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## **“THE DIFFERENCE BETWEEN THE INTERNAL AND EXTERNAL AUDIT AND THEIR IMPORTANCE”**

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International Faculty of Management, Business and Economy

**“THE DIFFERENCE BETWEEN THE INTERNAL AND EXTERNAL  
AUDIT AND THEIR IMPORTANCE”**  
Bachelor Degree

Lindita Vuksani

February / 2017  
Prishtinë



International Faculty of Management, Business and Economy

Bachelor Thesis  
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Student: Lindita Vuksani

**“THE DIFFERENCE BETWEEN THE INTERNAL AND EXTERNAL  
AUDIT AND THEIR IMPORTANCE”**

Supervisor: PhD Cand. Leonita Braha

February / 2017

This thesis is submitted in partial fulfilment of the requirements for a Bachelor  
Degree

## **ABSTRACT**

This thesis aims, through a detailed presentation to provide clarification for a better understanding of what internal and external audit definition, objectives, functions and stages of its development mean. It will also identify differences and similarities between them by analysing their characteristics such as: to whom they report, what are the objectives, what they cover and the responsibilities of improvement.

This study will use the quantitative and qualitative data by exploring literature and analysing previous researches to bring focus of importance the process of audit has, and comparing results of findings for different requirements entities have in different countries they operate.

Data used to support the study will be the primary data that can be extracted from reliable and official sources.

The result of this study will show the differences between the internal and external audit, benefits that the companies have from auditing their business, comparisons of requirements of audit in some selected countries, and also will show the importance of the external audit in regard to businesses in Kosovo which aims to enter in partnership with international businesses.

## ACKNOWLEDGMENTS

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Lindita Vuksani

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## ACRONYMS AND ABBREVIATIONS

<b>Abbreviation</b>	<b>Explanation</b>
AAA	American Accounting Association's
CCSA	Certification in Control Self-Assessment
CIA	Certified Internal Auditor
COSO	Committee Of Sponsoring Organisations of the treadway commission
CPA	Certified Public Accounting
CRMA	Certification in Risk Management Assurance
ECIIA	European Confederation of Institutes of Internal Auditing
GAAP	Generally Accepted Accounting Principles
IAASB	International Auditing and Assurance Standards Board
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IIA	Institute of Internal Auditors
IIARF	The Institute of Internal Auditors Research Foundation
IPPF	International Professional Practices Framework
ISA	International Standard on Auditing
SOX	Sarbanes-Oxley Act

## **1. INTRODUCTION**

The purpose of this thesis is to provide general information in relation to the audit, the reason and benefit that companies have for auditing their business, the difference between internal and external audit, and what is their importance.

Sarbanes-Oxley Act of 2002 (SOX) also known as 'Public Company Accounting Reform and Investor Protection Act' and "Corporate and Auditing Accountability and Responsibility Act" was the result of several events happened one after another. The initial motivation for SOX was the Enron scandal, revealed in October 2001, eventually led to the bankruptcy of the Enron Corporation, an American energy company based in Houston, Texas. After the public's interest in the Enron scandal was starting to die, the WorldCom scandal hit the news and it became impossible for anybody in Washington to argue against stronger corporate governance laws. With SOX that is an United States federal law that set new or expanded requirements for all U.S. public company boards, management and public accounting firms, the internal audit profession has experienced a major paradigm shift.

Gradually, the importance of audit profession experienced a significant increase among EU countries, so to the other EU-candidates and potential candidate's countries, also.

### **1.1. Background**

Audit process have important role in overall control system of organisations by providing several important control functions serving as control mechanisms to investigate and identify potentially errors or omissions. Audits may prevent future errors, misstatements and fraudulent activities, and results of audits can be used to identify and propose potential improvements to the audited entity. These results also bring confidence to potentially investors and lenders that audited entity aims to attract.

#### a) Internal Audit

Internal audits are performed by employees of the entity itself, by monitoring operating results, verifying financial records, in order to evaluate internal controls to help increasing efficiency and effectiveness of operations and to detect fraud. The audit is conducted in accordance with management's requirements and may be wide-ranging or narrowly focused. Internal audit can identify control problems, and help to correct errors before they are discovered during an external audit.

#### b) External audit

An audit performed by audit professionals, external to the entity is called an external audit. Such experts, that are independent from the entity conducts audits in accordance with requirements that are defined from beneficiaries of these audits. External audit objective is to determine, among other things, whether the accounting records are accurate and complete, prepared in accordance with financial standards and requirements, and the statements prepared from the accounts present fairly the organization's financial position, and the results of its financial operations. External audits that are most frequently performed are the statutory audits of the financial statements of companies and public sector entities.

### **1.2. Research objective**

Objective of this research is to bring in focus the importance of audit process, both internal and external, to the businesses operating in Kosovo, and in other countries, also.

### **1.3. Research problem**

The need for auditing the business has become one of the priorities of the owners and managers of companies, because audit reports help them to convince potentially investors, lenders and shareholders that investing in their businesses is safety investment.

#### **1.4. Research questions**

- Why should a company have internal and external audit activity?
- Which are the differences between the internal and external audit?
- Which are the benefits of audit?
- Explore examples of the audit reports?

#### **1.5. The structure of the research**

The research is based on exploring different literature and sources that describe the role and importance of internal and external audit, and different requirements entities in different countries have to undertake audit, and present their audited reports to public and authorities.

Furthermore this paper will also analyse the needs and reasons why a company should audit its business, when the company is legally required to audit their business, what are the benefits of the audit and does it outweighs its costs.

## 2. LITERATURE REVIEW

### 2.1. Introduction

The term 'audit' is derived from the Latin word that means 'a hearing'. Auditing as a process originates over 2000 years ago, firstly in Egypt, and then in Greece, Rome and elsewhere. Citizens that were entrusted with the collection and disbursement of public funds had to present themselves publicly before a responsible official (the so-called auditor) to give an oral account how they handled those public funds. (*Porter et al., 2003*).

In modern times audits have important role in overall control system of organisations. Providing several important controls functions they can serve as detective control mechanisms through investigations and by identifying and evaluating errors or omissions, and finding variances between the current condition and predetermined criteria. Also, audits may prevent future errors, misstatements and fraudulent activities, and results of audits can be used to identify and propose potential improvements to the audited entity (*Kagermann et al., 2007*).

According to American Accounting Association there is definition of auditing as follows:

*“Auditing is the systematic process of objectively obtaining and evaluating evidence regarding assertions about economic activities and events to ascertain the degree of correspondence between the assertions and established criteria and communicate the results to interested users (Committee on Basic Auditing Concepts, 1973)”*.

The objective of an audit of financial statements is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with a financial reporting framework.

An auditor must firstly be a qualified accountant in order to be able to understand and process the raw material, accounting data; although the processes that are involved in auditing and accounting are different. Accounting is primarily a *creative* process which involves identifying, organising, summarising and communicating information about

economic events. Auditing, on the other hand, is primarily an *evaluative* process. It involves gathering and evaluating audit evidence, and communicating conclusions based on this evidence, about the fairness with which the communication resulting from the accounting process (that is, the financial statements) reflects the underlying economic events (*Porter et al., 2003*).

The audits can be classified in different ways. One way of classification for example, may be according to:

- The primary objective of the audit; or
- The primary beneficiaries of the audit.

There may be recognised three main categories of audit based on *primary objective of audit*:

- i. financial statement audits,
- ii. compliance audits,
- iii. operational audits.

A **financial statement audit** is an examination of the financial statement prepared for shareholders and other interested parties outside the entity, to support the confidence of information in those financial statements. It is usually conducted by an experienced and qualified professional, who is independent of the entity, in order to be able to express an opinion about financial statements whether they provide a true and fair view of the entity's financial performance and position, and whether they comply with relevant statutory and other regulatory requirements.

Even if companies that are not legally required to have their financial statements audited may still require financial statement audits for specific advantages. As for example, if any of such entities approaches a bank for a loan, the bank may require financial statements to be audited to be more confident in decision whether or not to grant the loan.

**Compliance audits** purpose is to determine whether an entity has acted in accordance with procedures or regulations that are established by an authority, as for example entity's

management or a regulatory body. The compliance audits are conducted by experienced professionals, internal or external to the entity, that are appointed by and report to the authority which set the procedures or regulations in place.

An **operational audit** involves a systematic examination and evaluation of an entity's operations which is conducted with a view to improving the efficiency and/or effectiveness of the entity. Such audits are usually initiated by the entity's management or, sometimes, if there is one, by its audit committee. They are conducted by competent, experienced professionals (internal or external to the entity) who report their findings to the party which initiated the audit. An operational audit may apply to the entity as a whole or to an identified segment thereof, such as a subsidiary, division or department. The objectives of the audit may be broad, for example, to improve the overall efficiency of the entity, or narrow and designed, for example, to solve a specific problem such as excessive staff turnover.

After all, all audits share some **common characteristics** despite different categories and types of audit may be recognised. Regardless they audit financial statements, compliance or operational, or if they are external or internal audit, they all involve:

*the systematic examination and evaluation of evidence which is undertaken to ascertain whether statements by individuals or organisations fairly represent the underlying facts and comply with established criteria; and communication of the results of the examination, usually in a written report, to the party by whom, or on whose behalf, the auditor was appointed. (Porter et al., 2003).*

Another classification, that **primary on audit beneficiaries**, can be classified as:

- i. External audits, or
- ii. Internal audits.

## 2.2. External audits

An audit performed by a professional, external to the entity is called an external audit. Such experts, that are independent from the entity and its personnel conducts audits in

accordance with requirements that are defined from beneficiaries of these audits. External audits that are most frequently performed are the statutory audits of the financial statements of companies and public sector entities. Compliance audits are also examples of external audits.

In most developed countries, all publicly quoted companies and all large companies are required by law to produce annual financial statements and have them audited by an external auditor. Other organisations (e.g. small private companies, partnerships, etc.) may choose to be audited even if there is no legal requirement (*ACCA – F8, 2008*).

The purpose of an external audit is to give an opinion on the financial statements. Whilst an audit might also advise directors how to run the business, its objective is solely to report to shareholders. The key benefit to shareholders is the impartial view provided by external auditors, but the company benefits from these professional accountants by reviewing the accounts and system during this audit, also. External audits advantage includes also the recommendations that are being made in relation to accounting and control systems and the possibility that they might detect fraud and errors (*ACCA – F8, 2010*).

The external auditor's role and responsibilities are:

- To identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- To obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. In circumstances when the auditor also has a responsibility to express an opinion on the effectiveness of internal control in conjunction with the audit of the



financial statements, the auditor shall omit the phrase that the auditor's consideration of internal control is not for the purpose of expressing an opinion on the effectiveness of the entity's internal control (ISA).

In addition to this role, external audit may carry out other assignments on a contractual basis that do not conflict with their primary role. External auditors have sole responsibility for the opinions they express on the financial statements. International norms exist for the profession and are codified in the International Standard on Auditing (ISA) issued by the International Auditing and Assurance Standards Board. In each European country, specific laws apply for statutory audit in terms of nomination, standards and reports (ECIA - *European Confederation of Institutes of Internal Auditing*).

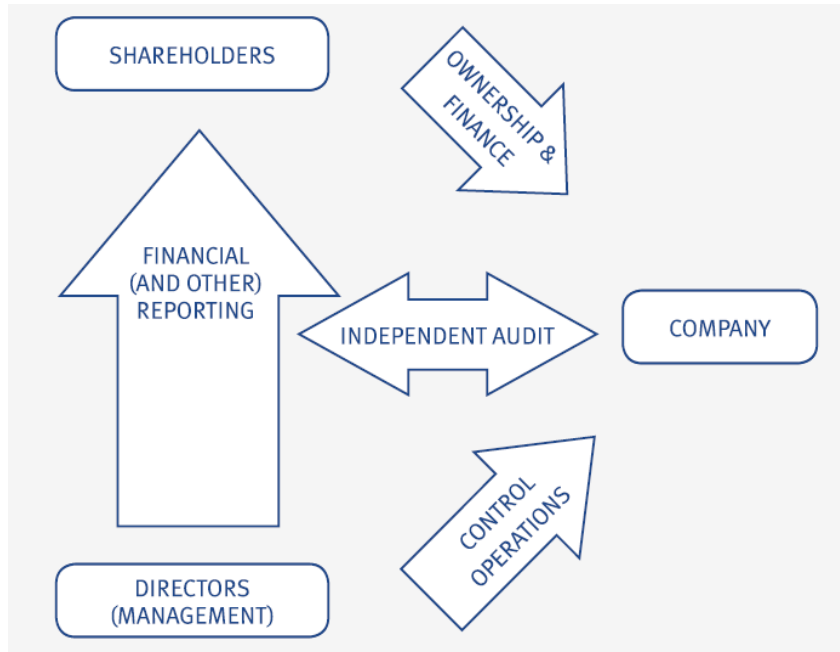


Figure 1. The role of the auditor (ACCA – F8, 2008)

An external auditor should follow certain general principles in the conduct of an external audit.

- Compliance with applicable ethical principles, ie the IFAC Code of Ethics for Professional Accountants and the ethical pronouncements of the auditor's professional body.

- Compliance with applicable auditing standards, ie the International Auditing and Assurance Standards Board's (IAASB's) International Standards on Auditing (ISAs).
- Planning and performing the audit with an attitude of professional scepticism that recognises that the financial statements being audited may be materially misstated. For example, the auditor should not simply accept an explanation about a matter given by management. The auditor should seek further evidence about the matter that confirms or contradicts management's explanation.

As a conclusion, an audit is designed to provide reasonable assurance that the financial statements taken as a whole are free from *material* misstatement and give a *true and fair view*. Information is *material* if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. It is almost impossible for anyone to state that financial statements are precisely and absolutely correct. But, by stating that the accounts are free from material misstatement the auditor give confidence that there are no alterations required that could alter the way in which someone might view/read the accounts (in other words, they are close enough to the truth!).

The directors have a statutory duty to produce financial statements which give a *true and fair* view, and the auditors are required by law to report whether, in their opinion, the financial statements give a true and fair view. However, there is no official definition in the IAASB Glossary of Terms or in any individual ISA of the meaning of 'true and fair'. *Truth* in accounting terms can be taken to mean not factually incorrect. The word *fair* have the meaning that financial statements are clear, distinct, plain, impartial/unbiased, just and equitable (ACCA – F8, 2008).

### 2.3. Internal audits

In contrast to external audits, internal audits are performed for parties (usually management) internal to the entity. They may be performed by employees of the entity itself or by personnel from an outside source (such as an accounting firm). However, in either case, the audit is conducted in accordance with management's requirements. These

may be wide-ranging or narrowly focused, and they may be continuous (on-going) or one-off in nature. They may, for example, be as broad as investigating the appropriateness of, and level of compliance with, the organisation's system of internal control, or as narrow as examining the entity's policies and procedures for ensuring compliance with health and safety regulations (*Porter et al., 2003*).

Internal audit is an important part of a company's governance and assists boards and executive management in the effective operation of the organisation. Internal audit acts as a catalyst for improving an organisation's effectiveness and efficiency by making recommendations based on objective analyses and assessments of data and processes. To support the accomplishment of these responsibilities, the IIA International Professional Practices Framework (IPPF) provides a global framework for the profession. It includes the Standards, the Code of Ethics and the Practice Advisories. Moreover, IIA has developed international qualifications, such as Certified Internal Auditor (CIA) and other specific certifications (CRMA, CCSA) to support the acquisition of the knowledge and skills required of an internal auditor. Some country institutes offer their own recognised equivalents (*ECIIA, 2016*).

*“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes (IPPF - International Professional Practices Framework, 2016)”*.

In the past, Internal Audit was mainly focused on financial and accounting matters, but today its role has developed to include active risk and control evaluations and is considered integral part to the corporate governance process. The internal audit is part of the internal monitoring system of the organization and therefore should be positioned within the organization such that the independence of internal auditors can be guaranteed. Ideally, Internal Audit should report functionally to the Audit Committee of the Board of Directors and administratively to the Chief Executive Officer (CEO) of the organization. Generally, an internal audit is a multi-step process aimed at determining whether existing processes

and procedures (the condition) comply with applicable rules and regulations (the criteria) or deviate in any way from these criteria (*Kagermann et al., 2007*).

Internal audit should assist management to achieve entity's objectives, particularly to establish good corporate governance. It is an appraisal or monitoring activity established within an entity as a service to the entity. Its function is to examine, evaluate and report to management and directors on adequacy and effectiveness of components of the accounting and internal control systems. Internal audit can play a key role in assessing and monitoring internal control policies and procedures.

The Mission of Internal Audit according to The Institute of Internal Auditors is:

***“To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight (IPPF, 2016)”.***

Core Principles for the Professional Practice of Internal Auditing as for IIA taken as whole, articulate internal audit effectiveness. For an internal audit function to be considered effective, all Principles should be present and operating effectively. How an internal auditor, as well as an internal audit activity, demonstrates achievement of the Core Principles may be quite different from organization to organization, but failure to achieve any of the Principles would imply that an internal audit activity was not as effective as it could be in achieving internal audit's mission.

An internal auditor should:

- ***Demonstrates integrity.***
- ***Demonstrates competence and due professional care.***
- ***Is objective and free from undue influence (independent).***
- ***Aligns with the strategies, objectives, and risks of the organization.***
- ***Is appropriately positioned and adequately resourced.***
- ***Demonstrates quality and continuous improvement.***
- ***Communicates effectively.***

- *Provides risk-based assurance.*
- *Is insightful, proactive, and future-focused.*
- *Promotes organizational improvement.*

Internal audits can be performed by a certified internal auditor or other professionals. Some small businesses do not employ internal audit staff, but may still perform self-audits as a means of verifying that proper internal controls are in place. Self-assessment tools are available online to help small businesses evaluate managerial, financial, and operational policies and procedures.

A survey conducted in 2010 by IIARF about Characteristics of an Internal Audit Activity related the scope and structure of the internal audit activity and its reporting relationships with audit committees and administration. Examining internal audit activities provides an understanding of what is expected from internal auditors and highlights the importance of the main internal audit characteristics such as independence, objectivity, and proficiency.

The survey presented the current status of general types of audits that are performed by internal auditors. Approximately 54 percent of the respondents indicate that the internal audit activity in their organizations has been established for more than 10 years, as shown in Figure 2.

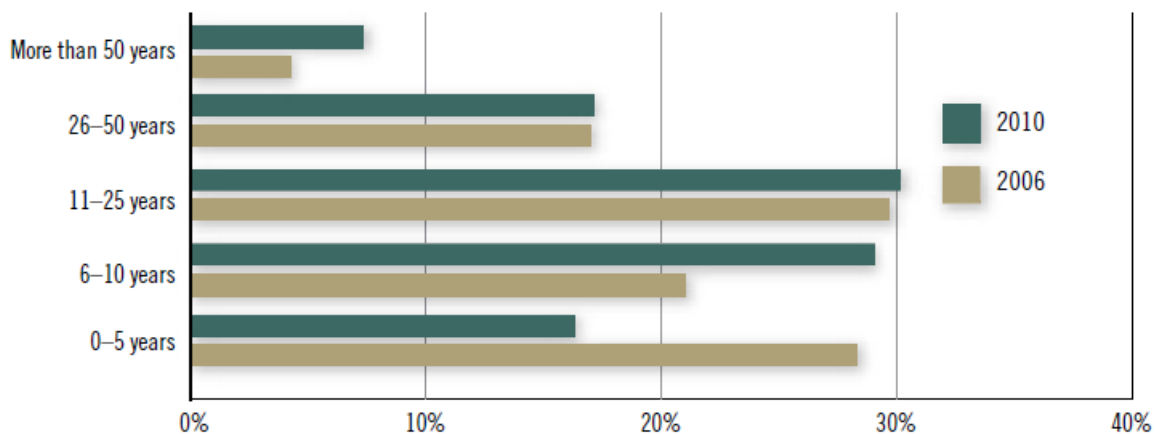


Figure 2. Longevity of Organizational Internal Audit Activity

Such growth in the maturity of the organization's audit activities is reflected positively in the number and quality of the activities that the internal auditors perform (*Alkafaji et al., 2010*).

An internal audit must meet today's need in the operating environment and is influenced by several factors, as regulatory and legal requirements, internal expectations and to deal with competitors. These factors an internal auditor must meet with flexibility and in accordance with company objectives, and the standards established by the professional institutes must be fulfilled also. The internal audit functions must be integrated within business processes of the organization to be in line with external environment and internal factors (*Kagermann et al., 2007*).

To be able to meet objectives as a whole the internal auditors in some manner have a dual identity, or two social categories. The first can be considered the professional identity that is the role they have as professional auditors, focused on assurance and governance of their organization through objective assessment. In this role the IA is seen as a "watch dog" by management (*Gray, 2004*). The second is considered employee identity, the role that is as an "organizational consultant" or "trusted partner," working alongside management to improve the overall governance of the organization (*Hass et al., 2006*).

As per survey previously mentioned conducted by IIARF, internal auditors perform different activities. In the Table 1 are shown activities that participants selected, ranked from the highest to the least selected.

Table 1. Internal Audit Activity Ranked Based on Current Experience

Internal Audit Activity	Currently	
	Percentage	Rank
Operational audits	88.9%	1
Audits of compliance with regulatory code (including privacy) requirements	75.1%	2
Auditing of financial risks	71.6%	3
Investigations of fraud and irregularities	71.2%	4
Evaluating effectiveness of control systems (using COSO, COBIT, etc., frameworks)	68.8%	5
Auditing of IT/ICT risks	61.7%	6
Auditing of information risks	61.4%	7
Audits of enterprise risk management processes	56.6%	8
Project management assurance/audits of major projects	55.4%	9
Security assessments and investigations	52.8%	10
External audit assistance	52.0%	11
Management audits	49.9%	12
Corporate governance reviews	44.5%	13
Disaster recovery testing and support	40.5%	14
Facilitating risk/control/compliance training and education for organization personnel	40.0%	15
Auditing of outsourced operations	35.0%	16
Ethics audits	32.1%	17
Business viability (going-concern) assessments	26.6%	18
Reviews addressing linkage of strategy and company performance (e.g., balanced scorecard)	25.3%	19
Due diligence reviews for corporate acquisitions/mergers, etc.	24.8%	20
Quality/ISO audits	24.0%	21
Social and sustainability (corporate social responsibility, environmental) audits	19.6%	22
Migration to International Financial Reporting Standards (IFRS)	19.4%	23
Executive compensation assessments	18.5%	24
Implementation of Extensible Business Reporting Language (XBRL)	5.3%	25

(Alkafaji et al., 2010)

#### 2.4. Differences and similarities between internal and external audit

Despite many differences, the work of internal and external auditors is closely aligned. Companies can achieve significant savings in audit fees if this alignment is well managed. Gaining cost savings and not compromising internal or external audit function requires careful management. In cases where internal auditors do not get involved with financial data of the company, but their focus is exclusively on the effectiveness and operation of controls in order to reduce identified risks, external auditors need to perform quite extensive compliance and substantive testing before they can present an opinion about the truth and fairness of the figures and other disclosures in the company's financial statements, resulting in most expensive situation. In contrary, when the company have a highly professional and well-staffed internal audit function that routinely performs detailed and periodic examinations of the internal controls that are designed to assure the integrity of the financial statement data, once the external auditors are satisfied with the professionalism of the internal audit staff, they can rely on the work of internal auditors, resulting on saving external audit time, thus saving the company external audit fees (Porter et al., 2003).

According to Chartered Institute of Internal Auditors of UK and Ireland, internal audit is distinct and different from external audit. While they are complementary functions within the assurance framework which may work closely together and need to be coordinated, organisations will not get the best or most cost effective assurance from internal audit unless the differences are recognised and internal audit is treated as a separate profession with its own value and expertise (Chartered Institute of Internal Auditors, 2016).

In some industries, such as the financial sector, it is required by law to establish an internal audit function. The objectives and scope of an internal audit function vary widely and depend on the size and structure of the entity and the requirements of management (ECIIA).

**ISA 610** "Using the Work of Internal Auditors" describe and present the relationship between Internal Audit Function and External Auditor, stating that while the objectives of the internal and external auditors are different, some of the ways in which the internal audit



function and the external auditor achieve their respective objectives may be similar. Irrespective of the degree of autonomy and objectivity of the internal audit function, such function is not independent of the entity as is required of the external auditor when expressing an opinion on financial statements. The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal auditors (*International Federation of Accountants, 2016*).

The international norms for internal audit define the way internal audit may rely on other assurance providers:

*Standard 2050: Coordination states, "The chief audit executive [CAE] should share information and coordinate activities with other internal and external providers of assurance and consulting services to ensure proper coverage and minimize duplication of efforts." This responsibility requires the CAE's inclusion and participation in the organization's assurance provider framework. This framework can consist of internal audit, external audit, governance, risk management, or other business control functions/disclosures performed by the organization's management team. Inclusion and participation in this framework helps ensure the CAE is aware of the organization's risks and controls in relation to organizational goals and objectives. (The Institute of Internal Auditors, 2012)*

For an effective governance of an organisation internal and external audit are essential. They both need to be independent, objective, highly professional and they work must rely on their respective international standards. As they perform different functions they need to report separately to the board or audit committee.

These differences must be taken into account when policy related to governance and internal audit is created. Legislative and regulatory references should be specific when they are referring to external or internal audit or auditor.

Table 2 presents differences of internal and external audit according to their scope, objective, focus, independence and other areas of work.

Table 2. The distinct roles of internal and external audit

	<b>INTERNAL AUDIT</b>	<b>EXTERNAL AUDIT</b>
<b>Employment/ Report</b>	Employed by the organisation and reporting to the board or audit committee	Hired external contractor reporting to the shareholders or equivalent
<b>Scope</b>	Assessment of all categories of risks and their management: financial, operational, compliance and governance	Express an opinion on the statutory financial statements and related disclosures, therefore examining internal controls relevant for the opinion
<b>Objective</b>	Provide assurance that senior management fulfil their duties related to governance, risk management and internal controls	Provide assurance to the stakeholders or equivalent regarding statutory financial statements and other reports as required by local law
<b>Focus</b>	Understanding the business, providing assurance on the efficiency and effectiveness of risk management and internal controls systems	Understanding the business sufficiently to express an opinion on the financial statements
<b>Independence</b>	Professional ethical standards overseen by the audit committee through a quality by the audit committee through a quality assurance and improvement programme Main focus: objectivity	Professional ethical standards reviewed and monitored by the audit committee and the regulatory framework Main focus: independent view on the financial statements
<b>Recipient of reports</b>	The board, the audit committee, senior management and auditees	Auditors' opinion to the shareholder(s) or equivalent. Management letters to governing body and senior management
<b>Timing and frequency</b>	According to an audit plan approved by the board or audit committee, and senior management	Statutory financial reporting, in some entities reporting to stock exchange
<b>Professional Framework</b>	International Professional Standards and Code of Ethics	Statutory and regulatory framework
<b>Improvements</b>	Systematic recommendations and follow up of corrective actions	Management letter on the processes reviewed and improvements needed mostly focused on financial reporting processes
<b>Skills</b>	Diverse skills sets required: being able to understand corporate governance, business risks, operational, strategic and compliance risks	Understanding the business to be able to challenge the use of the accounting standards

(ECIIA, 2016)

As we previously mentioned despite many differences, the work of internal and external auditors is closely aligned. For the maximum benefit of an organisation, internal and external auditors have to agree about their respective responsibilities. And, in this process, the audit committee of the company can play a key role. When internal and external auditors submit their annual audit plan to the audit committee, the committee has the possibility to ensure that the company derives maximum benefit from the skills and expertise of the two separate disciplines (Porter et al.).

This plan has to present the level of interaction and cooperation between internal and external auditors, where they will assess the work that can be reused from the other auditors. A minimum level of interaction must ensure that audit planning by both audit types should avoid duplication and overlap, that internal and external auditors should meet at least once a year to ensure coordination and discuss common issues and concerns, and that chief audit executive should attend the audit committee meeting for agenda items relating to the external auditors status report. In other side, a higher level of interaction may include discussions and exchange of information for almost every step and detail of respective work of internal and external auditors (ECIIA). Figure 3 graphically illustrates distinction and cooperation between external and internal audit.

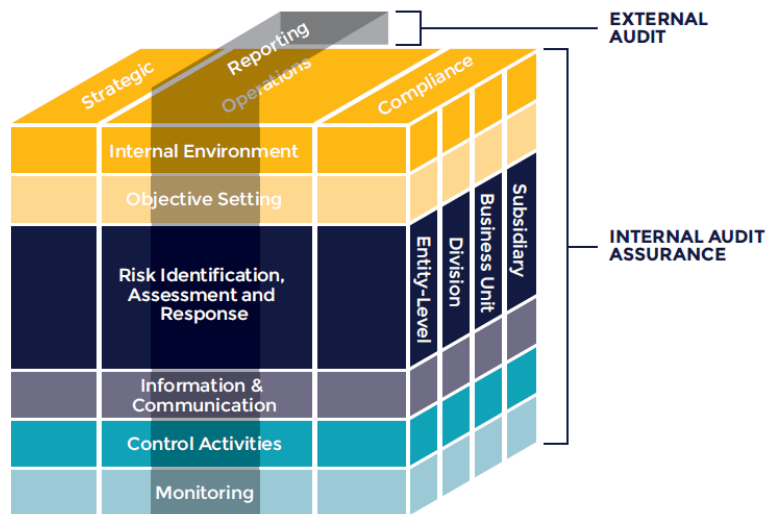


Figure 3. COSO's Enterprise Risk Management (ERM) framework (ECIIA, 2016)



### 3. PROBLEM STATEMENT

Developing countries such as Kosovo are in need to attract foreign investors in order to achieve faster development and economic growth. As the financial reporting has direct impact on financial stability, economic growth and credibility of companies, presenting external audit report may be the main instrument that creates a kind of credibility for foreign investors. In this line, if enterprises operating in Kosovo, want to attract foreign investors, they must present their stability and ensure credibility to investors. This can be done by presenting audited financial statements, because foreign investors before making a partnership with a local business they really want to see the reflection of their business in their financial statements.

According to the Law on Accounting, Financial Reporting and Audit (Republic of Kosovo Assembly, 2011) of Republic of Kosovo, not all businesses have an obligation to submit the audited financial statements. Under this law, large business organisations should apply IAS/IFRS as well as interpretations, recommendations and necessary guidance issued by International Accounting Standard Board (IASB), and are subject of presenting consolidated financial statements audited by licensed statutory audit firms, whereas medium business organisations can present financial statements audited by statutory firms or licensed auditors. Small business organisations can only submit prepared financial statements that are in accordance with IFRS and IASB.

The main reason of choosing to write about the internal and external auditing in this paper is to inform the reader about the importance of reliability that audited financial statements brings to shareholder and potential investors. On the other hand, companies in Kosovo need to be aware about the role and importance of the internal audit as it is an assurance and consulting activity, independent and objective, designed to add value and improve an organization's operations.

Given the importance of foreign investment to Kosovo and to the role of the internal and external audit on attracting this investment, this paper have tried to inform the reader about the internal and external audit in general, their duties and responsibilities, similarities and

differences between the two, benefits and also have given examples of their work with a local business.

The main questions of this paper are:

- Why do we need to audit our business?
- Why do we have an internal and external audit?
- Which are the differences between the internal and external audit?
- Which are the benefits of audit?
- Explore examples of the audit reports?

#### 4. METHODOLOGY

This research is characterized as descriptive research in which data are collected from relevant literature: books, articles in various academic and professional journals, reports and scientific papers. It informs readers about the audit in general, the role and tasks of external and internal audit and the difference between them.

Given that the need for audit business is increasing every day, the special focus of the research was the factors affecting this growth.

Regarding the method of research there are two approaches: qualitative research and quantitative research. Quantitative research has to do with the collection of data that can be expressed numerically and presented in tables or graphs. While qualitative research deals with specific studies of a small group, but it generates more concrete data than statistical (*Rajasekar et al., 2006*).

Because of the type of research, this paper is qualitative research, while the approach used was deductive, and because the goal of this research is used this approach where we started from a general level and have continued on a more specific level.

As a research method it is used the comparative method, where the comparison of the legal legislation of different countries in relation to the obligation of businesses to audit their business by the external audit it is done.

Attached to this research is the External Auditor's report in this case, "Deloitte" made to for the company XY LLC. In this report the reader has the opportunity to see in practice that what comprises an external auditor report.

## 5. RESULTS/FINDINGS

As mentioned in 'Literature Review' internal and external audit have important role in overall control system of organisations, and presenting audited financial statements to the public and different authorities will ensure credibility to potential investors, and reliability among shareholders and other parties of interest.

Because of such the significant public relevance European Union compiles a set of laws and directives among them the Directive 2014/56/EU (Access to European Union law, 2014) that amended Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts. Such legislation needs to be harmonised and transposed at respective laws of Member States of European Union, EU-member candidate countries, and eventually by potential candidates that are still non-EU members, as is the case of Kosovo. The recommendation and rules in this directive reinforces investor protection by strengthening public oversight of statutory auditors and audit firms, and credibility of the audited financial statements of public interest entities.

Article 29 of this Directive was amended in a manner that the auditing standards to be adopted in order to be proportionate to the scale and complexity of the business of the audited entity. For this purpose, Member States (and other countries aim to be EU-members) shall require competent authorities, when undertaking quality assurance reviews of the statutory audits of annual or consolidated financial statements of medium-sized and small undertakings, to take account of the fact of scale and complexity of the business.

This recommendation is related to the Directive 2013/34/EU (Access to European Union law, 2013) that takes into account the Commission Communication entitled "Smart Regulation in the European Union" and "Think Small First – Small Business Act for Europe", that recognises the central role played by small and medium-sized enterprises (SMEs) in the Union economy and aims to improve the overall approach to entrepreneurship and to anchor the "think small first" principle in policy-making from regulation to public service.



Article 3 of this Directive categorises undertakings and groups into micro, small, medium-sized and large undertakings and into small, medium-sized and large groups. As per this directive Member States shall define micro-undertakings as undertakings which on their balance sheet dates do not exceed the limits of at least two of the three following criteria:

- a) balance sheet total: EUR 350 000;
- b) net turnover: EUR 700 000;
- c) average number of employees during the financial year: 10.

Small undertakings shall be undertakings which on their balance sheet dates do not exceed the limits of at least two of the three following criteria:

- a) balance sheet total: EUR 4 000 000;
- b) net turnover: EUR 8 000 000;
- c) average number of employees during the financial year: 50.

Member States may define thresholds exceeding the thresholds in points (a) and (b). However, the thresholds shall not exceed EUR 6 000 000 for the balance sheet total and EUR 12 000 000 for the net turnover.

Medium-sized undertakings shall be undertakings which are not micro-undertakings or small undertakings and which on their balance sheet dates do not exceed the limits of at least two of the three following criteria:

- a) balance sheet total: EUR 20 000 000;
- b) net turnover: EUR 40 000 000;
- c) average number of employees during the financial year: 250.

Large undertakings shall be undertakings which on their balance sheet dates exceed at least two of the three following criteria:

- a) balance sheet total: EUR 20 000 000;
- b) net turnover: EUR 40 000 000;
- c) average number of employees during the financial year: 250.

Small groups shall be groups consisting of parent and subsidiary undertakings to be included in a consolidation and which, on a consolidated basis, do not exceed the limits of at least two of the three following criteria on the balance sheet date of the parent undertaking:

- a) balance sheet total: EUR 4 000 000;
- b) net turnover: EUR 8 000 000;
- c) average number of employees during the financial year: 50.

Member States may define thresholds exceeding the thresholds in points (a) and (b). However, the thresholds shall not exceed EUR 6 000 000 for the balance sheet total and EUR 12 000 000 for the net turnover.

Medium-sized groups shall be groups which are not small groups, which consist of parent and subsidiary undertakings to be included in a consolidation and which, on a consolidated basis, do not exceed the limits of at least two of the three following criteria on the balance sheet date of the parent undertaking:

- a) balance sheet total: EUR 20 000 000;
- b) net turnover: EUR 40 000 000;
- c) average number of employees during the financial year: 250.

Large groups shall be groups consisting of parent and subsidiary undertakings to be included in a consolidation and which, on a consolidated basis, exceed the limits of at least two of the three following criteria on the balance sheet date of the parent undertaking:

- a) balance sheet total: EUR 20 000 000;
- b) net turnover: EUR 40 000 000;
- c) average number of employees during the financial year: 250.

The Chapter 8 on ‘AUDITING’ of this Directive requires from Member States to ensure that the financial statements of public-interest entities, medium-sized and large undertakings are audited by one or more statutory auditors or audit firms approved by

Member States to carry out statutory audits. The statutory auditor(s) or audit firm(s) shall also:

- a) express an opinion on:
  - i. whether the management report is consistent with the financial statements for the same financial year, and
  - ii. whether the management report has been prepared in accordance with the applicable legal requirements;
- b) state whether, in the light of the knowledge and understanding of the undertaking and its environment obtained in the course of the audit, he, she or it has identified material misstatements in the management report, and shall give an indication of the nature of any such misstatements.

But, this Directive allows Member States to make some exemption for micro and small undertakings by exempting them from some general publication requirements, such as not requiring from them to have financial statement audited. This is described by point (23) with the following reasoning that users of financial statements typically have a limited need for supplementary information from small undertakings, and it can be costly for small undertakings to collate that supplementary information. A limited disclosure regime for small undertakings is, therefore, justified. However, where a micro or small undertaking considers that it is beneficial to provide additional disclosures of the types required of medium-sized and large undertakings, or other disclosures not provided for in this Directive, it should not be prevented from doing so.

European contact group maintains an implementation database about EU Audit Legislation (*European Contact Group, 2017*) that is periodically updated about the level of implementation in Member States of the EU Directive 2014/56/EU on statutory audits of annual accounts and consolidated accounts. As is presented in this database some Member States did not implemented this Directive at whole so that status of legal implementation states 'Not yet implemented' for them, as in case of Slovenia, Croatia, Norway, etc. In other side there are countries as in case of United Kingdom, Germany, Lithuania, Belgium, and some more that have status of 'Fully implemented', while France has the status as

‘Partially Implemented’. EU-member candidate countries, and potential candidates that are still non-EU members, were also encouraged to implement this Directive, and harmonise their laws conform it in order to be prepared for next stage of integration.

Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings have a better transposition status among Member States and the status of full transposition at 13 January 2017 was 96%. Some EU-member candidate countries and potential candidates that are still non-EU members adopted recommendations from this Directive in their respective countries laws. Table 3 presents an overview how some selected countries adopted Article 3 of this Directive by approximating criteria for categorisation of undertakings in ratio to their country size of undertakings. As the Directive recommends an undertaking fall in a category by meeting two of three criteria: total of balance sheet in the end of the year, net turnover and average number of employees during that year. Based on this Directive respective countries also took into account that for micro and small undertakings there is not a requirement by law for presenting financial statements audited.

“Lessons learnt from the Global Financial Crisis. Both regulators and business enterprises learnt many lessons from the global financial crisis and many questions were raised about the absence of the provision of adequate warning signs to the board and top management. The more serious shortfalls in corporate governance were not related to technology and risk model construction but to the role of individuals, decision making processes in general and the understanding and interpretation of risk models.” (*European Confederation of Institutes of Internal Auditing, 2015*).

The Directive 2014/56/EU deal with some recommendations for internal audit of undertakings, also. It recommends that the audit committee shall monitor the effectiveness of the undertaking's internal quality control and risk management systems.

Table 3. Criteria of categorizing undertakings in different countries of Europe

Category of undertakings	Country that adopted Article 3 of the Directive	Balance sheet total: (000)	Net turnover: (000)	Average number of employees:	Required to have financial statement audited
Micro-undertakings	Directive 2013/34/EU	≤ EUR 350	≤ EUR 700	≤ 10	No
	United Kingdom	≤ £ 316	≤ £632	≤ 10	No
	The Netherlands	≤ EUR 350	≤ EUR 700	≤ 10	No
	Slovenia	≤ EUR 2 000	≤ EUR 2 000	≤ 10	No
	FYR Macedonia	N/A	≤ EUR 50	≤ 10	No
	Republic of Kosovo	≤ EUR 25	≤ EUR 50	≤ 10	No
Small undertakings	Directive 2013/34/EU	≤ EUR 4 000	≤ EUR 8 000	≤ 50	No
	United Kingdom	≤ £5 100	≤ £10 200	≤ 50	No
	The Netherlands	≤ EUR 6 000	≤ EUR 12 000	≤ 50	No
	Slovenia	≤ EUR 4 400	≤ EUR 8 800	≤ 50	No
	FYR Macedonia	≤ EUR 2 000	≤ EUR 2 000	≤ 50	No
	Republic of Kosovo	≤ EUR 1 000	≤ EUR 2 000	≤ 10	No
Medium-sized undertakings	Directive 2013/34/EU	≤ EUR 20 000	≤ EUR 40 000	≤ 250	Yes
	United Kingdom	≤ £18 000	≤ £36 000	≤ 250	Yes
	The Netherlands	≤ EUR 20 000	≤ EUR 40 000	≤ 250	Yes
	Slovenia	≤ EUR 17 500	≤ EUR 35 000	≤ 250	Yes
	FYR Macedonia	≤ EUR 11 000	≤ EUR 10 000	≤ 250	Yes
	Republic of Kosovo	≤ EUR 2 000	≤ EUR 4 000	≤ 50	Yes
Large undertakings	Directive 2013/34/EU	> EUR 20 000	> EUR 40 000	> 250	Yes
	United Kingdom	> £18 000	> £36 000	> 250	Yes
	The Netherlands	> EUR 20 000	> EUR 40 000	> 250	Yes
	Slovenia	> EUR 17 500	> EUR 35 000	> 250	Yes
	FYR Macedonia	> EUR 11 000	> EUR 10 000	> 250	Yes
	Republic of Kosovo	> EUR 2 000	> EUR 4 000	> 50	Yes

## 6. DISCUSSIONS AND CONCLUSIONS

Analysing data from Table 3 on criteria in different countries for categorizing undertakings it is seen that different countries put different threshold on values that make undertakings in respective countries to fall in the group of micro, small, mid-size or large undertakings. Depending on these categories there are also different requirements on financial reporting and especially on the need to present audited financial statements.

Although there were advocacy that for small and micro undertakings can be costly to collate that supplementary information and that users of financial statements typically have a limited need for supplementary information from small undertakings, it was also suggested that where a micro or small undertaking considers that it is beneficial to provide additional disclosures of the types required of medium-sized and large undertakings, it should not be prevented from doing so.

Based on "think small first" principle, there is a kind of doubt what is small. Because, comparing thresholds in Table 3, different countries have different values of criteria to categorise an undertaking to small or micro. For example, Slovenia put bigger threshold for micro undertakings, and the Netherlands put bigger threshold for small undertaking comparing to the Directive 2013/34/EU, while countries with the status of EU-candidate as Macedonia, or Kosovo as potential candidate have far smaller threshold for all categories. This can be justified because they are small countries also, so had to adopt values for them.

United Kingdom adopted threshold values with Directive 2013/34/EU for other categories but, it put a bit bigger threshold for small undertakings category. Many directors of private limited companies in United Kingdom that are likely to qualify as small undertakings because of this big threshold, preferred to have a voluntary audit if the company were exempt from the statutory requirement, as they consider the audit provides a check on accounting records and systems, improves the quality of the financial information and has a positive effect on the company's credit rating score (*Collis, 2012*).

Existing and potential investors, lenders and creditors are widely considered to be the primary users of published accounts (*IFRS, 2010*). Concerning the users of the financial statements of small and medium-sized companies, the main focus is on lenders, and little is known about the information needs of suppliers, other trade creditors or third parties, such as credit rating agencies and credit insurers. Where small entities contract only with other small entities, credit relationships are only relationship-based. They rely on trust, personal knowledge and reputation. On other side, medium-sized and larger entities contract with each other and with small entities, the most important part of information derived from financial statements, as they are processed, analysed and accumulated with other information. Owners and managers of small entities may not be aware of the extent to which the availability of trade credit and the terms offered to them by suppliers depend on their willingness to make financial statements available for inspection, the amount of information disclosed and whether the financial statements are audited. Credit reference agencies and insurers use more extensively financial statement information by calculated accounting ratios and factored into the agencies' proprietary scoring models to arrive at credit scores and recommended levels of credit (*Association of Chartered Certified Accountants, 2013*).

Based on better reputation that audited financial statements brings to entities and positive effect on the company's credit rating score, some companies in Kosovo, although by criteria of law their entities can fall on small undertakings, that has not a requirement to present audited financial statements, they did audit their financial statements as is the case of XY LLC, independent audit report of which is presented in Annex.

Because of importance of audited financial statements, and as internal audit is an important part of a company's governance that assists boards and management in the effective operation of the organisation by acting as a catalyst for improving an organisation's effectiveness and efficiency, there is a conclusion that audit processes, both internal and external, even if for small entities have cost and require effort are highly important.

## **7. RECOMMENDATION AND FUTURE WORK**

There was a conclusion that both internal and external audit is highly important for all entities, although they may fall into micro or small entities category.

After evaluating different sources, research and analyses, during preparation of this thesis, there is a bold recommendation for all businesses operating in Kosovo and in other countries to undertake internal and external audit process.

Despite audit process involves costing services that require time and patience, engaging audit professionals and helping them to do their work, it ensures credibility to potential investors, the main intention of businesses if they aim to evolve and have steady stability for a long period of time.

Future research and analysis that can reinforce the importance of audit process for businesses and their countries' economies is highly recommended.



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## 9. APPENDIXES

XY LLC

Independent Auditors' Report and  
Financial Statements for the year ended  
December 31, 2012

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## INDEPENDENT AUDITORS' REPORT

### To the Shareholders and Management of XY LLC

We have audited the accompanying financial statements of XY LLC (the "Company"), which comprise the statement of financial position as at December 31, 2012, statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

#### *Management Responsibility*

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide basis for our audit opinion.

#### *Opinion*

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Prishtina, Kosova  
April 23, 2013

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see <http://www.deloitte.com/about> for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Member of Deloitte Touche Tohmatsu Limited

**XY LLC**  
**Statement of Financial Position**  
As at December 31, 2012

	Notes	As at December 31, 2012 EUR
<b>ASSETS</b>		
<b>Non-current assets</b>		
Property, plant and equipment	5	42,390
<b>Total non-current assets</b>		<b>42,390</b>
<b>Current assets</b>		
Inventories	6	167,778
Trade and other receivables	7	208,315
Receivables from related parties	8	134,526
Cash on hand and at banks	9	55,698
<b>Total current assets</b>		<b>566,317</b>
<b>TOTAL ASSETS</b>		<b>608,707</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Equity</b>		
Share capital		1,000
Accumulated (Loss) / Profit		(29,560)
<b>Total equity</b>		<b>(28,560)</b>
<b>Non-current liabilities</b>		
Long-Term Loans		-
<b>Total non-current assets</b>		-
<b>Current liabilities</b>		
Trade and other liabilities	11	441,519
Short term loans from related parties	12	195,748
<b>Total current liabilities</b>		<b>637,267</b>
<b>TOTAL EQUITY AND LIABILITIES</b>		<b>608,707</b>

The accompanying notes on pages 7 to 21 form an integral part of these financial statements.



**XY LLC**  
**Statement of Comprehensive Income**  
For the year ended December 31, 2012

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	Notes	For the year ended December 31, 2012 EUR
Revenues	13	984,139
Cost of sales		<u>(877,828)</u>
<b>Gross margin</b>		<b>106,311</b>
Staff costs	14	(24,984)
Depreciation	5	(14,237)
Other operating expenses	15	(96,650)
<b>Loss before tax</b>		<u><b>(29,560)</b></u>
Income tax expense	16	-
<b>Loss for the year</b>		<u><b>(29,560)</b></u>
Other comprehensive income		-
<b>Total comprehensive income</b>		<u><u><b>(29,560)</b></u></u>

The accompanying notes on pages 7 to 21 form an integral part of these financial statements.

**XY LLC**  
**Statement of Changes in Equity**  
For the year ended December 31, 2012

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	<b>Share capital</b>	<b>Accumulated Loss/Profit</b>	<b>Total</b>
	<b>EUR</b>	<b>EUR</b>	<b>EUR</b>
<b>As at January 1, 2012</b>	-	-	-
Paid up share capital	1,000	-	1,000
Loss for the year	-	(29,560)	(29,560)
<b>As at December 31, 2012</b>	<b>1,000</b>	<b>(29,560)</b>	<b>(28,560)</b>

The accompanying notes on pages 7 to 21 form an integral part of these financial statements.

**XY LLC**  
**Statement of Cash Flows**  
For the year ended December 31, 2012

	Notes	For the year ended December 31, 2012 EUR
<b>Loss for the year</b>		<b>(29,560)</b>
Adjustments for:		
Depreciation	5	14,237
		<b>(15,323)</b>
Movements in working capital:		
Increase in inventories	6	(167,778)
Increase in trade and other receivables	7	(208,315)
Increase in receivables from related parties	8	(134,526)
Increase in trade and other payables	11	441,519
<b>Cash generated from operations</b>		<b>(69,100)</b>
Income tax paid		-
<b>Net cash generated by operating activities</b>		<b>(84,423)</b>
<b>Investing activities</b>		
Fixed assets purchased	5	(56,627)
<b>Net cash used in investing activities</b>		<b>(56,627)</b>
<b>Financing activities</b>		
Proceeds from shareholders		1,000
Increase in short term loans from related parties	12	195,748
<b>Cash from financing activities</b>		<b>196,748</b>
<b>Net increase/(decrease) in cash and cash equivalents during the year</b>	<b>9</b>	<b>55,698</b>
Cash and cash equivalents at the beginning of the year		-
<b>Cash and cash equivalents at the end of the year</b>		<b>55,698</b>

The accompanying notes on pages 7 to 21 form an integral part of these financial statements.

## **XY LLC**

### **Notes to the Financial Statements**

For the year ended December 31, 2012

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## **1. GENERAL**

XY LLC (the “Company”) is Limited Liability Company incorporated and headquartered in Republic of Kosovo. The Company was registered with the Provisional Business Registration under Reg. No. xxxxxxxx dated September 01, 2011. The Company’s head office is located at the following address: yyyyyyyy., Prishtina, Kosovo.

The Company is 100% Subsidiary of Yy Group, XxxYyy a foreign legal entity registered in XXXXX.

The Company had no activity in 2011 and commenced its operations during 2012. It is registered in Kosovo to perform the activities of services of office machines and computers, sale and purchase of goods, and computers training.

On December 31, 2012 the Company had 7 employees.

## **2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS**

### **2.1 Statement of compliance**

These financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”).

### **2.2 Basis of preparation**

These financial statements have been prepared on the historical cost basis. The financial statements are presented in Euro, which is also the local currency in the Republic of Kosovo.

### **2.3 Adoption of new and revised standards**

#### **(i) Standards and Interpretations effective in the current period**

The following amendments to the existing standards issued by the International Accounting Standards Board and interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period:

- **Amendments to IFRS 1 “First-time Adoption of IFRS”** - Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (effective for annual periods beginning on or after 1 July 2011),
- **Amendments to IFRS 7 “Financial Instruments: Disclosures”** - Transfers of Financial Assets (effective for annual periods beginning on or after 1 July 2011),
- **Amendments to IAS 12 “Income Taxes”** - Deferred Tax: Recovery of Underlying Assets (effective for annual periods beginning on or after 1 January 2012).

The adoption of these amendments to the existing standards and interpretations has not led to any changes in the Company’s accounting policies or its financial position and performance.

## 2. BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS (CONTINUED)

### 2.3 Adoption of new and revised standards (continued)

#### (ii) Standards and interpretations in issue not yet effective

At the date of authorization of these financial statements the following standards, revisions and interpretations were in issue but not yet effective:

- **IFRS 9 “Financial Instruments”** (effective for annual periods beginning on or after 1 January 2015),
- **IFRS 10 “Consolidated Financial Statements”** (effective for annual periods beginning on or after 1 January 2013),
- **IFRS 11 “Joint Arrangements”** (effective for annual periods beginning on or after 1 January 2013),
- **IFRS 12 “Disclosures of Involvement with Other Entities”** (effective for annual periods beginning on or after 1 January 2013),
- **IFRS 13 “Fair Value Measurement”** (effective for annual periods beginning on or after 1 January 2013),
- **IAS 27 (revised in 2011) “Separate Financial Statements”** (effective for annual periods beginning on or after 1 January 2013),
- **IAS 28 (revised in 2011) “Investments in Associates and Joint Ventures”** (effective for annual periods beginning on or after 1 January 2013),
- **Amendments to IFRS 1 “First-time Adoption of IFRS”** - Government Loans (effective for annual periods beginning on or after 1 January 2013),
- **Amendments to IFRS 7 “Financial Instruments: Disclosures”** - Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after 1 January 2013),
- **Amendments to IFRS 9 “Financial Instruments” and IFRS 7 “Financial Instruments: Disclosures”** - Mandatory Effective Date and Transition Disclosures,
- **Amendments to IAS 1 “Presentation of financial statements”** - Presentation of Items of Other Comprehensive Income (effective for annual periods beginning on or after 1 July 2012),
- **Amendments to IAS 19 “Employee Benefits”** - Improvements to the Accounting for Post-employment Benefits (effective for annual periods beginning on or after 1 January 2013),
- **Amendments to IAS 32 “Financial instruments: presentation”** - Offsetting Financial Assets and Financial Liabilities (effective for annual periods beginning on or after 1 January 2014),
- **Amendments to various standards “Improvements to IFRSs (2012)”** resulting from the annual improvement project of IFRS published on 17 May 2012 (IFRS 1, IAS 1, IAS 16, IAS 32, IAS 34) primarily with a view to removing inconsistencies and clarifying wording (amendments are to be applied for annual periods beginning on or after 1 January 2013),
- **IFRIC 20 “Stripping Costs in the Production Phase of a Surface Mine”** (effective for annual periods beginning on or after 1 January 2013).

The Company has elected not to adopt these standards, revisions and interpretations in advance of their effective dates. The Company anticipates that the adoption of these standards, revisions and interpretations will have no material impact on the financial statements of the Company in the period of initial application.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### 3.1 Foreign currencies

Transactions in foreign currencies are translated to the functional currency at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency at the exchange rate at the reporting date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated. Exchange differences on monetary items are recognized in profit or loss of the period they arise.

#### 3.2 Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. Where an item of property and equipment comprises major components having different useful lives, they are accounted for as separate items of property, plant and equipment.

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognized in the income statement.

Subsequent expenditure is capitalized if future economic benefits will arise from the expenditure. All other expenditure, including repair and maintenance, is recognized in the income statement as incurred.

Depreciation is charged to the profit or loss based on the cost, less estimated residual value, of the asset on straight line basis over the estimated useful life. Depreciation commences when the assets are available for use. The estimated useful lives are as follows:

Category of assets	As at December 31, 2012
Leasehold improvements	Lease term
Vehicles	5 years
Office furniture and equipment	5 years

#### 3.3 Impairment of non-financial assets

Non-financial assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognized in profit and loss. The recoverable amount is the higher of an asset's net selling price and value in use. The net selling price is the amount obtainable from the sale of an asset in an arm's length transaction while value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset from its disposal at the end of its useful life. Recoverable amounts are estimated for individual assets or, if it is not possible, for the cash-generating unit.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**3.4 Financial assets**

The Company classifies its financial assets in the following categories financial assets at fair value through profit or loss, loans and receivables and available – for- sale financial assets. Management determines the classification of its investments at initial recognition

*Loans and receivables*

Loan and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 month after the statement of financial position date which are classified as non-current assets. As of the reporting date this category includes trade and other receivables and cash and cash equivalents

*Initial recognition of financial assets*

Purchases and sales of financial assets are recognized on trade-date- the date on which the Company commits to purchase or sell the asset.

All financial assets other than assets at fair value through profit or loss are initially recognized at fair value plus transaction costs.

Financial assets carried at fair value through profit or loss is initially recognized at fair value and transaction costs are expensed in the profit or loss.

*Derecognition of financial assets*

Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

*Subsequent measurement of financial assets*

Financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are carried at amortized cost using the effective interest method.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**3.4 Financial assets (continued)**

Gains or losses arising from changes in the fair value of financial assets at fair value through profit or loss category are presented in the profit or loss within other losses/gains, net. Changes in the fair value of monetary and non-monetary securities classified as available- for- sale are recognized in equity.

*Impairment of financial assets*

The Company assesses at each balance sheet date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset (an incurred 'loss event') and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults

*Trade and other Receivables*

Trade Receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables.

Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganization, and default or delinquency in payments are considered indicators that the trade receivables is impaired. Individually significant debtors are tested for impairment on an individual basis. The remaining debtors are assessed collectively in groups that share similar credit risk characteristic.

The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. Assets with an allowance account, and the amount of the loss is recognized in the profit or loss. When trade receivable is uncollectible, it is written off against the allowance account trade receivables. Subsequent recoveries of amount previously written off are recognized as current income in the profit or loss.

**3.5 Cash and cash equivalents**

Cash and cash equivalents include cash in hand and balance with banks.



### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

#### 3.6 Inventory

Inventories are stated at the lower of cost and net realizable value. Under the applicable standards, inventories have been valued as follows:

The cost of merchandise includes purchase price, import duties and other costs directly attributable to acquisition of merchandise. Merchandise on stock for wholesale purposes is carried at cost.

- The cost is determined using the FIFO method.
- Small inventory includes tools, plant and office fittings and similar items that are expected to be used for period of up to one year, as well as assets not considered fixed assets.
- Small inventory, tiers and spare parts are fully expensed when put in use.
- The company also determines the value of slow- moving and obsolete inventories, and recognized allowance for such inventories by reference to their fair value.

#### 3.7 Equity

Share capital consists of the fair value of monetary considerations contributed by the shareholder.

#### 3.8 Revenue and expenses recognition

Revenue is generated from the sale of goods and provision of services. Revenue is measured at the fair value of the consideration received or receivable.

##### *Sales of goods*

Revenue from the sale of goods is recognized when all the following conditions are satisfied:

- The Company has transferred to the buyer the significant risks and rewards of ownership of the goods;
- The Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective over the goods sold;
- The amount of the revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the Company; and the costs incurred on those transactions can be measured reliably;

**Financial income** is recognized on a time proportion basis that reflects the effective yield on the assets.

**Financial expenses** comprise of interest expense on borrowings and default interest expenses on late payments. Borrowing costs are recognized in profit or loss using the effective interest method.

**Operating expenses** are recognized in the profit or loss upon utilization of the service.

#### 3.9 Leasing

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfillment of arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset.

Payments of the operating leasing are recognized as an expense on a straight-line basis over the lease term. Associated cost as maintenance and insurance, are expensed as incurred.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**3.10 Provisions**

A provision is recognized in the balance sheet when the Company has a legal or constructive obligation as a result of past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by the discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

**3.11 Employee Benefits**

The Company makes contributions for the benefits of employees to the Kosovo Pension Saving Trust (KPST). The contributions are expensed as incurred.

**3.12 Commitments and contingencies**

Contingent liabilities are not recognized in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. A contingent asset is not recognized in the financial statements but disclosed when an inflow of economic benefits is probable. The amount of a contingent loss is recognized as a provision if it is probable that future events will confirm that, a liability incurred as at the balance sheet date and a reasonable estimate of the amount of the resulting loss can be made.

**3.13 Transactions with related parties**

Related parties are defined as those parties which have control over each other or have an influence on the financial and operational decisions of each other. For the financial statements disclosure purposes, the Company's shareholders, and their related entities are considered related parties.

**4. FINANCIAL RISK MANAGEMENT****4.1 Financial risk management**

The Company's activities exposes it to a variety of financial risks, including risk and risks associated with the effects of changes in foreign currency rates and interest rate. The Company's risk management focuses on unpredictability of markets and seeks to minimize potential adverse effects over the Company's business performance.

Risk management is carried out by the Company's Directors based on certain pre- approved written policies and procedures that cover overall risk management, as well as specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of appropriate securities and investing excess liquidity.

**4.2 Credit risk**

Credit risk is the risk of financial loss to the Company if a customer or counterparty to financial instruments fails to meet its contractual obligations, and arises principally from the Company's trade receivables, deposits with banks and cash and cash equivalents.

The Company has policies in place to ensure that sales of products and rendering of services are made to customers with an appropriate credit history.

The credit risk for cash and cash equivalents is considered negligible, since the counterparties are reputable banks.

The Company's maximum exposure to credit risk is represented by the carrying amount of each financial asset in the Statement of financial position, as stated in the following table (amounts in Euro):

<i>Classes of financial assets- carrying amounts:</i>	<b>As at December 31, 2012</b>
Trade and other receivables	198,934
Receivables from related parties	134,526
<u>Cash and cash equivalents</u>	<u>55,698</u>
	<u><b>389,158</b></u>

**4.3 Liquidity risk**

Prudent liquidity risk management implies maintaining sufficient cash, availability of funds through adequate credit facilities and ability to collect timely, within the terms established the amounts due from the customers. Due to the dynamic nature of the Company's business, the management aims to maintain flexible funds by keeping committed credit lines available.

The following tables present the remaining contractual maturities of financial liabilities of the Company. The tables are prepared of the basis of undiscounted cash flows of financial liabilities.

**XY LLC****Notes to the Financial Statements**For the year ended December 31, 2012

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**4. FINANCIAL RISK MANAGEMENT (CONTINUED)****4.3 Liquidity risk (continued)****December 31, 2012**

	<b>Current, up to 1 year</b>	<b>1 to 2 years</b>	<b>2 to 5 years</b>	<b>Non-current over 5 years</b>
<b>Financial assets</b>				
Trade and other receivables	198,934	-	-	-
Receivables from related parties	134,526			
Cash and cash equivalents	55,698	-	-	-
	<b>389,158</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Financial liabilities</b>				
Trade and other liabilities	441,356			
Loans due to related parties	195,748	-	-	-
	<b>637,104</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Net gap</b>	<b>(247,946)</b>	<b>-</b>	<b>-</b>	<b>-</b>

**4. FINANCIAL RISK MANAGEMENT (CONTINUED)****4.4 Market risk**

Market risk is the risk that changes in market prices, such foreign exchanges rates and interest rates will affect Company's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposure within acceptable parameters, while optimizing the return.

*Foreign exchanges risk*

The Company operates nationally, on the territory of Republic of Kosovo and is not significantly exposed to foreign exchange risk as all transactions as of 31 December 2012 are denominated in Euro.

As a whole, the Company is not exposed to currency risk because:

- Revenue is earned in Euro
- Purchases of main assets and materials used in the Company's investments activities are denominated in Euro
- Financial assets are denominated Euro.

*Cash flow and fair value interest rate risk*

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rate. The Company's management is primarily responsible for daily monitoring of the net interest rate risk position and it sets limits to reduce the potential of interest rate mismatch. There is no interest-bearing fund borrowed from local and foreign financial institutions at the financial position date. At the same time, the Company has no significant placements of its assets in time deposits and highly liquid securities, bearing additional interest income.

	<b>December 31, 2012</b>
<b>Assets</b>	
Trade and other receivables	198,934
Receivables from related parties	134,526
Cash and cash equivalents	131
<i>With fixed interest rate</i>	
Bank balances	55,567
	<b>389,158</b>
<b>Liabilities</b>	
Non-interest bearing	
Trade and other payables	441,356
Short term loan from Xx LLC,	100,000
Interest Bearing	
Short term loan from Yy Group	92,500
	<b>633,856</b>

The interest rate sensitivity analysis is not disclosed in these financial statements as at December 31 2012 and 2011 as most of financial instruments are non-interest bearing.

**4.5 Capital risk management**

The Company's objectives when managing capital are to safeguard its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

#### **4. FINANCIAL RISK MANAGEMENT (CONTINUED)**

##### **4.6 Fair value estimation**

Fair values represent the amount at which an asset could be replaced as a liability settled on an arm's length basis. Fair values have been based on management assumptions according to the profile of the asset and liability base.

##### **4.6.1 Financial instruments presented at fair value**

The financial assets measured according to the fair value in the statement of financial position in accordance with the hierarchy of the fair value are shown in the next table. This hierarchy groups the financial assets and liabilities into three levels that are based on the significance of the incoming data used during the measurements of the fair value of the financial assets. Fair value hierarchy is as follows:

- **Level 1:** Quoted prices (not adjusted) on the active markets for identical assets or liabilities;
- **Level 2:** Other incoming data, aside from the quoted prices, included in Level 1 which are available for asset or liability observing, directly (i.e. as prices), or indirectly (i.e. made of prices) and
- **Level 3:** Incoming data on the asset or liability that are not based on data available for market observing

As of 31 December 2012 the Company had no financial assets measured at fair value.

##### **4.6.2 Financial instruments that are not presented at fair value**

The carrying amounts of financial assets and liabilities approximate to fair value, due to the short term nature of assets and liabilities.

##### **4.7 Critical accounting estimates and judgments**

In the application of the Company's accounting policies, which are described in note 3 of these financial statements, Management is required to make judgments, estimate and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from their sources. The estimated and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

##### *(i) Impairment of trade receivables*

The Company calculates impairment of trade and other receivables based on estimated losses resulting from the inability of customers to settle their obligations. The estimation is based on the aging of account receivables balance and historical write-off experience, customer credit-worthiness and changes in customer payments terms when evaluating the adequacy of the impairment loss for doubtful accounts. These involve assumptions about future customer behavior and the resulting future cash proceeds. If the financial condition of customer were to deteriorate, actual write-offs of currently existing receivables may be higher than expected and may exceed the level of the impairment losses recognized so far.

**XY LLC****Notes to the Financial Statements**

For the year ended December 31, 2012

**5. PROPERTY, PLANT AND EQUIPMENT**

	<b>Leasehold Improvements</b>	<b>Vehicles</b>	<b>Office furniture and equipment</b>	<b>Total</b>
<b>Cost:</b>			<b>EUR</b>	<b>EUR</b>
As at January 1, 2012	-	-	-	-
Additions for the year	21,198	21,644	13,785	56,627
<b>As at December 31, 2012</b>	<b>21,198</b>	<b>21,644</b>	<b>13,785</b>	<b>56,627</b>
<b>Accumulated depreciation</b>				
As at January 1, 2012	-	-	-	-
Charge for the year	(8,395)	(3,607)	(2,235)	(14,237)
<b>As at December 31, 2012</b>	<b>(8,395)</b>	<b>(3,607)</b>	<b>(2,235)</b>	<b>(14,237)</b>
<b>Net book value</b>				
<b>As at December 31, 2012</b>	<b>12,803</b>	<b>18,037</b>	<b>11,550</b>	<b>42,390</b>

**6. INVENTORIES**

	<b>As at December 31, 2012 EUR</b>
Trade goods	167,778
<b>Total</b>	<b>167,778</b>

**7. TRADE AND OTHER RECEIVABLES**

	<b>As at December 31, 2012 EUR</b>
Local debtors	198,690
VAT receivable	9,381
Other receivables	244
<b>Total</b>	<b>208,315</b>

## XY LLC

### Notes to the Financial Statements

For the year ended December 31, 2012

#### 8. RECEIVABLES FROM RELATED PARTIES

	As at December 31, 2012 EUR
Receivable from Stipo Matic	100,000
Receivable from Xx LLC,	10,000
Receivable from sales of goods Xx LLC,	24,526
<b>Total</b>	<b>134,526</b>

The balance receivable from Stipo Matic is for the period from December 31, 2012 to December 20, 2013.

There is an agreement between the Company and Xx LLC, for a loan up to EUR 50,000. Xx during the year has used only the balance of EUR 10,000. The agreement is for the period from March 1, 2012 to March 1, 2013. While the balance of EUR 24,526 relates to the sales which were made to Xx LLC, and were received subsequently on February 1, 2013 and February 13, 2013.

#### 9. CASH AND CASH EQUIVALENTS

	As at December 31,2012 EUR
Cash at banks - Current accounts	55,567
Cash on hand	131
<b>Total</b>	<b>55,698</b>

#### 10. EQUITY

At December 31, 2012 and according to the Company's business registration no. xxxxxxxx with incorporation date May 21, 2012 and registration date September 01, 2011, the total registered share capital amounts to EUR 1,000.

As of December 31, 2012 the Company is 100% owned by Yy Group, XxxYyy, XXXXX.

#### 11. TRADE AND OTHER LIABILITIES

	As at December 31, 2012 EUR
<b>Trade payables</b>	
Foreign creditors/suppliers Yy Group (related party)	245,247
Foreign creditors/suppliers Wx Group (related party)	114,247
Zy LLC (related party)	11,030
Zz LLC (related party)	500
Other foreign creditors/suppliers	27,022
Local creditors/suppliers	40,776
	<b>438,822</b>
<b>Other current payables</b>	
Accrued expenses	2,000
Pension contribution	309
Withholding tax payable	164
Other payable	224
	<b>2,697</b>
	<b>441,519</b>



## XY LLC

### Notes to the Financial Statements

For the year ended December 31, 2012

#### 12. SHORT TERM LOANS FROM RELATED PARTIES

	<b>As at December 31, 2012 EUR</b>
Short term loans from Xx LLC	100,000
Short term loan from Yy Group	92,500
Accrued interest Yy Group	3,248
Total	<u><b>195,748</b></u>

The loan in amount of EUR 100,000 has been taken from Xx LLC, and provided to Stipo Matic for the period from December 31, 2012 to December 20, 2013.

The loan from M San Grup is for the period since February 29, 2012 to February 29, 2013.

#### 13. REVENUES

	<b>Year ended December 31, 2012 EUR</b>
Revenue from sale of products	1,013,539
Discounts	(38,116)
Other income	8,716
	<u><b>984,139</b></u>

#### 14. STAFF COSTS

	<b>Year ended December 31, 2012 EUR</b>
Gross salaries, regular staff	18,676
Contract on Act	5,374
Pension contribution	934
	<u><b>24,984</b></u>

#### 15. OTHER OPERATING EXPENSES

	<b>Year ended December 31, 2012 EUR</b>
Expenses for premises	36,103
Utilities	20,052
Office material expenses	18,959
Consulting expenses	10,736
Marketing	4,648
Representation	326
Travel expenses	275
Other expenses	5,551
	<u><b>96,650</b></u>

## XY LLC

### Notes to the Financial Statements

For the year ended December 31, 2012

#### 16. INCOME TAX EXPENSE

According to the corporate income Law no 03/L-162 into force commencing on January 1, 2010, the Company is required to pay income tax at a rate of 10% on the taxable profit, as calculated in the annual Income Tax Return Statement.

	Year ended December 31, 2012
	EUR
Loss before tax	(29,560)
<i>Adjusted for tax effects of:</i>	
Non-deductible expenses	5,603
Taxable loss	<u>(23,957)</u>
<b>Tax expenses at rate of 10%</b>	<u>-</u>

#### 17. CONTINGENCIES AND COMITMENTS

##### *Litigations*

As of the Statement of financial position date, there are no provisions from potential losses recorded, regarding legal proceedings. The Management of the Company on regular basis analyses potential risks resulting from losses regarding legal proceedings. As at December 31, 2012 there were no legal proceedings.

##### *Tax inspections*

For the year ended December 31, 2012 the Company's tax books and records have not been inspected by the local tax

Authorities, the Company has followed all tax rules and regulations in calculating tax liabilities, However tax interpretations as per tax authorities may differ from those used by the Company.

#### 18. RELATED PARTY TRANSACTIONS

Parties are considered related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

During its normal course of business activities, the Company is related to the legal entities shown in the tables below. Related party's transactions are carried out on normal commercial terms and conditions and at market prices. Following table's summarizes the related party's transactions and balances as of and for the years ended December 31, 2012:

	Receivables	Liabilities	Revenues	Costs	Investments
December 31, 2012					
Xx LLC,	34,526	100,000	24,526	-	-
Yy Group	-	340,995	-	-	1,000
Wx Group	-	114,247	-	-	-
Zy LLC	-	11,030	-	-	-
Zz LLC	-	500	-	-	-
Xx Yy	100,000	-	-	-	-
<b>Total</b>	<u>134,526</u>	<u>566,772</u>	<u>24,526</u>	<u>-</u>	<u>1,000</u>

#### 19. EVENTS AFTER THE END OF THE REPORTING PERIOD

There are no significant events after the reporting date that may require adjustment or disclosure in the financial statements.