Montenegro
State Audit Institution

SAI number: 40116/17-023-72
Podgorica, 17th January 2017

PERFORMANCE AUDIT
REPORT

Efficiency of internal audit in the public sector

Final report

Podgorica, January 2017
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1. GENERAL PART

1.1. Basis for audit

The legal basis for auditing the "The efficiency of internal audit in the public sector" is contained in:

- Constitution of Montenegro, Article 144 (Official Gazette of Montenegro, no. 01/07); Law on State Audit Institution, Article 4 (Official Gazette of the Republic of Montenegro, no. 28/04, 27/06, 78/06 and Official Gazette of Montenegro no. 17/07, 73/10, 40/11 and 31/14);
- The Annual Audit Plan of the State Audit Institution, adopted by the Senate on 22 December 2015 (no. 4011-06-1998);
- Decision on performance of audit of 23 March 2016 (number 40116/16-023-562) composed of: Branislav Radulović, PhD (Member of the Senate - Head of the Auditing Board) and Mr. Nikola N. Kovačević (Member of the Senate – Member of the Auditing Board).

The audit was performed in accordance with:

- The Rules of Procedure the State Audit Institution (Official Gazette of Montenegro no. 3/15);
- Instruction on the methodology of the performance audit and
- International Standards for Supreme Audit Institutions (ISSAI - level III).

The concept of public internal financial control (Public International Financial Control- PIFC) was developed by the European Commission to assist candidate countries to reform their system of internal control and management of national and EU funds, applying international standards and best practice of the EU.¹ PIFC system should provide assurance that the budget funds are spent in the "smart way"² and it is part of the negotiation chapter 32 - Financial control, which Montenegro opened in June 2014 in the process of joining the European Union.

The internal audit is an integral part of internal financial control system and is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and corporate governance.³ Internal audit in the public sector of Montenegro was established in 2004.

The public sector, at the moment of the given audit by the SAI, was not fully covered by the internal audit function in accordance with the applicable

¹ Welcome to the world of PIFC; European Commission, page 1.
² Welcome to the world of PIFC; European Commission, page 3.
³ Definition of the International Institute of Internal Auditors (IIA).
legal framework, due to the fact that it had not been established in all authorities or it had been established but not in sufficient functional form.

**Figure 1:** Overview of public sector entities which, in accordance with the applicable legal framework, were obliged to establish internal audit according to the records of the Ministry of Finance from June 2016

Regardless of the fact that the independent regulatory bodies, joint stock companies and other legal entities in which the state or municipalities have a controlling stake are also considered as the public sector, in addition to budget beneficiaries and municipalities, there is no accurate and up to date record of the establishment of internal audit in these entities.

According the data of the Ministry of Finance at the end of 2015, out of 35 budget beneficiaries, at the central and local government level, which have established an independent internal audit unit only 20% employs three or more auditors, as established by the Law and represents a minimum for effective and functional internal audit. Three internal auditors is a minimum in accordance with the Law.

The European Commission states in the Progress Report on Montenegro for 2015 that “the state of the capacity of the internal audit in the public sector is a reason for concern. The majority of public sector institutions, which in accordance with the law were required to establish an internal audit unit had done so but there are still institutions which in established units have no employees. Progress has been made in the certification or 75% of internal auditors are authorized, in accordance with national or International certification framework.”

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4 The consolidated report on the system of internal financial controls in the public sector of Montenegro for 2015, which the Ministry of Finance submits to the Government of Montenegro and the register of the Ministry of Finance (CHU), which applies to public companies.

5 Article 2 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).

6 Consolidated Report on the system of internal financial controls in the public sector for 2015.

7 Law on the System of Internal Financial Controls in the Public Sector.

8 Article 18 of the Law on the System of Internal Financial Controls in the Public Sector.

9 Page 74 of the Report.
SIGMA\textsuperscript{10} in the Principles of the Public Administration for 2015 states that “the legal framework for the internal audit functioning has been established but also that there are persistent weaknesses relating to the implementation of the legal framework. The level of the established operational framework and the quality of reports of internal audit is determined at the level of two out of the total of five.”\textsuperscript{11}

1.2. The audit objective

The audit process was to determine whether the audited entities, which had established independent internal audit units, created the necessary conditions for independent and objective functioning of the internal audit and the provision of advisory activities. That is, whether internal auditors conduct the internal audit process in accordance with the international standards, code of ethics, methodology of the Ministry of Finance and contributes to improving the system of operation.\textsuperscript{12}

In the audit process it was necessary to answer the main audit question:

**Have the users of the budget taken necessary measures and actions to ensure the effective functioning of the internal audit units?**

In order to obtain an answer to the main question of the audit it was necessary to answer the following audit sub-questions:

1. Has an appropriate system of planning been established?
2. Have the necessary conditions for performing internal audit been created?
3. Has an accurate and timely reporting system been established?
4. Has an appropriate system for monitoring the implementation of recommendations been established?

1.3. Scope and limitations

The audit included the users of budget funds, at the central and local government level, which had established, in accordance with the Law on the Public Internal Financial Control System\textsuperscript{13}, the separate organizational units for internal audit and which conduct the procedure of internal audit with other budget beneficiaries according to the signed agreements on assignment of activities of internal audit.

\textsuperscript{10} SIGMA (Support for Improvement in Governance and Management) is a joint initiative of the OECD and Europian Union.


\textsuperscript{12} Internal audit in the public sector requires: organizational independence; formal mandate; unlimited access; sufficient financial resources; professional managers, professional and objective internal auditors, the support of stakeholders and professional auditing standards - Supplemental Guidance: The Role of auditing in Public Sector Governance, 2nd Edition: The Institute of Internal Auditors (IIA), January 2012; page 8.

\textsuperscript{13} Official Gazette of Montenegro, no. 73/08...34/14.
The criterion for selection of the budget beneficiaries in the sample was the amount of allocated budget funds and the number of employed internal auditors. Local self-government units were determined in the sample according to the regional principle and the amount of the municipal budget.

The audit procedure covered 11 entities, at the central and local government level, and those are:

- Ministry of Finance;
- Ministry of Education;
- Ministry of Culture;
- Ministry of Economy;
- Ministry of Agriculture and Rural Development;
- Ministry for Information Society and Telecommunications;
- Pension Fund of Montenegro;
- University of Montenegro;
- The Capital City - Podgorica;
- Municipality of Nikšić;
- Municipality of Berane.

The audit covered the period 2014-2015.

1.4. Audit criteria

Planning of internal audit includes the development and adoption of a strategic plan, annual plan and individual audit plan. As a criterion for evaluating the planning of internal audit, the percentage of execution of planned activities, at the level of each internal audit unit, was used.

Internal audit is performed in accordance with international standards of internal audit, and international standards of the Institute of Internal Auditors (IIA) 14, the law and regulations, methodologies, guidelines and instructions which are established by the regulation of the Ministry of Finance and the Code of Ethics of the Institute of Internal Auditors (IIA). Therefore, those were used as a criterion for evaluating the process of performing internal audit.

The process of performing internal audit was assessed in terms of sufficiency and human resources capacity of the internal auditors, whereby as the criteria for assessment statutory requirement on the minimum number of internal auditors and requirements for performing tasks of the internal auditor were used. In addition, as a criterion for evaluation of staff capacity, the mandatory certification of internal auditors in the public sector and continuing education, according to the registers of the Ministry of Finance, was used.

14 The purpose of Standards is to: 1) describe the basic principles that represent the practice of internal audit; 2) provide a framework for performing and promoting a broad spectrum for adding value through internal audit; 3) determine the basis for assessment of the effectiveness of internal audit and 4) improve the processes and operations of the organization - the International Standards for the Professional Practice of Internal Audit, Introduction to international standards (www.theiia.org).
The process of reporting was assessed in terms of completeness, accuracy and timeliness of reports which the internal audit unit submits to the Head of the entity and to the Ministry of Finance.

The criteria for assessing implementation of the recommendations from the report of the internal audit was: number of recommendations which have not been agreed with the Head of the entity, number of implemented recommendations, the number of unimplemented recommendations and the percentage of implementation of the recommendations from the report of the internal audit for each unit separately, and their mutual comparison.

1.5. Sources of information and methods of data collection

The primary source of information during the audit was the documentation of budget beneficiaries that were included in the sample, as follows: strategic plans, annual plans, individual audit plans, internal audit reports, the registry of recommendations, reports that the Head of Internal Audit Unit submits to the Head of the entity (annual report on the work of internal audit and assessment of the adequacy and effectiveness of financial management and control, a report on the restrictions set forth to the Head of Internal Audit Unit and internal auditors in the performance of the audit, a report on the adequacy of resources for performance of internal audit, report on the results of each individual audit with all major findings and recommendations for improving the operations of the entity, periodic reports on the implementation of the annual internal audit plan), reports which are submitted by budget beneficiaries to the Central Harmonization Unit, etc.

Then, general acts of the audited entities: regulations on internal organization and job classification of the Internal Audit Unit, the decision on the allocation of internal auditors, training plans for internal audit, registries of trainings for internal auditors and so on.

The primary source of information was the documentation of the Ministry of Finance (CHU), which refers to: continuous professional training for authorized internal auditors, keeping of registers (internal audit units, charters, agreements on delegation of internal audit tasks, authorized internal auditors). Then, consolidated reports on the system of internal financial controls that the Ministry of Finance (CHU) submits to the Government and the conclusions of the Government relating to the internal audit area. In addition, the audit also covered the documentation of the Human Resources Agency concerning the recruitment procedure of internal auditors in the period 2014-2015.

Additional information during the audit were provided by means of the analysis of the Strategy of further development of financial control in the public sector (PIFC) in Montenegro for the period 2013-2017, action plans, internal audit manuals. Then, the International Standards of the Institute of Internal Auditors (IIA), the Code of Ethics, a document of the European Commission, etc.
1.6. Time of performing the audit

The audit was performed in the period from 23rd May to 30th November 2016.

The audit was conducted by the audit team of the SAI, consisting of:

- Blažo Savković, State Auditor – Head,
- Ivana Jovanović, Msc, State Auditor – Head of the Department,
- Dragan Radenović, Senior Associate in the audit.

2. INTERNAL AUDIT IN THE PUBLIC SECTOR

2.1. Development of the internal audit

The development of internal audit in the public sector of Montenegro is divided into two phases. The first phase covers the period 2004-2008, when the internal audit, in accordance with the Instruction on the manner and procedure of performance of internal audit in spending units, extra-budgetary funds and municipalities was performed in the centralized manner by the Department of Internal Audit of the Ministry of Finance. The current Law on the System of Internal Financial Controls in the Public Sector from December 2008 introduced a decentralized system of internal audit in the public sector and stipulated obligation that all users of the Budget of Montenegro, municipal budgets, state funds, independent regulatory bodies, shareholders companies and other legal entities in which the state or municipalities have a controlling stake establish internal audit in some of the ways envisaged by the Law. Internal audit in the public sector can be established in one of the following ways:

1. By organizing an independent organizational Internal Audit Unit within the entity, which is directly responsible to the Head of the entity. An independent organizational unit for internal audit in the public sector of Montenegro shall be obligatory to establish for 15 entities at the central level and 15 entities at the local level.
2. All the other public sector entities are obliged to ensure the performance of internal audit by organizing an independent organizational Internal Audit Unit or by performing internal audit by the internal audit unit of another entity, on the basis of the agreement and with the prior approval of the Ministry of Finance.

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15 Official Gazette of the Republic of Montenegro, no. 53/04.
16 Article 2 of the Instructions.
17 Official Gazette of Montenegro, no. 73/08.
18 the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
19 Decree on the Establishment of Internal Audit in the Public Sector (Official Gazette of Montenegro, no. 50/12).
20 Article 18 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
Central Harmonization Unit (CHU)\(^{21}\) of the Ministry of Finance coordinates the establishment and development of internal audit units in the public sector. That is, CHU, among other things, performs tasks related to: development of methodology for internal audit; preparation, organization and implementation of training programs for the exam for Authorized Internal auditor; implementation of activities in the field of continuous professional training of authorized internal auditors; keeping records of the Internal Audit Units, charters and authorized internal auditors, reviewing the quality of internal audit.\(^{22}\)

More intensive development of internal audit in the public sector was achieved after 2010, since when a higher level of coverage of budgetary resources was achieved by the function of internal audit, made amendments to the Law on Internal Financial Controls and adopted set of by-laws which further regulate the area of internal audit in the public sector. The current legislation in the field of internal audit includes:

- Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14);
- Decree on the Establishment of Internal Audit in the Public Sector (Official Gazette of Montenegro, no. 50/12);
- Decree on Titles of Internal Auditors in the Public Sector and Arrangements into Salary Grades (Official Gazette of Montenegro, no. 36/16);
- Rulebook on the Manner and Procedure of Work of Internal Audit (Official Gazette of Montenegro, no. 32/09);
- Rulebook on Programme and Manner of Taking the Exam for Authorized Internal Auditor in the Public Sector (Official Gazette of Montenegro, no. 30/15);
- Rulebook on the Methodology of reviewing the quality of internal audit in the public sector ("Off. Gazette of Montenegro, no. 11/13);
- Rulebook on the Manner and Deadlines for Keeping Audit Documentation (Official Gazette of Montenegro, no. 29/13);
- Instruction on Content of Report and Manner of Reporting on the Work of Internal Audit (Official Gazette of Montenegro, No. 55/12);
- Instruction on Continuous Professional Development of Authorized Internal Auditors in the Public Sector (number: 05-814/1 of 25 January 2016).

2.2. Internal audit at the central government level

By means of the Decree on the Establishment of Internal Audit in the Public Sector\(^{23}\) the Government of Montenegro determined in October 2012 15 budget beneficiaries, which were obliged to establish an independent organizational unit for internal audit. All 15 budget beneficiaries have

\(^{21}\) Directorate for Central Harmonization in accordance with the current Rulebook on internal organization and systematization of the Ministry of Finance.

\(^{22}\) Article 38 of the Law on the System of Internal Financial Controls in Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).

\(^{23}\) Official Gazette of Montenegro, no. 050/12.
established an independent unit for internal audit, and 14 of them conducted employment of internal auditors.

- Employment of internal auditors, by the end of 2015, was not completed by the Ministry of Justice contrary to the Conclusions of the Government of Montenegro from 2014 and 2015 on the basis of which it was obliged to undertake activities in respect of filling the vacancies for internal auditors.

Other beneficiaries of the budget, which are not required to form an independent unit for internal audit in accordance with the Decree, are obliged to provide functioning of the internal audit in one of the following ways: by organizing an independent organizational internal audit unit within the entity or by the performance of internal audit by internal audit unit of another entity, on the basis of the signed agreement. Other beneficiaries of the budget on the basis of the Conclusions of the Government of Montenegro from 2014 and 2015, are additionally tasked to ensure the performance of the internal audit function in one of the methods prescribed by the Law.

- According to the data of the Ministry of Finance (CHU), at the end of 2015, 53% of the budget beneficiaries had the established unit for internal audit, in one of the ways provided by the Law, and 47% of the budget beneficiaries did not ensure internal audit functioning, although it was in obligation to do so, in accordance with the Law and mentioned Conclusions of the Government from 2014 and 2015.

Presented in the amount of budgetary funds, which were allocated to the beneficiaries of the budget in 2016, 96% (2,041,142,528.19€) of the total budget funds is covered with the function of internal audit or for 4% (84,473,348.65€) there is no competence for performance of internal audit.

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25 According to the Conclusion of the Government of Montenegro, No. 08-86/3 of 4 July 2014, Item 7 all budget beneficiaries are tasked to undertake activities to fill the vacancies for the internal auditors, in accordance with the Law on the System of Internal Financial Controls, and to inform the Ministry of Finance on this matter. According to the Conclusion of the Government of Montenegro No. 08-1328 of 25 June 2015, Item 7 the Ministry of Justice is tasked to undertake activities to fill the vacancies for the internal auditors, in accordance with the Law on the System of Internal Financial Controls, and to inform the Ministry of Finance on this matter.


27 Law on the Budget of Montenegro for 2016.

Figure 2: Overview of the establishment of internal audit at the central level

Table 1: The beneficiaries of the budget that contrary to the conclusions of the Government of Montenegro from 2014 and 2015 have not provided the functioning of internal audit

<table>
<thead>
<tr>
<th>O/N</th>
<th>Name of the budget beneficiaries</th>
<th>Amount of the budget in 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Ministry of Justice</td>
<td>9,920,441.90€</td>
</tr>
<tr>
<td>2.</td>
<td><strong>Property Administration</strong></td>
<td><strong>20,180,993.11€</strong></td>
</tr>
<tr>
<td>3.</td>
<td>President of Montenegro</td>
<td>871,496.15€</td>
</tr>
<tr>
<td>4.</td>
<td>State Election Commission</td>
<td>1,894,711.48€</td>
</tr>
<tr>
<td>5.</td>
<td>Funds for the Work of Parliamentary Parties</td>
<td>4,635,340.62€</td>
</tr>
<tr>
<td>6.</td>
<td>Funding for Civilian Control of Police</td>
<td>37,420.00€</td>
</tr>
<tr>
<td>7.</td>
<td>Cetinje Parliamentary Forum</td>
<td>42,460.00€</td>
</tr>
<tr>
<td>8.</td>
<td>Prosecutors Offices</td>
<td>7,614,982.04€</td>
</tr>
<tr>
<td>9.</td>
<td>Centre for Training in the Judiciary and State Prosecution</td>
<td>399,724.00€</td>
</tr>
<tr>
<td>10.</td>
<td>Council for Privatization and Capital Projects</td>
<td>1,835,587.83€</td>
</tr>
<tr>
<td>11.</td>
<td>Montenegrin Investment Promotion Agency</td>
<td>120,000.00€</td>
</tr>
<tr>
<td>12.</td>
<td>Fund for Solidarity Housing</td>
<td>500,000.00€</td>
</tr>
<tr>
<td>13.</td>
<td>Commission for Concessions</td>
<td>51,225.00€</td>
</tr>
<tr>
<td>14.</td>
<td>Official Gazette of Montenegro</td>
<td>59,500.00€</td>
</tr>
<tr>
<td>15.</td>
<td>Council for Regulatory Reform and Business Environment Improvement</td>
<td>43,561.20€</td>
</tr>
<tr>
<td>16.</td>
<td>Commission for Allocation of Funds to NGOs</td>
<td>200,000.00€</td>
</tr>
<tr>
<td>17.</td>
<td>Council for Membership in NATO</td>
<td>200,000.00€</td>
</tr>
<tr>
<td>18.</td>
<td>Office for Cooperation with Non-Governmentan</td>
<td>59,400.00€</td>
</tr>
</tbody>
</table>

Source: Consolidated report on the system of internal financial controls in the public sector of Montenegro for 2015; Ministry of Finance, June 2016.
<table>
<thead>
<tr>
<th>Organizations</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>19. Commission for Allocation of Revenue from Games of Chance</td>
<td>3,129,477.27€</td>
</tr>
<tr>
<td>20. Commission for the Control of State Aid</td>
<td>13,199.00€</td>
</tr>
<tr>
<td>21. Faculty for Montenegrin Language and Literature</td>
<td>597,927.18€</td>
</tr>
<tr>
<td>22. Centre for Vocational Education</td>
<td>633,182.04€</td>
</tr>
<tr>
<td>23. National Archives</td>
<td>1,850,923.12€</td>
</tr>
<tr>
<td>24. National Library &quot;Đurđe Crnojević&quot;</td>
<td>1,238,095.54€</td>
</tr>
<tr>
<td>25. Natural History Museum of Montenegro</td>
<td>446,203.57€</td>
</tr>
<tr>
<td>26. Montenegrin Film Library</td>
<td>187,486.57€</td>
</tr>
<tr>
<td>27. Music Centre of Montenegro</td>
<td>1,634,288.53€</td>
</tr>
<tr>
<td>28. Library for the Blind of Montenegro</td>
<td>221,464.92€</td>
</tr>
<tr>
<td>29. PI National Museum of Montenegro</td>
<td>2,217,423.18€</td>
</tr>
<tr>
<td>31. Contemporary Art Centre of Montenegro</td>
<td>630,610.38€</td>
</tr>
<tr>
<td>32. Centre for Conservation and Archaeology of Montenegro</td>
<td>831,964.87€</td>
</tr>
<tr>
<td>33. PI Film Centre of Montenegro</td>
<td>37,340.00€</td>
</tr>
<tr>
<td>34. Directorate for Hydrocarbons</td>
<td>79,080.00€</td>
</tr>
<tr>
<td>35. Commission for the Investigation of Accidents</td>
<td>43,967.00€</td>
</tr>
<tr>
<td>36. Centre for Development and Preservation of the Culture of Minorities in Montenegro</td>
<td>281,418.28€</td>
</tr>
<tr>
<td>37. National Councils</td>
<td>300,000.00€</td>
</tr>
<tr>
<td>38. Grants to Municipalities</td>
<td>198,000.00€</td>
</tr>
<tr>
<td>39. Union of Associations of Veterans</td>
<td>110,000.00€</td>
</tr>
<tr>
<td>40. Matica crnogorska</td>
<td>240,000.00€</td>
</tr>
<tr>
<td>41. Agency for Protection of Personal Data and Free Access to Information</td>
<td>634,071.36€</td>
</tr>
<tr>
<td>42. Senate of Royal Capital</td>
<td>97,000.00€</td>
</tr>
<tr>
<td>43. Foundation Petrović Njegoš</td>
<td>466,666.00€</td>
</tr>
<tr>
<td>44. Audit Authority</td>
<td>492,866.95€</td>
</tr>
<tr>
<td>45. <strong>PE Radio and Television of Montenegro</strong></td>
<td><strong>14,211,000.00€</strong></td>
</tr>
<tr>
<td>46. Regional Centre for Underwater Demining, Assistance, Rescue and Control at Sea</td>
<td>319,420.96€</td>
</tr>
<tr>
<td>47. Agency for the Prevention of Corruption</td>
<td>1,541,713.54€</td>
</tr>
</tbody>
</table>

Out of the total amount of budget funds which are not included in the internal audit 41% refers to **Property Administration**, whose budget in 2016 amounted to 20,180,993.11€ and **PE Radio and Television of Montenegro**, which was allocated in 2016 budget funds in the amount of 14,211,000.00€.

During the audit an internal audit in the Prosecutor's Office was established and a Junior Internal Auditor was employed and State Archives entrusted internal audit to the Department of Internal Audit of the Ministry of Culture.

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30 Decision of the Prosecutorial Council number 01-4145-1/16 of 16 August 2016.  
31 Agreement on delegation of internal audit number Ministry of Finance No. 05-15049 of 30 September 2016.
According to the data of the Ministry of Finance, at the end of 2015 only 10% of budget beneficiaries at the central level, who have formed an independent unit for internal audit employed three or more of internal auditors and met the minimum prescribed by the Law\(^ {32}\), in respect of the number of internal auditors in the units for internal audit.\(^ {33}\)

### 2.3. Internal audit at the local level

Establishment of an independent organizational unit for internal audit is obligatory for municipalities which have more than 10,000 inhabitants or 15 municipalities in Montenegro, in accordance with the results of the population census in 2011.\(^ {34}\) Out of 15 municipalities, which in accordance with the Decree on Establishment of Internal Audit in Public Sector\(^ {35}\) were obliged to establish independent unit for internal audit, it was formed by 14 of them.

- According the data of the Ministry of Finance at the end of 2015, the Municipality of Ulcinj did not form unit for internal audit although it was obliged to do so in accordance with the current Decree.

Municipality of Ulcinj was additionally tasked by the Conclusions of the Government from 2014 and 2015\(^ {36}\) to establish an independent organizational unit for internal audit, to systematize job positions for that unit and to determine the number of employees\(^ {37}\), by means of an act on organization and manner of work of local government.

Out of 15 municipalities which were obliged to establish unit for internal audit, 13 completed the employment of internal auditors.

- According to the data of the Ministry of Finance, at the end of 2015, Municipalities of Budva and Plav did not employ internal auditors in accordance with the Law, although they were additionally tasked with Conclusions of the Government from 2014 and 2015 to do that.\(^ {38}\)

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\(^ {32}\) The Internal Audit Unit can not have less than three internal auditors with the Head of Internal Audit Unit - Article 18 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 073/08 ... 034/14).

\(^ {33}\) According to the data of the Ministry of Finance, at the end of 2015, an independent unit for internal audit was established by 21 budget beneficiaries at the central level. The minimum stipulated by the Law, in the part of the arranged Internal Auditors in the internal audit units, was met by the two ministries- the Ministry of Finance and the Ministry of Sustainable Development and Tourism.

\(^ {34}\) Article 3 of the Decree on the Establishment of Internal Audit in the Public Sector (Official Gazette of Montenegro, no. 50/12).

\(^ {35}\) Official Gazette of Montenegro, no. 50/12.


\(^ {37}\) Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).

Remaining municipalities which are not covered by the Decree, according to the current legal framework, are required to establish the internal audit units by organizing an independent internal audit unit within the entity or by the performance of internal audit by the internal audit unit of another entity, on the basis of an agreement with the prior approval of the Ministry of Finance.

According to the data of the Ministry of Finance, at the end of 2015, 78% of the municipalities in Montenegro had established internal audit in one of the ways provided by the Law.\textsuperscript{39}

\textbf{Figure 3: Overview of establishment of internal audit at the local level}

- Municipality of Budva, Municipality of Plav, Municipality of Ulcinj, Municipality of Kolašin, Municipality of Andrijevica, Municipality of Gusinje and Municipality of Petnjica did not provide functioning of the internal audit in accordance with the Law and Conclusions of the Government from 2014 and 2015.

According the data of the Ministry of Finance, at the end of 2015, out of 14 municipalities which had established an independent unit for internal audit in 5 municipalities\textsuperscript{40} or 36% of them met the minimum provided by the Law, in the part of the minimum number of internal auditors.\textsuperscript{41}

2.4. Internal Audit at other public sector entities

The obligation of establishing internal audit in one of the ways provided by the Law\textsuperscript{42}, other than beneficiaries of the budget of Montenegro

\textsuperscript{39} Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).

\textsuperscript{40} Capital City of Podgorica, Municipality of Berane, Municipality of Nikšić, Municipality of Rožaje and Municipality of Herceg Novi.

\textsuperscript{41} Unit for internal audit can not have less than three Internal Auditors with the Head of the Internal Audit Unit – Article 18 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 073/08 ...034/14).

\textsuperscript{42} Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
and municipalities, refers to independent regulatory bodies, joint stock companies and other legal entities in which the state or municipalities have a controlling stake.\textsuperscript{43}

The Government of Montenegro tasked with the Conclusion from April 2015\textsuperscript{44} the budget beneficiaries at the central level and entities in which the state holds a majority stake to take activities on the establishment of the internal audit function, not later than 31 May 2015. That is, it tasked the budget beneficiaries at central level and entities in which the state holds a majority stake to undertake activities on the filling of systematized working positions for internal auditors, in accordance with the Law on the System of Internal Financial Controls in the Public Sector.

According to the declaration of the Ministry of Finance, which was delivered in the audit procedure \textit{“The Ministry is not obliged to keep registers of the internal audit units, internal audit charters, authorized internal auditors for independent regulatory bodies, joint stock companies and other legal entities in which the state or municipalities have a controlling stake?”} \textsuperscript{45}

However, in order to implement the Conclusion of the Government from April 2015, the Ministry sent a letter to 39 legal entities in which the state holds a majority stake. Reply was submitted by 16 legal entities while 23 did not provide the answer.

\begin{center}
\textbf{Table 2: Public enterprises, joint stock companies and other legal entities that have submitted a response to the Ministry of Finance regarding the Conclusion of the Government number 08-57 of 30 April 2015}
\end{center}

<table>
<thead>
<tr>
<th>O/N</th>
<th>Public enterprise/Institution</th>
<th>Established unit for internal audit</th>
<th>Signed an agreement on entrusting the internal audit activities</th>
<th>Number of auditors</th>
<th>Do not have established internal audit</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Railway Infrastructure JSC Podgorica</td>
<td>x</td>
<td></td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Railway Vehicle Maintenance JSC Podgorica</td>
<td>x</td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Montenegro Airlines</td>
<td>x</td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Elektroprivreda AD Nikšić (EPCG)</td>
<td>x</td>
<td></td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>PI Centre for Eco-Toxicological Research</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>PE Coastal Zone Management</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Monteput</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Procon Ltd Podgorica</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Energy Regulatory Agency</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Montenegrin Transmission System JSC Podgorica</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>11</td>
<td>Bar Navigation JSC</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

\textsuperscript{43} Article 2 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).

\textsuperscript{44} Conclusion of the Government of Montenegro number: 08-57 of 30 April 2015

\textsuperscript{45} In the declaration the Ministry of Finance states: “Article 32 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14) stipulates that independent regulatory bodies, joint stock companies and other legal entities in which the state or municipalities have a controlling stake are not obliged to report to the Central Harmonization Unit of the Ministry of Finance.”
Considering the above, the audit found that there is no comprehensive register of independent regulatory bodies, joint stock companies and other legal entities in which the state or municipalities have a majority stake, and which are in accordance with the Law\(^{46}\) obliged to establish internal audit. Also, based on the records of the Ministry of Finance and their declaration that was submitted during the audit process it was not possible to determine to what extent the Conclusion of the Government from April 2015 had been realized.

2.5. Audit sample

The audit procedure covered 11 entities, 8 at the central government level and 3 at the local level, which have established an independent internal audit unit and which on the basis of the signed agreements on entrusting the activities of internal audit perform the audit of other entities.

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\(^{46}\) Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
The following table provides an overview of consumer units that were included in the audit, the number of employed internal auditors in the internal audit units at the time of performance of the audit, the number of signed agreements on entrusting the activities of internal audit and the amount of budget funds covered by the internal audit function.

<table>
<thead>
<tr>
<th>Name of the budget beneficiary</th>
<th>Number of Internal Auditors</th>
<th>Number of the signed agreements on entrusting the activities of internal audit</th>
<th>Amount of the budget funds which are covered by the internal audit in 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ministry of Finance(^{48})</td>
<td>6</td>
<td>18</td>
<td>549,487,444.86€</td>
</tr>
<tr>
<td>Pension Fund of Montenegro (PIO)</td>
<td>2</td>
<td></td>
<td>420,168,880.66€</td>
</tr>
<tr>
<td>Ministry of Education(^{49})</td>
<td>3</td>
<td>2</td>
<td>145,328,117.25€</td>
</tr>
<tr>
<td>Ministry of Agriculture and Rural Development</td>
<td>2</td>
<td></td>
<td>28,112,649.90€</td>
</tr>
<tr>
<td>University of Montenegro(^{50})</td>
<td>1</td>
<td></td>
<td>31,773,237.27€</td>
</tr>
<tr>
<td>Ministry of Economy(^{51})</td>
<td>1</td>
<td>5</td>
<td>8,275,023.40€</td>
</tr>
<tr>
<td>Ministry of Culture(^{52})</td>
<td>2</td>
<td>1</td>
<td>8,095,731.62€</td>
</tr>
</tbody>
</table>

\(^{47}\) Amount of budget funds includes funds of the spending unit that has established internal audit unit and the means of spending units in which the audit is performed on the basis of the signed agreement on entrusting the activities of internal audit.

\(^{48}\) The Ministry of Finance has signed 18 agreements on entrusting activities of internal audit, with: Secretariat for Legislation, Secretariat General of the Government, Administration for Prevention of Money Laundering and Terrorist Financing, Compensation Fund, Public Procurement Office, Protector of Property Law Interests of Montenegro, Ministry of Health, Statistical Office, Commission for Public Procurement, Agency for Peaceful Settlement of Labor Disputes, Police Academy, Mediation Centre, Directorate for Youth and Sport, Fund for the Protection and Realization of Minority Rights, Constitutional Court, Ministry of Science, Protector of Human Rights and Freedoms and with the Regulatory Agency for Energy (whose annual budget is not included because it does not represent budget beneficiaries in accordance with the Budget Law for 2016. The Ministry of Finance shall audit the financial transactions of expenditures and budget reserves.

\(^{49}\) The Ministry of Education has signed the agreement on entrusting the activities of internal audit with the Institute for Education and Examination Center.

\(^{50}\) The Budget for 2016 allocated the University of Montenegro budget funds in the amount of 16,857,228.10€. The amount of 31,773,237.27€ represents the amount of total expenditures from the Financial Plan of the University of Montenegro for 2016 (fifth rebalancing) July 2016.

\(^{51}\) The Ministry of Economy has signed the agreement on entrusting the activities of internal audit with the Intellectual Property Office, Bureau of Metrology, Directorate for Protection of Competition, the Secretariat for Development Projects and the PI Institute for Geological Research.

\(^{52}\) The Ministry of Culture has signed the agreement on entrusting the activities of internal audit with the Montenegrin Academy of Science and Arts.
3. **AUDIT FINDINGS**

3.1. Independence and objectivity of the internal audit

According to international standards of internal audit of the Institute of Internal Auditors (IIA) internal audit must be independent and objective, and internal auditors must be objective in the exercise of their duties.

Independence means the absence of conditions that threaten the ability of the internal audit or the Chief Executive Officer to carry out internal audit activities in an impartial manner. Threats to independence must be dealt with at the level of individual Auditor or at the organizational level. Objectivity requires the Internal Auditors not to subordinate their assessment in audit matters to other entities assessments. Violation of objectivity must be managed at the level of individual Auditor and engagement, as well as the individual functional and organizational level.

The principle of the independence and objectivity of the internal audit are incorporated in the provisions of the Law on the System of Internal Financial Controls in the Public Sector, which stipulates that the internal audit unit must be functionally and organizationally independent from other organizational units of the entity. Functional independence is achieved by independent planning, implementation and reporting of completed internal.

- In the process of performing the audit in 8 out of 11 entities irregularities were found that have or may have an impact on the independence and objectivity of the performance of internal audit in the public sector.

The established irregularities that may affect the realization of the **principle of independence** of the internal audit relate to the

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53 Municipality of Nikšić signed the agreement on entrusting the activities of internal audit with the Municipality of Šavnik and Municipality of Plužine.
55 Standard 1100 – independence and objectivity.
56 Article 20 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
57 Independence can be generally defined as freedom from dependent impact and the impact of control by any person, organization and country – 5.1. INTOSAI GOV 9140- Internal Audit Independence in Public Sector.
establishment of a legal framework for the operation of the internal audit units and the creation of formal conditions for its functioning.

The Pension Fund (PIO) did not provide the organizational separation of the internal audit unit from other organizational units of the entity. Rulebook on Internal Organization and Systematization of the Pension Fund the Department of Internal Audit is an integral part of the Department for Legal Assistance in the process of exercising the right to pension and disability insurance and internal audit. Therefore, the internal audit unit is not, in accordance with Article 18 of the Law on the System of Internal Financial Controls in the Public Sector, directly responsible to the Head of the entity.

The Director of the Pension Fund, who as the Head of the entity is responsible for the signing of an internal audit charter, had not signed it with the Head of Internal Audit Unit until the moment of performance of the audit. It is necessary that the Head of the entity approves and signs the internal audit charter so that the internal auditors would start performing the audit. Internal audit charter is a formal document that defines the purpose, authority and responsibility of the internal audit. Internal audit charter establishes the position of internal audit in the organization defines access to records, employees and physical assets that are important for the conduct of audits and defines the scope of internal audit activities.

Director of the Pension Fund in January 2014 authorized the Assistant Director for legal assistance in the process of exercising the right to pension and disability insurance and internal audit - the internal auditor to carry out tasks under the responsibility of the Assistant Director for the realization of pension and disability insurance. The aforementioned authorization is contrary to Article 20 of the Law on the System of Internal Financial Controls which stipulates the conditions for achieving the independence of internal audit, and according to which the Head of Internal Audit Unit and the internal auditors may perform only activities of internal audit.

University of Montenegro did not ensure functional independence to the Internal Audit Unit which is exercised by independent planning, implementation and reporting of the performed internal audits, in accordance with international standards and Law. That is, the Statute of the University of Montenegro has established that the Steering Board of the University determines by a general act type, scope and timetable for the performance audit.

The above provision of the Statute of the University of Montenegro is contrary to international standards for internal audit which determined that the Head of Unit for Internal Audit must define plans based on risk in order to identify priority areas of internal audit, which are consistent with the

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58 Paragraph 2 Article 19 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
59 Charter of Internal Audit number:01-2540 of 16 September 2016.
60 Instructions on the establishment and functioning of internal audit with beneficiaries of the budget of Montenegro and municipal budgets; Ministry of Finance, May 2015.
61 Interpretation of the standard 1000- Purpose, competence and responsibility.
62 Authorization number: 01-57/2 of 13 January 2014.
63 Article 161 of the Statute of the University of Montenegro.
goals of the organization. The Head of Internal Audit Unit is responsible for development of a plan based on the risk assessment, while taking into account the environment of organizational management including usage of the level of risk preferences determined by management for a variety of activities and parts of the organization. If such a framework does not exist, the Head of Internal Audit Unit uses his assessment of risks after consultation with senior management and the Board.

The above mentioned provision of the Statute of the University of Montenegro is contrary also to the Law on the System of Internal Financial Controls in the Public Sector, which stipulates that strategic and annual plan of performance of internal audit is developed by the Head of Internal Audit Unit on the basis of objective risk assessment, and those are approved by the Head of the entity.

Ministry of Education did not timely revise the charter of internal audit in accordance with the guidelines of the Ministry of Finance. The revision of the charter is particularly significant when structural changes occur in the organization, and in accordance with the Law Minister as the Head of the entity is responsible for providing conditions for the functioning of the internal audit and the signing of an internal audit charter. The charter was submitted to the Minister on 7 April 2015 for consideration and approval and it was signed in the period of performance of the audit.

The Ministry of Education did not complete employment of the Head of the Internal Audit Unit. In the period of performance of the audit, internal auditors in the Department of Internal Audit fulfilled conditions provided by the Law for performing the tasks of the Head of the Internal Audit Unit. Senior Internal Auditor of the Department of Internal Audit of the Ministry of Education performs tasks which are prescribed by the Law as the competence of the Head of Internal Audit Unit, in accordance with the individual authorizations of the Minister.

Ministry of Culture did not align the current Rulebook on Internal Organization and Systematization of Work Positions with the Decree on Titles of Internal Auditors in the Public Sector and Arrangements into Salary Grades. That is, the Ministry in the Department of Internal Audit did not foresee the title of the Head of Internal Audit Unit. In the period of performance of the audit, the Senior Internal Auditor in the Internal Audit

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64 Standard 2010- Planning.
65 Interpretation of the standard 2010- Planning.
66 Article 23 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
67 Charter of Internal Audit of the Ministry of Education was signed on 7 September 2016, number of the document: 023-1247/2016-2.
68 Article 19 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
69 Letter number: 01-1303/3.
71 Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
72 Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
Unit of the Ministry fulfilled the condition prescribed by the Law for acquiring the title of the Head of Internal Audit Unit and performed jobs which are in the competence of the Head of Internal Audit Unit.

**The Capital City - Podgorica** prescribed by the Decision on Organization and Working Method the Capital City Administration\(^74\) in the scope of work the activities that are not within the competence of the internal audit and which are contrary to the Law on the System of Internal Financial Controls in the Public Sector.\(^75\) This was established by the Ministry of Finance in the Report on reviewing the work of the Service for Internal Audit of the Capital City - Podgorica from December 2014. The Ministry made the recommendation that it is necessary to harmonize the mentioned legal acts; however the recommendation of the Ministry during the performance of the audit had not been realized.

The State Auditor established in the process of audit a set of circumstances that may affect the achievement of the **principles of objectivity**\(^76\) of internal auditors and those relate to the conditions of engagement of internal auditors for definite period and their employment status.

**Ministry of Finance** engaged on the basis of Contract on temporary employment\(^77\) for the period of seven months a person to perform tasks in the Internal Audit Unit regardless of the fact that the Rulebook on Internal Organization and Systematization of the Ministry\(^78\) provides for a vacant job position in the Internal Audit Unit. In addition to the fact that engagement of persons for internal audit on the basis of fixed-term contracts may affect the objectivity of the internal auditor, it is completely contrary to Article 163 of the Labour Law\(^79\) which stipulates that "the employer may, for certain jobs that do not require special knowledge and expertise, and by its nature are such that they do not last for more than 120 working days in a calendar year (temporary and occasional jobs), with a particular person who is registered with the Employment Agency, or the Agency for Mediation conclude a special employment contract".

**Municipality of Nikšić** also engaged persons for performing the duties of internal audit on the basis of the Contract on temporary employment in

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\(^75\) Article 20 of the Law.

\(^76\) **Internal Auditors are exposed to the highest level of professional objectivity in gathering, assessment and exchange of information about the activities or process being assessed. Internal Auditors make a balanced assessment of all relevant circumstances without affecting their own interests or other persons in the decision on assessment. Internal Auditors i) should not participate in any activities or relationships that violate or have the ability to undermine their unbiased assessment; ii) do not accept anything that impairs or has the ability to impair their professional judgment; iii) indicate all material facts known to them, if they do not indicate they give a false presentation of the activities examined in the report – Public Sector International Audit Standards- Applying the IIA International Standards to UK Public Sector; Issued by Relevant Internal Audit Standard Setters: CIPFA, Charter Institute of Internal Auditors etc: page 11.

\(^77\) Number: 01-4847/1 of 25 March 2016.

\(^78\) Rulebook from March 2014.

\(^79\) (Official Gazette of Montenegro, No. 049/08 ...053/14).
2015, contrary to these provisions of the Labour Law and despite the fact that the Rulebook on Internal Organization and Systematization of Work Positions of the Service for Internal Audit had foreseen vacant job positions.

**Capital City – Podgorica** in accordance with the Law and by-laws appoints the Head of the Service for Internal Audit for the period of four years. In the period of the performance of the audit, the Head of the Service for Internal Audit after the expiry of the four year period was appointed Acting Head of the Service for Internal Audit of the Capital City - Podgorica for the period of up to six months.

**Municipality of Berane** in accordance with the Law and by-laws, also by a decision appointed Acting Head of the Service for Internal Audit of the Municipality of Berane, until the appointment of the Head of the Service in accordance with the Law. At the time of the performance of audit the Head of the Service for Internal Audit had the status of the Acting for more than two years.

Employment of Heads of the Internal Audit Units at the local level for a definite period may have an impact on the realization of the principle of objectivity of the internal audit entity. Unlike the local level the Heads of the Services for Internal Audit at the central level, in accordance with the law, shall be employed on a permanent basis.

### 3.2. Operational capacities of the Internal Audit Units

The Law on the System of Internal Financial Controls stipulates that the Internal Audit Unit cannot have less than three internal auditors with the Head of the Service for Internal Audit. Six audit entities out of eleven, which were included in the audit procedure, met the minimum prescribed by the Law in the part relating to the number of internal auditors in the Internal Audit Units, and those are: Ministry of Finance, Ministry of Education, Ministry for Information Society and Telecommunication, Capital City-Podgorica, Municipality of Nikšić and Municipality of Berane.

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80 The Law on Local Self-Government.

81 Decision on Organization and Work Manner of the Capital City Administration and Decision on Amendments to the Decision on Organization and Work Manner of the Capital City.

82 Decision number: 01-033/16-264.

83 The Law on Local Self-Government.

84 Statute of the Municipality of Berane and Decision on Organization and Work Manner of Local Government.

85 Decision number 01-031-1061 of 8 July 2014.

86 Article 18 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).

87 In the course of the audit performance a public announcement for the position of a junior auditor in the Department of Internal Audit of the Ministry of Education was completed and one person was employed by the decision of the Ministry No. 023-670/2016-3 of 12 August 2016.

88 In the course of the audit performance a public announcement for the position of a junior auditor in the Department of Internal Audit of the Ministry for Information Society and Telecommunications and one person was employed by the decision number: 113-01-2450/1-16 of 22 July 2016. Also, following the procedure of public advertising for the position of the Senior Auditor the Ministry issued a decision on the selection of candidates.
Other entities of the audit, which performed the tasks of the internal audit with the number of auditors below the minimum determined by the Law, were obliged, in accordance with the Conclusions of the Government from 2014 and 2015, to undertake activities on filling the work positions for internal auditors and to inform the Ministry of Finance on this matter.

The State Auditor, based on documentation of the audited entities and the Human Resources Administration relating to the hiring of internal auditors in the public sector, found that the Ministry of Finance and the Pension Fund were not carrying out the procedure of advertising for jobs in the Internal Audit Units in the period 2014-2016. Therefore they were not undertaking activities to fill in positions for internal auditors, in accordance with the mentioned Conclusions of the Government of Montenegro.

**Table 5. Overview of the audit entities which, according to the data of the Ministry of Finance at the end of 2015 did not meet the minimum prescribed by the Law in the part of the number of auditors and which in the period 2014-2016 were performing the advertising procedure for work positions in the Internal Audit Units**

<table>
<thead>
<tr>
<th>O/N</th>
<th>Name of the authority</th>
<th>Work position</th>
<th>Advertisement type</th>
<th>Number of employed auditors</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Ministry of Education</td>
<td>Senior Auditor</td>
<td>Internal Advertisement(^{90}) within the authority</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Junior Auditor</td>
<td>Public Advertisement(^{91})</td>
<td>1</td>
</tr>
<tr>
<td>2.</td>
<td>Ministry of Culture</td>
<td>Junior Auditor</td>
<td>Public Advertisement(^{92})</td>
<td>1</td>
</tr>
<tr>
<td>3.</td>
<td>Ministry of Agriculture and Rural Development</td>
<td>Senior Auditor</td>
<td>Internal Advertisement(^{93}) within the state authority</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Senior Auditor</td>
<td>Public Advertisement(^{94})</td>
<td>1</td>
</tr>
<tr>
<td>4.</td>
<td>Ministry for Information Society and Telecommunication</td>
<td>Junior Auditor</td>
<td>Public Advertisement(^{95})</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Senior Auditor</td>
<td>Internal Advertisement(^{96}) between the state authorities</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Senior Auditor</td>
<td>There were no applications</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>University of Montenegro</td>
<td>Procedure was carried out through the Employment Agency on 7 November 2015.</td>
<td>The candidate was not employed</td>
<td></td>
</tr>
</tbody>
</table>

number: 112-01-1210/13-16 of 14 September 2016, which created a condition for one person to be employed in the Department for Internal Audit.


\(^{90}\) Advertisement number: 02/1-112/15-11986/2 of 17 July 2015.

\(^{91}\) Advertisement number: 02/1-112/16-8818/2 of 21 May 2016.

\(^{92}\) Advertisement number: 02-1965/1 of 5 March 2014.

\(^{93}\) Advertisement number: 02/1-112/14-14174/2 of 31 December 2014.

\(^{94}\) Advertisement number: 02-5364/1 of 30 June 2014.

\(^{95}\) Advertisement number: 02/1-112/16-6657/2 of 13 April 2016.

\(^{96}\) Advertisement number:02/1-112/16-8662/2 of 14 May 2016.

\(^{97}\) Advertisement number: 02/1-112/16-12710/2 of 13 August 2016.
During the audit process it was found that the Internal Audit Unit of the Pension Fund, in the period 2014-2016, for the most part was not operational and had not been implementing the necessary activities in the field of internal audit. Therefore, the budget funds in the amount of € 420,168,880.66 which was the budget of the Pension Fund in 2016 were not adequately provided with the function of internal audit.

The Internal Audit Unit of the Pension Fund, in that period, was employing two internal auditors one of whom was appointed by the authorization of the Director of the Pension Fund, contrary to the law, to carry out activities that were not related to the internal audit, and the other did not perform duties due to temporary disability for work (sick leave).

The corresponding operational capacity of the Internal Audit Units, in addition to the legally prescribed minimum number of the Internal auditors, include the appropriate expertise which involves the ability to apply knowledge to situations whose probability of occurrence is large and their resolution without resorting to extensive technical research and assistance.98

Knowledge, skills and other abilities include an umbrella term that refers to the professional expertise and which is required of internal auditors for effective performance of professional responsibilities.99

The audit procedure has found that in all Internal Audit Units, which were included in the sample, one or more auditors have a national or international certificate for the performance of internal audit, while the internal auditors of the Ministry of Economy and Ministry of Education have obtained certificates for performing internal audit in accordance with national and international certification process.

From the registry of trainings for internal auditors of the Ministry of Finance (CHU) it was found that the auditors, in the Internal Audit Units that were included in the sample, were regularly attending trainings and seminars that were organized, in the period 2014-2016, for the field of internal audit.

3.3. Planning the internal audit

The Head of the Internal Audit Unit must define plans based on the risk assessment in order to ensure priorities of the internal audit which are consistent with the objectives of the organization.100

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98 International Professional Practices Framework; IIA, June 2010; page 93.
99 Interpretation of the standard 1210- Competence.
100 Standard 2010- Planning. Interpretation: Head of Internal Audit Unit is responsible for developing a plan based on a risk assessment. Head of the Unit takes into account the environment of risk management organization, including the usage of the levels of risk preferences determined by management for the different activities or parts of the organization. If such a framework does not exist, Audit Manager uses his/her assessment of the risks after consultation with senior management and the Board.
The procedure of planning of internal audit in the public sector is determined by international standards, by the Law on the System of Internal Financial Control and guidelines of the Ministry of Finance. That is, the internal audit is performed on the basis of:

- Strategic plan for the internal audit performance which is developed by the Head of Internal Audit Unit on the basis of objective risk assessment and approved by the Head of the entity. The strategic plan is adopted for the period of three years and at least once a year is reviewed against the risks and audit scope;

- An annual plan of internal audit performance is developed by the Head of Internal Audit Unit and approved by the Head of the entity. The annual plan of internal audit is developed on the basis of a strategic plan and is adopted by the end of the current year for the next year;

- Individual audit plan describes in detail the subject, objectives, duration, resource allocation, audit approach, techniques, types and coverage of audit examinations. The Head of Internal Audit Unit approves the individual audit plan and related programs, which describe in detail the audit procedures.

The State Auditor has found during the audit that all the entities of the audit, included in the sample, adopted the strategic plans which cover the period 2014-2015 and which are based on the objective assessment of risk in accordance with the methodology determined by the Ministry of Finance. The Ministry of Agriculture and Rural Development did not have the strategic plan for the mentioned period which in December 2015 adopted the strategic plan for the period 2016-2018. The Internal Audit Unit of the Ministry became operational in the fourth quarter of 2014.

- Out of eleven spending units only four of them were adopting amendments to the strategic plan – Ministry of Economy, University of Montenegro, Municipality of Nikšić and Municipality of Berane. That is, the above mentioned spending units have re-examined the adopted strategic plans under the mandate in relation to risk and audit scope, in accordance with Article 23 of the Law on the System of Internal Financial Controls in the Public Sector.

Annual audit plans are aligned with strategic plans in the most spending units. The highest level of implementation of the annual internal audit plans, in the period 2014-2015, have the Internal Audit Units of the Ministry of Culture, the Capital Podgorica and the Municipality of Nikšić, while the Internal Audit Units of other entities realized annual plans in smaller percentages. Percentage of realization of the plan of the Ministry of

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101 Official Gazette of Montenegro, no. 73/08...34/14.
102 Article 23 of the Law on the System of Internal Financial Controls (Official Gazette of Montenegro, No. 73/08...34/14).
103 Bearing in mind that the Internal Audit Units in the public sector were set up in the different time intervals, for the purposes of the audit performance CHU submitted data at the time when the Internal Audit Unit from the sample became operational. It is considered that the Internal Audit Unit, became operational once it had published the first report of the internal audit.
104 Official Gazette of Montenegro, no. 73/08...34/14.
Agriculture and Rural Development and the Municipality of Berane relates to the implementation of the annual audit plan for 2015.

**Figure 4: Percentage of implementation of annual plans of the Internal Audit Units in the period 2014-2015.**

<table>
<thead>
<tr>
<th>Organization</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Municipality of Berane</td>
<td>83%</td>
<td>100%</td>
</tr>
<tr>
<td>Municipality of Nikšić</td>
<td>61%</td>
<td>100%</td>
</tr>
<tr>
<td>Capital City - Podgorica</td>
<td>56%</td>
<td>100%</td>
</tr>
<tr>
<td>Ministry for Information Society and…</td>
<td>75%</td>
<td>100%</td>
</tr>
<tr>
<td>Ministry of Agriculture and Rural Development</td>
<td>64%</td>
<td>100%</td>
</tr>
<tr>
<td>Ministry of Economy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ministry of Culture</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ministry of Education</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ministry of Finance</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The review did not cover the Internal Audit Unit of the Pension Fund of Montenegro, which has adopted a strategic plan for the period 2013-2015, but it is not in accordance with the Law and manual of Ministry of Finance relating to the planning process, was adopting the annual audit plans. The Internal Audit Unit of the Pension Fund in the mentioned time period performed three internal audits, in accordance with the adopted strategic plan.

The review did not cover the Internal Audit Unit of the University of Montenegro which, in the period 2014-2015, performed internal audit exclusively on the basis of the order of the Steering Committee of the University of Montenegro and Rector of the University. Conclusion of the Steering Committee from April 2014 the Internal Audit Unit of the University is tasked to perform audit for 2011 and 2012 by 1 July 2014 at all organizational units, in the same manner and same procedure as determined by orders issued in 2012. Then, the Conclusion of the Steering Committee from January 2015 to perform detailed audit of financial operations of all organizational units for 2014. The University of Montenegro, in the period to which the conclusions of the Steering Committee relate, consisted of 24 organizational units.

Since the Internal Audit Unit of the University of Montenegro, in the period 2014-2015, employed one internal auditor the stated conclusions of the Steering Committee prevented the realization of the adopted strategic

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105 Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).
107 Conclusion number: 07-536/2 of 15 April 2014.
108 Conclusion number: 07-262/1 of 30 January 2015.
109 The planning of internal audit involves calculating the number of productive days per auditor in one calendar year. Number of productive days per internal auditor is calculated when from the total number of days in the year (365) weekends (105), days of annual vacation (25), holidays (13), potential sick leave (15) and other activities - training and seminars (40) are subtracted. The stated number of days is taken from the Strategic Plan of the Internal Audit of the Ministry of Finance 2014-2016 which stipulates 167 productive
plan which is based on a risk assessment in accordance with international standards for internal audit and the guidelines of the Ministry of Finance. The Internal Audit Unit, in that period performed 13 internal audits: 11 upon the order of the Steering Committee of the University and 2 on the order of the Rector.

The audit also found that all the Internal Audit Units in a timely manner were developing individual audit plans. However, individual audit plans, of the entities covered by audit, contain only the estimated number of days for the internal audit and in some entities the members of the audit team.

- The individual audit plans do not contain the subject and objectives of the audit, the audit approach, techniques, types and coverage of audit examinations and does not describe in detail the necessary audit procedures. Incomplete and insufficiently detailed individual audit plans may affect the efficiency of the procedures of undertaking internal audits, particularly in the Internal Audit Units which employ a larger number of auditors and in the case of conducting complex audits.

3.4. Types of internal audit in the public sector

Internal audit in the public sector is performed by an objective assessment of the evidence by the internal auditor with the aim to provide objective, independent opinion or conclusion related to the process, system or other area covered by the audit. Internal auditors in the public sector can conduct six types of audits, including:

- Audit of the system;
- Audit of compliance;
- Audit of business performance (performance audit);
- Financial audit;
- Audit of information systems;
- Audit of programs and projects financed by the European Union.

...
In addition, internal auditors at the request of Head of the entity can perform ad hoc audits and extraordinary audits that are not planned by the annual plan of internal audit, and during the year arises the need for their implementation.

Depending on the audit there are standard report and audit memorandum, which is usually shorter than the standard reports and it is used: i) for fast and special examinations carried out on the request of management for reporting on the results of the follow-up audit; ii) where relatively minor findings stand out; iii) as an interim report for longer audits.\textsuperscript{113}

The Internal Audit Units, of the budget beneficiaries that were included in the sample, in the period 2014-2015, largely performed audits of the system. The Capital City Podgorica in this period performed 7 financial audits, and Municipality of Nikšić 4 financial audits and one audit of business performance. The Internal Audit Units, which were included in the sample, did not perform the audit of compliance and audit of programs and projects funded by the European Union.

\textbf{Figure 5: Types of audits that were performed by the Internal Audit Units, covered by the sample, during the period 2014-2015.}

\begin{figure}
\centering
\includegraphics[width=0.5\textwidth]{figure5.png}
\end{figure}

The review did not cover the audits performed by the Service for Internal Audit of the University of Montenegro which cannot be included in the above mentioned classification. In the mentioned period the Service performed 13 audits: 2 upon the order of Rector and 11 in accordance with the Conclusions of the Steering Committee of the University of Montenegro and made memorandums on performed internal audits. Regardless of the fact that the audits were conducted upon the order of Head of the entity in the form of memorandum, the drafted reports of the Service for Internal Audit of the University are significantly more complex in terms of content, scope and structure than the ad hoc audits.

\textsuperscript{112} Article 17 and Article 37 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 73/08...34/14).

\textsuperscript{113} Manuual for internal audit, fourth edition; Ministry of Finance, December 2014, page 112.
3.5. The methodology of performing the audit

Manual of the Ministry of Finance for internal audit provides the necessary guidelines to internal auditors during the audit and prescribes the procedure of internal audit. All the internal auditors in the public sector are expected to be fully familiar with the contents of the methodological part of the Manual for internal audit and to use in their work the proper procedures. During the audit the internal auditor should bear in mind the need to comply with the International Standards for the Professional Practice of Internal Audit.\footnote{Manual for internal audit, fourth edition; Ministry of Finance, December 2014, page 71.}

In the process of performing the audit, in the entities included in the sample the examination of the audit documentation was conducted, which in addition to the internal audit report included supporting documentation filed in the permanent\footnote{Manual for internal audit provides that for every audit two types of documentation should be kept - permanent audit file and the current audit file. Permanent audit file contains all information about the system and the organizational unit which is audited. This file provides to an auditor who performs the audit the basic information and he/she should review it at the beginning of each new audit of that system.} and current\footnote{Current audit file documents all the gathered information during the current audit. It contains detailed history of the current audit from the beginning when the scope is determined, objectives until the final plan of realization.} audit file.

The subject audit found the following:

- Three of the eight Internal Audit Units which conducted the audit of the system, were performing audit procedure in accordance with the Manual of the Ministry of Finance and in audit files archived the necessary documentation and forms, as prescribed by the Manual, namely: Ministry of Education, Ministry for Information Society and Telecommunications and Municipality of Berane. Ministry of Finance, Ministry of Culture, Ministry of Economy, Ministry of Agriculture and Rural Development and the Pension Fund during the audit of the system did not fully comply with the methodology prescribed in the Manual of the Ministry of Finance for performance of the audit of the system. The most common deficiencies were relating to the minutes of the initial meeting and final meeting with the audited entity, determining the sample size and the description of the method of sample selection, the working document for each test and checklist for quality assurance of the audit report.

- Selective approach of the Internal Audit Unit of the Ministry of Finance in the process of performing internal audit. Specifically, in accordance with the adopted Annual Plan of Audits for 2014 it is planned that the Department of Internal Audit of the Ministry of Finance, among other things, performs the audit of the system of travel orders and audit of the system of fleet management that will include the Ministry and adjoining administrations. The audit covered the Tax Administration, the Real Estate Administration and the Customs Administration, and it did not include the Administration for Games of Chance which was, in
accordance with the then current Decree on the Organization and Functioning of Public Administration\textsuperscript{117}, also the administration under the Ministry of Finance.

- Documentation of the Ministry of Finance, which relates to the field of internal audit, is not completely recorded and archived in the manner envisaged by law. Decree on Office Management of State Administration Authorities provided that the writing office of the Ministry performs the tasks of receiving, recording and dispatching documents, keeping files, documents and other material and archiving and storage of archived files, as well as other actions with official material.\textsuperscript{118}

- The Ministry of Culture contrary to the law and without the authorization conducted the audit of the Montenegrin National Theatre. The Law on the System of Internal Financial Controls in the Public Sector\textsuperscript{119} determined that the performance of internal audit by the Internal Audit Unit of another entity is conducted on the basis of the agreement, with the prior approval of the Ministry of Finance. The Ministry of Culture and the Montenegrin National Theatre, in the period of performance of internal audit did not have a signed agreement on assignment of activities of internal audit.

- The uniform methodology for performing financial audits which is prescribed by the Ministry of Finance has not been adopted. Therefore, the Internal Audit Units of the Capital City - Podgorica and Municipality Nikšić, which in the period 2014-2015 performed the financial audit, were using different methodological approaches in performing financial audits.

- Audit of performance (performance audits), which was conducted by the Internal Audit Unit of the Municipality of Nikšić is based on the methodology which is applied during the performance of audit of the system.

- The largest number of Internal Audit Units, which were included in the sample, conducted ad hoc audits upon the order of the Head of the entity. Ministry of Finance, Ministry of Agriculture and Rural Development, and Municipality of Nikšić did not have written orders by the Head of the entity to perform ad hoc audits but they were receiving them orally.

3.6. Performing audit on the basis of the agreement

Budget beneficiaries who have established a special unit for internal audit on the basis of the agreement on entrusting the activities of internal audit, and with the prior approval of the Ministry of Finance perform internal audit tasks with other public sector entities. Of the entities covered by the sample, internal audit activities, based on an agreement perform: Ministry of

\textsuperscript{117} Official Gazette of Montenegro, no. 005/12 ...041/16.

\textsuperscript{118} Article 2 of the Decree.

\textsuperscript{119} Official Gazette of Montenegro, no. 73/08...34/14.

The Internal Audit Unit of the Ministry of Finance, in the period 2011-2015, covered by the internal audit 50% of budget beneficiaries, with whom it has signed the agreement on entrusting activities of internal audit. That is, in the mentioned period it did not perform internal audit of the Protector of Property Law Interests, Commission for Public Procurement Control, Police Academy, Centre for Mediation, Directorate for the Youth and Sport, Fund for the Protection and Realization of Minority Rights, Constitutional Court and Protector of Human Rights and Freedoms.

- The Internal Audit Unit of the Ministry of Finance in that period did not perform the audit of transactions of financing expenditure and budget reserves, for which by the Budget Law for 2016 was allocated € 404,302,605.37.

The Ministry of Economy, from the establishment of the unit for internal audit by the end of 2015, covered by the internal audit 50% of the budget beneficiaries with whom it has signed the agreement on entrusting the activities of internal audit. That is, the Ministry of Economy did not perform the internal audit of the Agency for Protection of Competition and the Secretariat for Development Projects.

Internal Audit Units of the Ministry of Education and Municipality of Nikšić annually cover by the internal audit all budget beneficiaries with which they have signed the agreement on entrusting activities of internal audit.

3.7. Reporting to the Head of the entity

The final report of the internal audit with the proposed plan of activities for the implementation of the recommendations is submitted to the Head of the entity who is, in accordance with the Law, responsible for the implementation of internal audit recommendations.

The audit has shown that the Internal Audit Units of the budget beneficiaries who were covered by the audit process, in the period 2014-

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120 The Ministry of Culture signed an agreement on entrusting activities of internal audit on 2 September 2015 with the Montenegrin Academy of Science and Arts. Bearing in mind that the audit covers the period from 2014 to 2015, the same has not been taken into consideration.

121 The Internal Audit Unit has become operational in the fourth quarter of 2012. It is considered that the internal audit unit, became operational when it published the first report of the internal audit.

122 The Ministry of Economy signed with the Institute for Geological Research the agreement on entrusting the activities of internal audit on 15 July 2015. Bearing in mind that the audit covers the period from 2014 to 2015, the same has not been taken into consideration.

123 Municipality of Nikšić in 2014 and 2015 performed audit of the Municipality of Plužine while the agreement on entrusting the activities of internal audit with the Municipality of Šavnik was signed on 23 November 2015. Bearing in mind that the audit covers the period from 2014 to 2015, the same has not been taken into consideration.

124 Article 19 of the Law on the System of Internal Financial Controls in the Public Sector (Official Gazette of Montenegro, no. 073/08 ... 034/14).
2015, submitted in a timely manner their final reports with the agreed plan of activities for implementing the recommendations of the Head of the entity. However, after the submission of the final report of the internal audit by the Head of the entity most often there is no feedback that would additionally commit the organizational unit that was subject of the audit to implement the recommendations of the final report of the internal audit.

Only at the University of Montenegro the practice of adoption of the final report of the Service for internal audit implies the adoption of the conclusion of the Steering Committee of the University of Montenegro, by which the Department and the audited entity are informed that it has been considered and adopted. The Steering Committee of the University additionally obliges the audited entities (organizational units of the University) by the Conclusion to implement the recommendations and report on their implementation.

Head of Internal Audit, in addition to the final report of internal audit with the proposed plan of activities for the implementation of the recommendations, is obliged to submit periodically to the Head of the entity reports concerning the activities of the Internal Audit Units, in accordance with the Law.125

- The audit has shown that, out of the 11 audited entities, only the Ministry for Information Society and Telecommunications was submitting the reports to the Head of the entity in accordance with law. Most often the Heads of Internal Audit Units were not submitting to the Head of the entity the report on the restrictions set forth to the Head of Internal Audit Unit and internal auditors in the performance of the audit and report on the adequacy of resources for the performance of internal audit.

3.8. Reporting to the Ministry of Finance

Head of the entity budget beneficiary is obliged to submit to the Ministry of Finance (CHU) reports on internal audit and the actions taken to implement recommendations of the internal audit.126 The audit procedure found that the entities of the audit covered by the sample, mainly in a timely

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125 In accordance with Article 28 of the Law the Head of Internal Audit Unit is required to submit to the Head of the entity: an annual report on internal audit performance and assessment of the adequacy and effectiveness of the system of financial management and control; report on the results of each audit with all major findings and recommendations for improving the operations of the entity; periodic reports on the implementation of the annual plan of internal audit; reports on the restrictions set forth to the Head of Internal Audit Unit and internal auditors in the conduct of the audit and report on the adequacy of resources for the conduct of internal audit.

126 Article 32 of the Law on the System of Internal Financial Controls in the Public Sector.
manner\textsuperscript{127} were submitting complete and accurate annual reports on the performance of internal audit\textsuperscript{128} to the Central Harmonization Unit.

The exception is the Pension Fund which in the reports on internal audit work for 2014 and 2015 did not provide to the Central Harmonization Unit complete and accurate information on the activities of the internal audit unit.

Untimely, incomplete and incorrect delivery of data has a direct impact on the accuracy of data in the Consolidated report on the system of internal financial controls in the public sector in Montenegro which is submitted by the Ministry of Finance (CHU) to the Government of Montenegro once a year.

3.9. Quality control

The Head of Internal Audit Unit must develop and maintain a program of ensuring and improving the quality which covers all aspects of internal audit activities.\textsuperscript{129} The Head of Internal Audit Unit is responsible for development and maintenance of program of ensuring and improving the quality which covers all aspects of internal audit activities and to monitor continuously its effectiveness.\textsuperscript{130}

Program of ensuring the quality must cover internal and external assessments.\textsuperscript{131} Each audit should be monitored and reviewed to ensure that the quality of audit work is maintained and that the scope and time of the audit is in accordance with the audit plan (internal assessment).

The audit has shown that in the system of internal audit in the public sector there is no appropriate internal assessment, which should provide continuous control that includes policies and practices of internal audit management. The current system of internal estimates imply only an internal assessment in the reporting phase, or a checklist for quality assurance of the audit report (the content of the report, quality, tone and appearance of the report), which is determined by the Manual on Internal Audit of the Ministry of Finance.

The audit has found that out of the eight subjects of the audit, which had performed audit of the system, only the Internal Audit Units of the Ministry for Information Society and Telecommunications and the Ministry of Education in the internal audit procedure were filling in the mentioned checklist. Except that there is no comprehensive internal assessment of internal audit, the audit found that the checklist for quality assurance of the audit report, with the above mentioned entities, are filled in by the internal auditor who prepared the report of the internal audit.

\textsuperscript{127} Article 32 of the Law on the System of Internal Financial Controls in the Public Sector which stipulates that the Head of the entity is obliged to submit to the Central Harmonization Unit an annual report on the performance of internal audit, by the end of January of the current year for previous year.
\textsuperscript{128} Form GI-UR.
\textsuperscript{129} Standard 1300 Program obezbjeđenja i unapređenja kvaliteta.
\textsuperscript{130} Manual for internal audit, fourth edition; Ministry of Finance, December 2014, page 38.
\textsuperscript{131} Standard 1310 Requirements that must be met by the program of ensuring and improving the quality.
In addition to evaluating the quality of individual audits it is important to provide independent assurance that the policies and procedures for conducting internal audits are respected and that they are achieving their goals (external assessment). International Standards for the Professional Practice of Internal Audit recommend that external quality review is conducted at least once every five years. In the meantime, it is recommended that such checks are made by:

- CHU of the Ministry of Finance;
- State Audit Institution;
- Head of the Internal Audit Unit, unit for internal audit of another entity.\(^\text{132}\)

External quality assessment of internal audit until the moment of the performance of audit exclusively conducted the Ministry of Finance (CHU), in accordance with the Rulebook on the Methodology of Reviewing the Quality of Internal Audit in the Public Sector.\(^\text{133}\)

In the period 2014-2015, CHU conducted external assessment of internal audit performance of 10 budget beneficiaries: Ministry of Defence, Ministry of Culture; Capital City - Podgorica; Ministry of Economy, Municipality of Nikšić, Ministry of Interior, Ministry of Transport and Maritime Affairs, Ministry of Sustainable Development and Tourism, Ministry of Finance, Employment Agency and gave a total of 40 recommendations relating to the respecting the procedures for conducting internal audits. The largest number of recommendations in the report on reviewing the quality of the Department of Internal Audit referred to the Ministry of Defence (12) and the Ministry of Finance (8).

\(^\text{133}\) Official Gazette of Montenegro, no. 011/13 - Reviewing the quality of organizational arrangement of the internal audit is carried out by direct insight into the charter of the internal audit, to determine the content and the process of adopting and updating the charter; Strategic Plan of the internal audit, in order to determine the scope and methodology applied in the preparation, adoption and updating of the strategic plan; plan of training of internal auditors, to determine the content of training in relation to the acquisition of the necessary skills to perform internal audits and written requests of the heads of the entity for the provision of consulting services by the internal auditor, for special unplanned tasks, which aims to create added value and improve the management process, risk management and controls. Consideration of the quality of individual audit files is carried out by direct insight into a document of audit files, to determine the application of the methodology of performing individual audits in the following stages: planning the audit; recording of the system; rating of the system; testing of the system; audit conclusions and audit reports and action plans and monitoring.
Regardless of the obligation of the Head of the Internal Audit Unit of a budget beneficiary, in which the external assessment was conducted, to notify the CHU, after receiving the report on the plan of implementation of recommendations of the internal audit unit in which review of the quality of work was conducted, were not submitting reports on the implementation of recommendations from the report. Therefore, during the audit it was not possible to determine the degree of implementation of the recommendations from the report on reviewing the quality of work in the period 2014-2015.

Municipality of Nikšić and Ministry of Interior in the report on reviewing quality of work of the internal audit unit by CHU were not given the recommendations; therefore there was no obligation to submit the plan of activities for implementation of recommendations and reporting on their implementation.

3.10. Implementation of recommendations from the report of internal audit

The Head of Internal Audit must establish a process of monitoring and to ensure that management activities are effectively implemented\textsuperscript{134} while the Head of the entity is responsible for the implementation of agreed internal audit recommendations\textsuperscript{135}.

Internal auditors who monitor the implementation of the recommendations from the audit reports, in accordance with the Manual for internal audit of the Ministry of Finance, keep: a central register for monitoring the implementation of agreed internal audit recommendations\textsuperscript{136} and the summary records for monitoring the implementation of recommendations by years.

There are three ways that the internal auditor is satisfied that the recommendation has been implemented:

a) Send letters to the organizational unit that is subject of an audit to verify that the measures are taken. During the next audit a

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\textsuperscript{134} Standard 2500 A1 - Monitoring progress.
\textsuperscript{135} Article 19 of the Law on the System of Internal Financial Controls in the Public Sector.
\textsuperscript{136} CR form.
verification should be conducted to ensure that the appropriate activities are undertaken and that the controls are properly implemented;
b) Scheduling special audits of monitoring;
c) Audit monitoring as a part of the next audit.

In the process of auditing the State Auditor found that, in the period 2014-2015, with the budget beneficiaries that were included in the sample, in the internal audit reports there was no recommendation on which there were no agreements reached.

The highest percentage of recommendations, in the stated period had the Ministry for Information Society and Telecommunications and Testing Centre, which entrusted to the Ministry of Education by an agreement its internal audit performance. They have fully implemented all the recommendations from the internal audit report or realize the percentage of realization of recommendations 100%. Then the Capital City – Podgorica (98%) and the Ministry of Agriculture and Rural Development (92%). The lowest level of implementation of recommendations from the report of the internal audit has the Municipality of Plužine (40%) which has entrusted the internal audit activities by an agreement to the Municipality of Nikšić. The highest percentages of the outstanding recommendations from the internal audit report are recommendations of the high (60%) and medium (39%) priorities.

**Figure 7:** Percentage of implementation of recommendations from the report of the internal audit of the budget beneficiaries included in the sample, in the period 2014-2015

The Ministry of Finance and the Ministry of Economy of keep the unique registry for monitoring the implementation of the agreed recommendations of the internal audit for the ministry and budget beneficiaries with whom they have signed an agreement on entrusting the activities of internal audit. Therefore, the percentage of implementation of the recommendations from the report of the internal audit covers the two ministries with budget beneficiaries with which they have signed an agreement.
The review did not cover the Pension Fund whose internal audit unit, in accordance with the methodology of the Ministry of Finance, does not keep a central register for monitoring the implementation of agreed internal audit recommendations. Therefore, in the process of auditing the state auditor could not determine the percentage of implementation of the recommendations from the report of the internal audit of this entity.

In order to determine the status of implementation of recommendations from the report, internal audit units usually send letters to the organizational unit that is subject of an audit to verify that the measures are taken and in the course of the next audit verify if the appropriate actions are undertaken. Special audit monitoring was carried out by the Ministry of Finance and the Capital City Podgorica while no spending unit conducted the audit monitoring as part of the next audit.

The audit has found that the Ministry of Finance, Ministry of Culture, Ministry of Economy and Municipality of Berane did not have satisfactory documentary evidence on the basis of which it was established that the recommendations from the report are implemented or partially implemented. That is, in the central registry for monitoring the implementation of agreed internal audit recommendations it was noted that the recommendation was implemented or partially implemented solely on the basis of the letter of the audited entity without provided supporting documentation.
4. FINAL CONCLUSIONS AND IDENTIFIED SHORCOMINGS

After the conducted procedure of the performance audit, in the period May – November 2016, by the SAI audit team it was established that there are set of segments which need to be improved so that the system of internal audit in the public sector would function more efficiently and those are:

1) provision (hiring) of a sufficient number of internal auditors in accordance with the Law;

2) understanding the role of internal audit in the public sector by the Heads of the entity and their support to the development of the internal audit units;

3) realization of better communication of the internal audit units and entity under internal audit and achievement of a higher degree of mutual cooperation of the internal audit units in the public sector;

4) improving the methodology of work of internal auditors by the Ministry of Finance (CHU) and encouraging internal auditors to carry out new types of audits;

5) ensuring the long-term structural-oriented training programs for internal auditors.

4.1. Recruitment of internal auditors in the public sector

Insufficient staff capacity in the area of internal audit is one of the key limiting factors for further development of internal audit in the public sector. In the audited entities, the insufficient number of internal auditors in the internal audit units has a direct impact on:

- Performing audits in all business segments so that the budget funds would be fully provided by the internal audit;

- Periodical performance of audits within the budget beneficiaries on the basis of the agreement on entrusting the activities of internal audit.

The larger budget beneficiaries, which have established internal audit units, most often do not have sufficient capacity (sufficient number of internal auditors) and therefore do not always sign agreements on entrusting the internal audit work with smaller budget beneficiaries, for which the signing of the agreement represents a cost-effective way to provide internal audit function.

Ministry of Education was addressed, for the purpose of signing the agreement on entrusting the activities of internal audit, by the Centre for Vocational Education,\textsuperscript{138} Faculty of Montenegrin Language and Literature,\textsuperscript{139} PI Higher Vocational School “Police Academy”\textsuperscript{140} and Directorate of Youth

\textsuperscript{139} Response of the Ministry of Education number: 01-1956/4 of 8 June 2015.
\textsuperscript{140} Response of the Ministry of Education number: 01-5639/2 of 18 November 2013.
and Sport\textsuperscript{141} however, these have not been signed because of the lack of capacity of the internal audit unit of the Ministry.

Having in mind importance of increasing the number of internal auditors in the public sector, the Human Resources Administration, in the procedure of audit, was asked for documents that are related to the process of hiring internal auditors, during the period 2014-2015.

According to the data submitted by the Human Resources Administration the state authorities in the period 2014-2015, conducted 27\textsuperscript{142} advertising procedures and deployed 12 internal auditors in the internal audit units.

In the conducted procedures a number of persons who had already performed internal audit in the public sector, was employed in the internal audit unit of another state body, or was deployed with a higher title with the same authority.

According to the data provided by the Human Resources Administration, in the period 2014-2015, the most of the persons employed are younger and all of them were employed after the conducted procedure of public advertising.

**Figure 8: Number of announced vacancies and employed internal auditors according to the titles, in the period 2014-2015.**

<table>
<thead>
<tr>
<th>Title</th>
<th>Announced work positions</th>
<th>Filled work positions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Head/Manager</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>Higher Internal Auditor</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Senior Internal Auditor</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Junior Internal Auditor</td>
<td>8</td>
<td>5</td>
</tr>
</tbody>
</table>

**Figure 9: Percentage of filled vacancies for internal audit in the public sector, in the period 2014-2015, according to the type of advertisement**

<table>
<thead>
<tr>
<th>Type of Announcement</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal announcement - within the state authority</td>
<td>33%</td>
</tr>
<tr>
<td>Internal announcement - between state authorities</td>
<td>8%</td>
</tr>
<tr>
<td>Public announcement</td>
<td>58%</td>
</tr>
</tbody>
</table>

A number of authorities conducted the procedure of advertising for work positions in the internal audit unit in which there were no candidates.

\textsuperscript{141} Response of the Ministry of Education number: 10-3793/2 of 8 September 2014.  
\textsuperscript{142} 10 public advertisements, 8 internal advertisements between state authorities and 9 internal advertisements within the state authority.
For the most part this related to the process of internal advertisement\textsuperscript{143} for the authorities which, following the completed procedure of public advertising for the same work positions, conducted the employment.

The exception is the Ministry of Justice, which for the work position of a Higher Internal Auditor, conducted three procedures of advertising (internal advertisement - within the state authority\textsuperscript{144}, internal advertisement - between state authorities\textsuperscript{145} and public announcement\textsuperscript{146}) contrary to the then applicable Decree on Titles of Internal Auditors in the Public Sector.

For the needs of the Secretariat of the Prosecutorial Council the procedure of public advertising\textsuperscript{147} was conducted for the position of Head of Internal Audit Unit for which there were no candidates.

### 4.2. Role of the internal audit in the public sector

The efficient performance of internal audit requires a clear understanding of the role and responsibilities of internal audit by the Head of the entity, the Head of the organizational units and all employees at the budget beneficiaries. Internal audit is not inspection and it does not impose sanctions but it is, through its services and advisory activities, oriented towards the future and improving the operations of the entity. Internal audit "does not criticize the way of operating but it estimates the existing systems, assesses business performance and provides recommendations and advices to improve the system of financial management and controls".\textsuperscript{148}

#### Table 6: Difference between the role of internal audit and inspection in the public sector\textsuperscript{149}

<table>
<thead>
<tr>
<th>Internal audit</th>
<th>Inspection</th>
</tr>
</thead>
<tbody>
<tr>
<td>The internal audit activity in the service of the audited entity</td>
<td>Inspection is an investigating activity</td>
</tr>
<tr>
<td>The emphasis is on the future in order to support the management</td>
<td>Examines the past in order to establish specific infringements</td>
</tr>
<tr>
<td>Assesses systems and advises</td>
<td>Verifies the implementation of regulations</td>
</tr>
<tr>
<td>The focus is on the system rather than on transactions</td>
<td>The emphasis on the transaction</td>
</tr>
<tr>
<td>The objective of internal audit is to evaluate the system and recommend improvements</td>
<td>The aim of the inspection is to detect violations and determine the penalties</td>
</tr>
</tbody>
</table>

\textsuperscript{143} Internal advertisement between state authorities and internal advertisement within the state authority in accordance with the Law on Civil Servants and State Employees (Official Gazette of Montenegro, no. 039/11 ...016/16).
\textsuperscript{144} Number: 02/1-112/15-11420/2 of 1 July 2015.
\textsuperscript{145} Number: 02/1-112/15-12469/2 of 29 July 2015.
\textsuperscript{146} Number: 02/1-112/15-15117/2 of 17 October 2015.
\textsuperscript{147} Number: 02/1-112/15-13841/2 of 7 October 2015.
\textsuperscript{148} Instructions on the establishment and functioning of internal audit with the funds of the Budget of Montenegro and budgets of municipalities, May 2015: Ministry of Finance.
\textsuperscript{149} Instructions on the establishment and functioning of internal audit with the funds of the Budget of Montenegro and budgets of municipalities, May 2015: Ministry of Finance.
By the audit procedure it was established that it is necessary to further improve the status and position of the internal audit, so that the internal audit units would be able to perform internal audit in accordance with international standards, the applicable legal framework for the internal audit and with the guidelines of the Ministry of Finance.

Audit procedure found that the Steering Committee of the University, for a period of four years, five times ordered the audit of the Faculty of Philosophy. More than once the internal audit was included in the same time period and announced the necessity to take certain measures against the responsible persons in the Service for Internal Audit. The Service for Internal Audit of the University of Montenegro in 2014 and 2015 conducted the internal audits exclusively by order of the Rector and the Steering Committee of the University and was not able to realize activities from the adopted strategic plan.

The strategic plan for the performance of audits is based on methodological procedures of risk assessment in accordance with international standards and guidelines of the Ministry of Finance. The risk assessment, among other things, entails the identification of risk index on the basis of which the systems are categorized into high, medium and low risk.\textsuperscript{150}

However with the entity controlled by the audit, contrary to the defined methodology, the audited which was not included in the annual and strategic planning was conducted several times.

<table>
<thead>
<tr>
<th>Chronology - case study</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Audit of the Faculty of Philosophy for 2011 and 2012.\textsuperscript{151} The final report was adopted by the Conclusion\textsuperscript{152} of the Steering Committee.</td>
</tr>
<tr>
<td>2. The audit of the financial operations of the Faculty of Philosophy for the period 2010 - June 2014.\textsuperscript{153} The Steering Committee at its session on 5 September 2014, was presented the Information provided on the operations of the Faculty of Philosophy and noted that the Service for Internal Audit had not responded to the requests of the Steering Committee, and that assessment opinions and conclusions of the</td>
</tr>
</tbody>
</table>

\textsuperscript{150} Strategy of audit should include more frequently audits of the systems of higher risk - usually every year - to verify that systems are vital, covered by effective control. The audit of the systems of medium risk may be less common. If the cycle of audits is three years, these systems may be subject of audit for two out of three years of the cycles. Audit of the systems of low risk can be performed once in three years - and in some cases the audit may be limited to two or three key systems.

\textsuperscript{151} According to the order of the Steering Committee no. 07-2255, 072255/1 and the Conclusion of the Steering Committee number: 07-183, the subject of the audit were: structures of revenue, expenditure and balance of outstanding liabilities arising from taxes and contributions; payment of compensations for realized education to teaching staff not employed at the Faculty of Philosophy; payment of compensation for additional jobs to the administrative staff, with special focus on engaging employees in accounting; payment of compensations for the work of committees and realization of procedures of public procurement of goods, services and works with a special emphasis on realized procurement procedures by direct agreement.

\textsuperscript{152} Number: 07-183/4 of 2 April 2013.

\textsuperscript{153} According to the Latter of the Steering Committee number: 07-949 of 10 June 2014. Which demanded a comprehensive report on the financial operations for this period with the opinion of the spending of earmarked funds, whereby the report should contain the overview of realized savings by the years that are the subject of control.
auditor were lacking, which hinders the work of the Steering Committee. Service for Internal Audit has been given extra time for performance of obligations under the orders of the Steering Committee after which the Steering Committee will consider the necessity to take certain measures against responsible persons, and in particular to analyze the work of this service.\textsuperscript{154} The Final Report was adopted by the Conclusion\textsuperscript{155} adopted and submitted to the competent state authorities for further proceedings. That is, the Final Report was submitted to the Ministry of Finance – to the Minister and Financial Inspection,\textsuperscript{156} Ministry of Education\textsuperscript{157} and Tax Administration.\textsuperscript{158}

3. Financial audit at the Faculty of Philosophy for 2014\textsuperscript{159}. For the Final Audit Report at the Faculty of Philosophy the Steering Committee of the University noted that, as the earlier audit reports on the overall financial operations of the Faculty of Philosophy (2010-2014) it was insufficiently comprehensive and without precise recommendations.\textsuperscript{160}

4. Therefore the University of Montenegro adopted the Decision on the establishment of the special working group to carry out the re-audit of financial operations of the Faculty of Philosophy\textsuperscript{161} for the period 2010-2014. Members of the working group were the internal auditors of the Ministry of Finance and the persons employed at the University who, at that time, did not perform the tasks of internal audit.

5. Audit of the Faculty of Philosophy for the period 2011-2014.\textsuperscript{162} The Steering Committee was informed about the Final Report and ordered the Dean of Faculty of Philosophy to correct the irregularities to the extent possible and to adhere in the further work to the recommendations from the Audit Report.\textsuperscript{163}

Acceptance of Internal Audit by the Head of the budget beneficiary and the proper recognition of its role is the development process to be further enhanced. Head of the entity is obliged to provide internal audit function which is based on the principles of independence and objectivity, timely auditing and signing of an Audit Charter, adequate human resources, smooth and non-selective implementation of the adopted strategic and annual audit plans, which are based on objective risk assessment.

Head of the entity is obliged to provide internal audit function which is based on the principles of independence and objectivity, timely revising and signing of the internal audit charter, adequate human resources, smooth and non-selective implementation of the adopted strategic and annual audit plans, which are based on objective risk assessment.

Proper identification of the role of internal audit by the Head of the entity, the Head of the organizational units and all employees at budget beneficiaries will contribute to achieving the goals and improving the operations of the entity.

\textsuperscript{154} Conclusion of the Steering Committee of the University of Montenegro number 07-949/4 of 5 September 2014.
\textsuperscript{155} Number: 07-2013/1 of 30 September 2014.
\textsuperscript{156} Letter of the University of Montenegro number: 07-2251/1 of 3 October 2014.
\textsuperscript{157} Letter of the University of Montenegro number:07-2251/2 of 3 October 2014.
\textsuperscript{158} Letter of the University of Montenegro number:07-2251 of 3 October 2014.
\textsuperscript{159} According the order of the Steering Committee number 07-262/1 of 30 January 2015.
\textsuperscript{160} Conclusion of the Steering Committee of the University of Montenegro number 07-262/7 of 11 November 2015.
\textsuperscript{161} Decision number 01-863 of 2 April 2015.
\textsuperscript{162} According to the order of the Steering Committee of the University of Montenegro No. 02-267 of 2 February 2016. The subject of the audit were the issue invoices for accommodation of professors and assistants from the Faculty of Philosophy in Berane and in this regard the correctness of calculation and payment of daily and travel expenses for teaching in Berane.
\textsuperscript{163} Decision number: 02-267/9 of 18 May 2016.
4.3. Communication in the audit conducting

The Head of Internal Audit Unit must maintain an appropriate level of communication and be in direct interaction with the management of the entity.\textsuperscript{164} Direct communication exists if the Head of Internal Audit Unit attends and participates in meetings of the Board related to the responsibilities of the board in terms of supervision of the auditing, financial reporting, organization management and control. The presence of the Head of Internal Audit Unit at these meetings provides him/her an opportunity to be informed of the strategic business and operational innovations and to ask questions at an early stage related to the high level of risk, the system of procedures and controls. The presence at these meetings enables the exchange of information regarding plans and activities of internal audit, as well as for mutual informing on other issues of common interest.\textsuperscript{165}

The appropriate level of communication between internal auditors and managers of organizational units-entities and other employees at the audited budget beneficiaries has a direct impact on the efficiency of conducting the internal audit. The audit procedure found circumstances which indicate that, in some audited entities, communication in the procedure of conducting the internal audit needs to be further improved.

In the Ministry of Finance it is necessary to further improve the communication between the Internal Audit Unit and authorities within the Ministry. In other words, the audit procedure has found that the Draft report of the internal audit of the system of fleet management, which included Administrations within the Ministry, the statement had been submitted only by the Tax Administration. Statement of the Draft Report, during the audit, did not submit the Customs Administration and the Property Administration.

At the Ministry of Culture it is necessary to further improve the communication between the Internal Audit Units and managers of organizational units that are the audited entities so that the procedure of notification on the audit, responsibility for implementation of the recommendations and reporting on the implementation of the recommendations would be performed directly.

Heads of entities in which the internal audit unit is established should re-examine the possibility of adopting a formal act, after the adoption of the report of the internal audit, which would further commit the organizational unit-audited entities to implement the recommendations and report on their implementation. Adoption of the said act would contribute to the improvement of communication between internal audit units and audited entities, in part of the reporting on the implementation of recommendations and strengthening the role of internal audit within the entity.

The audit has also found that the Internal Audit Units, which were included in the sample, have adequate communication with the Ministry of Finance (CHU).

\textsuperscript{164} Standard 1111- Direct interaction with the Board.
\textsuperscript{165} Practical advices 1111-1 Interaction with the Board; International Framework of Professional Practice, IIA June 2010; page 84.
4.4. **The methodology of performing internal audit**

Internal audit is performed in accordance with regulations governing internal audit and International internal audit standards. Internal auditors are obliged to act in their work in accordance with the internal audit charter, the Code of Ethics of internal auditors, internal audit working methodology, guidelines and instructions laid down by the Ministry of Finance.166

The Internal Audit Unit of the entity, because of the complexity of the tasks and duties of the entity, may develop additional methodological guidance for performing internal audit, specifying in more details methods to be used in the audit procedure.167

The audit procedure has found that the Internal Audit Units, covered by the sample, when performing internal audit mainly rely on internal audit work methodology prescribed by the Manual for internal audit of the Ministry of Finance. Additional methodological guide for the performance of internal audit was prepared by the Service for Internal Audit of the Capital City - Podgorica in 2012168, however in the performing of the internal audit it uses the methodology prescribed by the Ministry. The fourth edition of the Manual for internal audit provides general information relating to the establishment of internal audit unit169 and guidelines on how to conduct internal audit170. The methodology established by the Manual is primarily related to system audits, however, the basic approach and principles apply to other types of audits, such as audit of the performance and audit of information technology.171

After the conducted audit procedure it was established that the existing methodology for conducting internal audits should be further upgraded and it should provide to internal auditors more detailed information in the part of:

i. The process of developing an individual audit plan by which it is described in detail the subject, objectives, duration, distribution of resources, the audit approach, techniques, types and coverage of audit examinations and the related programs which describe in detail the audit procedures.172 The individual plan of audit according to the

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166 Article 22 of the Law on the System of Internal Public Controls in the Public Sector (Official Gazette of Montenegro, No. 073/08 ... 034/14).
167 Article 22 of the Law on the System of Internal Public Controls in the Public Sector (Official Gazette of Montenegro, No. 073/08 ... 034/14).
169 Introduction to internal audit, internal audit charter, the role of Head of the Internal Audit Units, audit planning, personnel policy, external relations, quality policy, the policy of deception, an overview of the main types of audit, internal audit standards.
170 Audit planning, registering of the system, rating of the system, testing, conclusions of the audit, audit reporting and action plans. Then follow-up of the audit, the audit records and monitoring individual audits.
172 Article 23 of the Law on the System of Internal Public Controls in the Public Sector (Official Gazette of Montenegro, No. 073/08 ... 034/14).
model given in the Manual contains only the number of audit days that are planned for each individual phase of the audit. The mentioned audit plan does not provide the auditor with detailed information regarding the approaches, techniques and scope of audit checks which may be an aggravating circumstance in the case of internal audit units which employ a larger number of internal auditors or when the internal audit unit performs more complex audits.

ii. Using the sampling method - non-statistical and statistical, where possible, in such a way that a certain sample size is sufficient to reduce the risk of sampling to an acceptably low level and that particular sample is representative in respect of population. Sampling risk is the possibility that the auditor's conclusion, based on a sample, may be different from the conclusion which would be reached if the total population was subject of the same audit procedures. Internal Manual for internal audit of the Ministry of Finance during the audit determines the "quasi-random selection of documents" which need to be tested, which may have an impact on increasing the risk of sampling when performing more complex audits. Therefore, also statistical sampling should be introduced, which has a special significance in the process of performing financial audit in more complex entities.

iii. Assurance and quality improvement program, which implies continuous and periodic evaluation of the entire spectrum of audit activities and consultations carried out by the internal audit, especially procedures to supervise individual audits conducted in accordance with the approved audit plan. Manual for internal audit provides for a checklist - a form for quality assurance of the audit report (content of the report, quality, tone and appearance of the report). However, the Manual does not prescribe the quality assurance system in the stage of planning and performance of audit nor the persons responsible for the control of the audit procedure by stages. The audit procedure has found that in some spending units the form for quality assurance of the audit report is completed and signed by the person who prepared the report.

iv. Work methodology of financial audit and compliance audit, performance audit and audit of programs and projects funded by the European Union (audit of system and audit of operations), which should be in line with international standards and which would enable the internal audit units a unique approach in the performance of the audit.

Regardless of the fact that the Manual provides that the basic approach and principles of the methodology relating to the audit of the

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173 Article 46 and 47 of the Instruction on the methodology of the performance of financial audit and regularity audit of the State Audit Institution is in compliance with standards ISSAI 200/132; ISSAI 400/40.
system are applicable to other types of audits the stated methodology should take into account the specificities of each type of audit, in accordance with international standards and good auditing practice. In this way, a unique methodological approach for those types of audits would be provided and their implementation in accordance with international standards and regulations would be ensured.

v. Starting from the fact that the manual governs (standardizes) many questions of procedural and methodological importance, and considering that "manual" has no binding legal act character and formal power, the Ministry of Finance needs to address these issues by means of guidelines for performance of internal audit or by instructions on the methodology of performing the internal audit.

### 4.5. Training programs for internal auditors

Central Harmonization Unit (CHU) of the Ministry of Finance, during the period covered by the audit, conducted programs of continuous professional development of internal auditors in the public sector and prepared, organized and conducted training programs for the exam for authorized internal auditor.

The audit has found that the units covered by the sample during the implementation of programs of continuing education, to a large extent rely on training that are organized and conducted by CHU. Out of the eleven entities that were included in the audit procedure the Ministry of Economy, the Ministry for Information Society and Telecommunications, the Ministry of Education and the Municipality of Berane in accordance with the Law were adopting their own plans for continuous professional training and development of internal auditors. Out of the eleven entities only the Ministry of Education keeps its own registers of the trainings of internal auditors.

The Ministry of Finance (CHU) in the period from 2014 to July 2016, was conducting 37 trainings in the field of internal audit in the public sector, of which the largest number of trainings related to the local level (43%). The lowest number of trainings, in that period, related to the audit of business performance (5%).

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174 Audit of performance and audit of information technologies.
175 Article 27 item 9 of the Law on the System of Internal Public Controls in the Public Sector (Official Gazette of Montenegro, no. 073/08 ... 034/14).
According to the statement of the Ministry of Finance "CHU in the period from 2014 to July 2016, in addition to 37 trainings which are stated, organized 13 trainings within the Program of training and authorization of internal auditors in the public sector (TIAPS) that CHU organized in cooperation in cooperation with the CEF (Centre for Excellence in Finance) from Ljubljana and CIPFA (Chartered Institute of Public Finance and Accountancy) from Great Britain".

The audit procedure has found that the Ministry of Finance (CHU) has no long-term plan for the implementation of trainings in the field of internal audit but those are organized on the basis of the report of the Ministry of Finance (CHU) on the conducted procedure of reviewing the quality of internal audit, through the implementation of launched projects in communication with the internal audit units in the public sector.

With the aim of improving professional development of internal auditors Ministry of Finance in December 2015 proposed the Program of trainings for the system of internal financial controls in the public sector of Montenegro, which, among other things, provided for the continuous professional development of authorized internal auditors in the public sector and certification of internal auditors. The Ministry, in January 2016, adopted also the Instruction on continuous professional development of the authorized internal auditors in the public sector.176

Considering that, according to the data of the Ministry of Finance177, at the end of 2015, was employed 71 internal auditor or 60% of systematized work positions, a more efficient approach in planning trainings for internal audit would include a more long-term orientation in the area of internal audit in which it is necessary to carry out the trainings. A more efficient approach to planning also would include the continuation of the process of segmentation in determining the target groups especially bearing in mind that a number of internal auditors have the appropriate level of experience in...
performing internal audits, as well as that in the coming period the increase in the number of internal auditors is expected in the public sector.
5. OPINION AND RECOMMENDATIONS

Based on the conducted audit, established fact and response of the audited entities, and in accordance with Article 44 of the Law on State Audit Institutions and Article 45 of the Rules of Procedure of the State Audit Institution, the competent Auditing Board of the SAI comprising of: Branislav Radulović, PhD (Member of Senate – Head of the Auditing Board) and Mr. Nikola N. Kovačević (Member of Senate – a member of the Auditing Board), at the session of the Auditing Board of SAI held on 13th January 2017, adopted:

FINAL REPORT
on the performance audit

Efficiency of internal audit in the public sector

OPINION

During the process of performance audit “Efficiency of internal audit in the public sector“, the State Audit Institution (SAI) established that:

• There is legal framework which enables functioning and development of internal audit, which needs to be additionally upgraded, especially in the part of methodologies of performing audits;

• Heads of the entities in the public sector (ministers, presidents of the municipalities, directors and other) still do not recognize, to the extent necessary, the importance of internal audit and they should, in accordance with the responsibilities, undertake the activities in the area of establishing, strengthening and developing the internal audit so that the entire system would function more efficiently.

• The existing system of internal audit is not sufficiently efficient and in the coming period additional activities should be undertaken in order to remove identified shortcomings that hinder the realization of the internal audit function, and with the purpose to improve the overall business process.

Establishing an effective internal audit system contributes to improving the standards of management, better management and decision-making and effective use of taxpayers’ funds and to improve the efficiency of internal audit SAI issues the following:
RECOMMENDATIONS

Ministry of Finance (Central Harmonization Unit) should:

a) Methodologically improve the process of developing individual audit plan describing in detail the subject, objectives, duration, distribution of resources, the audit approach, techniques, types and coverage of audit checks; 178;
b) Methodologically improve the sampling procedure, which should contribute to more efficient performance of internal audit;
c) Improve the quality control system of internal audit through additional development of internal evaluation that, in accordance with international standards, has to provide continuous control over the effect of the internal audit and to conduct periodic monitoring through self-assessment or evaluation by other persons in the organization;
d) Establish a unified methodology of performing internal financial audit and compliance audit, performance audit and audit of programs and projects funded by the European Union in a way that determined the performance of the audit of the system and thus enable a unified approach in the performance of those audits;
e) Provide a long-term approach to planning, implementation and realization of trainings for internal audit, which should be based on objective needs of internal auditors and the development of internal audit in the public sector. 179

Ministry of Finance (Internal Audit Unit) should:

a) Perform a review of the adopted strategic plan in relation to the risks and audit scope at least once a year, and thus provide a comprehensive system of strategic planning.
b) When adopting the annual plan of audits, ensure periodic and non-selective performance of internal audit of all entities with which the Ministry has signed an agreement on entrusting the activities of

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178 According to the statements of the audited entity by the "Program of the reform of the management of public finances for the period 2016-2020, the improvement of work methodology of internal audit is planned, which includes updating manuals for internal audit. It is planned he plan that the update of the manual will start in the second quarter of 2017 and be completed by the end of 2017. During the updating of the manual it is planned to methodologically improve the process of developing individual audit plan, taking into account the achieved level of development of internal audit in the public sector ".

179 According to the statement of the audited entity "for the purpose of long-term approach to planning the conduct of training for internal auditors, the Commission for Economic Policy and Financial System of the Government of Montenegro, at the proposal of the Ministry of Finance, considered and adopted the Training program for the system of internal financial controls in the public sector of Montenegro. The Program includes topics from specific areas that will be realized in the calendar year. Topics will vary based on the report on the conducted procedure of reviewing the quality of internal audit. The program will be updated once in a year by the CHU in cooperation with the Human Resources Agency".
internal audit and other budget funds, which are under the jurisdiction of the Internal Audit Unit of the Ministry.

c) Terminate the illegal practice of hiring internal auditors in the internal audit unit on the basis of the contract on temporary employment (contract on the provision of temporary and occasional jobs) and future employment of internal auditors conduct in accordance with the applicable legal framework;

d) Ensure that the tasks of receiving, recording and dispatching documents, storage of items, documents and other material and archiving and storage of archived files, as well as other actions with official material related to the internal audit are carried out at the administrative office of the Ministry.

e) Perform audit of the system in accordance with the methodology of the Ministry of Finance and according the forms contained in the Manual for internal audit.

f) Improve the communication of the Internal Audit Unit and authorities within the Ministry in the process of auditing. Improvement of the communication would contribute to a more efficient procedure of conducting by the Internal Audit Unit of the Ministry.

g) The procedure for monitoring the implementation of recommendations is done according to the guidelines of the Ministry of Finance with the provision of sufficient and adequate audit evidence.

h) The Head of Internal Audit provide a comprehensive reporting system of the Head of the entity, in accordance with Article 28 of the Law on the System of Internal Financial Controls in the Public Sector.\textsuperscript{180}

**Pension Fund of Montenegro**

should:

a) By amendments to the Rulebook on Internal Organization and Systematization of Work Positions, the Pension Fund provide organizational separation of the Internal Audit Unit of other organizational units, which is responsible directly to the Head of the subject.

b) Conduct the employment of internal auditors at least up to the minimum number of internal auditors in the Internal Audit Unit provided by the Law\textsuperscript{181} and in accordance with the conclusions of the Government, whereby it is necessary that the Head of Internal Audit Unit and the internal auditors perform only internal audit jobs.

c) The Head of the entity in a timely sign the charter of the internal audit, which defines the purpose, competence, scope and responsibility of the internal audit, determines the position and defines access to records, personnel and assets that are important for the performance of audit. It is essential that the Charter is periodically reviewed and revised especially when structural or other changes occur in the organization.

\textsuperscript{180} Official Gazette of Montenegro, no. 073/08 ... 034/14.

\textsuperscript{181} The Law on the System of Internal Financial Controls in the Public Sector "Official Gazette of Montenegro", no. 073/08 ... 034/14.
d) Perform a review of the adopted strategic plan in relation to the risks and audit scope at least once a year, and thus provide a comprehensive system of strategic planning.

e) Adopt annual plan of audits in accordance with the Law182 and guidelines of the Ministry of Finance, on the basis of the strategic plan by the end of the current year for the next year.

f) Perform the audit of the system in accordance with the methodology of the Ministry of Finance and according the forms contained in the Manual for internal audit.

g) According to the prescribed forms keep the central register for monitoring the implementation of agreed internal audit recommendations and the summary records for monitoring the implementation of recommendations by years and monitor the implementation thereof, in one of the ways that are determined by the methodology of the Ministry of Finance.

h) The Head of Internal Audit Unit provide comprehensive system of reporting to the Head of the entity, in accordance with Article 28 of the Law on the System of Internal Financial Controls in the Public Sector.183

i) Accurately submit to the Ministry of Finance (CHU) reports that are made on internal audit work where it is necessary to objectively cover all the circumstances arising from the last reporting period.

j) Timely submit to the Ministry of Finance (CHU) reports on the work of internal audit within the time limits established by the Law.

University of Montenegro should:

a) Provide functional independence of internal audit by amendment of Article 161 of the Statute of the University of Montenegro in the area, which provides that the Steering Committee of the University by a general act shall determine the type, scope and deadlines for the performance of audit and align it with the Law on the System of Internal Financial Controls in the Public Sector184 and with international standards for internal audit.

b) Enable unit for internal audit realization of activities towards the adopted strategic acts that are based on objective risk assessment that is required under international standards for internal audit, law and a manual for internal audit of the Ministry of Finance.

c) Only in special order *ad hoc* audits (extraordinary audits) that are not planned by the annual work plan of internal audit, and only in case where there is a need for fast and special checks.

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182 The Law on the System of Internal Financial Controls in the Public Sector "Official Gazette of Montenegro", no. 073/08 ... 034/14.

183 Official Gazette of Montenegro, no. 073/08 ... 034/14.

184 Official Gazette of Montenegro, no. 073/08 ... 034/14.
d) Perform employment of at least up to the minimum number of internal auditors in the Internal Audit Unit provided by the Law\textsuperscript{185} and in accordance with the conclusions of the Government.

e) The Head of Internal Audit provide comprehensive system of reporting to the Head of the entity, in accordance with Article 28 of the Law on the System of Internal Financial Control in the Public Sector.\textsuperscript{186}

**Ministry of Education**

should:

a) Timely revise the internal audit charter which defines the purpose, competence, scope and responsibility of the internal audit, determine the position and define access to records, personnel and assets that are important for performance of the audit. Revising the charter is particularly important when the main structural and other changes in the organization occur.

b) Conduct the employment of Head of internal audit in accordance with the Law\textsuperscript{187} and requirements for the performance of tasks of the Head of Internal Audit Unit. Recruitment of the Head of Internal Audit has a special importance because of its responsibility in the development of internal audit, which are prescribed by international standards and the Law on the System of Internal Financial Controls.\textsuperscript{188}

c) Perform a review of the adopted strategic plan in relation to the risks and audit scope at least once a year, and thus provide a comprehensive system of strategic planning.

d) The Head of Internal Audit Unit provide comprehensive system of reporting to the Head of the entity, in accordance with Article 28 of the Law on the System of Internal Financial Controls in the Public Sector.\textsuperscript{189}

**Ministry of Culture**

should:

a) Align the Rulebook on Internal Organization and Systematization of Work Positions with the current Decree on Titles of Internal Auditors in the Public Sector and Arrangements into Salary Grades and systematize the work position of the Head for Internal Audit.

b) Conduct the employment of Head of internal audit in accordance with the Law\textsuperscript{190} and requirements for the performance of tasks of the Head of Internal Audit Unit. Recruitment of the Head of Internal Audit has a special importance because of its responsibility in the development of

\textsuperscript{185} The Law on the System of Internal Financial Controls in the Public Sector "Official Gazette of Montenegro", no. 073/08 ... 034/14).

\textsuperscript{186} Official Gazette of Montenegro, no. 073/08 ... 034/14.

\textsuperscript{187} The Law on the System of Internal Financial Controls in the Public Sector "Official Gazette of Montenegro", no. 073/08 ... 034/14.

\textsuperscript{188} Official Gazette of Montenegro, no. 073/08 ... 034/14.

\textsuperscript{189} Official Gazette of Montenegro, no. 073/08 ... 034/14.

\textsuperscript{190} The Law on the System of Internal Financial Controls in the Public Sector "Official Gazette of Montenegro", no. 073/08 ... 034/14.
internal audit, which are prescribed by international standards and the Law on the System of Internal Financial Controls.

c) Perform employment of at least up to the minimum number of internal auditors in the Internal Audit Unit provided by the Law and in accordance with the conclusions of the Government.

d) Perform a review of the adopted strategic plan in relation to the risks and audit scope at least once a year, and thus provide a comprehensive system of strategic planning.

e) Perform the audit of the system in accordance with the methodology of the Ministry of Finance and according the forms contained in the Manual for internal audit.

f) During the performance of audit adhere to the legally defined authorizations relating to the jurisdiction of the Internal Audit Unit of the Ministry in the performance of internal audit and implement it in the organizational units of the Ministry and in the entities with which it has signed an agreement on entrusting the activities of internal audit.

g) The Internal Audit Unit provide an adequate level of communication with the organizational units - audited entities in the part of reporting on audit performance, accountability for the implementation of recommendations and reporting on the implementation of recommendations and perform it in close interaction.

h) The procedure for monitoring the implementation of recommendations conduct according to the guidelines of the Ministry of Finance with the provision of sufficient and appropriate audit evidence.

i) The Head of Internal Audit Unit provide comprehensive system of reporting to the Head of the entity, in accordance with Article 28 of the Law on the System of Internal Financial Controls in the Public Sector.191

Ministry of Economy
should:

a) Perform employment of at least up to the minimum number of internal auditors in the Internal Audit Unit provided by the Law and in accordance with the conclusions of the Government.

b) When adopting the annual plan of audits examine the possibility of periodic internal audit performance of all entities with which the Ministry has signed an agreement on entrusting the activities of internal audit.

j) Performs audit of the system in accordance with the methodology of the Ministry of Finance and according to the forms contained in the Manual for internal audit.

c) The procedure for monitoring the implementation of recommendations conduct in accordance with the guidelines of the Ministry of Finance with the provision of sufficient and appropriate audit evidences.

191 Official Gazette of Montenegro, no. 073/08 ... 034/14.
d) The Head of Internal Audit Unit provide comprehensive system of reporting to the Head of the entity, in accordance with Article 28 of the Law on the System of Internal Financial Controls in the Public Sector.  

Ministry of Agriculture and Rural Development should:

a) Perform employment of at least up to the minimum number of internal auditors in the Internal Audit Unit provided by the Law and in accordance with the conclusions of the Government.

b) Perform a review of the adopted strategic plan in relation to the risks and audit scope at least once a year, and thus provide a comprehensive system of strategic planning.

c) Performs audit of the system in accordance with the methodology of the Ministry of Finance and according to the forms contained in the Manual for internal audit.

d) Ad hoc audits perform according to the written order of the Head of the entity.

e) The Head of Internal Audit Unit provide comprehensive system of reporting to the Head of the entity, in accordance with Article 28 of the Law on the System of Internal Financial Controls in the Public Sector.

Ministry of Public Administration (Ministry for Information Society and Telecommunication) should:

a) Perform a review of the adopted strategic plan in relation to the risks and audit scope at least once a year, and thus provide a comprehensive system of strategic planning.

Capital City Podgorica should:

a) Adopt amendments to the Decision on Organization and Working Method the Capital City Administration and ensure with the amendments that internal auditors in the Internal Audit Unit perform

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192 Official Gazette of Montenegro, no. 073/08 ... 034/14.
193 Official Gazette of Montenegro, no. 073/08 ... 034/14.
194 In the period of performance of audit the Ministry for Information Society and Telecommunication was established as the separate ministry (Decree on Organization and Work Manner of Public Administration "Official Gazette of Montenegro", no. 007/11 of 28 January 2011, 040/11 of 8 August 2011). However, by the time of finalization of the audit the competencies of the Ministry for Information Society and Telecommunication were transferred to the competence of the Ministry for Public Administration (Decree on Organization and Work Manner of Public Administration "Official Gazette of Montenegro", no. 005/12 ...073/16 of 25 November 2016).
exclusively activities of internal audit in accordance with the Law on the System of Internal Financial Controls and thus realize recommendations from the Report on reviewing the work of the Service for Internal Audit of the Capital City - Podgorica from December 2014.

b) The Head of the Internal Audit Unit and internal auditors in the Internal Audit Unit employ in accordance with the law, because the engagement of persons on fixed-term contracts for the performance of activities of internal audit may have an impact on the realization of the principle of objectivity of the internal audit.

c) Perform a review of the adopted strategic plan in relation to the risks and audit scope at least once a year, and thus provide a comprehensive system of strategic planning.

d) The Head of Internal Audit Unit provide comprehensive system of reporting to the Head of the entity, in accordance with Article 28 of the Law on the System of Internal Financial Controls in the Public Sector.196

**Municipality of Nikšić**

should:

a) Ad hoc audits perform according to the written order of the Head of the entity.

b) The Head of Internal Audit Unit provide comprehensive system of reporting to the Head of the entity, in accordance with Article 28 of the Law on the System of Internal Financial Controls in the Public Sector.197

**Municipality of Berane**

should:

a) The Head of the Internal Audit Unit and internal auditors in the Internal Audit Unit employ in accordance with the law, because the engagement of persons on fixed-term contracts for the performance of activities of internal audit may have an impact on the realization of the principle of objectivity of the internal audit.

b) The procedure for monitoring the implementation of recommendations conduct in accordance with the guidelines of the Ministry of Finance with the provision of sufficient and appropriate audit evidences.

c) The Head of Internal Audit Unit provide comprehensive system of reporting to the Head of the entity, in accordance with Article 28 of the Law on the System of Internal Financial Controls in the Public Sector.198

**All entities of the public sector** (beneficiaries of the funds of the Budget of Montenegro, municipal budgets, state funds, independent

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196 Official Gazette of Montenegro, no. 073/08 ... 034/14.
197 Official Gazette of Montenegro, no. 073/08 ... 034/14.
198 Official Gazette of Montenegro, no. 073/08 ... 034/14.
regulatory bodies, joint stock companies and other legal entities in which the state or municipalities have a controlling stake) are obliged to establish internal audit in one of the ways that are prescribed by the law and undertake activities on filling in the work positions in the Internal Audit Units in accordance with the law and the conclusions of the Government of Montenegro.

Audited entities are obliged, in accordance with the Article 15 of the Law on State Audit Institution, within 6 months from the date of receipt of the final Report on audit to inform SAI on the undertaken activities on the basis of developed and submitted recommendations.

Podgorica, 13th January 2017

Head of the Auditing Board of SAI
Branislav Radulović, PhD

Member of the Senate of SAI