

Increasing Transparency through promotion of Internal Audit role in the Accountability chain

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1 Acronyms and Abbreviations

AI	Administrative Instruction
AC	Audit Committee
BO	Budget Organisation
CAO	Chief Administrative Officer
COSO	Integrated Framework for Internal Control
CPF	Committee for Politics and Finances
CPD	Continuous Professional Development
FMC	Financial Management and Control
IA	Internal Audit
IAU	Internal Audit Unit
SAI	Supreme Audit Institutions
PSE	Public Sector Enterprises

Executive Summary

Openness, **accountability**, and **honesty** define **government transparency**. Government exists to serve people and in a free society, transparency is government's obligation to share information with citizens. Information on how officials conduct the public business and spend taxpayers' money must be readily available and easily understood.

Governments at central and local level while adapting and responding rapidly to changing economic, social, political and technological trends should try to increase the level of outflow of information and find ways on how they will communicate better the relevant information to the public.

Therefore, the primary objective of this report is to describe the current situation on the Transparency and the role of the Internal Audit in the Accountability chain at municipal level, followed by recommendations on the findings and suggesting strategic directions for improvement. Provision of public service at local level is limited due to scarce resources and in the same time local governments are exposed to risk of fraud, errors, misappropriation, inefficient and ineffective operations, while being in the spotlight of citizens about the transparency expectations. For every local government unit, there are risks that goals and objectives may not be achieved and all efforts aimed at identifying and/or recommending prevention of such risks, are received to be internal audit job, when as a matter of fact this should be a priority task of the operational and senior management. This document, will consider questioning if the current mechanisms working in this direction and that are in place are functional and if not what can be improved considering that Kosovo, as any other country in transition is looking forward at improving it's the transparency perception of the society. The current evaluation from the Transparency International ranks Republic of Kosovo on the 103rd place out of 168 countries assessed with the score 33 out of 100.

1 Introduction

The Project “Increasing Transparency through promotion of Internal Audit role in the Accountability chain” had a very wide scope as it has analysed key concepts toward good governance in the public sector, like **transparency** and **accountability**, involving promotion of **internal audit** role.

To promote the role of the Internal Auditor, we must ensure that there are some preconditions existing in the first place. Starting with the organisative set-up, sufficient number of staff in the Internal Audit Unit, quality work from IA, good communication between Internal Auditor and the Head of local government entity, establishment of Audit Committees and finally good system in place for following-up the implementation of the recommendations. Then this follows into analysing deeper the current situation and practical implementation of Internal Audit legal framework and ways on how the Municipal Transparency can be increased through promotion of this role.

While carrying out a thorough research via desk review and field survey, we have established that although there are some certain parameters in place for well-developed internal audit function, there is still room for improvement towards better understanding of the real Internal Audit role in the budget organisation and for more acknowledgment among other levels of management in a local government entity and in the other hand for the internal auditor to work harder to support the mayor in the accountability process., through provision of advices for continuous improvement of internal controls placed by senior management.

The internal audit function has another element creating so called internal audit triangle that is Audit Committee. They are established to support the work of the auditor and at the same time to advice and take care that internal and external audit recommendations are implemented from the management which so far has not shown a good progress especially in the area of implementation of external audit recommendations.

Therefore, we have considered on exploring other mechanisms that are in place to make sure that there is a good financial system running in the Municipalities and carry the responsibility for the budget

execution, while holding the Mayor accountable via Municipal Assembly. That mechanism is the Municipal Committee for Politics and Finances. Considering that greater involvement of this Committee would bring another “pair of eyes” in the Internal Audit System expansion of existing not very effective triangle would be more effective in the new format. This could be another possibility to increase the accountability of the holders which in turn increases the transparency on how public money is spent and what if the services given are good value for money.

Just on the transparency matter, the Ministry of Local Government Administration has issued an Administrative Instruction last year Transparency of Municipalities 01/20151, by which municipalities are required to produce an Action Plan for its implementation. The Instruction itself should be amended to include at least the process of implementation of external audit recommendations. Having said this, since the external audit reports are publicly accessible, than the municipalities should produce a timeline action plan on implementing agreed recommendations that would show municipal efforts towards better governance, while improving transparency and maintain professionalism.

From our field research conducted on 18 selected municipalities, we have found out that Officials on top of the Accountability Chain do not really appreciate the role of Internal Audit in supporting them with the accountability. At the same time, we could not find any institutionalized approach on how to make municipality transparent to the citizens. There has been some numerous unsuccessful and unsustainable attempts in this regard.

¹See <https://gzk.rks-gov.net/ActDocumentDetail.aspx?ActID=11403>

2 Project phases

In order to achieve aforementioned Project objectives, the Project team has divided the work in two main stages:

1. **Desk review**, including:
 - a. Standards and Guidance: International Professional Practice Framework for Internal Audit²;
 - b. Legal framework regulating internal audit function in the Republic of Kosovo, law and by-laws;
 - c. Laws, Regulation and Strategies that regulate the area of transparency and Accountability;
 - d. National Audit Office in Republic of Kosovo Reports for four consecutive years, for all municipalities in Republic of Kosovo;
 - e. Civil Society Reports acting in the area of transparency and scrutinizing the public sector;
 - f. Reports from International mechanisms and institutions.
 - g. Researching and testing the current online reporting of corruption in the Municipalities websites.
2. **Field research** consisted of:
 - a. Pre-prepared questionnaire, containing basic requirements for the establishment of Internal Audit as a function in the public administration;
 - b. Meetings with relevant actors to identify and suggest a communication platform;
 - c. Study visits in regional countries where internal audit was developed simultaneously with Republic of Kosovo;
3. Drafting a report based on the findings from desk review and field research;
4. Promotion of the findings and results;

² The latest version published at: <https://na.theiia.org/standards-guidance/Pages/Standards-and-Guidance-IPPF.aspx>

5. Monitoring.

Through this document, we will shortly summarize the key concepts mentioned above and how they are interpreted into municipal activities and suggest what could bring higher transparency to the municipalities, which in turn will reduce the level of reported corruption, by using a very valuable management tool, the Internal Audit.

2.1 Transparency

As a principle, public officials, civil servants, managers and directors of companies and organizations and board trustees have a duty to act visibly, predictably and understandably to promote participation and accountability and allow third parties to easily perceive what actions are being performed.

In practice it means that Mayor, Senior Management of the Municipality, Internal auditors should promote good governance and work towards its principles, by allowing third parties, i.e. people to understand what is happening in their surroundings. Not all of them will have the ability to absorb information given, but there are other stakeholders that could help in this process, like National Audit Office, an active civil society and media: written, electronic and online.

Simply making information available is not sufficient to achieve transparency. Large amounts of raw information in the public domain may breed opacity rather than transparency.

Also not all of type of information is aimed at being fully disclosed to the public.

Kosovo's Constitution, Article 41 states "that everybody has a right to request document and institutions are obliged to make documents available to public"³. Following to this there is Law on Access to Public Documents No.03-L-215 and more recently

Transparency is a characteristic of governments, companies, organisations and individuals that are open in the clear disclosure of information, rules, plans, processes and actions.

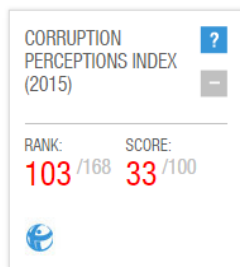
³ Kosovo Constitution, Page 13, article 41

Administrative Instruction on Municipal Transparency. This however does not make a government central or local being transparent in practice.

It is important that citizens know that they have a right and everybody is eligible to be informed. Information should be managed and published so that it is:

- **Relevant and accessible:** Information should be presented in plain and readily comprehensible language and formats. Information should be made available in ways appropriate to different audiences.
- **Timely and accurate:** Information should be made available in sufficient time to permit analysis, evaluation and engagement by relevant stakeholders. This means that information needs to be provided while planning as well as during and after the implementation of policies and programs. Information should be managed so that it is up-to-date, accurate, and complete.

WHY IT MATTERS?



Higher transparency equals lower corruption rate. If there is low transparency level of a Budget Organization, this is a strong symptom that there is high likelihood for corruption. In addition, the Budget Organizations at large operate from the taxpayer money, and in turn they have to convert that into better livelihood of citizens, if they are transparent, people can easily understand on how well their money is spend.⁴

Financial institutions should make a commitment to report annually on the measures they are adopting to strengthen risk management, especially in relation to bribery and corruption at the board and senior

⁴ The **Corruption Perceptions Index** ranks countries/territories based on how corrupt a country's public sector is perceived to be. It is a composite index, drawing on corruption-related data from expert and business surveys carried out by a variety of independent and reputable institutions.

*management levels*⁵. For Kosovo, the corruption perception index has not shown any progress towards improvement. Kosovo has been ranked 103 out of 168 with score 33/100⁶, having the lowest score comparing to the countries in the region⁷.

In the other hand, there should be a minimum set of criteria in a list to show if a Budget Organization, i.e. Municipality is transparent or not. During our desk and field research, we came across an Administrative Instruction on the Municipality Transparency that contains a set of criteria for the local level Budget Organizations to be transparent. But, despite the fact that AI has been approved in 2015 there have been just few activities undertaken to implement it. At the end of this report, we have put the criteria required by this AI combined with some other criteria used as best practice and compiled a Transparency Self-Assessment Questionnaire that should be monitored by Ministry of Local Government Administration on quarterly basis to measure transparency of Municipalities.

2.2 Accountability

The concept of accountability has a long tradition in both political science and financial accounting. As a concept in ethics and governance with several meanings, accountability is often used synonymously with such concept as responsibility, answerability, liability and other terms associated with the expectation of account giving.

As an aspect of governance, it has been central to discussion related to problems in the public sector, non-profit and private companies. Accountability can be in form of social accountability, financial accountability, political accountability, administrative accountability, ethical accountability and legal accountability.

⁵ <http://www.transparency.org/country/#KOS>

⁶ Scores range from 0 (highly corrupt) to 100 (very clean).

⁷ <http://www.transparency.org/country/#KOS>

Generally, **Accountability** means ensuring that officials in public, private and voluntary sector organizations are answerable for their actions.

Accountability is an **institutionalized relationship** between different actors.

One set of people/organizations are held to account, and another set do the holding.

Accountability can usefully be categorized in terms of horizontal, vertical and diagonal mechanisms, with the condition however, that success is most often found not in one of those approaches alone, but in their interaction.

- **Horizontal accountability** consists of formal relationships within the state itself, whereby one state actor has the formal authority to demand explanations or impose penalties on another.
- **Vertical forms of accountability** are those in which citizens and their associations play direct roles in holding the powerful to account.
- **Diagonal accountability** operates in a domain between the vertical and horizontal dimensions. It refers to the phenomenon of direct citizen engagement with horizontal accountability institutions when provoking better oversight of state actions.

Accountability - The concept that individuals, agencies and organisations (public, private and civil society) are held responsible for reporting their activities and executing their powers properly. It also includes the responsibility for money or other entrusted property.

2.2.1 Accountability chain

Republic of Kosovo Government has established and enforced Accountability by Law on Public Financial Management and Accountability L-029 and through the Treasury Financial Rule 01/2010.

According to Treasury Financial Rule 01/2010 the Accountability for the local administration is concentrated on the Mayor who is elected by people and therefore is directly accountable to people

and to the Municipal Assembly. The Chief Financial Officer, Directors and Internal Auditors are accountable to the Mayor.

According to this rule, under paragraph 1.2.1 it is stated that “Unlike a central budget organization, where the responsibility for its administration and operation relies with the CAO, the Mayor leads both the municipal government and its administration/operation and is responsible to the people for the action of both. Consequently all references to the responsibilities and accountabilities of the CAO in this Treasury Rule and the FMC Procedures Manual apply to both CAOs of the central budget organizations and Mayors.⁸”

In order to clarify the aspects for which mayors are account for, we will elaborate just two types of accountability, based on the Treasury Rule regulation accountability in Kosovo.

- **Political Accountability**

While Mayor would carry this responsibility along with being a manager of the local unit – municipality, there should be a clear division between these two roles.

Political accountability is the accountability of the government civil servant and politicians to the public and to legislative bodies such as a parliament or municipal assembly. Voters do not have any direct way of holding elected representatives to account during the term for which they have been elected. The only way this can be done is by measuring the output and outcome of the objectives set in the political plan of the winning candidate which in turn can be translated into and strategic plan for the Municipality or be a part of already established strategic plan.

At this point the political accountability is transformed into Managerial Accountability which is easier to be followed in comparison with Political accountability.

⁸ Treasury Financial Rule 01/2010, pg.

- **Managerial /Administrative Accountability**

Within the public sector, accountability is the process whereby public sector entities, and the individuals within them, are responsible for their decisions and actions, including their stewardship of public funds and all aspects of performance, and submit themselves to appropriate external scrutiny. The idea is to communicate accountability expectations, standards and principles to foster ownership of actions, processes, outputs and outcomes while allowing some flexibility in approaches used to promote this accountability.

Internal rules and norms as well as some independent bodies are mechanisms to hold civil servants within the administration of government accountable. To be accountable it should explain if and why its result differ from what was intended and what action it took.

But, how people can make officials accountable? In this regard, we have reviewed the role and responsibilities of different direct and indirect stakeholders in the accountability chain.

2.2.2 Municipal Assembly

According to the Law on Self-governance⁹, the Municipality is governed by the Mayor and Municipal Assembly. Municipal Assembly in turn, has two permanent Committees:

1. Committee for Politics and Finances; and
2. Committee for Communities.

Municipality Assembly has a right to establish other committees as per specificities of Municipality. In this report the focus will be in the role of the Committee for Politic and Finances as we consider that it is a key towards enhancing the role of the Internal Auditor in the Municipality, while keeping the Mayor

⁹ See Law on Self-governance *add number date approval*

and his subordinated staff, known as Board of Directors accountable for the actions taken in regards to the improvements required in the municipal process and systems, based on the findings and recommendations of Internal and External Auditors, via Municipal Assembly.

The composition on Committee for Politics and Finances varies from one municipality to another and same is in terms of gender and political parties' representation.

In 18 municipalities where the research was conducted the CPF counts from 7-16 members. Their role is to review:

1. All policies
2. Fiscal and **financial documents**
3. Plans, initiatives, including **strategic planning document**;
4. MTEF
5. Procurement annual plan
6. Annual regulation on taxes, fees and charges,
- 7. Annual working plan of internal audit**
8. Annual budget plan, medium-term and every other change in the budget during fiscal year, and
- 9. Obtaining reports from the Mayor and submitting recommendations in the municipal assembly.**

In relation to our report their role seems to be very important in addressing outstanding internal audit and external audit recommendations. They could be assisted by Audit Committee that is consisted from professionals of the area on understanding the Internal and External Audit reports given the fact that not all the members of this Committee have financial background.

2.2.3 Audit Committee

Audit Committee is an advisory and consultative body. The role of the committee is defined in the Law of Internal Audit 2010/01 and in more details elaborated in the Administrative Instruction for Establishing Internal Audit Committees No. 11/2010.

The roles of Audit Committee are to:

- 1.1 Provide advices of PIFC on all areas of senior management responsibility.
- 1.2 Ensure that the PSE management performs its activities in compliance with all applicable legal obligations:
- 1.3 Review and approve but not govern the Internal Audit Unit audit strategy and annual plans:
- 1.4 Review summarized internal audit reports, findings and recommendations aroused, and seek assurance that they have been properly addressed by PSE management
- 1.5 Review financial statements and external audit opinions and reports:
- 1.6 Review the management response to issues raised by the external auditing:
- 1.7 Ensure an effective relationship between the management, the Internal Audit Unit the External Auditor:
- 1.8 Protect the functional independence of Internal Audit Unit
- 1.9 Evaluate the adequacy of internal audit resources
- 1.10 Ensure that potential fraud or suspected corruption, identified by internal audit reports or otherwise brought to the attention of the Audit Committee are reported to competent authorities
- 1.11 Advise on issues related to identified risks and the PIFC system
- 1.12 Maintain data on all meetings along with reports provided by the internal audit function and all written evidence on all issues and evidences related to these reports as well as actions undertaken by the Audit Committee
- 1.13 Provide full and unhindered Access to all data or reports produced or maintained by the Audit Committee upon request of the Auditor General or other public authority vested with investigative or control functions

1.14 Prepare and issue the Audit Committee Charter, which shall be signed by the Audit Committee members and the management of the organisation concerned. The Charter shall cover the following topics: the composition of the Audit Committee, membership, participation at meetings, frequency of meeting, authority, tasks, reporting procedures and payment, which is made based on applicable laws and instructions.

2.2.4 Internal Audit Role

The weak governance and transparency are considered to be the main cause of ineffective government accountability in the public sector and impact all taxpayers and citizens.

With governments facing ever increasing deficits and debt, the lack of effective government accountability is becoming a major challenge to the services that they can provide with the resources available.

Given this environment, Internal Audit has a great opportunity to help improve oversight and governance practices in the public sector. As explained above, there is no direct role for the internal auditor in the Accountability Chain. But, indirectly they can help the Head of BO to be accountable by recommending improvements on internal controls of the organisation.

How the Internal Auditor can improve the situation?

The IIA Definition says that the *“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to **evaluate** and **improve** the effectiveness of risk management, control, and **governance processes.**”*

According to International Practice for Professional Framework for internal Auditor, **Governance** is combination of processes, structures implemented by the board in order to inform, direct, manage and monitor the action of the organization toward achievement of its objectives.¹⁰

¹⁰ Professional Practice Framework: International standards for Professional Practice

Kosovo has established the Internal Audit function almost a decade ago to make it mandatory for implementation by all budget organisations by first Law on Internal Audit, promulgated in 2008. Since then, there have been enormous efforts provided, mainly through the EU Technical Assistance Support to bring the Internal Audit Function to its advisory role, rather inspection or revision.

There has been continuous support to the Ministry of Finances, to train and certify the existing Internal Auditors in the Public Sector. It seems that over the time, the focus was however in enhancing professionally the internal auditors towards meeting International Standards for Internal Auditing, and there was less focus in educating the management of Budget Organisations to utilize the Internal Audit as a tool to improve Governance, at the same time, to provide instruments for the internal auditors to be able to check the budget organization performance. Having said this, the internal audit could really perform well if there is a good Financial Management and Control in place, aiming firstly at clear rules and regulations, general and specific internal procedures, risk assessment and communication and information. Without this elements existing and put in place by the Management, then internal audit cannot add real value to the organization.

The regulation of Internal Auditor profession is same in the central level as in the local level, with one **very important difference**. At the Central level the Internal Auditor reviews the work of CAO (Permanent Secretary) and reports to the Minister and at the local level the internal auditor reviews the work of CAO (Mayor) and reports to the Mayor.

Mayor according to the Law on Public Finance and Accountability No.L-029 is equivalent to the CAO of central level and in turn is administratively and politically accountable to the People as per accountability chain presented on the Financial Rule No. 01/2010:

At the same time, the Law on Internal Audit No.128, Article 3.1¹¹ states that internal Auditor should be positioned at the highest levels of Budget organisation reporting directly to the Senior Management-Mayor. But our concern is that even though the Internal Auditor in general from the Municipalities under our research, is placed at the highest level of the Municipality reporting directly to the Mayor and

¹¹ <http://www.kuvendikosoves.org/common/docs/ligjet/2009-128-eng.pdf>

being at horizontal reporting level with other Directors of Departments, this doesn't ensure that they are fully independent in performing their work. The reason we are stating this is that there is a discrepancy between Internal and External Audit Reports in the area of findings. This same issue was of concern even in the neighbouring countries that we have visited and this was brought up in the discussions that we had with other stakeholders.

2.2.5 Internal Audit role in neighbouring countries (Albania and Macedonia)

During the Field Research we have visited five institutions in two neighbouring countries: Albania and Macedonia, respectively PIFC Departments and SAI Institutions and Tirana City Hall.

The purpose of the visit was to see if there are better modalities that could bring the role of the internal auditor to better level. In both countries we seen that there are concerns about the independence of the internal auditor and the denominator for both of them is that the internal auditors should be hired and paid from an institution like Prime-minister's office or something similar, the only alternative that could ensure their independence.

SAI in Albania, gives a lots of credit to the internal audit work, by relying on their work while in Macedonia the External Auditors do not rely on the internal audit work.

SAI Macedonia has done last year an audit of PIFC System and included 80 Budget Spenders and several other institutions including PIFC Department of Macedonia. This was a good example to be suggested in our country.

The institutions were audited for performance and mainly on COSO elements. And the findings and recommendations were reported to the Assembly.

In regards to the education of internal auditors and the CPD, both countries have differently approached to the training of internal auditors. Albania is currently starting with an open programme for the internal auditors that is seven-module based and is well improved in comparison with what they had before.

Macedonia is running a training programme with technical assistance.

None of the countries do not rely on the Audit committees, while Macedonia has one audit committee with more than 10 members and established by the Minister of Ministry of Finances, in Albania they do not think that they are of any use because the members of the Audit Committee are selected by the heads of entities.

2.2.6 Cross-cutting issues

As being one of the main actors in contributing to sound financial management in the public sector, by giving assurance for the content of financial statements and providing recommendations for the overall improvements of budget organisations, the National Audit Office has been consulted during the implementation of this project.

National Audit Office conducts auditing on all Budget Organisations in Kosovo and is primarily focused on the Financial Statements of Budget Organizations. But, part of the audit is also review of the Internal Audit function. Every year there is a number of different recommendations that are putted forward for implementation, but as noted from the three years' comparison the same or similar recommendations are carried forward from one to another year with no or little progress. Since that the role of NAO ends by submitting the reports to the management of audited BO, then Assembly via parliamentary Commission for the Oversight of Public Finances, and made public, there is no much power to push things forward in improving the general situation. Nonetheless, this year General Auditor has signed a MoU with Persecution Office, that where there is violation they will report to the Persecution Office as a final authority dealing with this.

Despite of the progress in training internal auditors to international standards, National Audit Office's auditors still do not rely on the work of the Internal Auditor and reasons for this were discussed. The main problems were outlined below:

1. **Scope.**
2. **Sampling.**

3. **Audit file.**
4. **Productivity.**

As a part of implementation of this project was inclusion of Parliamentary Commission for Oversight of Public Finances point of view. During the discussions that we had with Head of this Commission it was disclosed that there has been some progress made to improve the situation but there is a lot of room for improvements.

The Commission for Oversight of Public Finance has no other mandate rather to recommend based on the National Audit Office reports, which still depends on the majority of votes in the commission. The National Audit Office has done a great job, but there are a number of unimplemented recommendations made to Budget Organisations to improve the situation based on the findings some of which represent violations made by Budget Organisation that should be addressed with a priority.

In terms of putting an institutionalized mechanism, there should be a regular communication between the Parliamentary Commission for the Budget and Commission for Oversight of Public Finances, mainly at the time of the year where the budget is approved for the local level. This could help in pushing forward implementation of recommendations from the budget organisations at the local level, by taking into consideration putting a reduction in a next year budget in the municipalities neglecting in one way or another implementation of recommendations for several consecutive years.

3. Field Research

3.1 Executive Summary

Municipalities in Kosovo are established according to the Law No. 03/L-040 on Local Self Government. Among other core competences of the municipalities, there also delegated competences from central level. According to basic principles for finances, municipalities across Kosovo have their own budgets and finances to finance their competencies regulated by Law No. 03/ L- 049, on Local Government Finance.

The local administration is of a complex nature in terms of providing services to citizens and streamlining the central government activities. In the other hand, Municipality Budget is comprised by three types of budget, central budget covering mainly the area of Education and Primary Health Care and cultural activities, own-source revenues collected from different types of municipality taxes and fees, and donations. The Municipal Budget is approved by the Municipal Assembly and its execution is under the scrutiny of Municipal Assembly Members.

From the desk research of a number of documents available, we have structured the field research phase which has consisted in the selection of a representative sample of Municipalities to answer to pre-prepared questionnaire for the Directors of Internal Audit and the Mayor.

Our field research was focused on main areas that are required for Internal Audit function to be properly established in an organization according to the International Professional Practice Framework for Internal Audit requirements, adopted in terms of Kosovo Public Sector, combined with requirements from Law on Internal Audit and Administrative Instructions regulating Internal Audit, putting forward obligations for the Budget Organisation to establish internal audit function and the last part of questionnaire was related more directly to the accountability and transparency of Municipalities.

One thing to be noted is that Mayors in general has responded very well to the purpose of the project although the field research took place in July/August and with some exemption they are all aware, in

general, of the role of the Internal Auditor Units. In the other hand there were no major complaints from the Directors of Internal Audit in regards to functional independence. And this shows a progressive interest of people to undertake the responsibilities of being accountable and also it leaves room to believe that there is a need for further awareness raising toward transparency of municipalities and understanding that the functions and budget of municipality belong to people that live and contribute there.

3.2 Field research objectives

The field research objective was to undertake the research of internal audit function from the perspective of the Head of Accountability Chain, the Mayor, based on the rules and regulation and Internal Auditor of certain municipalities.

In first part of the questions we attempted to assess the Organisative Establishment of Internal Audit in the organogram. The second part of the question treats Management of Internal Audit, while third part is dealing with Execution of internal audit Engagement, on the forth section we measure Audit Activity Impact and having all four element in place, fifth elaborates on how this all fits in the transparency of the municipality.

3.3 Methodology

The methodology used was survey method consisting of predetermined questionnaire. Designing of questions was a combination between closed-ended the majority and ended-closed in some cases, and rating-scale questions in few cases.

3.3.1 Target groups:

This research has been targeted and focused into two major target groups:

1. Directors of Internal Audit Units; and
2. Mayors of selected municipalities;

3.3.2 Instruments used for the field research:

1. Two predetermined questionnaires:
 - a. Questionnaire for Internal Audit Unit Directors; and
 - b. Questionnaire for Mayors;
2. Meetings with relevant stakeholders in the field of Accountability and Transparency
 - a. Committee for Overseeing of Public Finances;
 - b. National Audit Office , Department for Local Audit;
 - c. Municipal Association;
3. Focus group with Heads of active Internal Audit Committees;
4. Study visit:
 - a. Macedonia:
 - i. Public Internal Financial Control Department;
 - ii. Supreme Audit Institutions
 - b. Albania:
 - i. Public Internal Financial Control Department;
 - ii. Supreme Audit Institutions
 - iii. Tirana City hall

3.3.3 Selection of the Sample for field review

Based on the three years reports 2012, 2013 and 2014, as National Audit Office Reports for 2015 were not published until we have prepared the questionnaire, we have selected 19 municipalities, representing 50% of total municipalities of Kosovo, covering a budget of € 380,975,368.00, comprising just a bit over 90% of total budget allocated to the municipalities based on 2015 Annual Budget Law¹² and an area of 5822.91 m2, and population of 779,379. The diversity of selected municipalities based on the ethnicity was also one of the criteria.

We based our research approach into the 4 components:

¹² Budget Law, for 2015

1. Municipalities selected based on the qualified NAO opinion:
2. Municipalities selected based on the unqualified opinion but with emphasize of the matter:
3. Municipalities that are at the same time regional:
4. Municipalities that were identified after the meeting with NAO:

3.4 Survey results

Our field research part one, has included questionnaire prepared based on the International Professional Practice Framework for Internal audit and IIA basic requirement for an internal audit to function in the practice which has been completed through one-to-one interviews.

There were 19 Municipalities that participated in the research, selected based on the criteria explained on point 1.3 above, and only one has not responded to our request. During the period June/July 2016 we have managed to meet 16 Directors of Internal Audit Units in selected municipalities and 16 Mayors plus two Deputy-Mayors. Interviews were held separately to get a better, objective input in our questions.

In the following section, data gathered through the interview are presented into aggregated form. It is important to mention, that questionnaires consisted of combination between open and closed questions, and as a consequence the presentation of findings in the tables is done with yes/no/maybe answers, while the answers in open question are summarised at the end of this part.

From the questions and answers we can see that the Directors of Internal Audit Units and Mayors, do not share always same opinion about the same questions and these differences lead as to finding and conclusions, by trying to recommend actions in narrowing the gap between two parties.

The questionnaire contains five main chapters dealing with the Organisative Establishment of Internal Audit, the Management of Internal Audit Function, Execution of Internal Audit engagement, the Impact of Audit Activity and Municipal Transparency.

The results of survey are broken down below.

3.4.1 Organizational Establishment of Internal Audit

3.4.1.1 Internal Audit Charter

1000 - Purpose, Authority, and Responsibility

The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics, and the *Standards*. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval.

Interpretation:

The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity's position within the organization, including the nature of the chief audit executive's functional reporting relationship with the board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board.

1000.A1 - The nature of assurance services provided to the organization must be defined in the internal audit charter. If assurances are to be provided to parties outside the organization, the nature of these assurances must also be defined in the internal audit charter.

1000.C1 - The nature of consulting services must be defined in the internal audit charter

	Mayors			Directors of IAU		
	Yes	No	N/N	Yes	No	N/N
1.1.1: Is there an Internal Audit Charter and is it signed by the Mayor and Audit Committee?	67%	11%	22%	88%	13%	0%
1.1.2: Is IA Charter revised periodically and is a new one issued if it necessary?	44%	39%	17%	44%	56%	0%
1.1.3: Is IA Charter available for all auditees and other staff so the function of Internal Audit is widely understood in the Municipality?	67%	22%	11%	81%	19%	0%

Table 1.1: Internal Audit Charter

On our survey the replies from both parties have a considerable discrepancy on the first question of 22%. While the Directors of Internal Audit unit has replied on 88% that there is an Internal Audit Charter signed by Mayor and the Audit Committee and only in 13% of them said that the Internal Audit Charter is not signed by Mayor and Audit Committee, in the other hand Mayors have a different view by having 67% of respondents answering with yes and 11% of respondents with no, while 22% do not know.

According to the above mentioned standard, the Internal Audit Charter should be reviewed periodically, 44% of Directors of Internal Audit Units have responded that they review it periodically and 56% that is not periodically reviewed. While in the same question Mayors said that the Internal Audit Charter is reviewed periodically only in 44% and 39% responded that it is not while 17% do not know.

In order to have authorized access to records, personnel and physical properties relevant to the performance of engagements and clear definition of the scope of internal audit activities, the charter should be available for all employees of the audited subject so they would understand the functioning of internal audit in the Municipality. Out of 16 respondents from the group of Directors of Internal Audit Unit 81% has responded positively and 19% of them replied negatively to this question, in comparison with replies from the Mayors group we again face discrepancies with 67% of respondents from this group share the positive opinion, 22% say that the Internal Audit Charter is not available and 11% do not know or they think that maybe it is available.

3.4.1.2 Organisational Position of IA Function

1110 - Organizational Independence

The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

Interpretation:

Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:

- *Approving the internal audit charter;*
- *Approving the risk based internal audit plan;*
- *Receiving communications from the chief audit executive on the internal audit activity's performance relative to its plan and other matters;*
- *Approving decisions regarding the appointment and removal of the chief audit executive; and*
- *Making appropriate inquiries of management and the chief audit executive to determine whether there are inappropriate scope or resource limitations.*

1110.A1 - The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results.

1111 - Direct Interaction with the Board

The chief audit executive must communicate and interact directly with the board.

	Mayors			Directors of IAU		
	Yes	No	N/N	Yes	No	N/N
1.2.1: Is IA Unit positioned at the highest level of the Municipality and functionally independent from other organisative units?	100%	0%	0%	100%	0%	0%
1.2.2: Does IA Unit Director, direct communication with the Mayor and the senior management of the Municipality?	94%	6%	0%	94%	6%	0%

Table 1.2: Organisative Position of IA function

The position of Internal Audit in the organizational chart of the Budget Organization shows a lot for the capability of the BO to give required space and authority to the Internal Audit to perform their tasks independently. It also gives possibility for direct interaction with the board. In this regard, the survey has included the question above if the IAU is reporting directly to the Mayor and if it is functionally independent from other organisative units and 100% of respondents have answered with yes from both groups. Following to this we liked to explore the level of direct communication of IAU Director with the Mayor and the senior Management of the municipality and on 94% of cases the response was that there is a direct communication between both parties and just in 6% of the cases there was no direct communication.

3.4.1.3 Internal Audit Independence

1120 - Individual Objectivity

Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest.

Interpretation:

Conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. Such competing interests can make it difficult to fulfil his or her duties impartially. A conflict of interest exists even if no unethical or improper act results. A conflict of interest can create an appearance of impropriety that can undermine confidence in the

internal auditor, the internal audit activity, and the profession. A conflict of interest could impair an individual's ability to perform his or her duties and responsibilities objectively.

1130 - Impairment to Independence or Objectivity

If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.

Interpretation:

Impairment to organizational independence and individual objectivity may include, but is not limited to, personal conflict of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations, such as funding.

The determination of appropriate parties to which the details of an impairment to independence or objectivity must be disclosed is dependent upon the expectations of the internal audit activity's and the chief audit executive's responsibilities to senior management and the board as described in the internal audit charter, as well as the nature of the impairment.

1130.A1 - Internal auditors must refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an internal auditor provides assurance services for an activity for which the internal auditor had responsibility within the previous year.

1130.A2 - Assurance engagements for functions over which the chief audit executive has responsibility must be overseen by a party outside the internal audit activity.

1130.C1 - Internal auditors may provide consulting services relating to operations for which they had previous responsibilities.

1130.C2 - If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure must be made to the engagement client prior to accepting the engagement.

	Mayors			Directors of IAU		
	Yes	No	N/N	Yes	No	N/N
1.3.1 Are adequate arraignments in place to ensure that internal auditors avoid every type of potential conflict of interest?	94%	0%	6%	94%	6%	0%
1.3.2 Have you taken adequate arraignments to ensure that Internal Auditors, are not included in performing audits in the areas for which they might have been responsible before joining to IA, as requested by law?	56%	39%	6%	100%	0%	0%
1.3.3 Does Mayor require from Internal Audit Unit that at certain times performs other engagements outside of the area of audit scope	6%	94%	0%	13%	88%	0%

Table 1.2: Internal audit independence

The Directors of Internal audit Units were asked if there are adequate arraignments in place to ensure that internal auditors avoid every type of conflict of interest and the answers were quite pleasing with 96% of respondents that replied that there are adequate arraignments in place while only 6% of them said that there are no such arraignments in place. Mayors also share the same opinion in this matter.

To reaffirm this we have raised another question if the auditors are included in auditing areas that they have been previously responsible for before joining to IA Unit and the total of 100% was no. But Mayors have responded differently in this question, 56% of them said that yes they are included, with 39% saying no, while 6% of them do not know.

One concerning finding to the independence of the internal auditors was that when asked if they are asked from the Management and Mayor to perform other engagements beside audit work in 13% of respondents replied with yes while 88% with no. While Mayors said that they engage internal auditors in other works beside internal audit in 6% and 94% responded with no to this question.

3.4.1.4 Internal audit qualification and competency

1220 - Due Professional Care

Internal auditors must apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility.

1220.A1 - Internal auditors must exercise due professional care by considering the:

- Extent of work needed to achieve the engagement's objectives;
- Relative complexity, materiality, or significance of matters to which assurance procedures are applied;
- Adequacy and effectiveness of governance, risk management, and control processes;
- Probability of significant errors, fraud, or noncompliance; and
- Cost of assurance in relation to potential benefits.

1220.A2 - In exercising due professional care internal auditors must consider the use of technology-based audit and other data analysis techniques.

1220.A3 - Internal auditors must be alert to the significant risks that might affect objectives, operations, or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified.

1220.C1 - Internal auditors must exercise due professional care during a consulting engagement by considering the:

- Needs and expectations of clients, including the nature, timing, and communication of engagement results;
- Relative complexity and extent of work needed to achieve the engagement's objectives; and
- Cost of the consulting engagement in relation to potential benefits.

1230 - Continuing Professional Development

Internal auditors must enhance their knowledge, skills, and other competencies through continuing professional development.

Interpretation: Internal Auditors must at all time be alerted on new risks organization might face. At the same time they should keep themselves equipped with new knowledge and skills on how to perform their work.

	Mayors			Directors of IAUs		
	Yes	No	N/N	Yes	No	N/N
1.4.1 Does all auditors of your municipality possess adequate qualification to exercise internal audit profession?	83%	11%	0%	94%	6%	0%
1.4.2 Have you undertaken anything to qualify those auditors that are not qualified yet?	56%	44%	0%	75%	25%	0%
1.4.3 Do auditors attend any training programme for the Continuous Professional Development?	83%	0%	17%	81%	19%	0%
1.4.4 If there is a training to be attended do you have support from the management?				56%	31%	6%
1.4.5 Are internal auditors informed with important changes that has happened in the Municipality in the recent period? (New legislation, new strategic documents, NAO reports, etc.). What about changes in laws and IA from the central level?	100%	0%	0%	88%	13%	0%

Table 1.4: Internal Audit qualification and competency

This section addresses the most usual and disputable question if the auditors in the municipality possess adequate qualifications to exercise the IA profession and 94% of respondents have replied with yes and only 6% with no from the Directors of Internal Audit Units, while 83% of Mayors consider that their internal auditors possess adequate qualification while 11% considered that not all of them possess the adequate qualification.

This was followed-up with the question if there is anything undertaken to qualify those auditors that are not qualified yet and 75% of respondents have replied with yes and 25% from the directors group thinks that nothing has been undertaken in this matter. While the mayors were more reserved where 56% said that there has been necessary action undertaken to qualify internal auditors, and 44% of them said that no action was undertaken in this regard. In order to maintain accredited qualification there is a requirement for Continuous Professional Development provided via a special scheme offering different subjects in areas important to internal auditor's everyday work. 81% of respondents from the Directors of IAU group has answered with yes, and 19% with no. While mayors have responded with yes at 83% of cases while 17% don't know or thinks that there has been something undertaken toward attending CPD.

Still achieving proper qualification and obtaining CPD training, requires time out from work and this can collate with already planned audits or with management having other planned activities. So the following question was addressed to the Directors of Internal Audit Units if the management will support the IAs if they require training and it came out that 56% of respondents say yes and 31% would have no support and 6% do not know or they think that is maybe possible.

In order for the auditors to perform their tasks as required they should also get informed about the changes that are important and have happened into the municipality (like new legislation, new strategic documents, OAG reports to their municipality) they serve or from the central level (like legislation). In their answers Directors of Internal Audit Department have replied that they are informed in 88% of cases and only 13% of them replied with no. While the mayors said in 100% that the Internal Auditors are informed.

Conclusions: Positioning Internal Audit Unit to report directly to the Head of BO, creates an independent working environment, nevertheless, Mayors should ensure that Audit Charters are signed (approved) and updated all the time. Auditors should have at all time direct communication with the management. The Management and Director of Internal Audit Unit should undertake all necessary steps to prevent possible conflict of interest by not engaging the internal auditors to audit areas for which previously has been responsible for. The independence and qualifications are two key pillars of internal audit to which all auditors should be subject to and managers should support them in achieving this.

3.4.2 Managing Internal Audit Function

The internal audit function based on the Standard 2010 planning that includes preparation of IA Strategic and Annual Plans, working procedures

3.4.2.1 Internal Audit Strategic and annual planning

3.4.2.1.1 Performance Standards

2000 - Managing the Internal Audit Activity

The chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organization.

Interpretation:

The internal audit activity is effectively managed when:

- *The results of the internal audit activity's work achieve the purpose and responsibility included in the internal audit charter;*
- *The internal audit activity conforms with the Definition of Internal Auditing and the Standards; and*
- *The individuals who are part of the internal audit activity demonstrate conformance with the Code of Ethics and the Standards.*

The internal audit activity adds value to the organization (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management, and control processes.

2010 - Planning

The chief audit executive must establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization's goals.

Interpretation:

The chief audit executive is responsible for developing a risk-based plan. The chief audit executive takes into account the organization's risk management framework, including using risk appetite levels set by management for the different activities or parts of the organization. If a framework does not exist, the chief audit executive uses his/her own judgment of risks after consultation with senior management and the board.

2010.A1- The internal audit activity's plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board must be considered in this process.

2010.A2 - The chief audit executive must identify and consider the expectations of senior management, the board, and other stakeholders for internal audit opinions and other conclusions.

2010.C1- The chief audit executive should consider accepting proposed consulting engagements based on the engagement's potential to improve management of risks, add value, and improve the organization's operations. Accepted engagements must be included in the plan.

	Mayors			Directors of IAU		
	Yes	No	N/N	Yes	No	N / N
2.1.1 Is internal audit strategic plan is related to Municipal Strategic Objectives?	100%	0%	0%	94%	6%	0 %
2.1.2 Are Strategic plan and annual plans are approved by Mayor and Audit Committee?	94%	6%	0%	94%	6%	0 %
2.1.3 Are you contacted by IA unit while preparation of IA Strategic Plan and do they give any contribution?	31%	69%	0%			
2.1.3 Were there was any additional comments/proposal from the Audit Committee related to the IA strategic and annual plan?				31%	69%	0 %
2.1.4 Is management is contacted and do they give any contribution to the Internal Audit Unit for preparing an IA Strategic Plan?				81%	19%	0 %
2.1.7 Are there any other request for ad-hoc audits during the year by management?	78%	17%	6%	69%	31%	0 %
2.1.8 Did you provide the IA annual plan to the auditees?	88%	6%	6%	88%	13%	0 %

Table 2.1: Internal Audit Strategic and annual planning

On the question if the internal audit strategic plan is related to Municipal Strategic Objectives, mayors responded with yes in 100% out all respondents, and Directors of Internal Audit Units 94% of respondents has responded yes, 6% with no.

On the following question if that Strategies plan and annual plans are approved by Mayor and Audit Committee? 94% all respondents responded with yes and 6% with no.

Just in this matter we have asked mayors if they are contacted by IA unit while preparing IA Strategic Plan and do them give any contribution and the answer was not very positive to show that there is a

good preparation process in place by having 31% of mayors answering with yes and 69% of them with no.

In the following question raised only to the Directors of Internal Audit Units if there was any additional comments/proposal from the Audit Committee related to the IA strategic and annual plan, 31% of respondents were yes answers and 69% were no.

The Management of Municipality should contribute to the preparation of the Internal Audit Strategic plan and consecutively Internal Audit Annual Plan and at the end of the process should sign it as a form of him/her agreeing on the objective and scopes of the Internal Audit Activity and Directors of Internal Audit Unit were asked if management is contacted and do they give any contribution to the Internal Audit Unit for preparing an IA Strategic Plan and they respond was at almost satisfying levels with 81% of respondents replying with yes and 19% no.

Following to this the group of Directors of IAU was further asked on how this communication is done (question 2.1.5 on How this communication is done in writing or through meetings?) and out of 16 respondents 56% has replied that they communicate in writing and via meetings and 26% said that they communicate via regular meetings while only 1 has said that the communication is done only in writing.

In determining the process deriving from question 2.1.1 in aligning internal audit strategic objectives and how they are interrelated with the Municipality objectives and Managements' priorities, the answers from the Directors of Internal Audits Units were different. In general their plans are aligned with Municipality Objectives, but sometimes they also prepare their plans based on the meetings they have with management, based on MTEF, budget very rarely based on risks

The management is entitled to request ad-hoc audits to be carried out from the Internal Audit Unit over the year. Ad-hoc audits are audits that do not belong to the annual audit plan and therefore are not scheduled in the Strategic plan neither, so it means that the internal auditors should actually plan ahead in their plan to leave around 10-15% of their internal audit timing to cover for ad-hoc audits requests. On our question to both groups Directors of IAU and Mayors if there are such a requests the answer from the Mayors on 78% of cases said yes, on 17% said no and 6% said no. In the other hand the Directors replied that yes there are such request in 69% of the cases, in 31 % said that there are not.

This question was followed up with another open question to determine if this exceeds the amount

allowed to be allocated to these types of audits and in general the average was between 15-20% of audits.

The final question for this part was if the annual plan was provided/communicated to the auditees, is it important for the other staff in the BO to be informed when they will be audited and/or which part of their processes and systems will be part of the audit. From the both groups under survey we got yes answer in 88% of the cases and Mayors said no 6% while 6% do not know, while Directors of Internal Audit Units said yes in 88% and no in 12% of the replies.

3.4.2.2 Communication with the Mayor and Audit Committees regarding the IA plans

Reference on IPPF IA: **Standard 2020/2060 Communication and approval/reporting to the management and the Board**

2020 - Communication and Approval

The chief audit executive must communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and the board for review and approval. The chief audit executive must also communicate the impact of resource limitations.

2060 - Reporting to Senior Management and the Board

The chief audit executive must report periodically to senior management and the board on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan. Reporting must also include significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by senior management and the board.

Interpretation:

The frequency and content of reporting are determined in discussion with senior management and the board and depend on the importance of the information to be communicated and the urgency of the related actions to be taken by senior management or the board.

	Mayors			Directors of IAU		
	Yes	No	N/N	Yes	No	N/N
2.2.1 Is Director of IAU reporting periodically to the Mayor and Audit Committee for execution of IA Plans?	94%	6%	0%	88%	6%	6%
2.2.2 Is IAU provided with and answer from Audit Committee/Mayor, based on the received reports and do they propose actions?	59%	29%	12%	75%	25%	0%
2.2.3 Does Audit Committee communicates when needed with the Director of IAU?	82%	0%	18%	94%	0%	6%

Table 2.2: Communication with the Mayor and Audit Committee on Internal Audit Plans

Since communication is not only required with Standards but also is one of five elements of COSO Framework¹³, and it is the only way to maximize the benefits of any type of work and especially audit work, Directors of Internal auditors and Mayors were asked same questions as regards to communication, which derived in different opinion/answers from the both groups.

On the first question under this sub-chapter if IAU Directors reports periodically to the Mayor and Audit Committee for the implementation of internal audit plans, Mayors said that they do in 94% of the cases and only 6% answered with no, while Directors of IAU replied with yes in 88% and No 6%, maybe/I don't know 6%.

On the second question if IAU is provided with a reply from the Mayor/Audit Committee based on the received reports and do they propose any actions, Mayors said yes in just above average 59%, with no in 29% and 12% of them do not know/maybe. The Directors in other hand firmly responded with yes in 75% of the cases and no in 25%.

The third question concluding this section was if the Audit Committee communicates when it is needed and have to communicate with the director of IAU, Mayors in 82% said that yes while 18% do not know. The directors of course should know better about this communications and replied with yes in 94%; doesn't know/maybe in 6%.

¹³ COSO Framework

Conclusion:

Managing internal audit activity is not as simple as it may look like, as there are other parties involved in the process. Sometimes, internal audit is considered to be time-consuming for the auditees and many times can be seen as it doesn't bring lots of values to their work as compared to time taken to prepare the documents requested and meetings held.

Good strategic and annual planning is crucial for the IAU to succeed in managing the activity and at the same time, add value to the organisation. Also Internal Auditors needs to involve Management in preparation of Strategic Plan prior to send it for approval and once approved together with annual IA distribute it across the Budget organization.

3.4.3 Execution of IA engagement – Audit Process

Reference on IPPF IA **Standard 2040 Policies and procedures**

2040 - Policies and Procedures

The chief audit executive must establish policies and procedures to guide the internal audit activity.

Interpretation:

The form and content of policies and procedures are dependent upon the size and structure of the internal audit activity and the complexity of its work, and Internal Audit Director should make sure that what is planned is achieved and reporting on the implemented activities is done in due time, followed by preparation of Action plan for implementation of Internal Audit recommendations.

	Mayors			Directors of IAU		
	Yes	No	N/N	Yes	No	N / N
3.1.1 Are all planned audits have been implemented during the last year?	83%	11%	6%	88%	13%	0 %
3.1.3 Are all audit reports finalized on time for finished audits?	89%	6%	6%	100%	0%	0 %
3.1.4 Did management prepared action planes for implementation of IA recommendations?	72%	17%	11%	69%	31%	0 %

Table 3.0: Execution of IA engagement

When asked if all planned audits have been implemented during the last year, Mayors responded with yes in 83%, with no in 11% and there is a 6% of them that they do not know, while the Directors said yes in 88% and no in 13%.

The following question 3.2.2, was related to this year audits on how the implementation of the internal audit activities is going, even it was mid-July the average answer was at 57% from Directors of Internal audit Units.

Mayors said that 89% of reports were completed on time for all undertaken audits 6%, of them said no and 6% do not know, while Directors of Internal Audit Units said that yes in 100% of responses.

Conclusion: Reporting is the third stage of Internal Audit process and it is a responsibility of Director of Internal Audit Unit to finalise the report on time, and it should be submitted to the management which in turn would prepare the action plan to address Internal Audit recommendations.

3.4.4 Audit activity impact

Reference on IPPF IA **Standard 2500 Monitoring process**

3.4.4.1 Follow-up of internal audit recommendations

2500 - Monitoring Progress

The chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.

2500.A1- The chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

2500.C1- The internal audit activity must monitor the disposition of results of consulting engagements to the extent agreed upon with the client.

	Mayors			Directors of IAU		
	Yes	No	N/N	Yes	No	N/N
4.1.1 Is database for given recommendations established and is regularly updated?	72%	22%	6%	88%	13%	0%
4.1.2 Is there a follow-up procedure established to monitor implementation of agreed IA recommendations?	72%	17%	11%	88%	6%	6%
4.1.3 Are unimplemented or ongoing recommendations reported to the mayor and Audit Committee?	78%	22%	0%	94%	6%	0%
4.1.4 Based on your opinion how efficient is the internal audit in promoting the ethics and values within the organisation?	28%	61%	11%	19%	81%	0%
4.1.5 Has Internal Audit unit demonstrated efforts in minimization of overlapping work within officers?	33%	44%	22%	81%	6%	6%

Table 4.1: Follow-up of internal audit recommendations

Given the fact that the internal audit planning as recommended allows certain amount of time for following-up

recommendations and if there is no system in place than it will require more efforts for the follow-up stage, our first question was if the database for given recommendation is established and is it updated regularly, out of 18 respondents from Mayor's group has answered with yes in 72%, no in 22% and 6% do not know, while Directors of Internal Audit Unit answered in 88% with yes, 13% with no.

In the question if a follow-up procedure is established to monitor implementation of agreed recommendations for IA, the answer was 72% with yes from the group of mayors, 17% said no and 11% do not know. Directors of IAU said that yes it is established in 88%, No 6% and do not know or maybe 6%.

The important part of the follow-up stage is also reporting on implemented recommendations, and more importantly on the recommendations that remain unimplemented or pending. This reporting should go from the IAU to the Mayor and the Audit Committee and in the opinion of mayors they are reported on 78% of respondents, 22% respondents said no, while the Directors of Internal Audit Units said that they do report in 94% of cases and 6% do not.

On a very important question on how effective is Internal Audit Department in promoting the ethics and values within organization. Mayors have replied with 28% of positive answers as they consider IAU very effective in this matter, 61% said they are effective and only 11% said they are little effective, while Directors of IAU said that they're very effective in 19% of cases and 81 said they are effective.

One of tasks of the internal auditor in the sound financial management system, is that they also should make efforts to minimize duplication of work among official working a budget organization. On this question if IAU has demonstrated efforts to minimize overlapping of work of officials, mayors said yes 33%, no in 44% and 22% do not know or maybe, while Directors said yes in 81% and 6% said no while 6% do not know or maybe.

Conclusion: The final stage of the audit process is the Follow-up of recommendations. This stage, in fact shows how the internal audit added value to the organization, as it brought to the improvement of processes. It is not an easy task to do the follow-up as it does involve several people agreed to make changes presented in the action plan, and in practice it might not always happen. Having this situation it comes to a number of the recommendations that were not implemented or are still hanging over in the audit reports waiting to be actioned upon.

3.4.5 Municipal Transparency

Our fifth and final part of the questionnaire is related to the transparency of Municipalities, which are obliged to be transparent toward citizens and accountable on how they use their public money.

Ministry of Local Government Administration has approved last year an Administrative Instruction on Municipal Transparency containing number of criteria that Municipalities must obey to implement this Administrative Instruction. Nonetheless, this is just a small step and not all-inclusive as it completely leaves aside reporting on implementation of recommendations. Related to this, our question raised to two groups was to determine on how they see each other's role in the accountability process moving toward transparency. On six open questions, two groups under research were supposed to give their opinion on:

How the Mayor/Director of Internal Audit Unit can be supported on their daily work from each other and the answers were very variable, but the joint denominator is that: Mayors do not in general appreciate the real role of the internal auditor, by expecting that the internal auditor should perform controls, check the work of others, and implement laws and other relevant legislation.

Just small number of Mayors has really understood the role by saying that they are supported by internal auditor through recommendations for continuous improvements of municipality performance.

While Directors of Internal Audit Units in majority of answers said that they could be supported by the Mayor if he/she implements recommendations, prepares risk registers and employs sufficient staff in the internal audit unit.

On the second question on how Mayor can be helped by the Internal Auditor which is the core element of our project, since he is in the head of Accountability Chain, to achieve this easier, in general mayors were of the opinion that they can be helpful through recommendations.

In the other hand, some of the Directors also felt that they do not play any major role in the Accountability Chain, but helping the Mayor with recommendations and advices.

As communication and information is key to successful accomplishment of tasks and it is one of the five COSO components¹⁴ it was important to have the opinion of two groups on this matter. On the question on how the communication between the Mayor and senior management, Director of IAU and Audit committee and Commission for Politics and Finances works, both groups gave similar answers that Mayors and Directors of Internal Audit Units have in general said that the communication triangle Director IAU, Mayor and Audit Committee is well functioning with exemption of Pristina that there are serious matters to be addressed and Peja municipality that communication is at the level of Deputy-Mayor. The communication with Committee for Politics and Finances is done only at the request of the CPF with Director of IAU while with the Mayor as requested by Law.

Just related to the above question if there is anything that can be improved in the level of communication almost around 50% of Mayors do not consider that there is something to be improved. While less than 30% of Directors of Internal Audit Units share the same opinion, the other 70% suggested several improvement, like regular meetings with the Mayor, meeting with Directors of Directorates in the Municipality as horizontal communication is not working very well.

On the question regarding internal whistleblowing policy in case of violation, the groups of mayors have answered in general that there is a disciplinary commission. While the other group of Directors of Internal Audit said in more than 50% that there is no such a policy or at least not in written. Some have answered if they see such cases they report them to the Mayor, or in few cases to the Audit Committee.

For a transparent municipality there should be an established policy on how they address if there are any complaints or violation reported from the public, meaning external Whistleblowing policy. In general they referred to three elements:

1. Report corruption in the website;
2. Complaint box;
3. Reporting directly to the Mayor.

Conclusion: Mayors should understand clearly that the internal auditor is not there to implement, enforce or play the role of inspector. But is rather consulting and advising activity. It is obvious that even though there it is not a direct part of accountability chain, internal audit can enhance

¹⁴ COSO Internal Control- Integrated Framework. most widely accepted internal control framework

accountability in the local government system, by recommending improvements for quality of internal control, preventing fraud and misuse of public money. This all together will enhance transparency.

Internal Auditors cannot be seen by their colleagues as nothing else rather than part of their organization, therefore communication at horizontal level should be running smoothly. No budget organization can afford of cutting communication with their internal audit office and alternatives should be sought to solve this matter.

Having no Internal Procedures on how to treat certain matters like internal or external whistleblowing policy, it makes it easier for things to be seen but not reported as people are afraid of exposure.

Also what is important at this stage, is that none of the groups didn't bring to the attention the existence of the Administrative Instruction of Transparency of Municipalities and consecutively the required Action Plan.

4 Summary of Conclusions, Findings and Recommendation

This document has described into details the identified importance of internal audit in the management of local government resources. Without internal audit, an effective internal control system that will enhance accountability and effective management of resources cannot be established. The paper also has made an attempt at identifying and discussing the problems hindering effective operation. We have identified that at the level of local government there are several gaps in understanding of the role of the internal audit in a budget organisation. At the same time, it was identified that internal auditors are not able to make a full impact in improving the overall accountability in the Local Level Entities.

Through the report we have brought up different actors that are included into Internal Audit function showing that the Internal Auditor's work is a part of accountability chain, but they are limited in the scope as they perform independent and objective assessments of risks and controls put in place to mitigate risks. The expectations are that Internal Auditors provide advices for improvement of overall operations in the organisation that are expected to be implemented by Senior management. No doubt, that it is not always about implementation of recommendations but also for the quality of internal audit work and management's ethical values and integrity in addressing weaknesses on the operations and

strengthening internal controls. But, if the management has already agreed with the final audit report and has prepared the action plan, in this way they have committed themselves to improvements, therefore if the agreed recommendations are not implemented by the management then there is no sufficient contribution of internal auditor in the Accountability Chain.

In order to achieve Accountability, various controls within the Budget Organisation can be put in place to safeguard the assets of the local government, ensure compliance with all the relevant legislation, policies and objective as well as ensure that internal and external audit recommendations are taken seriously.

From the Desk Review and the Field Research, it has been noted that the legal framework related to accountability and transparency, including establishment of internal audit function is in place but not satisfactory implemented in the practice and suggestions derived from these analyses to improve practical implementation are described under the Strategic Direction Section.

Trying to find out the mechanism that will put different existing actors to act in the process of safeguarding public money from misuse, waste and fraud, the role of existing stakeholders was reviewed in the local level, with involvement of the central level bodies. Currently, we have Mayor, Municipal Assembly, Internal Auditor and Audit Committee scrutinized by the National Audit Office which reports are made available publicly and undergo review at the Parliamentary Commission for Oversight of Public Finances.

The process of Internal Audit starts with the Strategic and consecutively Annual Plan, which is prepared in consultation with the Mayor and approved from this level. This document should be sent to the Audit Committee and be approved by them as an advisory body. This document should be reviewed from the Assembly Committee for Politics and Finances, then made available for all auditees in the organisation. The same route is gone with the end product of internal audit activities and that is the Internal Audit Report for the Audit Engagement, with one loophole that the CPF do not receive regular final reports. Therefore, we have recommended for better inclusion of CPF in the follow-up on recommendations stage, as this committee can hold Mayor accountable through the Municipal Assembly. CPF can be assisted by AC on professional matters for improving the overall situation of public internal financial control.

This would be a major contribution in the transparency of the Municipality itself, as the meeting minutes of CPF meetings are published. And at the same time, based on our suggested Transparency Check list for Municipalities, the implementation of audit recommendations is part of it and would be publicly available.

Based on what is has been outlined so far, suggestion for strategic directions are related with better utilization of existing bodies within the Internal Audit function, that will have impact on the improvement of implementation of recommendations and as a result improvement of internal controls towards efficient governance in providing value for money and efficient and effective public money in the local level while being transparent towards the citize

	Findings	Recommendations
1. Organizational Establishment of Internal Audit	<ul style="list-style-type: none"> ✓ Internal Audit Units on the selected municipalities are organisationally established to report directly to the Mayor, with one exception: Gjakova Municipality that in its Municipal chart does not present the internal audit unit at all and also four of municipalities (Prizren, Malisheva, Suhareka and Gracanica) have no published organisation charts at all. Apart of Pristina, Glogoc municipality that have updated organisative charts, others either are old or there is no date of their issuance. ✓ Internal Audit Charter is not periodically reviewed in the light of new changes. ✓ Internal Audit Units are not 	<ul style="list-style-type: none"> ⇒ Municipality Organograms should be published in the latest version and present any changes to Municipality. ⇒ Every BO should have an updated Internal Audit Charter which is placed in the Municipality website along with other municipal documents. ⇒ Municipalities should implement IAL to staff IAU with the required staff. ⇒ Management should support training of internal auditors related to the profession and Internal Auditors should plan their trainings during calendar year.

	<p>fully staffed as required by Law in majority of Municipalities.</p> <ul style="list-style-type: none"> ✓ Internal Audit Unit Directors would not expect from their management to support them in attending the training. 	
2. Managing Internal Audit Function	<ul style="list-style-type: none"> ✓ In general, there are no Risk register prepared by the Management of Municipality that Internal Auditors refer to. ✓ We found out the not always Strategic and Annual Planning is approved. ✓ Not all of auditees are informed about the strategic and annual plan. ✓ The level of ad-hoc audits initiated by management has shown progress toward down-sizing. 	<ul style="list-style-type: none"> ⇒ Senior managers of Municipality must prepare a Risk Registers for the Municipality as a most necessary tool to track achievement of Municipalities' Objectives. ⇒ Strategic and consecutively annual IA plans must be approved by the Mayor and AC. ⇒ All of the auditees should be informed with the Internal Audit plan, in fact it should be sent to the whole BO in order to inform directors well in time and allow for a preparation of the audit. ⇒ Management should pay more close attention to what is planned for the year and make efforts to keep down the level of requested ad-hoc audits
3. Execution of IA engagement – audit process	<ul style="list-style-type: none"> ✓ The level of preparation of action plans by the Management of Budget Organisation is not at satisfactory. 	<ul style="list-style-type: none"> ⇒ Management should know and be aware of their accountability for improving the situation in the municipality they run, therefore they should act on

		time and accurately in preparing action plans for overall improvement of internal controls.
4. Audit activity impact	<ul style="list-style-type: none"> ✓ Mayor are not fully informed if follow-up of recommendation database exists, and maintained regularly ✓ Existing procedure in reporting number of unimplemented recommendations is not functioning. ✓ Internal Auditor promotes at satisfactory level ethics and values of organization. ✓ Internal auditors are not demonstrating enough efforts in minimising overlapping work of officials. 	<ul style="list-style-type: none"> ⇒ Every Internal Audit Unit should have an Implementation of recommendation database and that would be updated on ongoing basis, and inform in due time, before the deadline expires all people responsible for implementation ⇒ There should be a clear, written procedure to report unimplemented recommendations. ⇒ Internal auditors should continuously recommend the minimisation of work overlap among officials, to ensure effective, efficient and economic utilisation of human resources.
5. Municipal Transparency	<ul style="list-style-type: none"> ✓ Internal audit is not fully understood by Mayors; ✓ Mayors don't expect that the internal audit can help them in the accountability, nor the internal audit considers that too; ✓ Communication so far is done in the Audit Triangle 	<ul style="list-style-type: none"> ⇒ Mayors to be fully informed for the real internal audit role in the accountability through trainings or other information methods and this should be provided to the Directors of Departments. ⇒ Internal audit helps Accountability by recommending continuous improvements.

	<ul style="list-style-type: none"> Management, Internal Auditor and Audit Committee only; ✓ ; ✓ There is no internal policy for whistle blowing of violation, apart of disciplinary commission; ✓ Same is valid for the external policies of Municipality towards Public. 	<ul style="list-style-type: none"> ⇒ Communication should be extended to other actors in the Municipality as Municipal Assembly. ⇒ Budget Organisations should make efforts to prepare internal and external whistleblowing policy according to the municipality specificities
National Audit Office	<ul style="list-style-type: none"> ✓ The External Auditors do not rely on the work of Internal Auditors; ✓ There is no established programme of coordination nor communication between External Auditors and Internal Auditors; ✓ The real role of the NAO in Kosovo is considered sometimes differently. 	<ul style="list-style-type: none"> ⇒ Efforts to be made to find cooperation in the areas where there is work overlap. ⇒ The form, type and the level of communication between internal and external auditors to be determined; ⇒ There should be continuous awareness raising for the role and the responsibilities of NAO.
Audit Committees	<ul style="list-style-type: none"> ✓ The relationship with Internal Auditor and the Management was considered at very good level; ✓ Chair and members of Audit Committee are not trained nor properly informed about their duties and responsibilities; ✓ Some members of Audit Committee are coming from 	<ul style="list-style-type: none"> ⇒ There should be some types of training provided to the Chair and existing/new members of Audit Committee; ⇒ Chair and members of Audit Committee should be selected from position that are not subject to audit as this consist conflict of interest.. ⇒ The relationship between AC

	<p>the positions that are subject to audit.</p> <ul style="list-style-type: none"> ✓ There is no relationship between this Committee and Commission for Politics and Finances; ✓ Payment of AC Chair and members is not still clear; ✓ The main reason for difficulties in implementing recommendations is that Middle Management is not putting forward their implementation; 	<p>and Commission for Politics and Finances should be established;</p> <ul style="list-style-type: none"> ⇒ Payments for Chair and members of Audit Committee should be defined by secondary legislation; ⇒ Middle Management should be asked from the Mayor to implement recommendations for which they have agreed to improve systems and processes in the Municipality. ⇒ Audit Committee should propose to IAU to include mid-year follow-up audit to check implementation if internal and external audit recommendations.
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5 SUGGESTED STRATEGIC DIRECTON

Based on the conclusions, findings and recommendation, the following list presents future strategic directions in a short-term, that do not require changes into legislative framework or engaging additional resources, and those in a long-run which might require engagement of other stakeholders that were not subject to this report and changes into legal framework.

In a short-run:

Municipalities should implement existing IA on Transparency, by drafting and implementing plans and MLG to follow-up the level of municipal transparency through parameters suggested at the Transparency Check-list;

Mayors to count more for the support of internal auditors in the Accountability process by improving financial management and internal control, based on the IA recommendations at the same time to commit to improvements in the Public Internal Financial Control;

The Committee for Politics and Finances should be continuously involved in the audit process and the cooperation between this and Audit Committee should be intensified.

Mayors to assume more responsibility for implementation of recommendations, and make Directors of Municipal Departments implement agreed improvements and recommendations from National Audit Office.

The process of follow-up in implementation of recommendations should be in place and their non-implementation should be duly informed to the mayor with additional explanations.

National Audit Office should consider the modalities of regular communication with internal auditors on challenges and changes, and find ways to minimise overlapping work between internal and external audit where this is possible.

In a longer term:

Ministry of Local Government should establish follow-up process on transparency increase by municipalities, to be reported on quarterly basis.

Staffing of Internal Audit Units with sufficient staff to ensure the quality of internal audit work and participation of internal auditors in the Continuous Professional Development schemes;

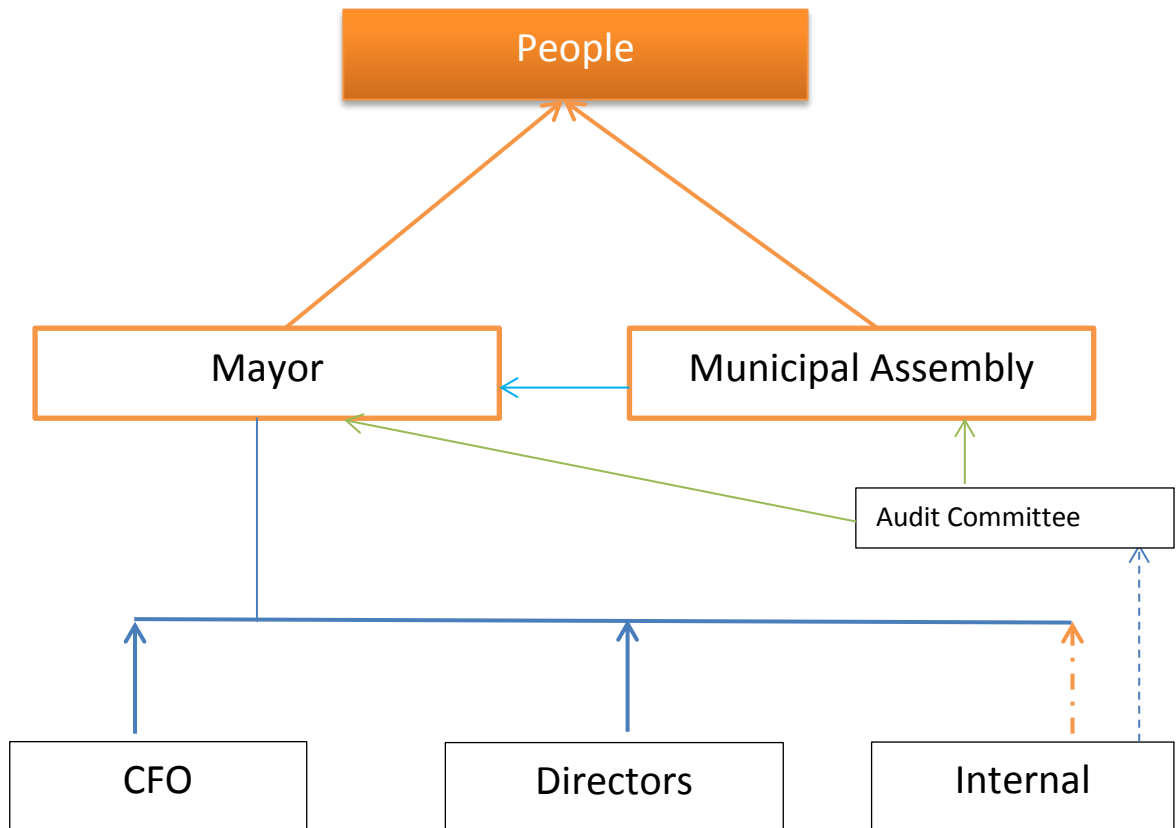
Training to be provided for the Audit Committees member in regards to their obligations and their remuneration to be clarified.

To work on identification of legal basis, in placing legal obligations for Municipalities that do not implement external audit recommendation, in consecutive years. These obligation can be in the form of sanctions in downsizing budget allocation that reflect percentage of public money lost or misused.







National audit office makes more effort in promoting their role;

And at the end, but not least, there should be an institutionalised communication between two Parliamentary Commissions, the Budget and the Oversight of Public Finances.

6 Accountability Chain: Existing and suggested changes



Legend:

	Accountability
	Functional Responsibility
	Administrative/functional responsibility
	Administrative responsibility
	Oversight function
	Advisory function

- ⇒ Internal Auditor should functionally report to the Audit Committee;
- ⇒ Internal Auditor should report administratively to the Mayor and provide advices to directors of the Municipality (operational management) on how to improve effectiveness and efficiency of operations;
- ⇒ Audit Committee can advise Committee for Politics and Finances within Municipal Assembly.

7 Draft Municipal Transparency Assessment Checklist

Main parameters in assessing transparency

Parameter	Description	Rationale
Budget and Investments Plans	The website should include the current budget and investment plan as well as comparisons with previous years and a graph showing increases or decreases over time to help citizens evaluate and understand trends in local government spending.	Budgets and investments plans show the big picture of what goals and priorities the local government established for the year. Additionally, the details within a budget and investment plan serve as a comparative tool to determine how the municipality performed in relation to past years.
Meetings with the public	The website should include notices about public meetings of its governing board and minutes of past meetings. Also, meeting agendas for future and/or past meetings should be available.	Meetings are one of the few ways the public can engage in true dialogue with representatives. Given the reality of busy schedules, governments should offer alternatives for meetings.
Elected officials	The website should include names of elected officials and their contact information, including email addresses. Also, the elected official's voting record should be available.	Officials are elected to represent their constituents. In order to do so effectively they should be engaged in regular dialogue and be as accessible as possible by providing a variety of ways to be contacted (email, phone, fax, by mail, for example).
Transparent	The website should contain information	This would ensure transparency in

recruiting procedures	about vacancies and include consequent information from job advertisement until the selection of successful candidate.	regards to employments in the municipality.
Building permits and zoning	At the very least, building permit and zoning applications should be available for download online. In addition, constituents should be able to track the process online.	Almost all government processes are going toward digitalisation. By facilitating the process online municipality could cut down on cost and time barriers as well as improve communication and services to their constituents.
Audits	The website should include regular audit information including: report results and the level of implementation of recommendations.	While budgets give the big picture to constituents, an audit reveals how well the government performs on their goals and enables constituents to hold them accountable.
Public Procurement and Contracts	The website should include information about public procurement procedures in the municipality and include bids and contracts for purchases of more than €10,000.	This would enable correct information and transparent procurement process.
Public records	The website should include updated public documents.	The municipality is obligated by law to publish public documents or to give access to such if it is requested.
Taxes	The website should general information on taxes and the level of collection of different types of municipal taxes, charges and fees.	Disclosing tax burdens accurately reflects the cost of living.

8 Annex: The list of municipalities involved in field research

1. Malisheva
2. Vushtrri
3. Suhareka
4. Glllogoc
5. Lipijan
6. Fushë – Kosovë
7. Prishtina
8. Prizreni
9. Peja
10. Gjilani
11. Gjakova
12. Mitrovica
13. Ferizaj
14. Gracanica
15. Novobërd
16. Ranillug
17. Deçan
18. Shtimje
19. Viti

9 Resources used:

- Law on Self-governemnt;
- Law on managing public finances and responsibilities;
- Law on Internal Audit;
- Bylaws;
- Reports of SAI for 2012, 2013, 2014 dhe 2015;
- Integrated framework COSO;
- Professional Standards of Proffessional Practice, 2016
- Different publications from Internal Audit Body IIA;
- Transparency International;
- <http://www.kuvendikosoves.org/common/docs/ligjet/2009-159-ang.pdf>
- <http://www.kuvendikosoves.org/common/docs/ligjet/04-L-228%20a.pdf>
- http://www.kuvendikosoves.org/common/docs/ligjet/2007_02-L133_en.pdf
- <http://www.kuvendikosoves.org/?cid=2,159,2615>
- <http://www.kuvendikosoves.org/?cid=2,159,4737>
- <http://gzk.rks-gov.net/ActDocumentDetail.aspx?ActID=11403>
- See the list at the bottom of the document
- USAID and ATRC Project
- The latest version published at: <https://na.theiia.org/standards-guidance/Pages/Standards-and-Guidance-IPPF.aspx>
- The three lines of defence in Effective Risk Management and Control, January 2013;
- The Role of Internal Auditing in the Enterprise-wide Risk Management, January 2009;
- The Role of Internal Auditing in Resourcing the Internal Audit Activity, January 2009
- Kosovo Constitution, Page 13, article 41
- The Corruption Perceptions Index ranks countries/territories based on how corrupt a country's public sector is perceived to be. It is a composite index, drawing on corruption-related data

from expert and business surveys carried out by a variety of independent and reputable institutions.

- <http://www.transparency.org/country/#KOS>
- Scores range from 0 (highly corrupt) to 100 (very clean).
- <http://www.transparency.org/country/#KOS>
- Treasury Financial Rule 01/2010, pg.
- See Law on Self-governance and number date approval
- Professional Proactive Framework: International standards for Professional Practice
- Law on Budget, for year 2015
- COSO Framework
- COSO Internal Control- Integrated Framework. most widely accepted internal control framework.