



**SIGMA**

**Support for Improvement in Governance and Management**

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**MONTENEGRO**  
**EXTERNAL AUDIT**  
**ASSESSMENT MAY 2009**

## Summary

### *Main Developments since last year*

The main developments in external audit since last year's assessment were the increased number of audits and the increased number of staff in the State Auditors Institution (SAI). The SAI has joined the network of heads of supreme audit institutions of EU candidate and potential candidate countries supported by the European Court of Auditors. It also became a member of EUROSAI at its meeting in Cracow in June 2008.

### *Main Characteristics (strengths and weaknesses)*

The SAI is a young institution, established in 2004. It has opted for a sound step-by-step approach whereby it gradually improves its capacity and performance. The SAI is a constitutional entity, and the institutional legal framework supports its independence. External audit in Montenegro has a sound legal basis.

The institution has also taken a real place in the checks and balance system of the state. The audited entities seem to respond to audit recommendations. The SAI follows up on the implementation of its recommendations. The media shows interest in the SAI's reports.

Since its establishment the SAI has gradually improved its audit capacity and audit coverage by increasing both the number and the professional capacity of its staff. A strategic development plan is being drafted (with bilateral technical assistance).

These elements constitute a good step forward in strengthening the SAI's capacity to contribute to building a sound public finance base in Montenegro and to ensuring the validity and efficacy of accountability mechanisms.

The SAI is making good progress in meeting INTOSAI and EU good practice auditing standards. The development of a supreme audit institution takes time, however. The SAI performs audits and transmits audit reports to the auditees as a continuous process throughout the year; however, consideration could be given to presenting the audit reports to parliament earlier. It will still be some years before the SAI will be in a position to undertake the full range of audits envisaged in the legislation and to contribute to an improved discussion of the execution of the state budget.

It is positive that the SAI closely follows the development of the budget process. However, the evolution of the audit process will also be dependent on improvements in the quality of budget execution, public internal financial and control, the newly broadened internal audit practice as well as parliament's administrative capacity to discuss its reports. The secretariat of the Parliamentary Committee on Economy, Finance and Budget has very few staff. At the time of writing the Committee should be scrutinising the budget proposal for fiscal policies, the medium-term framework and medium-term priorities for next year's budget.

### *Recommendations for Reform*

The SAI is committed to further building its administrative capacity to conduct the efficient external audit of the government. However, as the SAI is quite small, technical assistance support should be aligned with the SAI's administrative capacity to both absorb the assistance given and implement any recommendations.

The strategic development plan, which is being drafted, will help the further development of the SAI by providing a strategy for institutional strengthening, staff and professional skills development, public relations, and development of an internal information system. Institutional strengthening is an important part of enabling the SAI to comply with INTOSAI standards. However, INTOSAI standards are general and need adaptation to national circumstances. The audit remit in Montenegro is quite large compared to the existing resources in the SAI, and there is no strategic audit plan to ensure that all budget entities are regularly subject to audit.

A strategic audit plan should therefore be developed to ensure that all budget entities are regularly subject to audit, e.g. covering a period of up to two or three years. This is particularly important, as a small institution like the Montenegrin SAI needs to develop a sound approach to determining the volume of work that could be reasonably expected of the institution given its limited resources, professional skills and capacities, while ensuring the fulfilment of its legal audit mandate according to generally accepted EU and international auditing standards. Consideration should therefore be given to developing the methodology for implementing and regularly updating the strategic audit plan. The specific methodology for developing the strategic audit plan should be included in the audit manual.

## 1. Legal Framework

No changes have been observed in the legal basis for external audit in Montenegro. The State Auditors Institution (SAI) was established in April 2004<sup>1</sup>. The Law on the State Auditors Institution (hereafter referred to as the “SAI Law”) was drafted with assistance from the German Agency for Technical Co-operation (GTZ).

The SAI’s status is guaranteed in the Constitution, adopted by parliament on 19 October 2007, as an autonomous and supreme state audit entity reporting to parliament.

The SAI follows the collegial model; the SAI Senate, which presides over the institution as a whole, is appointed by parliament, in accordance with the SAI Law. Parliament also selects the SAI President from among the members of the Senate. The President is appointed by parliament for a period of nine years, with a non-renewable mandate. At the end of this period, the President takes office as one of the members of the Senate, whose appointments are permanent.

The SAI Senate is composed of five members. A member of the SAI Senate cannot be a member of parliament, hold any other office or be engaged in any other professional activity (article 35). A member of the Senate cannot be a member of “any body” of a political party (article 36). This provision is interpreted as meaning that a member of the SAI Senate cannot be a member of a political party or hold a leadership position in a political party. This provision is also supported by the Constitution (article 54).

The SAI’s budget is submitted to parliament (SAI Law, article 51). The SAI budget is included in the state budget and hence channelled through the Ministry of Finance in the consolidated budget process prior to submission of the state budget to parliament. However, as the SAI’s budget is submitted to parliament, it can be treated separately by parliament in the event that negotiations are necessary. Since its establishment, the SAI has only from time to time suffered from problems in obtaining the budget funds requested. This was mainly linked to the need for an increase in staff resources. The SAI has not experienced any other major difficulties in receiving the budget funds needed for its activities. Its financial independence thus seems to be preserved.

The audit remit of the SAI comprises the authorities and budget-users managing the budget and property of the state and local self-government units, as well as the Central Bank of Montenegro and other legal entities in which the state holds a share.

The SAI reports to parliament, the audited entity and, if appropriate, other authorities whenever the SAI deems it necessary. In practice, the reporting to auditees on the review of the implementation of the budget is carried out regularly. The SAI’s annual report on its activities is to be submitted to parliament and to the government by the end of October (article 19). This report should include an overview of the SAI’s findings on the budget and state property, pointing out the causes and consequences of the major findings, together with suggestions of remedies.

The annual SAI report is made public. However, the President of the Republic, the President of Parliament and the Prime Minister are to be informed of circumstances of a confidential nature.

The SAI should inform parliament and the government of particularly important issues through special reports.

On the basis of the SAI Law, Rules of Procedure and the Instruction on the Methodology of Work were established and approved on 10 January 2005. The Rules of Procedure were amended in January 2008 to reflect the creation of new staff positions. These rules regulate the organisation, working methods and operations of the SAI.

The constitutional independence of the SAI is in place, and its financial independence seems to be respected in practice. However, its operational independence might be reduced, as discussions are

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<sup>1</sup> *Official Gazette of the Republic of Montenegro*, no. 28/2004

ongoing to place the Audit Authority (AA) for the Instrument for Pre-accession Assistance (IPA)<sup>2</sup> funds within the SAI. Practice has shown that wherever the AA has been placed within a supreme audit institution the EU requires the AA to operate as a special department of the institution, with its own head.

There are many factors that need to be analysed before such a decision is taken, as there are several risks that would have an influence on the institution as a whole and on its capacity to fulfil its audit mandate in an independent and objective manner.

First of all, there would be automatic pressure from the EU on the organisation of the institution to ensure that there is sufficient capacity to audit EU funds. For example, the AA submits the annual audit plan to the European Commission and to the National Authorising Officer (NAO) - which in Montenegro is the deputy minister of the Ministry of Finance responsible for the Treasury sector – and requirements for amendments to the audit plan seem to be of a rather imposed nature. The AA reports primarily to the NAO, the Competent Accrediting Officer (CAO) – who in Montenegro is the Minister of Finance – and the EC.

A conflict of interest would also be created, as the SAI Senate (and the President of the Senate) presides over the institution as a whole. The independence of the AA seems rather artificial, as the SAI will hardly be able to independently carry out its core obligations, i.e. to review implementation of the national budget, which also includes the totality of activities financed by EU funds, the activities of the AA included. In addition, there is a risk that the audit mandate of the national budget would not be sufficiently met, given the overall constraints on resources that generally exist in a small administration.

The sheer appearance of independence is not the same as the view of this independence from an operational perspective, including solutions for it to be safeguarded in reality. Credibility and reputation are core features of the notion of operational independence. It would be difficult to argue that the decision to establish the AA in the SAI would safeguard the SAI's operational independence, especially in a newly established institution such as the SAI in Montenegro.

**The SAI is a constitutional authority that has a broad audit remit and the authority to audit public and statutory funds and resources in line with the INTOSAI Lima Declaration. It will be important to continue to transpose the notion of its constitutional independence into operational independence, i.e. by promoting sound financial management, which constitutes the main *raison d'être* of a supreme audit institution.**

## 2. Institutional Framework

Parliament deals (in the year 0) with the draft Final Accounts Act (year -1) together with the draft Budget Act (year +1). Thus parliament receives the proposed annual budget by end-November in respect of the fiscal year beginning the following January, and the budget needs to be adopted by end-December. Consequently, parliament only has one month to scrutinise fiscal policies, the medium-term framework and medium-term priorities.

According to the (Organic) Budget Law, the government is required to attach the SAI's audit report to the annual budget execution statement. The government (Ministry of Finance) attaches this audit report to the annual budget execution statement and forwards the entire package to parliament in July. In addition, according to the SAI Law (art. 19), the institution is also required to submit an annual report on its activities to parliament by the end of October.

During the period October 2007 – October 2008, the SAI audited the Republic's annual financial statement for 2007. In October 2008 the President of the SAI submitted the SAI's fourth annual report to parliament. In practice, the annual report is a compilation of the SAI's report on the annual budget execution statement together with the other audit reports that it has issued since its last annual report. The SAI has the discretion to submit its audit reports to parliament in this way.

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<sup>2</sup> Council Regulation (EC) No. 1085/2006 dated 17 July 2006; for the implementation of this regulation, Commission Regulation (EC) No. 718/2007 was published on 12 June 2007.

Consequently, during the above-mentioned period the SAI submitted the annual budget execution statement and conducted individual audits on the annual financial reports of nine ministries, as well as one audit of the final budget account of a municipality. In 2007 only five audits had been performed in addition to the audit of the annual budget execution statement. This is a significant increase in the number of audits and is mainly a result of the increase in the number of audit staff since last year.

There is an audit plan for 2009 and 17 audits are planned, which is also an increase from the 2008 figures. Three of these audits started as preliminary audits during 2008. The SAI audits entities on a rotation basis and in any one year it audits entities that account for around 70% of the consolidated public expenditures. However, there is little guidance as to how audit risks should be identified. In addition, there is no medium-term strategy indicating how the institution is to fulfil its mandate, i.e. to regularly audit all entities within its mandate.

The Instruction on the Methodology of Work requires audits to be conducted in accordance with INTOSAI auditing standards. Whilst the Instruction contains the basic elements of sound audit approach, these instructions are still quite general. There are some internal documents describing the audit methodology and indicating how audits should be done in practice, starting with audit planning and ending with audit reporting, with the aim of ensuring that all audits are carried out, documented and evaluated in the same manner with minimum quality requirements.

All audit reports contain audit recommendations. There are signs that the management of the audited entities, including the Ministry of Finance, responds to these recommendations. The SAI also follows up on its own recommendations and reports on the results to parliament, e.g. the SAI comments specifically on the follow-up or implementation of the recommendations made in its previous annual report. The media has also shown an interest in the SAI audit reports.

The SAI's audit reports are submitted to the Parliamentary Committee on Economy, Finance and Budget. Reports are used by parliament in its discussions on the adoption of the annual financial statements. For example, parliament's conclusions regarding the Financial Statements of 2007, which were issued in the *Official Gazette* no. 75 of 8 December 2008, drew on the SAI's findings and recommendations. However, there is an important time lapse between the end of the period audited for the annual audit report and the audits of the individual reports of ministries, as some audits are not reported to parliament in the same year as they are carried out. It is therefore not clear that all audit recommendations are made and followed up on a timely basis.

In addition, the secretariat of the Parliamentary Committee on Economy, Finance and Budget has only two staff members. It is obvious that there is not enough capacity within the legislature to perform a detailed analysis of either the proposed budget or the annual audit report, given the amount of work expected of this committee.

To date only regularity audits have been performed, although the law also provides for effectiveness and efficiency audits. The Ministry of Finance is moving towards programme budgeting, and for this purpose the ministry has set up a working group in which the SAI has a representative. This work would allow the SAI to prepare for audits, including aspects of performance audits, but the institution does not currently conduct any performance audits.

According to the Rules of Procedure, the SAI is foreseen to have a total staff of 66. Approximately two-thirds of the SAI staff are auditors and one-third is comprised of support staff. The total number of staff currently employed is 39, including the five members of the Senate. Of these, 23 are auditors and the plan is to employ eight new auditors in 2009. The auditors have civil servant status. To become state auditors, the auditors must pass a general professional examination and a state auditor's examination. The SAI Senate has established a Commission for the State Auditors' Examination. The members of this commission are the members of the Senate. Professionals outside the SAI have drafted the training and examination curricula. During the past year 37 candidates sat the state auditor's examination, and by the end of the year 23 auditors had passed the examination.

The SAI auditors have a relevant professional background for carrying out regularity audits, i.e. as tax experts, economists, and a few as certified accountants from the commercial sector.

Since last year's assessment, the SAI has also held a number of seminars for its staff to ensure continuous professional development. The seminars covered topics such as public procurement, public accounting, audit report drafting, IT audits, auditing of public enterprises, and audit management (efficient team work and job analysis). A list has also been compiled of the staff's training demands, and the SAI has started work on a strategic development plan for the institution.

The SAI has been a member of INTOSAI since its XIX Congress held in Mexico in November 2007. The SAI also became a member of EUROSAI at its meeting in Cracow in June 2008 and it has joined the network of heads of supreme audit institutions of EU candidate and potential candidate countries supported by the European Court of Auditors.

**The execution of the budget is regularly audited by the SAI, and individual audits are decided upon in an annual work plan. There is, however, neither a methodology for the development of a strategic audit plan nor guidance on the development of longer-term audit planning to ensure that all budget entities are regularly subject to audit in a more strategic perspective (e.g. every two to three years). Consideration should be given to shortening the delay before the annual reports are sent to parliament so that it can act on them more quickly.**

### **3. Capacity for Reform and External Assistance**

The Government of Montenegro has proposed a significant number of laws designed to facilitate reforms required by the EU. The government adopted a Public Internal Financial Control (PIFC) Policy Paper (20 December 2007) for the enhancement of financial control and internal audit, together with an action plan for implementation. The first step of the action plan was to develop the Public Internal Financial Control Law, which was adopted on 29 November 2008.

The development of a system cannot take place in isolation, and therefore the further development of the PIFC system is also dependent on the development of the supreme audit institution, as the main *raison d'être* of a supreme audit institution is to promote sound financial management of the execution of the budget. In the annual audit plan for 2009, the SAI therefore also decided to draft a strategic development plan (SDP) for the institution to enable it to undertake an efficient external audit of the government with high quality standards. The SDP should include the strategy for institutional strengthening, staff and professional skills development, international co-operation and partnership, public relations, and the development of an internal information system. The German Ministry for International Development and Economic Co-operation, through the German Agency for Technical Co-operation (GTZ), has provided technical assistance for the creation and establishment of a supreme audit institution since July 2002. German bilateral support will continue this assistance and help the SAI to further improve its administrative capacity.

**The SAI is steadily developing its administrative capacities to ensure the efficient external audit of government activities. However, some time is still needed to ensure that all of these efforts are consolidated in the institution.**