EXCERPT

FROM THE AUDIT REPORT ON 2012 ANNUAL FINANCIAL STATEMENTS

OF THE MINISTRY OF HEALTH

Audit type: General audit
Audited entity: Ministry of Health
Subject of audit: 2012 Annual financial statement
Audit duration: 120 auditing days
Collegium members: Mr Milan Dabovic, PhD, President of Senate – Head of Collegium
Mr Dragisa Pesic, member of Senate – member of Collegium
I. INTRODUCTION

1. Legal Basis

According to Article 4 of the Law on State Audit Institution ("Official Gazette of Montenegro" № 28/04, 27/06 and 17/07) and Decision passed by the Collegium of the SAI № 40113-03-40 as of 16th January 2013, the State Audit Institution of Montenegro (hereinafter: the Institution), performed the Audit of 2012 Annual Financial Report of the Ministry of Health (hereinafter: the Ministry).

The audit has been performed in accordance with the Law on State Audit Institution, the Rules of Procedure of the State Audit Institution and the Instructions on the Work Methodology of the State Audit Institution. The audit procedures have been conducted in accordance with International Standards on Auditing in the Public Sector (ISSA). These standards require that the audit is carried out in accordance with ethical requirements and plan, and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement.

2. Subject and Scope of Audit

The subject of performed audit is the Annual Financial Statement of the Ministry for 2012 and compliance of its financial operation with applicable legislation and other regulations. In accordance with Article 4 of the Rulebook on Drafting, Composing and Submitting Financial Reports on the State Budget, Extra-budgetary Funds and Local Governments, the Ministry is obliged to submit the Annual Financial Statements to the Ministry of Finance on the following Forms:

- Form 3 – Cash flow Statement
- Form 5 – Statement on outstanding liabilities
- Form 8 – Statement on the manner of spending funds submitted upon the expiry of a fiscal year
- Form 9 - Report on using current budget reserve funds

The respective audit includes the cash flows control, lawfulness in spending funds, the accuracy of reported data and the level of their disclosure, as well as the functioning of the internal control system. The coverage or the scope of audit has been set out depending on determined level of the audit materiality (significance) and identified audit risk.

3. Audit Objective

The objective of audit was to express our opinion on reliability and accuracy of the Annual financial statements of the Ministry of Health for 2012 and compliance of the operations of the audited entity with laws and regulations, as well as evaluation of the internal system of financial management and control.

According to the audit objective, the following has been examined:

- true and fairness of financial statements;
- regularity of operation, i.e. financial transactions and decisions in respect of receipts and expenditures, in order to determine whether the reported transaction was executed in accordance with the law, other regulations, given authorization and for the intended purposes;
- system of internal control.
4. **Type of Audit**

The State Audit Institution has conducted a general audit (compliance and financial audit) within the respective audit, which implies a comprehensive insight into the financial operations of the audited entity as of 31st December 2012.

5. **General Information on the Audited Entity**

The audited entity, the Ministry of Health, is the authority of the state administration, seated in Podgorica, 46, Rimski Trg. The Head of the authority is the Minister, during the audit, Assoc.Prof. Miodrag Radunovic, PhD. General information about the audited entity include the activity of the audited entity, organization and systematization of posts.

5.1 **Activity of the Audited Entity**

In accordance with the Law on State Administration, the minister shall represent the Ministry, operate and administer its work. For his/her work, for the work of the ministry, as well as for the conditions in the state administration in the field of health, the minister is responsible to the Parliament of Montenegro and to the Prime Minister. The Ministry has a Secretary. The Secretary of the Ministry coordinates the work of the organizational units within the ministry, provides the exercise of relations and cooperation with the administrative bodies in the administrative areas which it is established for and other bodies and reports to the Minister and the Government. Deputy Ministers manage and organize work in the sectors. For his/her work, the Deputy Minister is responsible to the Minister.

The Ministry of Health performs tasks of the state administration in accordance with the Law on State Administration and Regulations on State Administration Organization and Manner of Operations. In accordance with the Regulation on the organization and operations of the State Administration Ministry of Health shall carry out administrative tasks related to: drafting and managing policy in the field of health protection; health insurance and provision of health protection from public revenues; establishing and organizing medical institutions and laying down requirements regarding space, human resources and equipment of medical institutions; professional training and specialisation of medical staff and medical associates; sanitary safety of imported food-stuffs and things of common use; protection of citizens against contagious diseases; national policy in the field of production and trade of medications and medical supplies protection of citizens against tobacco products; issuing approvals for the transfer of toxins over the state border and within domestic traffic; field of poison production and trade of poison; field of production and trade of narcotics and precursors coordination and monitoring of realisation of inter-sectoral activities in the field of narcotics; management of medical waste and biologically dangerous materials; proposing, negotiating, concluding and implementing agreements and other international treaties, affairs related to international cooperation and European integrations; cooperation with international and non-governmental organisations; administrative procedure; first instance misdemeanour procedure; administrative supervision in the field for the purpose of which this Ministry has been established, as well as other affairs falling within its competence.

5.2 **Organization and Systematization of Posts**

The internal organization and systematization of the Ministry of Health is governed by the Regulation on Internal Organization and Systematization of Posts. In 2012, the applicable Regulation on Internal Organization and Systematization was № 10-2479 as of 21st July 2011, the Rulebook on Amendments to the Regulation on Internal Organization and Systematization, № 10-2479/16-2011 as of 20th February 2012 and the Regulation on Internal Organization and Systematization № 10-2991 as of 19th September 2012. The Rulebook establishes organizational units and their scope of work, name, conditions and job description and
number of employees. Carrying out tasks beyond the organizational units is provided through a Secretary of the Ministry and Advisers of the Minister. The organizational units of the Ministry, established by Regulation on Internal Organization and Systematization № 10-2479 and № 10-2479/16 -2011, include five sectors, two departments, service, the Cabinet and regional units. The number of employees is 110 civil servants and state employs, including the minister and managing officials.

Pursuant to Article 60 of the Regulation on Organization and Manner of Operation of State Administration, a new Regulation on Internal Organization and Systematization of Posts of the Ministry of Health, № 10-2991 as of 19th September 2012 was determined, which excluded the regional units of health and sanitary inspections from the internal organization of the Ministry, because these were taken over by the Administration for Inspection Affairs. By the Agreement on taking over of officers employed as health and sanitary inspectors, their employment at the Ministry is terminated as of 31st May 2012.

Regulation on Internal Organization and Systematization of Posts of the Ministry of Health № 10-2991 as of 19th September 2012, 67 posts for civil servants and state employees were systematized (categorized), by organizational units, as follows:

1. Cabinet
2. Sector of Health Protection
3. Sector for Health Management
4. Sector for Economics in Healthcare
5. Sector for Quality Control and Improvement
6. Sector for Bioethics and Pharmaceuticals and Transplantation Programmes
7. Department for Drugs
8. Department for European Integration and International Cooperation
9. General affairs Office and Finance

The audit has found that the organizational structure of the Ministry corresponds to the structure defined by the Regulation on Internal Organization and Systematization of Posts. On 1st January 2012, the Ministry employed a number of 87 persons, whereas on 31st December 2012 the total number of employees amounted to 48.

The audit procedure included the control of personnel records and employment. Pursuant to Article 10 of the Regulation on Internal Organization and Systematization of Posts, the Service for General affairs and Finance administers personnel records and other records in the field of labour, as well as activities related to the implementation of the recruitment process. By examining personnel files of the employees of the Ministry, the audit has found that the procedure in respect of employment is being conducted in compliance with the Law on Civil Servants and State Employees.

6. Audit Methods

The audit has been planned and performed in accordance with the ISSAI standards, in the manner which provides obtaining reasonable assurance about whether the financial statements are free of material misstatement and whether the operations of the audited entity is compliant with statutory requirements and other regulations. The audit involves performing audit methods and techniques in order to obtain audit evidence supporting the amounts and disclosures in the financial statements.

The audit has been performed based on sample-testing, by using analytical procedures and interviews to verify the amounts and disclosures in the financial statements. Determination of risk and materiality has been done by using Methodological guidelines of the State Audit Institution, whereas sampling has been carried out by application of the audit program IDEA.
According to the drafted Record of determining risk and materiality, № 40113-03-40/3 as of 13th February 2013, there was an inherent risk determined (Ri) at the level of 25.82% (medium risk) and risk of control (Rk) at the level of 29.00% (medium risk), i.e. the audit risk was estimated at the level of 0.34%. Materiality, i.e. estimation of the extent for tolerating misstatements in the financial statements, and that it does not significantly affect the truthfulness and objectivity thereof, was estimated to be at 1.77% or EUR 22,366.46. The sample determined at 70.16% covered the expenditure of the audited entity. We believe that the evidence obtained is sufficient, appropriate and provide a valid basis for our audit opinion.

7. The System of Records

The basic regulations governing the accounting operations of the budget users is the Law on Budget with the bylaws. There is no document that would particularly elaborate accounting policies in the Ministry (system of information, control, evaluation and reporting), and the system of accounting records of the Ministry uses a cash basis accounting, in accordance with the regulations governing the accounting operations of the budget users. The Ministry is connected to the SAP information system (the software of the State Treasury which keeps records on treasury operations).

Ministry carries out cash transactions via the Treasury Consolidated Account, using the SAP (software Treasury). The persons authorized for disposal of funds at the account 907-000000083001-41301, according to Specimen signatures issued by the Ministry of Finance - State Treasury, are: Miodrag Radunovic, the Head of the authority, Zoran Kostic, the Secretary of the Ministry, Nebojsa Todorovic, Assistant Minister in the capacity of Authorizing officer, with a single mode of signature, Jela Raonic - IV state employee and Julija Lazovic state employee IV.

The person authorized for cash withdrawals for the Ministry, as determined by a document № 10-408 as of 10th February 2012 is Lazovic Julija. Cash transactions on the basis of raising the advance were executed via a single treasury.

In the Law on Budget for 2012 and the Law on Amendments to the Law on the Budget for 2012, the Ministry, according to the organizational classification, is recorded under the code 41301, for the Programme "Administration" - 2981 and "Development, economical sustainability and health care quality improvement" - 3451.
II. OPINION, DETERMINED FACTUAL STATE AND RECOMMENDATIONS

Based on the established state of facts, and after deliberation of the audited entity's Opinion regarding the Preliminary Report on Audit of 2012 Annual Financial Statements (letter № 03-40113-40/22-9 as of 9th September 2013), and pursuant to Article 50 of the Rules of Procedure of the State Audit Institution, the competent Collegium, composed of Mr Milan Dabovic, PhD (President of Senate – Head of Collegium) and Mr Branislav Radulovic, PhD (member of Senate – member of Collegium), at its session held on 23rd September 2013, adopted the Final Audit Report on 2012 Annual Financial Statements of the Ministry of Health, and passed the following.

OPINION
WITH PROPOSAL OF RECOMMENDATIONS AND MEASURES

According to state of facts established by the audit, the competent Collegium decided to express qualified opinion, for the following reasons:

1. The audit has found that the Ministry of Health has not fully approached budget planning by analysing factual needs, in accordance with the structure of expenditure and defined purposes. The Ministry has planned budget allocations through two Programmes, but did not determine the programme indicators as a mechanism of tracking results in meeting the programme objectives. The Request for budget allocations does not present identified programme tasks, which define particular and measurable standards and actions, which the spending unit is obliged to execute during the fiscal year, in order to meet the set goal of the programme.

   • It is deemed necessary for the Ministry of Health to adopt the budget plan based on factual activities, cost analysis and realistic projections of needs and to draft a Request for budget allocations in accordance with the Instructions for the Preparation of Budgets of Spending Units, which is made by the Ministry of Finance, pursuant to Article 21 of the Law on Budget.

2. In the Statement of cash flows, the column Plan for 2012, the Ministry reported the funds in the amount of EUR 1,298,450.17, which is, in respect to the current budget (in accordance with the Law on Budget for 2012, the Law on Amendments to the Law on Budget for 2012 and executed redirection of funds), increased by EUR 46,723.82. The disclosed difference, amounting to EUR 46,723.82, appeared as a result of inconsistent application of the Law on Amendments to the Law on Budget for 2012, and thus the Ministry increased its resources by 3.95% in relation to the amount approved by the Law, and exceeded the approved amount of allocations by 1.96%. Therefore, the Ministry did not comply with Article 11 of the Law on Budget, which provides that no expenditure shall be paid out of the Treasury Consolidated Account, unless it is approved by the Law on the State Budget.

   • It is recommended to the Ministry of Health to provide a consistent application of regulations which have an impact on the use of funds approved by law.
3. In one particular case, the Ministry reallocated funds in the amount which exceeded the limit defined by law. The allocation reduced funds in the amount of EUR 28,800.00 against the account 4139 - Contracted services (Programme - Development, economic sustainability and health care quality improvement), and thus exceeded the legally defined amount by EUR 6,900.00 or by 13.15%. According to Article 35 of the Law on Budget, spending units, with the approval of Ministry of Finance, may reallocate funds among individual programmes and expenditures in the amount of 10% of the funds determined by Law on State Budget for programmes and expenses whose amount decreases.

- The Ministry is required to comply with the limits defined by Article 35 of the Law on Budget when reallocating.

4. The Ministry has opened accounts at commercial banks. The audit has confirmed that certain accounts have not been opened in accordance with Article 12 of the Law on Budget, which stipulates that the Ministry of Finance issued an order to open government bank accounts. Therefore, the requirements for carrying out financial transactions (revenue collection and payment of expenses) have not been provided in accordance with the provisions of the Law on Budget and applicable laws.

Cash transactions executed and reported by the accounts opened with commercial banks, have not been recorded in the accounting records of the Ministry, as stipulated by Article 1 and Article 6 of the Regulation on Uniform Classification of Accounts for the Budget, Extra-budgetary Funds and Budgets of Municipalities, which governs the economic classification of accounts for budget users applying cash-based or modified cash-based accounting system.

- It is recommended to the Ministry to undertake the procedure of closing bank accounts that were not opened in accordance with the applicable regulations.

- It is recommended to the Ministry to consistently follow provisions of the Law on Budget and bylaws in the procedure of opening bank accounts.

- It is recommended to the Ministry to establish keeping records of cash transactions, carried at open bank accounts, pursuant to Article 1 and Article 6 of the Regulation on Uniform Classification of Accounts for the Budget, Extra-budgetary Funds and Budgets of Municipalities.

5. The Report on outstanding liabilities, submitted by the audited entity, has not disclosed outstanding liabilities at the end of the reporting period. The Ministry does not have accounting records of the accounts of Class 2. Thus, the provisions of the Rulebook on drafting, composing and submitting financial reports on the State Budget, extra-budgetary funds and local governments, which stipulate that the figures recorded in the accounts of Class 2 - Liabilities (categories 21, 22, 23, 24, 25, 26 and 27), shall be entered in the Report on outstanding debts of Class 2. were not complied with.

- The Ministry should provide records of liabilities in the accounts of Class 2 pursuant to the Regulation on Uniform Classification of Accounts for the Budget, Extra-budgetary Funds and Budgets of Municipalities, and prepare a Report on outstanding debts in accordance with the Instructions on Filling Reports on Outstanding Liabilities.
6. The execution of the Ministry of Health budget has shown certain irregularities referring to the following:

a) Inappropriate spending of funds in the amount of EUR 33,295.48, which is not in accordance with the Regulation on Uniform Classification of Accounts for the Budget, Extra-budgetary Funds and Budgets of Municipalities. Inappropriate spending, based on tested sample, refers to the following expenditures:
   - expenditure in the amount of EUR 630.00 has been recorded as other remunerations, and it is related to the separate life allowances,
   - expenditures in the amount of EUR 31,028.38 recorded in the group of accounts 413, whereas related to the expenditure as outlined in the table on page 30 of the Report,
   - expenditure in the amount of EUR 1,637.10 EUR has been recorded as ongoing maintenance, whereas related to expenses for purchase of equipment.

b) The audit of the tested sample has found that the liabilities paid in the amount of EUR 16,273.32 does not refer to the reporting period, but the debt-creditor relationship created in the previous period.

c) Payment of expenses for other remunerations has been executed based on decisions made by the Government of Montenegro and the decision passed by the Minister of Health on composing a working team, which determined the composition and mission of the work team, as well as the obligation of submitting the Report on activities to the Government of Montenegro and the Minister of Health, but did not define a time limit for the completion of the task. The Report on the activities that working team should have developed and which presents the basis for the payment of remunerations, was not enclosed in the documentation provided to justify the expenditure and certified and approved by authorized persons, which indicates to an inadequately established system of internal controls.

d) The audit has determined that the Finance officer keeps the treasury book (journal) by chronological order following the payment of cash, but does not record the payment of cash by the type of expenditure (Eco code), which is not in accordance with Paragraph 157b of the Instruction for the State Treasury Operations.

e) The audit has examined whether the received invoices are in compliance with the contracts concluded with suppliers, preceded by public procurement procedure and the accepted bid, and two cases have been found where it has not been possible to confirm compliance with the terms of the contract regarding price, due to the manner of issuing invoices by the supplier, without specifying the elements of the calculation for the reported commitments arising from services rendered.

- In accordance with the established irregularities, it is deemed necessary for the Ministry of Health to plan budgetary spending more precisely, in order to avoid improper spending and allocations by the lines of expenditure above the approved limit. The Ministry of Health must take care of the fiscal discipline and not allow transactions without valid supporting documentation.

7. By the inspection of business documents related to engagement of persons based on temporary service contracts, it has been determined that four persons were hired on the basis of such contracts in 2012, for the duties and tasks whose posts were systematized (categorized) by the Regulation on
Systematization of Posts. This way of engagement for performing tasks determined by the Regulations is incompliant with the procedures prescribed by Articles 16 to 30a of the Law on Civil Servants and State Employees. Calculated liabilities for taxes and contributions on the basis of paid compensation. Calculation of expenses in respect of taxes and contributions were not attached with Payment Requests for net contractual compensation. Therefore, it is impossible to reliably determine compliance with the applicable laws governing this area (Law on Income Tax of Natural Persons and Law on Contributions for Mandatory Social Insurance).

- **Engagements based on temporary service contracts for carrying out tasks and duties included in the regular jurisdiction of the Ministry, envisaged by the Regulation on Internal Organization and Systematization of Posts, is not compliant with the provisions of the Law on Civil Servants and State Employees.**

8. The Ministry has started activities on the establishment and development of the system of financial management and control, in accordance with the provisions of the Law on Public Internal Financial Control System. However, activities on the establishment and implementation of the system of internal financial controls, including the adoption of the plan and methodology, internal rules and procedures for defined operational processes have not been carried out in a manner regulated by the Law on Public Internal Financial Control System and the Rulebook on the Manner and Procedure of Establishment and Implementation of Financial Management and Control, both in the planning process and in the management of funds.

It has been ascertained that the audited entity did not comply with the Instruction for the State Treasury Operations, Section III EXPENDITURE CONTROL, as it has not submitted supporting documents, confirming an obtained verification in writing that the service has been performed or goods or equipment delivered in accordance with an approved Purchase Order, along with the certified and approved Payment Requests.

- **It is recommended to the Ministry to establish a system of internal financial controls at all levels and in all processes, in accordance with the Law on Public Internal Financial Control System.**

9. The public procurements show a deviation in the application of legislation in the area of annual reporting. According to a Report on awarded public procurement contracts in 2012, the Ministry has conducted 339 procurement procedures of small value through direct agreements, totalling EUR 121,290.74. The annual value of small value procurements, executed through direct agreements, is not in accordance with Article 30, Paragraph 2 of the Public Procurement Law.

- **The Ministry is obliged to ensure the full implementation of the Public Procurement Law, which regulates the procedure of procurement of goods, services and works, with the purpose of legitimate use of budget funds, thus making the public procurement procedure transparent and cost-effective.**

- **The Ministry should undertake activities aimed at enhancing the system of public procurement, which, among other things, includes the adoption of written procedures and guidelines which will additionally defined tasks and duties of employees in the matters of public procurement, in accordance with Articles 8, 9 and 10 of the Law on Internal Financial Control System.**