COALITION “EUROBLOCK”

PROJECT:
“STRENGTHENING THE CIVIL SOCIETY CAPACITY TO CONTRIBUTE TO EU INTEGRATION AND ACCESSION PROCESS”

PIFC DEVELOPMENT IN MONTENEGRO

CIVIL SOCIETY STANDPOINT

May, 2012.

This project has been financially supported by the European Union. This study has been produced with the financial assistance of the European Union. The contents of the document are the sole responsibility of EMIM and can under no circumstances be regarded as reflecting the position of the European Union.
PIFC Development in Montenegro

Civil Society Standpoint

May, 2011 Podgorica

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Title of the publication:

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Civil Society Standpoint

Publisher

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For publisher

Stevo Muk, President of the Managing Board

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Design and printing

Studio Mouse total graphics center

Circulation

100

Translation of all studies produced within the project “Strengthening the civil society capacity to contribute to EU integration and the accession process” has been financially supported by the British Embassy Podgorica.

The project is co-funded by European Union and managed by Delegation of European Union to Montenegro. This study has been produced with the financial assistance of the European Union. The contents of the document are the sole responsibility of IA and can under no circumstances be regarded as reflecting the position of the European Union.
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Summary

Five years from the adoption of the Strategy, and four years after the enactment of the Law – Public Internal Financial Control System of Montenegro (hereinafter: PIFC) is still not operational. The progress achieved so far in this area is almost exclusively reflected in the development and adoption of the legal framework, while the key provisions of PIFC Development Strategy, relating to the application of the Law and establishment of the organizational framework for the implementation of the internal financial controls, have not been fulfilled within the period envisaged (2008 - 2012).

As far as the financial management and control (hereinafter: FMC) is concerned, the current situation in Montenegro is as follows: persons responsible for FMC development have been appointed in the total of 71 of the budget users, out of which 64 at central and 7 at the local government level. FMC managers’ appointment is one of the first and less demanding steps towards establishing an effective FMC system, thus an excessive delays and relatively low coverage extent of the total number of the users of the budget, are providing vague hopes that the system will, with all its components, become fully operational, and ultimately generate results.

At both the central and local government level, the total of 56 users of the budget have introduced the internal audit function using one out of two options prescribed by the Law for the internal audit establishment. Considering the fact that the PIFC Law is requiring all users of the budget to establish the internal audit system, this figure is illustrating a relatively modest penetration of the internal audit in the public sector of Montenegro, and the problems in the implementation of adopted legislation governing this area. The situation at the local government is particularly alarming, given the fact that only three local government units have introduced the internal audit function, of which only the Capital City, has established the unit based on statutory requirements.

It is necessary to strengthen the capacity of the Central Harmonization Unit for PIFC (hereinafter: CHU), representing currently the sector with the lowest number of systematized and filled vacancies in the Ministry of Finance, being understaffed.
The Parliament of MNE and the State Audit Institution (hereinafter: SAI) are almost excluded from the process of the PIFC system development monitoring. The system is lacking from formalized procedures of cooperation, reporting, information exchange. PIFC Annual Report produced by CHU, is confidential and the public may not get a detailed insight into the fulfillment degree of activities and the overall PIFC functioning.

Human resources for filling vacancies are scarce, and sustainable and systemic mechanisms for trainings have not been established. Salaries of the internal auditors in the public sector are almost four times below the ones in the commercial sector, constituting major impediment to the establishment of the audit teams. The independence of internal auditors is questionable, because they are left “at the mercy of” the head of the entity, having the option to dismiss or reassign the internal auditors to other work position without bearing any consequences, due to the disclosure of particular facts or making recommendations.

Problems in the PIFC implementation are triggered by the slow pace of implementation of the key reforms, such as the reform of public administration and public finance, the successful outlook of which is, to the great extent, dictating both the practical application and the future prospects of PIFC.

The upcoming start of the membership negotiations with the EU brings the obligation to prepare for the negotiation procedure in the Chapter 32 of the acquis - Financial Control, encompassing the PIFC. Although we are currently meeting the required criteria for opening the Chapter (part related to PIFC), Chapter’s closure depends on, almost exclusively, implementation and existence of an effective, functional PIFC.
The process of the PIFC introduction in the public finance system of Montenegro is in a critical juncture. The period of rounding up the legal framework has been completed and the key primary and secondary legislation has been adopted. We still cannot address the results of PIFC system, because the implementation of the adopted legal framework delays or takes place very slowly. The key reasons rest in the fact that this is an extremely complex and demanding reform process, representing, to the greatest extent, a new concept for the national administration. Furthermore, this is a huge undertaking in terms of required funds, human resources and necessary knowledge and expertise.

The Ministry of Finance for 2012, has ranked the PIFC function and capacity strengthening in the five top priorities, recognizing that the investment in internal control system, in times of the economic and financial crisis, may generate beneficial effects triggering the sound functioning of public finance, simultaneously providing a significant cost rationalization, or savings in the long run.

What lies ahead in the future is to confront with serious challenges such as the full implementation, human resource training, filling systematized vacancies with qualified personnel, strengthening the CHU capacities, etc. Above all, however, it is necessary to carry out the substantial reforms of both the public administration and the public finance management system, which will lead to a greater degree of managerial responsibility, confidence in the operation of internal controls and generally create a comprehensive understanding of the benefits that an effective PIFC system can bring.

2007 PIFC Strategy will cease to effect during this year. Having in mind the fact that the new Strategy will be developed, the objective of this research paper of the Institute Alternative is to provide a contribution from the civil society perspective, as well as to pursue in providing an objective review of the current status of play of PIFC introduction, with the recommendations for the future development directions and specific problems that need to be addressed.
The PIFC concept and strategy was developed in the 1990’s by the European Commission (hereinafter: the EC) for the purpose of assisting candidate countries acquiring the EU membership, in reforming their public internal control systems. Based on PIFC system, the EC pursued in understanding and implementation of a well developed and efficient internal control system in the process of joining the EU.

Corruption in the public sector and poor financial management in the former communist countries are the main reason for the PIFC development. PIFC has become an integral part of pre-accession negotiations with the countries of Central and Eastern Europe. In the light of the above, all new member states have, up to becoming a full-fledged EU members in 2004 and 2007, adopted the latest international trends and standards in the public management, control and audit. After the Western Balkan countries obtained an open EU membership prospect at the Summit held in Thessaloniki in 2003, along with other reform processes, they commenced also with the preparations for the PIFC introduction, supported by the EC (DG Budget).

When addressing the PIFC, we are making a reference to the combination of financial management and control (FMC), Internal Audit (IA) and CHU. In short: FMC is the concept of managerial accountability for the process of internal controls; IA is functionally independent and decentralized internal audit which examines the effectiveness of internal controls, and CHU is a special organizational unit (usually established within the Ministry of Finance), which develops and directs the process of PIFC.

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1 The European Council held in Thessaloniki in the period 19 - 20 June 2003, has fully supported the European perspective of the Western Balkans countries, emphasizing that they will become the integral part of the EU once they fulfill the Copenhagen criteria (from 1993);
2 In this paper we are using four acronyms, the use of which is common, deriving from the English term: PIFC - Public Internal Financial Control, FMC - Financial Management and Control, IA - Internal Audit, CHU - Central Harmonization Unit;
3 “PIFC is developed through four stages: Conceptualization - broad debate and understanding of new concepts necessary for PIFC Strategy implementation; Legislation - drafting and adoption of the relevant framework of primary and secondary legislation; Organization - development of the organizational framework for implementation; Training - training of an adequate number of managers, financial controllers and internal auditors. At average, this process, from the earliest discussions to the commencement of the full implementation may take up 5-6 years.
PIFC development in Montenegro was triggered by the EC, based on Montenegro’s Progress Report. In the part relating to financial control, the EC states that Montenegro must:

“Develop decentralized managerial accountability, supported by the adequate financial management and control system and functionally independent internal audit.”

The obligation of the PIFC development is prescribed by the Stabilization and Association Agreement 4 entered in 2007. In the period from 2007 – 2011, the activities of both the Government and the Ministry of Finance were, to the greatest extent, focused on the legal framework development.

As a first step in PIFC implementation, the Government required the Ministry of Finance to develop the PIFC Strategy, 5 which was subsequently adopted in December 2007. The adopted PIFC Strategy of MNE, 6 was accompanied by the Action Plan for Strategy implementation for the period 2008 - 2012. This strategic documents have defined the general policy of the Government in the PIFC area. After the development of a conceptual framework in the Strategy, conditions were created for the adoption of the Law on Public Internal Financial Control system 7 (hereinafter: the PIFC Law) in November 2008. In the current period, the PIFC Law was subjected to two amendments:

In April 2011:

The EC’s 2010 Analytical report 8 contained the proposal for making amendments to the PIFC Law, aimed at limiting the scope of the Law to government authorities, or, exclusion of independent institutions such as SAI from the obligation of submitting the FMC Annual Report to the Ministry of Finance. The amendments to the PIFC Law, 9 made in April 2011, have addressed this recommendation. The following entities are exempted from the obligation of reporting to the Ministry of Finance: SAI, Parliament of MNE, Constitutional Court of MNE, judiciary authorities and state prosecutors offices, Protector of Human Rights and Freedoms, independent regulatory bodies, shareholders companies and other legal entities in which the government or municipalities have a controlling stake. The objective of the amendment was to achieve the independence of these institutions in relation to the executive power.

4 Article 92 of Stabilization and Association Agreement between the European Communities and their Member States of the one part, and the Republic of Montenegro, of the other part, entered in 2007;
5 This activity envisaged by the Government’s Work Programme, derived from the Action Plan for implementation of recommendations of the European Partnership from December 2006 (Chapter 2.7. – Financial Control);
7 “Official Gazette of MNE”, No. 73/08 of 2 December 2008, 20/11 of 15 April 2011;
8 “The PIFC Law, inter alia, encompasses the Montenegrin “users of the budget”. Pursuant to the Budget Law, SAI is defined as the “user of the budget” thus it falls under the competence of the PIFC Law. However, the scope of the PIFC Law must be limited to the government bodies and not to include independent institutions such as SAI. These independent institutions should follow up the general PIFC principles, but it is necessary to regulate them separately.” Analytical Report accompanying the EC’s Opinion on the Montenegro’s application for the EU membership http://www.mip.gov.me/en/images/stories/download/Evropske_integracije/Analiticki_izvjestaj_RADNI_PREVOD.pdf
9 The Parliament has adopted the Law on Amendments to PIFC Law;
In May 2012:

Adopted were the new amendments to the PIFC Law, encompassing several important changes. Introduced was a quarterly reporting obligation (in addition to the current annual reports) on the progress in the area of FMC and IA. The bodies and institutions not subjected to the reporting to the Ministry of Finance (CHU) were exempted from the quarterly reporting obligation. However, introduced was the obligation of the bodies to report to the Parliament of MNE (and competent Committees), envisaging two reports: a) Annual Report on the internal audit work; and b) Annual Report on the implementation of planned activities in the FMC establishment and development. An interesting change introduced by the PIFC Law was the inclusion of the National Security Agency on the list of bodies and institutions that are exempted from the reporting obligation to the Ministry of Finance, having in mind the fact that this institution was not a part of the original set of bodies and institutions that have been exempted from this obligation. On the other hand, the list doesn’t include the Agency for Personal Data Protection, although it meets the requirements for the exemption from the reporting obligation.

The PIFC legal framework was, to the greatest extent, completed by the adoption of a set of subordinate and other legislation in the area of both the FMC and IA:

<table>
<thead>
<tr>
<th>FMC</th>
<th>IA</th>
</tr>
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<tbody>
<tr>
<td>Rulebook on the manner and procedure for the financial management and control establishment and implementation FMC Manual, FMC Guidelines, Instruction for the development and description of internal rules and procedures;</td>
<td>Decree on establishment of the internal audit in public sector, Decree on titles of internal auditors, Rulebook the manner and procedure of the internal audit work, Internal Audit Manual, Rulebook on examination curriculum and the manner of conducting the examination for authorized internal auditor in the public sector;</td>
</tr>
<tr>
<td>Instruction on the content of the Annual Report on implementation of planned activities for the financial management and control establishment and development and the Annual Report on the internal audits work.</td>
<td></td>
</tr>
</tbody>
</table>

Furthermore, following the adoption of the PIFC Law, for the compliance purposes, amendments were made to the Organic Budget Law and subordinate legislations such as the Directions on State Treasury Operations.

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10 Some of the changes brought by the new amendments to the PIFC Law are also as follows: precise definition of the term “reasonable assurance”; quarterly reporting obligations for FMC and IA systems; abolishment of the possibility of organizing a joint internal audit unit since this solution is inapplicable in practice, providing for the authorization to the Government of Montenegro to prescribe more detailed requirements and procedures for carrying out the audit on the basis of an agreement; Defining obligation of the head of the internal audit unit to submit the Reports on results of individual audit at the request of CHU of the Ministry of Finance; more precise defining of the obligation of to maintain the confidentiality of data and information obtained in the conduct of the audit and keeping of documents and empowering the Ministry of Finance to prescribe the manner of records keeping;

11 Agency for Personal Data Protection meets the requirements of institutions that are outside the executive power, since the President and the members of the Council, appointing the director of the Agency, are elected by the Parliament of MNE, at the proposal of a competent working body. Furthermore, the Agency is reporting to the Parliament.
FINANCIAL MANAGEMENT AND CONTROL (FMC)

What was done? The legal framework was completed based on adopting primary, secondary legislation and other regulations. The appointment process of the FMC managers (persons in charge of FMC establishment, implementation and development) with the users of the budget has commenced, whereas the FMC system is still at its earliest development stage.

FMC means the comprehensive internal control system that is established by and is the responsibility of the head of the entity, and which, together with risk management, provides reasonable assurances that the Budget and other public funds will be used properly, economically, efficiently and effectively. Based on the risk management, FMC provides assurance that the entity’s mission statement and objectives will be accomplished in compliance with the legislation. FMC is introduced for the purpose of achieving management transparency, encompassing application of the new management techniques, public sector modernization and provision of professional heads at all levels.

FMC encompasses activities particularly pertaining to the budget execution and planning, public procurement procedure implementation, servicing of liabilities on the basis of concluded contracts and other commitments, protection of assets against losses caused by mismanagement and fraud and other non-financial activities in the entity’s operation.

The PIFC Law sets forth that head of the entity shall appoint a person responsible for the establishment, implementation and development of financial management and controls. The adoption of the Action Plan represents the basis for FMC establishment with the users of the budget, envisaging the following:

- Activities for FMC establishment;
- Persons responsible for implementation of activities;
- Deadlines for activities implementation.

Up to present, the total of 20 Action Plans for FMC establishment, development and implementation were adopted, while 25 Action Plans are pending adoption.

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12 Definition taken over from the PIFC Law, Article (“Official Gazette of MNE”, No. 73/08 of 2 December 2008, No. 20/11 of 15 April 2011)
13 Article 2 of the Rulebook on the manner and procedure for FMC establishment and implementation (“Official Gazette of MNE”, No. 37/10 of 9 July 2010);
14 Article 4 of the Rulebook on the manner and procedure for FMC establishment and implementation (“Official Gazette of MNE”, No. 37/10 of 9 July 2010);
Persons becoming FMC managers are the persons appointed from the number of current employees, performing their duties in the FMC area parallel with their regular responsibilities in the entity. For example, CHU is recommending that the FMC managers are the heads of the entity in charge of finance (e.g. in local governments, secretaries of finance). The current situation in Montenegro is as follows: FMC managers were appointed in total 71 users of the budget, out of which 64 at the central and 7 at the local government level.

15 FAQ in the PIFC area;
What was done? Required subordinate and other legislation has been adopted enabling internal audit establishment and functioning, commenced was the process of introducing independent internal audit units and filling of systematized vacancies, agreement on conferral of the internal audit work to the internal audit unit of another entity. Briefly, we are at the beginning.

Internal audit means an independent, objective review and advisory activity, aimed at providing added value and improving the operations of entities, which assists an entity in achieving their objectives by providing a systematic, disciplined approach to the evaluation and improvement of risk management, controls and management processes.\textsuperscript{16}

Internal Audit Establishment

All users of the budget are obliged to establish the internal audit in one of the following ways: \textbf{a)} by organizing an independent organizational internal audit unit within the entity; or \textbf{b)} by agreement that internal audit shall be performed by the internal audit unit of another entity.\textsuperscript{17}

The latest PIFC Law amendments have abolished the third option – by organizing a joint internal audit unit upon proposal of two or more entities. In the explanatory note, it was stated that this solution proved to be inapplicable in practice, inter alia, also due to uncertain legal status of this joint internal audit unit of a number of the users of the budget. It should be emphasized that this third option for the internal audit unit establishment was commended by SIGMA's 2011 Report. This idea has been interpreted as an initiative for the adjustment of PIFC model and the demands that it brings to the real possibilities of the state and its administration, in order to achieve greater chance of successful implementation.

\textbf{The establishment of an independent internal audit unit} is particularly challenging process - both in terms of funds and human resources required. The number of employees in the internal audit unit must be at least three internal auditors, including the head of the internal audit unit.\textsuperscript{18} Furthermore, the internal audit unit must be functionally and

\begin{itemize}
\item Definition taken over from the PIFC Law, Article 4, ("Official Gazette of MNE", No. 73/08 of 2 December 2008, 20/11 of 15 April 2011);
\item The PIFC Law is setting forth the following ways for internal audit establishment:
  \begin{itemize}
  \item By organizing an independent organizational internal audit unit within the entity which will report directly to the head of the entity;
  \item By organizing a joint internal audit unit upon proposal of two or more entities, subject to the prior approval of the Ministry of Finance;
  \item By agreement that internal audit shall be performed by the internal audit unit of another entity or local government unit, subject to the prior approval of the Ministry of Finance." Article 18 of the PIFC Law ("Official Gazette of MNE", No. 73/08 of 2 December 2008, No. 20/11 of 15 April 2011);
  \end{itemize}
\item Article 18 of PIFC Law ("Official Gazette of MNE", No. 73/08 of 2 December 2008, 20/11 of 15 April 2011);
\end{itemize}
organizationally independent from other organizational units of the users of the budget, which means that internal auditors can not perform other functions and duties with the auditees, other than those falling into the internal audit area.

Pursuant to a subordinate legislation, the total of 20 users of the budget was obliged to establish an independent internal audit unit by March 2010. In addition to the budget users, an independent audit unit should be established in all other users of the budget “employing more than 200 employees and annual expenditures, or expenses exceeding EUR 5 million.” Based on this criterion, the total number of the users of budget that have to establish independent internal audit units amounts at 35. Defined criteria are among the highest ones in the region, which can be regarded as a compromise with the modest capacities of the public administration. However, despite the relatively high requirements for a low number of units that need to be established, the process is evolving very slowly.

In the current period, 26 users of the budget, obliged by the PIFC Law, have established an independent internal audit unit. An additional problem represents the fact that out of 26 users of the budget, only two of them adhered to statutory provision on the mandatory number of 3 assigned internal auditors (in all other cases, the internal audit units are understaffed, having one or two internal auditors). In four cases, the internal audit Systematization has been developed contrary to the PIFC Law, envisaging less than three job positions.

The total of 34 auditors is reassigned in internal audit units, out of which 28 at the central and 6 at the local government level. The largest number of auditors was reassigned in the second half of 2011 and early 2012.

Other users of the budget at central and local level, having less than 200 employees and annual expenses below EUR 5 million may confer the internal audit work to the internal audit unit of another entity based on the agreement. This method of establishing the internal audit is becoming more pronounced. There is currently the total of 23 agreements, while additional 4 were approved by CHU, pending signing.

19 “Ministry of Internal Affairs, Ministry of Defense, Ministry of Finance, Ministry of Foreign Affairs and the EU Integration, Ministry of Education and Sports, Ministry of Culture, Ministry of Economy, Ministry of Transportation and Maritime Affairs, Ministry of Agriculture and Development of Rural Areas, Ministry of Sustainable Development and Tourism, Ministry of Labor and Social Care, Police Administration, Customs Administration, Tax Administration, Real Estate Administration, Prison Institute, Pension and Disability Insurance Fund of MNE, Health Insurance Fund of MNE, Employment Bureau of MNE and the Capital City Podgorica: Article 2 of the Decree on establishment of the internal audit in public sector of MNE (“Official Gazette of MNE, No. 35/11);”
20 Article 3 of the Decree on establishment of the internal audit in public sector of MNE (“Official Gazette of MNE, No. 35/11);”
21 The requirements for the establishment of an independent internal audit unit are different from country to country, reflecting the capacity of the administration. For example, in Croatia, with the exception of enumerated categories of the users of the budget that must establish an independent internal audit unit, the users of the budget employing more than 50 employees and the expenditures of which are exceeding HRK 30 million (around EUR 4 million) are also obliged to establish the IAU. In Macedonia, an independent internal audit unit, in addition to enumerated special users of the budget, must be established also by the entities, the average budget plan of which exceeded the amount of MKD 50 million (approximately EUR 850,000) in last three years;
22 Employment Bureau of MNE and the Capital City Podgorica;
23 Ministry of Sustainable Development and Tourism., Health Insurance Fund of MNE, Ministry of Culture and the Ministry of Foreign Affairs and the EU Integration;
24 All data are taken over from the registry of internal audit units of the CHU, as of 15 May 2012;
25 Data from the information on activities in the PIFC, submitted to the Institute Alternative by the CHU;
26 These users of the budget are not prohibited to establish their independent internal audit units, if deemed necessary based on their needs assessment. Thus, the Ministry of Science, Ministry for information Society and Telecommunications and the Parliament of MNE have established an independent internal audit units, regardless of not fulfilling all requirements enlisted in the Decree for the internal audit establishment.
These are mainly the administrations, directorates, bureaus and public enterprises conferring internal audit work to the internal audit units of ministries, based on the agreement. There is a tendency of centralizing internal audit operations with the internal audit unit of the Ministry of Finance: out from total 23 agreements, in 10 cases different entities conferred the internal audit work to the internal audit unit of the Ministry of Finance, at CHU's approval. 27 If we bear in mind that, pursuant to the Rulebook on Systematization and Organization, this unit of the Ministry of Finance is employing only three internal auditors, while only two were reassigned, the unit's capacity to perform the internal audit work with such a significant number of the users of budget is questionable.

Altogether, the total of 56 users of the budget, both at the central and the local government level, provided the internal audit work applying one of the possible two ways of organizing. Concerning the fact the PIFC Law is requiring all users of the budget to establish the internal audit system, this figure is illustrating a relatively modest penetration of internal audit in the public sector of Montenegro, as well as some problems in the implementation of adopted legislation in this area.

“Independence”

Internal audit unit must be functionally and organizationally independent from other organizational units of the entity. Functional independence is established through independent planning, implementation and reporting of completed internal audits. Organizational independence is reflected in the fact that the head of the internal unit and internal auditor can only perform internal auditing.

The PIFC Law is declaratively stipulating that head of the internal audit unit is independent in his/her work and may not be reassigned to other work position or dismissed due to the disclosure of particular facts or making recommendations in the internal audit report. 28 However, in the absence of penalty provisions and certain types of protection, this provision is inapplicable. The head of the internal audit unit has been left “at the mercy of” the head of the entity, having the option to dismiss or reassign the internal auditors to other work position without bearing any consequences, due to the disclosure of particular facts or making recommendations. In the Croatian Law on PIFC, this option was subject to forestall by introducing the obligation of the head of the entity to:

“Prior to imposing disciplinary measures, reassignment or dismissal of the internal auditors, the head of the budget user shall be obliged to inform the CHU of the Ministry of Finance and submit all supporting documentation.” 29

Where to find qualified staff and how to retain them?

For the purpose of carrying out the operation in the capacity of internal auditor, high standards have been prescribed: in addition to the general requirements set forth by the Law on Civil Servants and State Employees, the internal auditor must have a university diploma; at least two years of work experience in auditing, financial control and accounting - financial operations and passed examination for authorized internal auditor. The

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27 All data are taken over from the registry of CHU, as of 15 May 2012;
28 Article 21 of the PIFC Law (“Official Gazette of MNE”, No. 73/08 of 2 December 2008, 20/11 of 15 April 2011);
29 Article 23 paragraph 2 of the Croatian PIFC Law;
requirements for the head of the internal audit unit are stricter, envisaging longer work experience. Since this staff is scarce in Montenegro (persons with approximate criteria were already engaged in the CHU), the CHU has motivated the users of the budget to start with the appointment of internal auditors, even if they do not meet the statutory requirements, obliged to acquire the necessary knowledge and certificates based on additional trainings.  

This fact has further diminished the chances of generating a significant impact on the internal audit activities in the early stage of the PIFC implementation due to the appointment of unqualified and untrained staff.

Relatively low income is also representing a problem in the appointment of necessary auditors. Salary difference in the public and commercial sector is huge, impeding the incitement of qualitative personnel. The average net salary of the internal auditor in the public sector amounts to EUR 439.70, amounting at EUR 1,629.00 in the commercial sector.  

Persons who have not passed the examination for certified internal auditor, and who are meeting other statutory requirements, may perform the internal audit work without having passed the examination for certified internal auditor, at maximum two years of the effective date of the Rulebook on examination curriculum and the manner of conducting the examination for authorized internal auditor in the public sector. This deadline shall start to expire from January 2012, from the effective date of the Rulebook on examination curriculum and the manner of taking examination for authorized internal auditor;

Data from the Answer to EC’s Questionnaire 32 – Financial Control, additional questions; https://www.upitnik.gov.me/02/Doc/K32.pdf
Central Harmonization Unit (CHU)

What was done? CHU has been established within the Ministry of Finance, being the driver and the cornerstone of the recent efforts aimed at completing the legal framework and encouraging the PIFC implementation. It is still too early for CHU to evolve from driving and developmental actor and to assume role of monitoring the system, because, the system itself is not fully operational. The CHU, itself, has a modest capacity to carry out its competences.

The third PIFC pillar is the CHU. In Montenegro, this function is performed by the Sector for central harmonization of financial management and control and internal audit in the public sector, being one of the eight sectors of the Ministry of Finance. The key task of the CHU is to coordinate the PIFC establishment and development at the central and local government level. In other words, CHU exists to ensure uniform development of PIFC structures and procedures, i.e. to coordinate the FMC and IA establishment with the users of the budget. 32

CHU of the Ministry of Finance is composed of the two units, and these are the Sector for FMC harmonization and Sector for Internal Audit harmonization.

The CHU’s mission statement is to ensure the coordination and harmonization of methodologies and guidelines for FMC and internal audit in the public sector.

CHU has six employees out of the total eight systematized job positions in the Sector. 33 The CHU is the sector with the least systematized job positions in the Ministry of Finance.

32 CHU competences pursuant to the PIFC Law: “The Central Harmonization Unit shall be established for the purpose of: preparation of professional basis for development of laws and enabling regulations in the area of financial management and control and internal audit; development of methodology and work standards in financial management and control and internal audit; preparation, organising and running training programs for taking examinations for authorised internal auditors; ensuring a continuing professional development plan for authorised internal auditors; preparing, organising and running training programmes and training of persons responsible for and involved in financial management and control and internal audit; coordination of establishment and development of internal financial management and control and internal audit; maintaining register of: internal audit units, internal audit charters, authorized internal auditors and persons included in financial management and control; monitoring of the implementation of laws, enabling regulations and internal rules, standards for financial management and control and internal audit, ethical code of internal auditors, instructions and methodologies for financial management and control and internal audit; review of quality of the financial management and control system and internal audit with entity, with the objective of monitoring over implementation of recommendations for the purpose of collecting information for the improvement of work methodologies and standards; cooperation with professional bodies and institutions in the area of financial management and control and internal audit, etc.”

To date, the CHU was the main driver and anchor of the overall PIFC project in Montenegro. CHU, inter alia, was engaged in the development of the strategic documents, primary and secondary legislation, and other regulations (Guidelines, Manuals, Charters, etc.), organization of trainings, seminars, training for FMC manager, working on training programmes and certification of internal auditors (creating conditions for obtaining qualified staff to fill vacancies in the internal audit sector), etc. The CHU, therefore, in addition to the conceptualization and operation on the legal framework, has played an active role in the area of the PIFC coordination and establishment.

Monitoring the PIFC System establishment and functioning

Once established, the FMC system requires continuous monitoring and evaluation, aimed at ensuring that the system is functioning according to the plan and in order to initiate timely changes. Therefore, the CHU, through the PIFC Law, has introduced the obligation of quarterly and annual reporting on the implementation of planned activities for FMC and internal audit establishment and development. 34

CHU is developing the Annual Consolidated Report on FMC, devised pursuant to the reports submitted by the users of the budget: annual reports on the implementation of planned activities for FMC establishment and development, 35 i.e. Annual Reports on the internal audit work. 36 As of this year, the users of the budget are required to submit the quarterly reports. The purpose of the Annual Consolidated Report is to inform the Government about the progress achieved in the PIFC establishment, simultaneously encompassing the monitoring over the work of the FMC managers and internal audit units with the users of the budget by the CHU.

In its current work, CHU has prepared one Annual Consolidated Report on the FMC system (for 2011). For 2010, this Report was developed in a form of information. 37 These documents are not

34 Article 15 of the PIFC Law (“Official Gazette of MNE”, No. 73/08 of 2 December 2008, 20/11 of 15 April 2011);
35 Obligation of entities referred to in Article 15 paragraph 2 of the PIFC Law (“Official Gazette of MNE”, No. 73/08 of 2 December 2008, 20/11 of 15 April 2011);
36 Obligation of entities referred to in Article 32 paragraph 1 of the PIFC Law (“Official Gazette of MNE”, No. 73/08 of 2 December 2008, 20/11 of 15 April 2011);
37 Article 38 paragraph 2 of the PIFC Law (“Official Gazette of MNE”, No. 73/08 of 2 December 2008, 20/11 of 15 April 2011);
38 Data from the response of CHU to the Questionnaire of the Institute Alternative, of 15 May 2012;
This project has been financially supported by the European Union

publicly available, and the CHU is stating that the Report was compiled of information that are owned by other authorities and institutions (users of the budget reporting the CHU), and that without their consent, the Report may not be published.

In the area of reporting on the status of play of the PIFC implementation at the central and local government level, it is obvious that the Parliament of MNE is not taking part in the monitoring of the process. The Law doesn’t impose the reporting obligation on the Parliament, or Committee in charge, through the Consolidated Annual Report on the FMC system. Furthermore, the Law doesn’t stipulate the obligation of submitting this Report to SAI. In this way, the best practice advocated by the EC and DG Budget has been neglected.

PIFC Law doesn’t stipulate penalty provisions for sanctioning any possible delays or failure in submitting the aforementioned FMC and IA Reports (quarterly and annual).

It seems that the CHU has done a little or insufficiently enough to expand the understanding of the PIFC concept, that would go beyond the narrow scope of personnel trained for FMC managers or internal auditors, particularly among managerial personnel of the users of the budget, whose understanding of the PIFC essence is pivotal for the success and application of the concept. The same situation is in terms of cooperation and networking with the key institutions/bodies in the public finance control area, such as SAI, Audit Authority, Parliamentary Committee for Economy, Finance and Budget, etc.

CHU has failed in establishing the regular mechanisms for exchange of experiences, knowledge and information between the persons engaged in the FMC, i.e. internal audit, in the form of the e-network, shared on-line forums, holding of regular meetings of all FMC managers, internal auditors in the public sector, i.e. exchange of the latest technical information through regular newsletters, magazines or bulletins.

CHU is keeping the register of internal audit units, Internal Audit Charter, authorized internal auditors and persons involved in the FMC. In the process of the FMC managers or internal auditors’ appointment, the users of the budget are obliged to submit copies of the decisions on appointment and systematization to the CHU, for the purpose of entering the data into the Registry and planning of trainings. The Register is not public, i.e. not published on the CHU web-page, yet the data can be obtained through a request for the free access to information.

39 “In order to enhance transparency, CHU is producing the Consolidated Annual Report on the status of play of the PIFC, which will eventually enable the creation of indicators for monitoring the development of the system. The report shall be submitted to the Ministry of Finance, as well as to the Parliament and the SAI. This will improve parliamentary oversight of risk and control processes dealt by the management structures in the public sector. This can also help in the work of the SAI in the external audit. (...) PIFC system that has been successfully established and effective, should, inter alia, (...) provide to the Parliament a clear overview of the situation regarding the control environment and the functioning of the public sector” Source: Welcome to the world of PIFC, DG Budget;
Two CHU’s?

Some EU member states, i.e. candidates for membership, have experience in having two CHU’s: separate one in charge of the FMC development and another for the IA development. Generally accepted opinion is that in the early PIFC development stages, the most acceptable option is to have a model – which currently exists in Montenegro – of one CHU composed of the two organizational Sectors in charge of the FMC and the IA. The experiences of other countries show that, in the more advanced stages of PIFC development, there is a tendency of creating two CHU’s, whereas the one in charge of CHU usually and formally is becoming a part of the Treasury Department within the Ministry of Finance (closer – related to the budget management and control).

HR Development Strategy

Currently, there isn’t a viable and continuous training system and training of personnel who are a part of the PIFC process - persons involved in the FMC (FMC managers) or internal auditors in the public sector. The first indication of a systematic process of training is of recent date. Specifically, according to the CHU’s announcement, training curriculum and certification of 40 internal auditors will be organized in Montenegro. In addition to certification of internal auditors, being appointed from different public sector areas, envisaged was the training of 9 local trainers, with the objective of introducing qualified personnel for the training curriculum of the internal auditors in the public sector. 40

With the objective of establishing sustainable training arrangements and training curriculum, it is necessary to establish also the regular cooperation with the Human Resources Management Authority (hereinafter: HRMA), SAI, Institute of Internal Auditors, as well as the academic community representatives, or the Faculty of Economics.

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40 Training curriculum is organized in cooperation with CEF (Center of Excellence), with the financial support of the German and Slovenian Government, as well as the CEI (Central European Initiative).
The Ministry of Finance should, through the CHU, represent a link between SAI and the PIFC system. Close cooperation between the SAI and the Ministry of Finance, i.e. CHU, is considered pivotal for achieving a comprehensive and effective system for managing and controlling the public funds.

In the current work, the SAI, when conducting audits, was issuing the assessment of the current status of play with regard to the internal control system functioning. Due to the fact that the development of PIFC system is in early stage, the SAI was generally referring to the absence of established internal audit units, noncompliance with the obligations of the functional independence of internal auditors who have been already appointed, as well as noncompliance with issued internal audit recommendations by the users of budget/spending units.

Cooperation between the Ministry of Finance and SAI in the PIFC area has commenced during the production of the PIFC Development Strategy in 2007, and it ended after producing the Strategy. Currently, there are neither formal procedures of cooperation between the SAI and the PIFC system, nor the CHU is informing the SAI about its Annual Consolidated Report on the FMC. The SAI is not involved in the development of the new Strategy for the period 2013 - 2017. The PIFC Law is neither making a reference to the SAI, nor did it define the cooperation manner.

Recommended method of formalizing cooperation is the holding of regular meetings between the SAI and CHU, used for discussing identified issues and the most suitable ways to address them. However, there are a number of other options:

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41 With the National Tourist Organization, even after the first Audit Report in 2010 and conducted control audit in 2011 - http://www.dri.co.me/index.php?option=com_docman&task=doc_view&gid=99 p. 9;
42 For example, the obligation of functional independence is not adhered to, due to the fact that the Rulebooks on Systematization and Organization contrary to the PIFC Law are in force, because the persons appointed for performing internal audits are envisaging other duties and responsibilities. An example is the case of Radio Television of Montenegro, where the appointed internal auditor received orders by the Director General to perform tasks unrelated to the internal audit, e.g. engaging in his capacity as a chairman of the Commission for the assessment of equipment;
43 Case with the University of MNE, SAI’s Annual Report for the period October 2009 – October 2010, p. 109;
44 In Croatia, the PIFC Law defines the issue of cooperation with the national audit: “The Head of the Internal Audit Unit shall cooperate with the National Audit Office which, at his request, provides all information relating to the contents of completed internal audits. At the request of the National Audit Office other forms of cooperation shall be carried out.” PIFC Law of the Republic of Croatia, Official Gazette 141/06, Article 33;
45 Welcome to the world of PIFC, European Commission, DG Budget,
Experience of Slovenia - a good example of cooperation between the CHU and SAI (Court of Audit - CA)

- Meetings – Representatives of CHU and CA are meeting on regular basis, for the purpose of exchanging information and discussing issues relevant to the implementation and development of the internal controls system. Exchange of information, in addition to the meetings, is obtained through the regular electronic communication.

- Development of regulations, guidelines, methodologies – pursuant to the procedure defined in the Public Finance Law, the Ministry of Finance is submitting to the CA the draft guidelines for comments. MF and CA, using joint efforts, are developing methodologies for the new EU’s financial perspectives, performance audit, audit trail, Internal Controls Charters. MF and CA cooperate during the translation of international standards.

- Training - Both institutions are pursuing in meet their training needs and ensuring a continuous professional development of their employees. The cooperation takes place through the establishment of initial basic Training Curriculum for acquiring the title of state auditors and the internal auditor.

- Exchange of information – pursuant to the procedure defined by the Public Finance Law, MF (CHU) is submitting a copy of the Consolidated Annual report to the CA. The CA is informing the MF on its findings when evaluating the internal control system of the auditee, while the recommendations for making improvements in this area are created using the joint efforts of CA and MF.

- An example of cooperation: in 2007, the CA as part of the audit of the Year-end accounts, made an estimate of the established internal control system with an emphasis on the development of the Annual Report on internal control and filling out of questionnaires on the self-evaluation. Based on recommendations issued by CA, the MF amended the reporting methodology, self-evaluation and other aspects of the internal control system functioning.

Source: Co-operation Between the Ministry of Finance and the Court of Audit Regarding the Public Financial Control, Nataša Prah, Director Ministry of Finance, Slovenia, Workshop on “Audit/Evaluation of Public Internal Financial Control (PIFC) Systems” Ankara, 8 – 9 July 200
The situation regarding the implementation of PIFC is particularly alarming in the local governments, where the process of the PIFC establishment is running very slow. Out of the total 21 local government units in Montenegro, internal audit was established in only three of them.

10 Municipalities are required to establish an independent internal audit unit. Out of this number, currently only 3 (Podgorica, Bijelo Polje and Pljevlja) have fulfilled this obligation and have established an independent internal audit unit. Out of these three, in Podgorica was appointed the total of 3 internal auditors, while the other two have failed in fulfilling the statutory minimum.

Seven Municipalities (Nikšić, Cetinje, Budva, Bar, Herceg Novi, Berane, and Ulcinj) still did not establish the internal audit units. It is worth mentioning that the deadline for the establishment of these units pursuant to the Decree on the establishment of internal audit in the public sector expired in March 2011.

The remaining 11 municipalities are obligated to organize the conduct of internal audit, or based on the agreement, to confer the internal audit work to the unit of another entity/institution. None of them fulfilled this obligation so far.

As far as the FMC is concerns, only seven local government units appointed the FMC managers (Plav, Plužine, Bijelo Polje, Mojkovac, Podgorica, and Danilovgrad).

aimed at creating optimum and most economical ways for the PIFC establishment at the level of municipalities.

As the main reason for the delay in the establishment of internal audit, emphasized are the high criteria for acquiring the title of internal auditors and lack of personnel. Secretaries of finance in Municipalities that were the subject of research of the Institute Alternative, titled the control of local government finance in 2011, 46 have stated that they will commence with the appointment of internal audit officers, despite the lack of the required training and qualifications. It has been announced that this will be followed, in cooperation with the Ministry of Finance, by a subsequent training of this officers. However, a year later, the situation in this area has changed only slightly.

Having in mind a very low level of the PIFC implementation in the local governments units, in terms of both the FMC and the IA, it is necessary to pay a special attention to this problem. Conditions in the Municipalities are differentiating from the ones in ministries, or state administration bodies. These differences should be reflected in the process of considering future strategic PIFC development. It is necessary to tackle the PIFC development at the local level by devising a separate development strategy or future, new, PIFC Development Strategy for the period 2013 – 2017, and to devote a special chapter to the local level, with specific measures, activities and performance indicators. SIGMA's recommendations is focusing on this issue, which believes that CHU must consider the possibility that, for example, the development of FMC at central and local level takes place in a different direction. 47

47 SIGMA Assessment Montenegro, Public Expenditure Management and Control, May 2011
If at this moment, the negotiation process for the EU membership were to involve the Chapter 32 (Financial Control), there would be the ground, at least in part related to the PIFC, for opening the Chapter. Under the new benchmarks for negotiations after 2006, for the opening of this Chapter, it is necessary that a candidate country has a comprehensive PIFC Development Strategy and defined basic principles of internal control system in its organic law on budget.

Up to closing the Chapter, however, the PIFC area would require a significant amount of work, because the EC’s criteria in this regard are reduced to the implementation, i.e. the existence of an effective FMC system, established internal audit system and powerful CHU in the Ministry of Finance.

We should bear in mind that the EC requirements in this area are not only focused on the formal nature, i.e. that the situation in the area of managerial accountability and control is not only assessed on the basis of the formal criteria defined by the PIFC concept. For example, Iceland is currently in negotiation stage for the EU membership, and the screening report has shown

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48 **Benchmarks for opening the negotiations on the Chapter 32, related to PIFC:**
The country has developed a coherent strategy for the public internal control based on international standards and best practices in the EU, as well as a gap analysis of existing systems and organizations. Specially developed principles of managerial responsibility for the FMC systems, independent and decentralized internal audit function and central harmonization of FMC, including internal audit, identified in a concept paper which endorsed by the Government, together with the implementation plan with realistic deadlines; Budget Law defines the principles of managerial accountability; Development of PIFC legislation should be based on the concept paper.

**Benchmarks for (temporary) closure of negotiations in the Chapter 32, part related to PIFC:**
Adoption and full implementation of primary and secondary legislation; Adoption of regulations, including manuals of control and audit, audit charter; code of ethics and forms for audit procedures; Established and effective application of the managerial accountability system; Established an effective FMC system and a system of decentralized and functionally independent internal audit; Established capacity for the central harmonization FMC systems and internal audit function, which are sufficiently staffed, trained and competent personnel, located in the Ministry of Finance; Established sustainable capacities for the provision of training for all managers and employees working in the FMC or internal audit systems. Quoted pursuant: **PIFC: Public Internal Financial Control: a European Commission Initiative to Build New Structures of Public Internal Control in Applicant and Third-party Countries,** Robert de Koning, 2007. p. 105;
that, although the formal PIFC elements are not in place, the internal control and audit functions are in a satisfactory manner. The Commission has proposed certain amendments with the gradual introduction of formalized procedures and forms that represent the PIFC, as a manner of additionally strengthening the manner of further improvement of the existing situation. Insisting on all formal elements of PIFC in Montenegro is more a consequence of the belief that, through strictly formalized forms and structures, improvements will be eventually made in the area of managerial responsibilities and functioning of the system of internal controls, which have neither are traditional nor they have been at a satisfactory level in the past.
PIFC can not develop by itself and isolated from other reform processes, encompassing the overall reform of public finance (the introduction of the programme budgeting, etc.), or public administration reform.

One of the recent conclusions of the EC 49 is to provide for the better integration of PIFC into the reforms that are under way in the country, or, that the PIFC must fall within the scope of these major reform processes, such as the public administration and public finance reforms. Concerning the fact that these reforms are generating the radical impact on the legal and administrative structure of the country, they require long-term political support and coordination of the national and donor strategies.

Specifically, the managerial responsibility principles, representing the backbone of the PIFC, can be achieved only through normative interventions and change of practice that occurs during the public administration reform. 50 Establishment of internal financial controls is associated with the development of a decentralized management structure and responsibilities. Head of the users of the budget is responsible for establishing an effective and efficient internal financial control system. Effective systems imply that clear lines of jurisdiction and responsibility within the organizational structure are established at all levels of governance. Management at the higher, middle and lower levels is featured by the objectives that need to be achieved and the responsibility that the achievement of objectives is taking place based on the compliance with the laws and regulations, quality standards and within the deadlines, simultaneously ensuring the economical and efficient use of the budgetary resources. FMC systems developed in the aforementioned manner are providing for a reasonable assurance to a certain line of management, that the objectives will be successfully met with the efficient and economical use of the budgetary funds 51. Through FMC and IA systems, management at the higher levels may have an insight into whether the lower level management is achieving what is expected of them and how successful they are. [2] Furthermore, the process of the FMC system introduction is closely linked with other reform processes in the context of the public finance reform, among which, the introduction of programme budgeting is of special importance.

Public Administration Reform Strategy of Montenegro for the period 2011 – 2016, in a part related to the public finance, is emphasizing the importance of the PIFC introduction. Therefore, the Action Plan for the implementation of the Strategy, within the objective

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49 Conference “Assessing PIFC in practice”, organized by the EC, DG Budget, held in Brussels, 28/29 September 2009;
50 “Public Administration Reform”, Francisco Cardona, SIGMA, Conference “Assessing PIFC in practice”, organized by the EC, DG Budget, held in Brussels, 28/29 September 2009;
51 Explanation taken over from the PIFC Development Strategy of the Republic of Croatia for the period 2009 – 2011;
“Improved Control System,” envisages two generally stated activities: “the establishment and development of an adequate management and control system”, as well as “the establishment and development of an independent internal audit function in the public sector,” the inclusion of which means that the first step toward connecting these two reform processes has been made.

Problems in the PIFC implementation are caused also by the slow pace of implementation of key reforms, such as the public administration and public finance reforms, from the success of which the future PIFC prospects of being applied in practice is relying upon.
The Implementation Degree of the Action Plan for PIFC Strategy Implementation

Most of the measures outlined in the Action Plan for the implementation of the PIFC Development Strategy in Montenegro are fulfilled. The measures from the Action Plan were mainly related to the completion of the legal framework – development of primary and secondary legislation and other regulations, trainings, as well as the systematization, establishment, reassignment of structures that should be conducted by the PIFC. Out of 14 measures, it can be concluded that 10 were fully met, while the rest of the measures (B3, B4, C1, C3) were partially fulfilled (in some cases more important than others, but generally at a low level). It is important to note that the unfulfilled obligations related to the implementation and appointment of persons responsible for the PIFC implementation. During its effectiveness, the implementation of the Action Plan was not systematically followed up and evaluated, and the Strategy itself was not revised.

The Strategy for the fight against corruption and organized crime for the period 2010 – 2014, recognizes the importance of PIFC in the area of creating preconditions for the prevention and sanctioning of corruption at all levels. Therefore, the Action Plan for the implementation of the Strategy encompasses two objectives related to the PIFC and activities for both objectives. However, almost all planned activities actually represent a duplicate, or a copy of the measures outlined in the PIFC Development Strategy. The objectives in the thematic area titled Public Finance related to PIFC are as follows: 1) “efficient internal audit system with the spending units and efficient internal audit of public sector entities” and 2) “efficient and effective FMC system (FMC)”

52 Available at: [link]
53 Action plan for implementation of the Strategy for the fight against corruption and organized crime for the period 2010 – 2012, available at: [link]
54 Envisaged measures are: Conduct internal audit of the budget funds with the users of the budget; Organize trainings for the managers and employees in the public sector relating to the internal audit; Establish internal audit units in the public sector entities at the central level; Establish internal audit units with the public sector entities at the local level; Develop a training programme and certification to enable employees to gain a certificate of internal auditors in the public sector; Increase the number of employees in internal audit area; Enhance capacities for the implementation of performance audits;
55 Envisaged measures are: appointment of persons in charge of FMC establishment and development at both the central and local government level, development of action plans for FMC establishment, development of guidelines for the improvement of the current FMC status of play;
**Action Plan for the Implementation of the PIFC Development Strategy**

### A) Joint activities

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<td>Development of the PIFC Law</td>
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### B) Activities related to the internal audit

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<td>Development of the IA Manual</td>
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<td>Adoption of the Internal Audit Charter</td>
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<td>Systematization and establishment of internal audit units with the users of the budget at the central government level</td>
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<td>4.</td>
<td>Systematization and establishment of internal audit units with the users of the budget at the local government level</td>
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<td>5.</td>
<td>Adoption of the Training Curriculum for education of internal auditors</td>
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<td>6.</td>
<td>Training of internal auditors:  - Pilot internal audit exercises with the selected users of the budget at the level of Republic level; training of internal auditors with the users of the budget at the level of the Republic that will be covered by the first stage of development; training of internal auditors with the users of the budget at the level of the Republic, which will be covered in the second stage of development; training of internal auditors with the local level users of the budget. Continuous training of internal auditors of all users of the budget at the Republic and local level and adoption of the curriculum for the certification of internal auditors.</td>
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### C) Activities related to the managerial accountability and FMC

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<td>1.</td>
<td>Amendments to the Rulebook on organization and systematization of the users of the budget for the purpose of establishing an adequate managerial accountability and FMC.</td>
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<td>2.</td>
<td>Production of a manual for the development of managerial accountability and FMC</td>
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<td>3.</td>
<td>Development of written procedures for the current business processes with selected pilot institutions, at the level of all users of the budget</td>
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<td>Adoption of the training programme for the heads and FMC managers with the users of the budget</td>
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<td>5.</td>
<td>Training for managerial accountability and FMC for  - Managers and heads at the level of the Republic; managers and heads at the local level; ongoing training.</td>
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Recommendations

- Building SAI’s capacities for cooperation with the internal auditors in all budgetary units. Take advantages of the networks of internal auditors for the horizontal application of the recommendations of individual audit reports and the audit reports of the Year – end account of the budget produced by DAI (according to the early warning principle, or, elimination of problems identified with an auditee and problems outlined in SAI’s audit report with all entities that may have the same problems/defaults/irregularities. Introduce the obligation of reporting internal audit on how the work of SAI was used and whether controls were performed for the purpose of verifying the existence of the problem identified with other users of the budget.

- Necessary to work on securing a better financial position of employees in the internal audit in the public sector.

- Strengthening the independence of internal auditors/heads of the internal audit units through the introduction of the obligation for the head of the entity to, prior to undertaking disciplinary measures, reassignment or dismissal of internal auditors, inform the CHU on the reasons for such actions and to submit the supporting documentation.

- Continuous improvement of CHU’s capacities, in terms of the staffing and training of the existing staff.

- Register of IAU, Internal Audit Charters, authorized internal auditors and persons involved in the FMC must be made available on the web-site of the Ministry of Finance (PIFC Sector), enabling access to the public in reference to the PIFC implementation status.

- Devise long-term and sustainable training programmes for FMC managers and internal auditors, in cooperation with institutions of higher education (universities) and organizations such as the Institute of Internal Auditors, or institutions such as the HRMA.

- The Law should define the procedure of submitting the Annual Consolidated Report on the PIFC system to the Parliament of MNE and the SAI, and to make it available to the public.

- Initiate the setting up of the network of FMC officers/internal auditor as a kind of a forum for learning, networking and cooperation, aimed at exchanging experiences and information on the development of the FMC system, i.e. the manner of overcoming the problems in their work. Establishment of the e-network and forum for discussion. Allow them to meet (in the form of multi-day seminars, training and networking), and establish the e-network and forum for discussion. CHU has to work more intensely on fostering cooperation and exchange of information within these two professions.

- CHU must establish closer cooperation with other institutions/bodies such as SAI, Department of Budget/Treasury, the Audit Authority, and the Parliament in order to coor-
dinate activities, exchange information, organize joint events, training programmes, etc.

- When approving the agreement on conferral of internal audit work to the internal audit unit of another entity, CHU must make sure to avoid overloading the internal audit unit of the various entities that may affect the quality of the internal audit performance.

- In accordance with the latest amendments to the PIFC Law, adopt the Guidelines on the content of quarterly report on the implementation of planned activities for the FMC establishment and development, and quarterly report on the internal audit work.

- It is necessary to make the amendments to the PIFC Law in a part related to the list of bodies and institutions that are exempted from reporting obligations to the Ministry of Finance, and to include the Agency for the Personal Data Protection.

- Parliament of MNE should make additional efforts aimed at creating a basis for an effective evaluation and competent conduct of insight into the Annual Reports on the PIFC implementation which, pursuant to the new amendments to the PIFC Law will be obtained from the “independent” entities/users of the budget. Establishment of a special committee or sub-committee for budget and audit could be a first step towards achieving this objective.

- Introduction of penalty provisions in the PIFC Law that would sanction the possible failure or delay in the submission of the Annual and quarterly FMC and IA reports by the spending units to the CHU.

- Having in mind a very low level of implementation of PIFC in the local government units, in terms of both the FMC and the IA, it is necessary to pay special attention to this problem. It is necessary to consider the option of addressing the PIFC development at the local level by adopting a specific development strategy or the future, new, PIFC Development Strategy for the period 2013-2017, a special chapter should be devoted to the local level, with specific measures, activities and performance indicators.

- PIFC development up to date, relied to a large extent on the EU and other donors funds. USAID/Bearing Point, CARDS project “First steps for a decentralized implementation system,” the IPA 2009 project “Strengthening the management and control systems for EU financial assistance in Montenegro,” twinning project “Legal Harmonization,” German Organization for Technical Assistance and Cooperation (GTZ). Excessive dependence on the international aid and the lack of support from the national sources can result in suspending the long-term PIFC development. Therefore, it is necessary to insist on a gradual strengthening of the financial responsibility for the development of PIFC with national actors and maintaining of the political will to provide financial support for specific programmes and initiatives.

- Establishment of mechanisms for monitoring the implementation of the Strategy and obligation of producing semi-annual reports on Strategy’s implementation. Consider the idea of establishing the PIFC Council, modeled on the Croatian experience - body of
mixes membership, composed of, in addition to the Ministry of Finance, the representatives of SAI, Parliament, independent experts, etc. One of the key tasks of this body would be the monitoring of the Strategy’s implementation, initiating amendments thereto, and provision of guidance for further development of PIFC, and monitoring the development of the entire system, and in advanced stages, provision of guidelines for the areas of importance for the control, verification, etc.

- It is necessary to intensify efforts towards the fulfillment of measures from the Public Administration Reform Strategy because its effects are closely associated with the prospect of PIFC be applied in practice. This specifically refers to the reforms, or improvements in the area of clerical system and the introduction of programme budgeting.
Sources:

Primary and secondary legislation and other regulations, strategies:

- (Organic) Budget Law (“Official Gazette of the RoM”, No. 40/01, 44/01, 28/04, 71/05, and the “Official Gazette of MNE”, No. 12/07 of 14 December 2007, No. 73/08 of 2 December 2008, No. 53/09 of 7 August 2009);
- PIFC Law (“Official Gazette of MNE” No.73/08);
- PIFC Law of the Republic of Croatia, Official Gazette, No. 141/06;
- Decree on internal audit establishment in the public sector (“Official Gazette of MNE”, No. 23/09);
- Decree on titles of internal auditors (“Official Gazette of MNE”, No. 23/09);
- Rulebook on Internal Organization and Systematization of the Ministry of Finance;
- Rulebook on the manner and procedure of the internal audit work (“Official Gazette of MNE”, No. 32/09);
- Rulebook on the manner and procedure for FMC establishment and implementation;
- Rulebook on examination curriculum and the manner of conducting the examination for authorized internal auditor in the public sector;
- FMC Guidelines;
- Guidelines for internal rules and procedures development and description;
- Instruction on the content of the annual report on implementation of planned activities for FMC establishment and development, and the annual report on the internal audit work;
- Directions on State Treasury Operations;
- IA Manual;
- FMC Manual;
- Public Administration reform Strategy of Montenegro for the period 2011-2016 “Aurum”;
- CHU Register FMC Managers;
- CHU Register of Internal Audit Charters;
- CHU Register of IA Units;
- CHU information on the PIFC activities;
- Stabilization and Association Agreement between the European Communities and their Member States of the one part, and the Republic of Montenegro, of the other part, entered in 2007;
- Action plan for the implementation of recommendations of the European Partnership issued in December 2006;
- PIFC Development Strategy of the Republic of Croatia for the period 2009- 2011;
- PIFC Development Strategy of MNE;
- Action plan for the implementation of the Strategy for the fight against corruption and organized crime for the period 2010-2012;

Reports:

- Montenegro’s Progress Reports, the EC, 2006-2011;
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This project has been financially supported by the European Union

Miscellaneous:
- Information on the activities in the PIFC area, submitted to the Institute Alternative by the CHU;
- Response of CHU to the questionnaire of the Institute Alternative;
- Financial control mechanisms in Montenegro - Confronting the joint task”, addresses from the Conference of the Institute of Alternative and the Office of the United Nations Development Programme (UNDP) in Montenegro;
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The Institute Alternative is a non-governmental association established in September 2007, by a group of citizens experienced in the civil society, public administration and business sector.

The Mission Statement of the Institute Alternative is the strengthening of democratic processes in Montenegro through the identification and analysis of public policies options.

The Strategic objectives of the Institute Alternative: increasing in quality of development of public policies, contributing to the development of democracy and rule of law and contributing to the protection of human rights in Montenegro.

Values that we follow in our work are the commitment to the mission, independence, continuous learning, networking and cooperation and the team work.

The Institute Alternative acts as an alternative think-tank, i.e., the research center, dealing with areas of a good governance, transparency and accountability. The scope of the topics of the Institute that are subject to its research, generating an impact through the representation of its own recommendations, include the following: parliamentary oversight of the security and defense sector, parliamentary oversight function and its role in the European integration process, public administration reforms, public procurements, public-private partnerships, state audit and budgetary control at the local government level.

Up to present, following publications/research papers have been released:

- Secret Surveillance Measures in the Criminal Proceedings – Neglected Control;
- National Security Agency and Secret Surveillance Measures – Is there any control?
- Parliament of MNE in the EU integration process – Observer or active participant?
- Parliamentary Inquiry – Oversight tool lacking political support;
- Montenegro under the Đukanović’s and EU’s watchful eyes;
- Regulatory Impact Assessment (RIA) in Montenegro – Towards "good legislation";
- Budget control at the local government level;
- State audit in Montenegro - proposals for strengthening its impact;
- Report on democratic oversight of security services;
- Think Tank – The role of independent research centers in the public policies development;
- Public-private partnerships in Montenegro - accountability, transparency and efficiency;
- Public procurement in Montenegro - Transparency and accountability;
- Evaluation of legal framework and practice in the application of certain oversight tools of the Montenegrin Parliament: consultative hearing, control hearing and parliamentary inquiry;
- Parliamentary oversight of the security and defense sector – What next?
- Case Lipci 2008 – Ways of routing it out;
- Case “Prva Banka” – Experience for supervisors and other decision makers;
- Public administration of Montenegro: Salary schemes, remuneration tools and professional capacity building options;
- Political criteria for the EU accession.

In the current period, the work of the Institute Alternative was supported by: European Fund for the Balkans, Foundation Open Society Institute - Representative Office Montenegro (FOSI ROM), Open Society Institute - Think Tank Fund, Friedrich Ebert Foundation, and Committee for allocation of funds for NGO’s projects of the Parliament of MNE, Canada Fund and the European Commission. The Institute has established cooperation with the European Stability Initiative (ESI), headquartered in Berlin, which has conducted capacity building programme for IA associates.

The Institute has established cooperation with a great number of national organizations, and the cooperation was established with a number of institutions and administration bodies, such as the State Audit Institution, Public Procurement Directorate, Parliament of Montenegro (particularly its working bodies, Committee for Economy, Finance and Budget and Committee for Security and Defense), Ministry of Finance, Concessions Commission, etc.

The Institute Alternative is the member of NGO’s self-regulatory body and it has provided complete information on its financial operations pursuant to the NGO’s Code of Conduct, to which IA is a signatory.

To find out more about the Institute Alternative:
www.institut-alternativa.org
Strengthening the civil society capacity to contribute to EU integration and the accession process


The project is co-funded by European Union and managed by Delegation of European Union to Montenegro. This study has been produced with the financial assistance of the European Union. The contents of the document are the sole responsibility of IA and can under no circumstances be regarded as reflecting the position of the European Union.