certificate fee is defined by Regulation 07/2011.

CAA planned to collect €1,500,000 in 2014, but collected €1,368,556 or 91% of the planned.

Issue 4 –Licences were issued regardless the payments were not made – High Priority

Finding Six licenses of €1,200 in total were issued for air traffic controllers at Pristina Airport. The invoices for these licenses were issued but the payment was not made.

According to Regulation No. 07/2011 the payment must be executed within 7 days from the issuance of the license. Otherwise penalties are applied and interest calculated. However, this regulation does not specify the amount of the fine or the interest rate license beneficiaries are due in case of delayed payment.

Risk Beneficiaries' failure to pay the license fee leads the risk that account receivables are increased. Failure to determine fines and interest rates in the Regulation 07/2011 may affect the efficiency of revenue collection.

Recommendation 4 The Director General should revise the regulation and specify penalties and interest rates to be applied in case of delayed payments.

4.4 Expenditures

4.4.1 Procurement

Description

CAA had a procurement plan in place and reported it on time. CAA signed fifteen (15) contracts. To ensure that procedures were implemented and that provisions of the Law on Public Procurement were adhered to, we tested five (5) contracts. Tests covered the entire procurement process, from initiation of procurement activities over to contracts management and implementation as well as execution of payments. We identified adequate controls over these processes and we have no recommendations on this area.

4.4.2 Non Procurement Expenditure

Description

Other expenditures are those not subject to procurement procedures. These include utilities, official lunches, official trips etc.

We tested a number of samples for these expenditures. Controls seemed to be adequate and we have no recommendations for this area.

4.4.3 Remunerations (Wages and Salaries)

Description

We reviewed payroll and compared it with the records provided by the Treasury, KFMIS and their presentation in AFS. We also tested samples of personnel files and recruitment procedures conducted in this period. The CAA's staff number allowed in the budget is 27. Currently there are 27 full-time employees and one part-time employee. The larger staff number is as a result of the CAA's Deputy Director General appointment in February based on the Government's decision,

Issue 5 – Payments on Special Service Contract – Medium Priority

Finding CAA has engaged an official for professional technical support in the Flight Safety Department on Special Service Contract since 2013. The contract is renewed every five months and remuneration is made from the Goods and Services category³. In addition, for training purposes to CAA staff organized by Training Organization of the Joint Aviation Authorities (JAA-TO), CAA engaged the same officer and paid her €2,436.

Risk Renewal of the Special Services Contract affects the performance of staff and the quality of administrative services. Covering travel expenses for non-full-time staff creates uncertainties which could have a negative impact on the performance of other staff or their treatment.

Recommendation 5 The Director General should consider organization's needs for permanent positions and consider the possibility of recruiting regular staff. Travel expenses should be covered only for officers who have regular employment relations in this institution.

³ According to Civil Service Law temporary appointments for a period shorter than 6 months should be concluded through "Special Service Agreement" which are included within the Law of Commitments and where a simple recruitment procedure is required.

Issue 6 – Promotions – Medium Priority

Finding	CAA promoted an officer to the position of inspector prior to ending the probation period ⁴ . According to the CAA management, the officer attained the required professional qualifications and met promotion requirements for obtaining the grade of inspector based on the prior work experience at the airport.
Risk	This situation may result in the promoted officer's failure to fully achieve the objectives of the required position.
Recommendation 6	The Director General should ensure that promotions into positions are reasonable and justifiable and serve to achieve specific objectives. He should ensure that promotions are made by taking into account relevant rules and procedures.

4.5 Assets and Liabilities

4.5.1 Capital and Non Capital Assets

Description

The value of non-financial assets owned by CAA is €38,246. This includes the amount of €7,239 for assets over €1,000, the amount of €24,075 for assets under €1,000 as well as €6,932 for stocks.

CAA's Assets Officer acts also as the Receipt/Logistics Officer.

The Board of Directors' mandate has expired, but they still use CAA assets.

⁴ According to the Civil Servants Law, all candidates hired in the Civil Service career positions are appointed for a probation period with duration of twelve (12) months. At the end of the probation period, the direct superior, based on positive assessment of performance of civil servants, gives his/her confirmation or otherwise over working in that position.

Issue 7 – Failure to return assets – Medium Priority

Finding The Board of Directors consisting of five (5) members was equipped with laptops and mobile phones for discharging official duties during its mandate. The Board’s mandate expired and they are no longer active but they have not returned the equipments yet.

Risk The former board members’ failure to return the equipments is a misuse of institutional assets for private purposes and may be considered as an illegal acquisition, causing material damage to CAA.

Recommendation 7 The General Director should ensure that additional measures are taken by reminding assets’ users on the legal procedures and requirements on assets use and return.

Issue 8 – Lack of the E-Assets register – Medium Priority

Finding CAA does not have an operational e-Assets⁵ system in place to manage expendable materials. The recording of expendable material is managed through lists in the depot.

Risk The lack of E-Assets register may lead to the presentation of information not in compliance with the required standard formats. Therefore, the presented data may be confusing, particularly in regard to expandable materials.

Recommendation 8 The CAA Director General should ensure that the e-Assets System is put in place and that all required registrations into the system are made.

4.5.2 Handling of Receivables

Description

Receivables of CAA presented in the 2014 AFS were €198,212 for invoices of November, December 2014 and a licence liability. These relate to the Memorandum signed between CAA and “Limak Kosovo” Company wherefrom funds are transferred to the CAA account 45 days after the end of each month.

Recommendations

We have no recommendations in this area.

⁵ According to the Regulation on Management of Assets, each organization must maintain the E-Assets registry to identify assets under €1000.

4.5.3 Handling of Debts

Description

The statement of outstanding liabilities not paid to suppliers at the end of 2014 was €3,630. These liabilities are carried forward to be paid in 2015.

Recommendations

We have no recommendations in this area.

4.6 Internal Audit System

Description

According to the AI no.23/2009 on the establishment of the Internal Audit Unit (IAU), CAA does not meet the criteria for the establishment of this unit. Therefore an internal audit of CAA can be carried out only by the internal audit unit within the Ministry of Finance.

For the purpose of assessing effectiveness of internal controls and accrediting the quality management system in the organization, the Director General has considered the establishment of the Internal Audit and Quality Control Office (IAQCO)⁶. This office is responsible for monitoring the continuous compliance with quality standards.

Issue 9 – Internal Audit and Quality Control Management - High Priority

Finding During 2013 the IAU Department within the MoF carried out one (1) internal audit which covered 2012 and the first half of 2013, whilst no audit was carried out in 2014.

On the other hand, the IAQCO's objectives and scope appear quite challenging taking into consideration the conclusions and reporting to the CAA Management.

Risk Failure to carry out internal audit may lead to inevitable weaknesses and shortcomings in the internal control may be present and inevitable.

Objectives set and challenges faced by IAQCO might not provide the Management with the appropriate level of assurance on the effectiveness of internal controls.

Recommendation 9 The Director General should consider an internal audit conducted by another IAU. On the other hand, he should review the IAQCO scope and see whether there is a feasible and effective plan to achieve the CAA objectives.

⁶ Internal audit of quality management system is made for the Civil Aviation Authority and has nothing to do with internal financial audit in terms of Law on Internal Audit.

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
4.5.1. Capital and non capital assets	The CAA General Director should ensure that the assets registry (E-Assets) is updated by removing assets over €1,000.	Implemented		