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Frequently Asked Questions on Financial Auditing

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Common causes of Qualified Audit opinions in Kosovo municipalities and how to addressthem

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This document provides a collection of frequently asked questions and guidelines to assist municipalities in Kosovo in preparing for audits, ensuring financial compliance, and addressing common issues encountered during the auditing process. It aims to educate everyone, including non-financial staff, to understand the financial audit terminology and key issues facing Kosovo municipalities in financial management.

Main sources: *Kosovo national legislation, audit reports for Kosovo municipalities, issued by the National Audit Office of Kosovo, the ISSAIs – the International Standards of Supreme Audit Institutions, issued by INTOSAI, the IFRS – the International Financial Reporting Standards.*

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Contents

1 General overview of financial auditing in Kosovo

Financial auditing of Kosovo municipalities involves several key stakeholders working together to ensure transparency, accountability, and proper management of public funds. The National Audit Office, municipal finance departments, internal auditors, and elected officials all have a crucial role in addressing audit findings and improving municipal financial practices.

What is financial auditing? Financial auditing is the independent evaluation of an entity's financial statements to determine their accuracy, transparency, and compliance with applicable laws, regulations, and standards. It provides assurance that the reported financial position, performance, and use of resources are presented fairly and in accordance with the relevant financial reporting framework.

Why is financial auditing important for municipalities? Financial audits are essential to ensuring that public funds are managed appropriately. They increase transparency, promote accountability, and support good governance in the use of municipal resources.

What is the role of the Auditor General and the National Audit Office (NAO)?

The Auditor General, as the head of the NAO, is accountable to the Assembly of Kosovo and operates under the authority of the Constitution, national legislation, sub-legal acts, and internationally recognized public sector auditing standards.
The NAO is the independent institution responsible for auditing the financial statements of Kosovo's municipalities. It identifies weaknesses in financial management, provides independent opinions on financial reports, and issues recommendations for improvement to strengthen transparency and accountability of public sector, including at the municipal level.

What is the difference between internal and external audit?

- **Internal audit** is conducted by staff within the organization. It focuses on evaluating and improving internal control systems, risk management, and operational efficiency.
- **External audit** is performed by an independent auditor (such as the NAO) to express an objective opinion on whether the financial statements are free from material misstatement and presented fairly according to the applicable financial reporting framework.

2 Common reasons for a qualified audit opinion in Kosovo municipalities – and how to fix them

Issue 1: INADEQUATE ASSET REGISTRATION

Deficiencies in the registration of capital and non -capital assets

What is meant by inadequate asset registration?

Inadequate asset registration, as understood under Regulation MoF – No. 02/2013 on Management of Non-Financial Assets by Budget Organizations, refers to the failure of a budget organization to fully comply with the requirements for recording, classifying, and maintaining accurate data on non-financial assets in the official asset registers. This includes the omission of assets, incorrect or incomplete entry of asset details such as value, location, and ownership, lack of timely updates following acquisitions or disposals, and discrepancies between physical assets and recorded information.

Why is this a problem?

Inadequate asset registration is a problem because it weakens financial reporting, increases the risk of asset loss or misuse, and hinders effective planning and control. It undermines transparency, accountability, and proper management of public resources.

How can municipalities improve asset registration?

Here are some key steps:

- Establishing a complete and updated asset register that includes all non-financial assets with accurate details (e.g., value, location, acquisition date, condition)
- Assigning unique identification numbers or barcodes to each asset to enable tracking and physical verification
- Ensuring proper classification of assets
- Conducting regular physical inventories and reconciling results with the asset register
- Maintaining proper documentation for each asset, including contracts, invoices, and transfer records.
- Implementing internal controls and periodic audits to verify the accuracy and completeness of asset records
- Establishing clear asset management internal policies

Procedures for initial asset registration

(For organizations that have not fully or partially identified and registered their assets)

In cases where a budget organization has not previously conducted the identification and registration of its assets, the procedure for initial asset registration must be applied. This procedure includes the following steps:

Establishment of the Asset Identification and Valuation Commission

The organization establishes a temporary commission by internal decision to identify, verify, and assess all existing tangible and intangible assets.

Full physical inventory

The commission carries out physical inspection and documentation of each asset, including:

- Location
- Technical description
- Physical condition
- Estimated value (in the absence of supporting documentation)

Preparation of Asset Lists

Upon completion of the identification process, the commission prepares detailed lists according to asset categories (capital and non-capital), which are then approved by the Head of the Budget Organization.

Preparation of registration documentation

In the absence of original documents (purchase orders, invoices, etc.), the commission drafts an official valuation report for each asset, which serves as the basis for registration.

Registration in the E-Asset System and, if applicable, in SIMFK

The Asset Officer registers all assets in the E-Asset system, and assets with a value exceeding €1,000 are also recorded in the Free Balance system (SIMFK), if applicable.

How to ensure that all assets purchased during the fiscal year are recorded in asset registers?

To ensure an accurate recording of all assets purchased during the fiscal year, it is essential to conduct a thorough verification of the financial register (Free Balance) for all purchases made during the reporting period. This process involves reviewing all expenditures, regardless of their category: capital investments, goods and services, or subsidies and transfers, to identify payments related to assets and confirm their registration in the asset registers.

1. Verification of payments from the Capital Investments category

- Identify all payments from the economic category of capital investments.
- Verify that the appropriate documents have been received for all payments.
- Ensure that the acquired assets are accurately recorded in the asset registers.

2. Verification of payments from the Goods and Services category

- Review all payments made under the Goods and Services category to determine whether any involve the purchase of assets.
- If any such payments have resulted in asset acquisition, the Asset Officer must collect the necessary supporting documentation and ensure the asset is accurately recorded in the appropriate asset register.
- Additionally, the Asset Officer can enhance the accuracy of the asset register by comparing municipal property-related payments with recorded assets. For instance, reviewing payments for electricity, water, waste services, and other utility bills for properties such as schools, health centers, and municipal buildings, and cross-checking them against the asset register, can help identify unregistered properties and address any gaps or inaccuracies in asset documentation.

3. Verification of payments from the Subsidies and Transfers category

- *Identify payments to assess if any of them resulted in asset creation.*
- *If any such payments have resulted in asset acquisition, the Asset Officer must collect the necessary supporting documentation and ensure the asset is accurately recorded in the appropriate asset register.*
- *Verify payments to ensure that subsidies and grants given to third parties are not mistakenly recorded as municipal assets.*
- Additional verifications that the Asset Officer may consider necessary to ensure all municipal assets are accurately recorded include: cross-checking procurement records with the asset register; reviewing documentation related to asset disposals, transfers, expropriations, donations made by the municipality to other organizations or received by the municipality; and property exchanges based on municipal assembly decisions. The process also involves inspecting maintenance and insurance records and coordinating with departments responsible for managing physical assets. These actions help verify the existence, condition, and proper classification of assets, thereby contributing to the completeness and accuracy of the asset register.

This verification process should be carried out periodically throughout the year, and at a minimum, once at the end of the fiscal year, to ensure all municipal assets are accurately recorded. Regular updates enhance transparency and strengthen the management of public assets, ensuring their correct presentation in the municipality's financial statements.

Why It Matters

Accurate asset registration is fundamental to sound public financial management. Properly recorded municipal assets enable informed planning, budgeting, and maintenance of public infrastructure. It ensures that public resources are safeguarded, reduces the risk of asset misuse or loss, and supports informed decision-making.

Moreover, transparent and reliable asset records enhance accountability to citizens and oversight institutions, reinforcing public trust in local governance.

Inadequate registration, on the other hand, undermines these goals and can lead to inefficiencies, waste, and even corruption.

Issue 2: CONTINGENT LIABILITIES NOT PROPERLY RECORDED

Incomplete disclosure of contingent liabilities in the financial statements – underestimation or overestimation of them

What are contingent liabilities?

Contingent liabilities are potential financial obligations that arise only if certain future events occur — most commonly, court rulings.

Why are they important for municipalities?

If not properly recorded or reported, they can lead to budget overruns, audit qualifications, and reduced financial transparency.

Main sources of contingent liabilities in municipalities:

- Lawsuits filed by teachers under the 2017 & 2021 Collective Agreements, including claims for: daily meal allowance, jubilee bonuses, severance pay, annual salary bonus, and other benefits deriving of such agreements.
- Other legal disputes (e.g. property, contracts, HR, procurement, etc)

Even though both collective agreements (education and health) were cancelled in 2022, courts still rule in favor of claimants (concerning legal actions initiated prior to the cancellation of these contracts), creating significant financial impact to municipalities.

How to improve management and reporting:

- ➔ **Create and maintain a Contingent Liability Register:** Include all ongoing lawsuits and potential obligations; update regularly.
- ➔ **Ensure regular communication between:** Legal Office / Legal Representative, Finance Department, Relevant sectors (HR, Procurement, Education, Health)
- ➔ **Formalize the reporting process:** Legal Office informs Finance of new cases => Finance notifies Legal Office of payments made => Remove settled cases from the register
- ➔ **Regular reviews and controls:** Compare legal case data with State Advocacy Office records. Ensure consistency between registers and financial statements (AFS).

Why it matters

Accurate and proper disclosure of contingent liabilities in municipal financial statements is essential for transparency, accountability, and effective financial planning. In Kosovo municipalities, where financial resources are often limited and public scrutiny is high, failing to disclose potential future obligations like pending court cases unresolved property claims, or contractual disputes can misrepresent the municipality's true financial position. This lack of disclosure prevents informed decision-making and risks unexpected costs that may disrupt service delivery and damage public trust. Clear disclosure of contingent liabilities enhances oversight, promotes responsible governance, and supports long-term fiscal stability.

Issue 3: INCORRECT CLASSIFICATION OF EXPENSES

Incorrect registration of expenses under inappropriate economic categories

What is expenditure misclassification?

It occurs when expenditures are recorded under the incorrect economic codes in the budget or financial reports — for example, paying a legal obligation from the wrong category (e.g. goods and services instead of wages or capital investments). This misclassification can involve assigning costs to inappropriate budget lines, like categorizing capital expenditures as operational expenses or incorrectly labeling payments related to salaries or utilities.

Why is this a problem for municipalities?

- Leads to inaccurate financial reporting
- Complicates budget planning for future years
- Hinders budget monitoring
- Obstructs timely and legal payments, especially for court-ordered liabilities

What causes misclassification?

- Incorrect budget planning
- Payments made from inappropriate codes (in recent years, primarily caused by payments made by the Treasury for the execution of payments for court decisions and enforcement procedures related to lawsuits arising from the labor-related collective agreements)
- Lack of communication between legal, financial, and other departments
- Delays in fund transfers or reallocations

How can municipalities prevent or reduce misclassification?

➔ **Plan the Budget carefully:** Align obligations (e.g., from court cases or contracts) with appropriate codes from the start.

➔ **Choose the right time for fund transfers:** When needed, propose fund reallocations to the Municipal Assembly based on thorough financial analysis.

➔ **Improve interdepartmental communication:** Maintain consistent communication between: Legal Office, Finance Department and Treasury and encourage cooperation among other departments (Finance, HR, Procurement, Education) to fully understand all expenses and their correct classification and forecast payment timing and legal obligations.

➔ **Conduct regular budget performance reviews:** Track deviations and issues during the year to allow timely corrective action.

➔ **Train staff regularly:** Offer periodic training to finance and admin staff on budgeting, classification, and reporting procedures.

Why it matters

Correct classification ensures: Compliance with laws and regulations; Clear and accurate financial statements; Stronger internal control and accountability

Issue 4: INADEQUATE PRESENTATION OF RECEIVABLES IN THE FINANCIAL STATEMENTS

Overestimation/underestimation of receivables from taxes and other sources

What are accounts receivable in municipalities?

Accounts receivable in municipalities refer to billed but uncollected revenues owed by individuals, businesses, or institutions including those from property tax, business activities, and other municipal income sources. Accurate recording and disclosure of these receivables in the Annual Financial Statements (PFV) are essential for reliable financial reporting, efficient revenue collection, and effective municipal budgeting.

Why is this an issue?

Many municipalities face challenges in reporting receivables due to:

- Incomplete or outdated records
- Weak internal controls
- Weak coordination between finance and revenue departments
- Lack of ongoing review and legal compliance
- Poor follow-up on collections

What needs to be done?

➔ **Maintain a complete and updated Receivables Register:** All billed but unpaid revenues must be documented, regularly updated, and reflected in the AFS under the correct category.

➔ **Strengthen internal controls:** Ensure that all supporting documents (invoices, contracts, tax decisions) are verified and match the figures in the receivables register and AFS.

➔ **Improve coordination between key staff:** The Chief Financial Officer (CFO) and Revenue Officers must work closely to

- Regularly review outstanding balances (especially from property tax)
- Analyze legal and financial documents
- Classify and age receivables properly
- Prevent overstatement of expected collections

➔ **Ensure proper follow-up on collections:** Adequate procedures for monitoring and collecting overdue amounts.

➔ **Conduct aging analysis of receivables:** Categorize receivables based on how long they've been outstanding and assess their likelihood of collection. Adjust the AFS accordingly.

➔ **Implement real-time or periodic updates:** Update receivables for new billings, collections, or write-offs as they occur. Regularly reconcile data with payment evidence.

- ➔ **Ensure legal compliance:** Verify that receivables are managed in accordance with applicable laws and local regulations on taxes, fees, and revenues.

Why it matters

Accurate reporting of receivables: Increases financial transparency; Ensures audit readiness; Helps manage revenue collection efficiently; Aligns with legal and accounting standards

3 Roles and responsibilities for implementation of audit findings

Who is responsible for implementation of audit findings? The responsibility for implementation of audit findings primarily lies with the municipal leadership, including the Mayor, Chief Financial Officer (CFO), municipal finance departments, and other relevant staff. These actors are expected to implement corrective measures in response to audit recommendations.

External auditors, including the National Audit Office (NAO), support this process by providing independent assessments and follow-up audits to monitor progress.

What role do Municipal Assemblies play in financial auditing? Municipal Assemblies have an oversight role. They are responsible for reviewing audit reports, holding the executive leadership accountable, and ensuring that recommended measures are implemented to improve financial governance. The Audit Report and the Action Plan for implementation of audit recommendations are discussed at a special session of the Municipal Assembly.

How does the National Audit Office follow up on audit findings? The NAO monitors whether municipalities have addressed the issues raised in audit reports through follow-up audits and annual reporting. It may highlight recurring weaknesses or lack of progress and can recommend further actions.

Can municipalities be penalized for failing to act on audit recommendations? While the NAO does not impose penalties directly, failure to act on recommendations may lead to reputational damage, increased scrutiny, or intervention by higher levels of government. It may also impact funding or project approval from external donors or institutions. For compliance issues related to noncompliance with the legal framework, audit findings may serve as a source of information for initiating investigative procedures by law enforcement authorities.

What is the role of internal audit units within municipalities? Internal audit units help ensure that internal controls are working effectively and that risks are managed properly. They also support management in preparing for external audits and addressing audit findings proactively.

4 How should municipalities implement audit recommendations

Municipalities should take a structured and proactive approach to implementing audit recommendations. This includes the following key steps:

Develop a detailed action plan

After receiving the audit report, the municipality should prepare a time-bound action plan that clearly outlines how each audit recommendation will be addressed. Each action should have a designated responsible person or department as foreseen with the NAO template.

Prioritize and allocate resources

Successful implementation often requires financial, human, and technical resources. Municipal leaders must ensure that sufficient resources are allocated to carry out the corrective measures identified in the audit.

Ensure staff training and capacity building

In some cases, audit findings stem from a lack of knowledge or capacity. Municipal staff, particularly those in finance, procurement, and asset management, should receive targeted training to strengthen their understanding of financial procedures and compliance requirements.

Establish a monitoring and reporting mechanism

Regular monitoring is essential. Municipalities should track progress on implementing recommendations and report this internally and to oversight bodies such as the Municipal Assembly. Regular updates (e.g. quarterly progress reports) help maintain momentum and ensure accountability.

Collaborate with internal and external auditors

Internal audit units can support the implementation by assessing progress and advising on risk management. External auditors, including the NAO, can provide guidance and conduct follow-up audits to assess whether the issues have been adequately addressed.

Foster a culture of accountability and transparency

Long-term improvement depends on building a culture where public servants understand the value of sound financial management and the consequences of inaction. Municipal leadership must set the tone by taking audit recommendations seriously and promoting ethical practices.

5 Impact of non-compliance with Financial Accounting Standards

What are the consequences of non-compliance with financial accounting standards?

Non-compliance with financial accounting standards can lead to:

- Qualified, adverse, or disclaimer audit opinions
- Ineligibility for the Municipal Performance Grant
- Legal or financial penalties
- Loss of public trust
- Reduced access to donor funding or project support

What does a qualified audit opinion mean for a municipality?

A qualified opinion signals that some parts of the financial statements do not comply with standards or are materially misstated. Consequences include:

- Exclusion from the Municipal Performance Grant
- Greater scrutiny from oversight bodies and the public
- Damage to the municipality's reputation and credibility

6 Financial audit – Glossary of Terms

Audit	means a qualified examination of legal and financial compliance or performance, carried out to satisfy the requirements of management (internal audit), or an external audit entity, or any other independent auditor, to meet statutory obligations (external audit)
Auditor	the person or persons conducting the audit. In the context of Kosova – auditor is an officer authorized by the Auditor General to carry out all functions under the Law on Auditor General;
Auditor General	the head of a Supreme Audit Institution appointed by the Assembly of Kosovo upon the proposal of the President of the Republic of Kosovo.
Audited Entity	any public institution, publicly owned enterprise or other authority managing public funds subject to audit.
Audit Findings	issues identified during an audit, including areas where the municipality has failed to comply with legal requirements or where improvements in financial management are needed. Audit findings are usually detailed in the audit report.
Audit Opinion	means a formal written expression of an opinion on the financial statements or any certain process within a specified framework, indicating the auditor's overall conclusion based upon audit evidence obtained that provide a reasonable level of assurance (high but not absolute assurance);
Annual Financial Report	a report prepared by the municipality at the end of the fiscal year, summarizing its financial position, performance, and cash flow. The AFR is subject to audit and helps assess the municipality's financial health and governance.
Asset Register	a detailed record of all assets owned by the municipality, including land, buildings, infrastructure, and equipment. The asset register helps ensure that assets are correctly accounted for and properly managed.
Compliance audit	compliance audit deals with the degree to which the audited entity follows rules, laws and regulation, policies, established codes, or agreed upon terms and conditions etc. Compliance auditing may cover a wide range of subject matters.

Criteria	the benchmarks used to evaluate or measure the subject matter including, where relevant, benchmarks for presentation and disclosure. Criteria can be formal or less formal. There can be different criteria for the same subject matter.
Emphasis of Matter	a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.
Financial Audit	an independent assessment, resulting in a reasonable assurance opinion, of whether an entity's reported financial condition, results, and use of resources are presented fairly in accordance with the financial reporting framework.
Financial Statements	a structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information.
Internal Audit Function	an appraisal activity established or provided as a service to the entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control.
Internal Auditors	those individuals who perform the activities of the internal audit function. Internal auditors may belong to an internal audit department or equivalent function.
Internal Control	the whole system of financial and other controls, including the organizational structure, methods, procedures and internal audit, established by management within its corporate goals, to assist in conducting the business of the audited entity in a regular economic, efficient and effective manner; ensuring adherence to management policies; safeguarding assets and resources; securing the accuracy and completeness of accounting records; and producing timely and reliable financial and management information.
ISSAI	the International Standards of Supreme Audit Institutions, issued by INTOSAI. The ISSAIs are the authoritative international standardson public sector auditing.
INTOSAI	means International Organization of Supreme Audit Institutions.
Misstatement	a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

Material Misstatement	a significant error or omission in the financial statements that could influence the decision-making of users of those statements. This could relate to the recognition, measurement, or disclosure of assets, liabilities, income, or expenses.
Modified Opinion	a qualified opinion, an adverse opinion or a disclaimer of opinion.
Supreme Audit Institution	the public body of a State which, however designated, constituted or organized, exercises by virtue of law, the highest public auditing function of that State.
Unmodified Opinion	the opinion expressed by the auditor when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework

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