Peer Review of the National Audit Institution of Montenegro

29 November 2011

1. Introduction

Preliminary remarks

The National Audit Institution was established in April 2004. Since then, there has been steady development over the seven years and the Institution now has a real role in the checks and balance system of the Republic of Montenegro. The Senate of the Institution has now reached the stage where it wishes to further develop its professional capacity using existing capacity-building elements. The aim of the Institution is to bring those together in an overarching Strategic Development Plan (SDP).

On 25 October 2010 Mr. Miroslav Ivanisevic, President of the National Audit Institution requested Sigma to arrange an external independent review (Peer Review) of the Institution as input to its further capacity development. The development of the SDP will constitute an important document for the President and the Senate in setting priorities on how to lead the institution forward for it to be in a position to undertake the full range of audits envisaged in the legislation and to contribute to an even more enhanced discussion of the execution of the State Budget. The National Audit Institution will need to ensure the formal adoption of the Strategic Plan and of the audit methodology and manuals in order to provide a sound foundation for its co-ordinated programme of institution-building and capacity-strengthening. The Institution will also need to ensure that its management and staff are dedicated to its implementation.

However, future development will not be effective if it is implemented in isolation. Further development in the areas of internal control and internal audit in the Ministry of Finance and in budget beneficiaries will also be needed so as to ensure a continuous process of evolution of the Montenegrin public administration.

The objective of this Peer Review is to provide an independent review of the quality and adequacy of the current operations of the National Audit Institution with the aim of presenting recommendations that could be considered by the Senate for further institutional capacity building. These recommendations are intended to help the National Audit Institution to develop towards being a fully effective Supreme Audit Institution in line with international standards and good European practice, whilst taking into account the country's very specific circumstances and being fully responsive to their prevailing needs. The process should also constitute an important contribution to the strengthening of public accountability in Montenegro.

The Peer team consisted of:

- Mr. Tomaz Vesel, First Deputy President, the Court of Audit of the Republic of Slovenia;

- Ms. Dace Nulle, Council Member and Director, the National Audit Office of the Republic of Latvia

- Mr. Jan Pieter Lingen, former, Head of Cabinet to the Dutch Member of the European Court of Auditors, Sigma expert

- Mr. Vilhelm Reuterswärd, former Audit Director at the Swedish National Audit Office, now a Senior Advisor with Sigma;

For Sigma, Ms. Ulrika Klingenstierna, former Deputy Audit Director at the Swedish National Audit Office, and Sigma Senior Advisor was responsible for the project. The project assistants were Ms. Susanne Kleve-Guérinet and Ms. Annes McGoogan of the Sigma Secretariat.

The scope of the review encompassed both the activity and internal functioning of the National Audit Institution and its relationship with its institutional environment, including the impact of its work. The Peers have worked according to the benchmarks and methods described below.

Benchmarks and methodology

Benchmarks

The standards and yardsticks applied in the Peer Review are the Lima and Mexico Declarations of the International Organisation of Supreme Audit Institutions (INTOSAI), the INTOSAI auditing standards, including its Code of Ethics, and the Prague Recommendations concerning the functioning of a Supreme Audit Institution (SAI) in the context of European Integration (1999) as well as good international practice.

As an evaluation yardstick, we have also used what could be called "good" practice among the SAIs across Europe, based on the knowledge and experience of the members of the peer group. This could prove useful as many important aspects of the management of a SAI are not specified in standards, and it helps by offering practical solutions to the SAI being reviewed. The benchmarks we have applied are that:

- The SAI has a legal framework in accordance with international standards for a SAI (statutory position);

- The SAI has pro-actively determined a vision setting out its objectives and has put strategies in place to achieve them (leadership and strategy);

- The SAI manages its operations transparently and properly in accordance with national legislation and standards (accountability and proper conduct);

- The SAI interacts effectively with external stakeholders (relations with external stakeholders);

- The SAI has developed and implemented an audit approach in compliance with international audit standards (audit methodology) in order to deliver audit work of high quality;

- The SAI has at its disposal an adequate number of qualified and well trained staff (adequacy of staff resources);

- The SAI has at its disposal an adequate level of budget and physical resources (premises, IT facilities) to meet its operational needs (adequacy of non-staff resources);

- The SAI delivers timely audit reports of high quality and monitors regularly the effect of its recommendations (achievements of results).

Methodology

The Peer Review was introduced during a National Audit Institution Senate meeting on 18 January 2011. The fieldwork was carried out 14–18 March 2011 in Podgorica. We also met representatives of the stakeholders

closest to the Institution (the list of the persons interviewed can be found in Annex 1). We gathered information through extensive interviews and analysed relevant laws, regulations and guidelines and, via the Self Assessment carried out by the National Audit Institution itself, all audit staff have participated in the Peer Review.

Discussions were held with the Institution's management and most of the audit staff in Podgorica. Further discussions were held with government officials and parliamentarians. These discussions helped the team in analysing the main areas of current concern for the key actors of external audit in Montenegro.

It is emphasised that a Sigma Peer Review is not an audit. By its very nature it concentrates largely on challenges and problem areas. The time-frame and resources available to the Peers do not make it possible to fully substantiate all findings or investigate issues as deeply as would be required to be absolutely certain about their validity or how representative they are. At the end of the Review a contradictory procedure is used whereby the Montenegrin authorities confirm the Peers' findings, to ensure that their understanding of the relevant areas is not materially or significantly incorrect.

Acknowledgements

We wish to express our warm thanks to the President, Mr. Miroslav Ivanisevic and the Members of the Senate of the National Audit Institution for the way in which the mission was organised and also all its staff for spending so much time with us and providing us with a number of open and inspiring discussions. Their way of co-operating enabled us to have interviews with all key players in full openness. We are most grateful for having been offered the opportunity to have access to the results of the Self Assessment. This has proved to be very useful background to the Peer team and it bears testimony to the Senate's determination to fully benefit from this Peer Review.

We are further grateful to Ms. Marija Zugic who took care of the administrative arrangements for the review. We would also like to thank the management and all staff in the Ministries and institutions for their contributions. They provided us with open and informative discussions. Additionally, the Peer Review team were appreciative of the help and support received from the EU Delegation in Podgorica (Ms. Dona Prodanova); DG Enlargement (Ms Margriet Keijzer) and from DG Budget (Messrs. Robert Gielisse and Raymond Hill).

Reader's guidance

The name of the Institution under review, according the English version of the Law governing the Institution is the State Auditors Institution. When we refer to the Law the abbreviation used is the Law on SAI. However, in this report, in order to distinguish the Institution from the generic term Supreme Audit Institution (SAI) we have given the Institution the name National Audit Institution which is also the name in the English version of the Constitution.

After this introductory Chapter, Chapter 2 deals with the legal framework of the National Audit Institution and where its independence, mandate, powers etc are analysed. Chapters 3 focuses on the organisation and management of the Institution, and in Chapter 4 support services such as human resources management and IT support are analysed. In Chapter 5 the primary processes of the Institution are discussed where audit programming and planning are the main topics. The audit standards and methodology are the main subjects in Chapter 6 which is followed by Chapter 7 dealing with audit procedures and quality control. Reporting and follow-up are the subjects of Chapter 8. Finally, Chapter 9 deals with Relations with Parliament and media.

The ways our findings and recommendations are presented in this Report follow the structure that has proven to be suitable in other reviews. An introduction to the section is given upon which observations are presented and then finally the recommendations are made.

In this Report the Peers not only evaluate the current state of the art but also present a perspective for the National Audit Institution, both for the near future and in the medium to long term. Accordingly, the recommendations are categorised as follows: short term recommendations refer to immediate actions to be taken before the end of 2012; the medium-term recommendations refer to those activities to be carried out during the two years following 2012 in order to have the Institution's systems in place, or at least developed by end 2014, and long term recommendations which are beyond that date, which will enable the National Audit Institution to develop into a modern, effective operating and well respected audit institution. All recommendations are listed in Annex 2.

The Peers note that the recommendations, if implemented, may represent complex and significant changes to the current approaches, working practices and procedures. They may also require amendments to the existing National Audit Institution's internal regulations, sufficient investment of resources, and more understanding by management of the issues involved. We consider, however, that these recommendations will assist the Senate of the National Audit Institution in deciding upon the priorities to take forward in the development of the Institution.

These changes cannot all be made overnight. The significance of our recommendations should be seen in this context.

Reaction of the National Audit Institution

The outcome of the interviews and the analysis of the legislation, reports and documentation studied by the peers are summarised herein. The draft report was sent to the National Audit Institution on 22nd July 2011 to check and ensure the correctness of the background information described and matters highlighted for consideration. Sigma received comments to the report on 23rd September 2011 and these have been taken into account. This final version of the report constitutes the main proposals for the National Audit Institution to consider regarding the Strategic Development Plan and for their further consideration and action.

2. Legal Framework

Introduction

The legal framework of a Supreme Audit Institution is crucial to the functioning of an external audit institution. In the case of Montenegro, the Constitution dates from 2007, whereas the Law on the State Auditors Institution (SAI Law) was originally enacted in 2004, before Montenegro's independence. Although since amended, the SAI Law, as with other laws, needs to be aligned with the Constitution. This follows from the Law on the Implementation of the Constitution. The Peer Review team has looked at the Constitution, the Law on the SAI, and other relevant Laws related to it, in order to get a picture of the legal framework under which the National Audit Institution operates. This analysis of the legal framework has been carried out against the background of the international standards of INTOSAI, in particular ISSAI's 1 and 10, the Lima Declaration and the Mexico Declaration, which amongst others lay down principles and requirements for the independence of Supreme Audit Institutions and the legal foundation thereof.

Observations

The Constitution

The independence of the National Audit Institution of Montenegro has been defined in Article 144 of the Constitution where also the mandate of the Institution is described. It covers regularity, and "success in the management of state assets and liabilities, budgets and all the financial affairs of the entities..", which can be understood as meaning the efficiency and effectiveness of management of audited entities. The entities falling under the remit of the National Audit Institution are defined as all entities which are financed from public sources. In respect of reporting, this Article obliges the Institution to submit an annual report to Parliament. The National Audit Institution's Senate is mentioned as the governing body of the Institution. Article 82 (14) regulates the appointment and dismissal of the President and Members of the Senate by Parliament, but neither requirements for appointments or dismissal nor procedural arrangements are defined. In addition, Article 54 of the Constitution forbids Members of the Senate to be a member of a political organization. Other incompatibilities are defined in Articles 35 and 41 of the Law on the SAI: Member of Parliament, any other public office, or engaged in another professional activity which is understood to mean: -- no other paid job and no membership of a management board of a company or other legal entity. Article 36 repeats the constitutional condition that Members of the Senate may not be a member of a political organization, although the wording slightly differs. In this way the independence and objectivity of Senate Members can be considered to have a certain legal foundation, but these provisions do not set objectivity, integrity and impartiality as requirements for the Members in their work. The Constitution contains articles that regulate the (functional) immunity of Members of Parliament (Art. 86), Judges (Art. 122), and the State Prosecutor and Deputy State Prosecutor (Art 137). A similar provision for Members of the Senate does not exist, although Parliament has taken an initiative to amend the Constitution in this sense.

Law on the State Auditors Institution

The SAI Law confirms the independent status of the National Audit Institution in Article 2, but the wording differs from the wording of the Constitution: instead of an independent body, the English version of the law speaks of

an autonomous body. Article 2 (2) forbids anyone to influence Members of the Senate whilst exercising their duty. As a matter of principle this is correct, but compliance seems difficult to enforce. The audit remit and mandate are further detailed in Articles 4-8 of the Law on the SAI. Articles 4 and 8 establish a more detailed remit, than the one set out in the Constitution, and Articles 5-7 lay down the precise mandate, a description which is in line with the international language. Article 5 clearly sets out the power of the Institution to carry out regularity / compliance and performance audit, but financial / certification audit is not specifically mentioned. Article 7 states that the Institution is to audit documents and activities that may have a financial effect on revenues, expenditures, state property, debt level, granting of guarantees and the efficient use of allocated funds. Although it refers to Article 5, the scope of Article 7 seems to be more restricted than Article 5. Article 6 is about the expected output from the National Audit Institution: what and how it is expected to contribute to sound financial management, how and on what it reports to Parliament in the annual report, and how it is supposed to provide expert advice to Parliament, government and other state bodies. The SAI Law does not explicitly foresee a mandate to audit the use of EU funds nor other foreign funds, although if these are channelled through the budget of entities that fall within the Institution's remit it can be understood that the Institution does have the mandate to carry out an audit on the totality of activities of these funds and report to Parliament.

Independence of the National Audit Institution with regard to the establishment of the audit work programme is defined in Article 9. The Annual Audit Plan needs to be adopted by the 10th of January, so in the beginning of the current year, and not at the end of the previous year. There is no obligation in the SAI Law to establish a Multi-Annual Audit Plan. However, both the SAI Law and the Rules of Procedure allow for a Strategic or Multi-Annual Audit Plan (see further analysis under the Chapter on Audit Programming and Planning). The Institution has the necessary discretion to establish the Audit Plan. The only mandatory audit is the obligation to carry out an audit on the financial statement of the Republic of Montenegro on an annual basis. The results of this audit need to be reported to Parliament in the Annual Report, in line with Article 19 (1) and Article 26.

Article 10 defines the obligation of audited entities to provide all necessary information to the National Audit Institution. As it relates to the submission of documents and other audit information, it does not provide a legal basis for the submission of documents which are not related to an audit to the National Audit Institution – for instance, when the Institution would like to carry out a study in order to select audit subjects or topics.

Article 33 defines the Parliamentary procedure for appointing the President and a Member of the Senate. It reads that the Members are appointed or relieved from duty on recommendation of the competent Parliamentary working body. In practice, it is the Administrative Committee within Parliament that is considered to be the competent working body in this respect, without a role for the Committee on Economy, Finance and Budget which deals with the Institution's audit reports. Article 34 sets the criteria for relieving a Member from office. Apart from resignation and retirement, a Member will be dismissed when he is sentenced to imprisonment or when he has exercised his duty in an unprofessional or unscrupulous manner. The initiative for a dismissal procedure lies with the Senate, as defined in Article 34(4). The retirement age is not mentioned in the Article. The incompatibilities mentioned in Articles 35 and 41 are not explicitly linked to the criteria for starting a dismissal procedure.

The term of office for Members of the Senate is indefinite. The President's term of office is nine years, without the possibility of renewal. As a Member of the Senate, a President can stay on after his term of office as President expires.

Financial independence

Financial autonomy is regulated under Article 51. It foresees the submission of a draft budget by the National Audit Institution directly to the Parliamentary working body responsible for financial affairs, i.e. the Committee on Economy, Finance and Budget. After adoption, this parliamentary committee is to submit the budget for inclusion in the State Budget to the Minister of Finance. As the Law on the SAI does not set exceptions from the application of other laws, the Institution as budget user falls under all rules set for budget users by law. Employees of the Institution fall under the Civil Service Law and the Law on Salaries of Civil Servants and State Employees, although the salary of auditors may be supplemented by the Institution on the basis of Article 45a (2). Article 28 provides for the external audit of the financial statement of the Institution. Parliament is to entrust this audit to a professional organisation. So far, this has not happened, which leaves the Institution in a -- for an external audit institution -- very uncomfortable position of unaudited financial statements.

Code of Ethics

The Code of Ethics, enacted in April 2006, is applicable for all employees of the National Audit Institution. There is no Code of Ethics for the Senate Members. The Code of Ethics does not foresee a procedure for checking or ensuring compliance, apart from a general reference to (disciplinary) provisions of the Law on Civil Servants and State Employees.

The name of the Institution

It has also been noticed that different names of the Institution appear in the English versions of the legal framework governing it and even within the Constitution the name of the Institution is not coherent. Neither is it coherent with the SAI Law.

Conclusions and recommendations

In general, the legal framework of the National Audit Institution is relatively well developed. The Constitution includes provisions for ensuring the Institution's independence and its mandate. The SAI Law details the independence of the Institution, its audit mandate, remit, and powers. The Senate is clearly the highest authority, and has full power to govern the Institution. The provisions in respect of the term of office of Members of the Senate have a positive influence on their independence: they are not dependent on political decisions for reappointment, and the indefinite term of office makes their position quite strong and allows for a strong leadership of the National Audit Institution.

The INTOSAI standards are applicable to all Institutions who are members of INTOSAI. They are developed for institutions that are established either as a court model with judicial powers or as office models that have no judicial powers, and in the latter case irrespective of the governance structure, collegial as in Montenegro or under one head, the auditor-general model. If we systematically compare the eight principles of the Mexico Declaration (ISSAI 10) with the legal framework of the National Audit Institution in Montenegro, we come to the following assessment:

> **Principle 1:** The existence of an appropriate and effective constitutional/statutory/legal framework and of de facto application provisions of this framework. The legal framework in Montenegro is in compliance with this principle.

Principle 2: The independence of Supreme Audit Institution (SAI) heads and members (of collegial institutions), including security of tenure and legal immunity in the normal discharge of their duties. Independence of Members of the Senate is not laid down in the Constitution as such, although the Constitution does contain the provision that members may not be a member of a political party. The Law on the Supreme Auditors Institution defines the independence in two other indirect ways, when it forbids any influencing of members and when it defines incompatibilities. Immunity of Members of the Senate is not laid down in the Law or the Constitution.

Principle 3: A sufficiently broad mandate and full discretion, in the discharge of Supreme Audit Institution functions. This principle is complied with, although the wording might be improved and the mandate to audit the entire management and use of EU funds made explicit.

Principle 4: Unrestricted access to information. This principle is complied with to the extent that audited entities have the obligation to submit any information the Institution requests, but outside the direct context of an audit such an obligation does not exist.

Principle 5: The right and obligation to report on their work. This principle is complied with.

Principle 6: The freedom to decide the content and timing of audit reports and to publish and disseminate them. This principle is complied with.

Principle 7: The existence of effective follow-up mechanisms on Supreme Audit Institution recommendations. This has not been laid down in the law, for instance by obliging the audited entity to inform the National Audit Institution on the follow-up given on the conclusions and recommendations in an audit report.

Principle 8: Financial and managerial/administrative autonomy and the availability of appropriate human, material, and monetary resources. Financial autonomy (not independence that is not what INTOSAI standards require) is relatively well enshrined in the SAI Law and works well in practice, but the autonomous management of the Institution is restricted by the administrative laws that govern the management of all public sector and all budget users. If the Institution would consider its resources to be insufficient, then the procedure for submitting a draft budget directly to Parliament allows for the appeal to the Legislature which Principle 8 foresees.

Recommendations

Although there is no urgent need for amending the Constitution or the SAI Law, there are a couple of possible improvements that might be considered when the Constitution or the SAI Law is amended in the near future. Following on from the observations and the assessment above, the Constitution might be amended to ensure the name of the Institution is coherent within that document as well as throughout the legal framework governing the Institution.

For the SAI Law, amendments may be considered on the following issues:

- A provision could be included to secure the functional immunity of Members of the Senate, similar to the immunity of judges. However, such a functional immunity should be very precisely worded, so as to cover only immunity for liability for decisions of the Members of the Senate in respect of audit reports and audit opinions.

- Care should be given in Article 2 of the English version of the SAI Law to the use of the word "autonomous". This should be changed to reflect the text of the Constitution which uses the word "independent". The independence of the Members could be further strengthened by inserting a provision which sets the requirements for members when exercising their duties. For instance, Members of the Senate exercise their duties impartially, objectively and with integrity. Although such a provision will not be easily enforceable, it allows for the Senate as a whole to discuss individual behaviour internally on the basis of legal principles.

- It might be considered to explicitly mention in Article 5 the mandate of the Institution to carry out financial and certification audits. Article 5 and Article 7 (1, sub 4) might be reworded slightly so as to include economy and effectiveness instead of only efficiency. Article 4 is the best place to insert a provision that also entities managing, using and reporting of EU funds (and funds from international financial institutions) are within the remit of the National Audit Institution.

- In Article 9 review of the date before which the Annual Audit Plan needs to be adopted might be considered. It would be advisable to have the plan finalised before the year end. Article 10 could be extended so as to include the obligation of all entities under the remit of the Institution to submit any information requested by the National Audit Institution, also outside the context of an announced audit. In order to make a report by an audited entity on the follow up of recommendations obligatory, it might be considered to insert such a provision in Article 25. In Article 34 the retirement age should preferably be mentioned, although it has to be ensured it is compatible with the Law on Civil Service and consideration should be given to link the reasons for dismissal to the incompatibilities mentioned in Articles 35 and 41.

- Although in principle the National Audit Institution should follow the rules in the public sector for budget users when implementing the budget, it cannot be excluded that this may in practice run counter to the autonomy required for the discharge of its duties. This might necessitate amendments to the Civil Service Law and the Budget Law, to allow for exceptions for the National Audit Institution - as is the case for Parliament and the judiciary. In terms of resources, the Institution should consider how, apart from increasing the number of staff, outsourcing and use of alternative audit arrangements could be used (e.g. private sector auditor's public auditing companies, and the National Audit Institution relying - on their results and applying the relevant professional standards).

- As long as Parliament does not appoint an external auditor for the National Audit Institution's financial statements, the Institution should initiate an external audit of those on its own, for instance, by contracting a private sector audit firm.

- The Senate should consider developing a professional Code of Ethics for Members, and include in the current Code of Ethics for State Employees a clearer provision allowing for disciplinary measures in case of non-compliance. The Code of Ethics is not enforceable as such but it would allow for the discussion mentioned under the suggestion related to Article 2 above.

3. Organisation and Management

Introduction

The National Audit Institution is headed by the President who has the coordinating role within the Institution and who presides over the Senate. The Senate is the collective body charged with the management of the Institution. It consists of five Members who supervise the work of five individual sectors. While they are considered as being Heads of the Sectors, it is State Auditors who are responsible for the day-to-day audit management of the sectors. The work within the sectors is followed by the Members of the Senate, but the final decision is given to a two-member Auditing Board. General matters, staffing as well as financial and accounting issues and technical support are the responsibility of a Secretary, who is directly accountable to the Senate.

Observations

Senate

On the basis of Article 38 of the Law on SAI, it is the Senate as the governing body of the National Audit Institution which takes the most important and sensitive decisions of the Institution such as, for example, the Annual Report and special reports, draft budget, rules of procedure, audit standards, the Annual Audit Plan, financial statement of the Institution, etc. The collegial principle of the Institution's management is highlighted by Article 9 of its Rules of Procedure which lays out a list of duties for the Senate. The President chairs the Senate and directs the work of the Institution acts as its public representative and coordinates the work of the Senate and the Auditing Boards.

Through the discussions with the Members of the Senate the Peers were informed that it was appreciated that they have the opportunity to operate in a collective management body. They consider it advantageous to be able to openly exchange their views and communicate well with each other in order to be able to support progress being achieved in the operational aspects of the Institution. In the Peers view the understanding of this has great value for the further development of the Institution, as it is faced with the task of adopting some key decisions for this development and for also being able to follow the public sector process in Montenegro in moving towards EU accession.

In the minutes of the Senate meetings the Peers have noted that the Senate is mainly focused on administrative and organisational issues and procedures, whereas less focus is given to leadership and strategic issues of the Institution in respect of enhancing its institutional capacity of external audit. The Peers did not find evidence that key issues under a particular audit were referred to the level of the Senate. In practice, the role of the Senate is thus addressing the issues which may be related to the work of the National Audit Institution but are often of a less important, technical or organisational nature.

The need for strategic guidance is however recognised by the Senate, hence the decision to develop the SDP. The Members of the Senate have also prepared several starting points, inter alia the Institut Alternativa Study "The State Audit Institution in Montenegro – the Influence Strengthening Proposal" (Nov 2010). To this end, they also formed a self assessment working group with a special focus on issues of strategic development policies as well as preparing and also discussing several strategic proposals. An early first draft of an SDP which runs up until

2015 has been produced in collaboration with the German Gesellschaft für internationale Zusammenarbeit (GIZ) in an EU technical assistance project. This Peer Review can also be understood as an attempt to identify the areas needed to be focused on as the basis for the adoption of strategic development policies.

The Institution is organised into five sectors. In fact, the Senate Member responsible for managing the audit in a sector should be considered the Supervisor of the Sector, whereas the direct day-to-day management is in the hands of the State Auditor appointed as Head of the Sector.

For the time being only four Senate Members are performing their duties while one post has been empty for over a year after the resignation of the previous Member. The Parliament has not yet designated a new Member, although the Senate has asked for a swift decision. The delay caused by the Parliamentary Committee which has to prepare the appointment of a new Member leads to the unfortunate circumstance that the Senate cannot operate in its full composition. Auditors within the Sector missing the Senate Member do not therefore have their representative in the collegial decision-making body. Nevertheless, other Senate members have been nominated for audit work for the sector missing the Senate Member. In this way issues related to the audit work are dealt with but the more strategic issues in respect of raising the institutional capacity of external audit which this sector contributes to be still unresolved.

President

The President is a "first among equals" and plays a coordinating role. When executing his tasks the President, under Article 40 of the SAI Law (determination of his duties to others), is bound by the continuous reaching of agreement between the Members of the Senate. The President's tasks are additionally determined in Article 10 of the Rules of Procedure and are predominantly related to the provision of conditions for the work of the Senate. At the same time, the President should also be responsible for the organisation of the Institution's work, but in practice this role is limited. Such a role for the President of the National Audit Institution is complicated due to his direct involvement in audit responsibilities and the manner of operation of the Senate limiting the President's possibilities to take decisions on organisational issues.

Auditing Board/Collegium

The Auditing Board is a two-member body of the Institution which is comprised by the Senate Member responsible for managing the audit within a Sector and one of the other Senate Members either appointed by the Senate or designated within the Annual Audit Plan. According to the SAI Law, the Rules of Procedure and other various sub-legal acts the Auditing Board is in charge of and supervises the audit procedure, and is responsible for the results of the audit. It is this collective authority which exercises the management of individual audits. This body is referred to in legal texts as the Auditing Board and collegiate body. The Auditing Board will be referred to as Collegium (also the term used during the Peer interviews) in the rest of this report. It is this body which decides the final output from individual audits.

Members have a significant degree of operational freedom within the Collegiums and there is no centrally determined and uniform approach to audit. It is notable that the Members of the Senate have considerable discretion in the way they approach their tasks. During the discussions with the audit teams the Peers got an impression that the practice of the Collegium is also quite varied. By that the Peers would like to indicate that this arises from the different approaches of Senate Members during the audit procedure and also by quality management - which should by all means be the key work area of the Members of the Senate. Special attention should also be given to the fact that the process of cooperation between the members of the Collegium is under-

documented (commenting about drafts, providing recommendations, assuring quality, addressing auditee objections, etc.).

In practice, decisions are made unanimously within the Collegium, and it is the Collegium who analyses the objections from auditees and approves conclusions arising from audit work. Where the college cannot agree on a particular decision, it will be referred to the Senate for the final decision. The Peers were informed that so far, in practice, such a situation has never arisen.

Sectors

Each of the five Sectors is headed by a State Auditor who is appointed as Head of Sector and he/she is responsible for the day-to-day audit work management. This Sector Head will be referred to as Head of Sector (also the term used during the Peer interviews) in the rest of this report.

Each Sector is responsible for the audit of specific ministries and other entities, but audit Sectors can also undertake cross-departmental audit work in different areas. In addition, the Sectors have other tasks and competencies, which are related to the horizontal responsibilities of the Members (standardisation of the audit procedure, staff training, scientific research and publishing, IT in auditing of public sector and improvement of IT systems of the Institution, etc). A list of Sector responsibilities is attached in Annex 3.

During the interviews and during the analysis of the selected audit reports the Peers noted that there are different sector practices in place, also in respect of sector management and cooperation of the management in the field work as well as methods of assuring quality in audit implementation. It could be understood that the Collegiums would counteract development of sectoral approaches and would rather ensure consistency and harmonisation of the audit procedures. The Peers are however of the opinion that extensive harmonisation for consistent and uniform audit procedures are required, though it is likely that this task will be challenged by the seemingly strongly developed sector approaches adapted to audit work. A strengthened Senate engagement to overcome this is highly recommended. Furthermore, the overall quality assurance should be ensured at the level of the Institution (not just within the Sectors) to adequately follow good practices in each Sector and so as to further build on them and use them for the rest of the Institution.

The Peers also regard the incorporation of certain functions (IT, legal service) within sectors as relatively inefficient. The circumstances described above also indicate a high risk of audit approaches and good practices developing in many different ways. There is no obvious connection between the sectors, no interconnectivity either in the area of management of resources resulting in the composition of audit teams or in the area of exchange good practices. In Sector 3, for example, certain audit tools (sampling, expressing opinions, etc.) have been developed, and which can be evaluated as an example of good practice. However, they are not used uniformly within the framework of Institution. Also, the self assessment exercise performed by the Institution actually asked for standardised Audit Reports and other "harmonisation" which is of interest. In this report there are findings that also show that the Institution has adopted a significant number of internal documents. The guidelines (audit planning, audit process, materiality, follow-up, quality assurance, etc.) in accordance with ISSAI Standards are an important piece of work which is being undertaken. It is of vital importance that further efforts are taken to finalise those guidelines on the basis of good practice in the past and in cooperation with a variety of Sectors.

It should also be noted that the Institution had to face a significant challenge in establishing an Audit Authority as part of complying with rules of the EU Instrument of Pre-Accession (IPA) Funds. This will amongst other things affect its staffing resources (number of auditors, competencies and skills) and audit remit.

In theory Departments should also be established as parts of a Sector (Article 29 of the SAI Law). With the relatively low number of auditors within Sectors, Departments have so far only been established in Sector II. This pragmatic approach is understandable.

Secretary

The Secretary is in charge of providing administrative and support services and is appointed for an indefinite period by the Senate, based on a public announcement. He is accountable to the Senate and not directly to the President.

The Secretariat is responsible for administrative and professional activities and performs a variety of tasks that can be divided into three main sections: a section for general and staff issues, a section for financial and accounting issues, a section for technical support. The support services such as human resource management and IT issues are further analysed and discussed in the following Chapter on Human resources and IT.

Internal communication

Communication to staff of the Institution by means of circulars containing guidance, and the maintenance of up-to-date policies, standards and practices, is important in maintaining the quality of audits (INTOSAI: ISSAI 200). Based on the interviews the Peers held with various Sectors it can be claimed that the communication within those is adequate and sometimes very intensive. However, there are no "general" staff meetings, very little of sharing of experiences, or encouragement from the top. The Senate Members have also understood that it is necessary to overcome this lack of internal communication. Based on the variety of approaches to work described above the Peers also consider it is of vital importance that internal communication in the Institution be enhanced considerably. Bearing in mind that there are currently less than 60 employees, the Senate could create opportunities for strengthening internal communication with regular staff meetings. The fact that it is a relatively small Institution could be considered as advantageous as it makes it easier to manage.

Advisory role

The National Audit Institution has the power to provide help and guidance to the public sector with its expert knowledge, to give advice to auditees within its audit responsibilities and state its position regarding the proposals for regulations that affect public finance. Based on the findings gained through the audit, and based on Article 21 of SAI Law, the Institution may advise Parliament and the Government on financially significant measures and important projects. The Institution has been actively involved in the discussion about the approval of budgets and the government's final accounts as well as in adopting some recent fundamental regulations. The Institution has also been consulted on some changes in regulation introduced by the Government that have financial consequences. However, in this context there is no clear definition of the advisory role of the Senate Member or the more specific scope which would enable them to express their advice, based on their own judgement or as the Institution only within the framework of an already undertaken audit assessment.

Assessment of the Institution's performance

So far no overall assessment of the Institution's performance has been made. With no clear definition of strategic policies this is to be expected, so only with the adoption of an SDP, agreed upon by all the Members of the Senate, will it be possible to define objectives and measure outcomes of the work of Institution. Considering the

structure and the manner of the management within the Institution, it will also be necessary to define indicators of effectiveness of work and tasks performed by a particular Sector.

Conclusions and recommendations

The Peers recognise that, over a period of seven years the National Audit Institution has evolved enormously and matured into an organisation to a point where it is now ready to define and achieve the next step in evolving into an even more professional organisation. The decision taken to build on its existing capacity-building elements (such as, for example, the draft audit standards) and formalise this in a Strategic Development Plan is an important decision. In this plan it is equally important to focus on the development of human resources. The human resource development plan is discussed in the Chapter on Human Resources.

Management is the ability to guide or show the way, in such a manner that others follow willingly and with commitment. It is important for the management in any organisation to demonstrate the quality and skills of leadership as it promotes cohesion and greatly reduces the likelihood of internal management discord and dissension that can seriously impair the organisation's efficiency and effectiveness. This is particularly important in an organisation comprised of professional individuals, such as a Supreme Audit Institution, much of whose work must be individually managed on a day-to-day basis, but which must at the same time be focused on achieving the mission, values, common goals and objectives of the Institution. In the Peers view the Institution has reached a level where stronger management leadership is needed. The Senate has an important key role to ensure this is achieved.

The SDP should set out the key factors which are likely to have an impact on the Institution over a given period of time, its response and its strategic objectives. In the Peers view the SDP should cover three to six years at the most. In the SDP, the Institution should notably define long-term objectives for the main audit areas and individual types of audits as well as activities for the achievement of these objectives. The initial action would be to define the mission and vision as the leading principles to provide the basis for the development of an SDP.

The next step would be defining strategic objectives. To this end, key external factors that can significantly affect the performance of audit responsibility and achievement of strategic objectives but cannot be influenced by the Institution should be identified in addition.

The SDP should also include the values of the Institution, the defining factors affecting their work and measures to be taken, the key audit areas, and the definition of strategic objectives (by audit areas). The SDP should also define required resources and measures for capacity building in order to enable a successful realisation of the strategy. Criteria for the assessment of the effectiveness of the Institution should be also developed within the framework of the SDP and work on the basis of these criteria evaluated in the Institution's annual activity report. (For the annual activity report please refers to the Chapter on Relations with Parliament and Media).

Short term

- The Institution should define its mission and vision in order to provide a basis for its SDP. By doing so the management indicates to employees of the Institution as well as outside stakeholders that it has a clear mission and vision for a given period of time and highlights the strategic audit areas and how it aims to achieve them. This would also constitute a good step forward in strengthening the Institution's capacity to contribute to the building of a sound public finance base in Montenegro and to ensure the validity and efficacy of accountability mechanisms.

- A competent replacement for the Senate vacancy should be designated enabling the Institution to operate in its full legal composition and enabling equal distribution of tasks and responsibilities between Senate Members. The Institution should do its utmost to convey to Parliament the necessity of the designation of the fifth Member.

- In order to more clearly delineate the responsibilities of the Senate between its audit responsibilities and current organisational issues, it would be advisable to adopt the Rules of Procedure of the Senate and define the role of the Members of the Collegium, the manner of solving the discord between them and define the role of the Senate rapporteur. In addition, in order to highlight more operative functioning of the Institution and its Secretariat it would be reasonable to once again question the additional competencies of the Senate in accordance to the Rules of Procedures (hiring an external expert, new or additional employment, international cooperation, etc.).

- For the further development of the Institution it would be advisable to keep taking advantage of possibilities for the implementation of personal development tasks and objectives of the Members of the Senate (types of audit, methodological issues, organisational issues), who seem to be willing to contribute towards further development of the Institution as a whole.

- From observations in this and other Chapters further on in this report it can be concluded that also the lack of clarity in the separation of duties between various sectors and the Secretariat can be considered a complication in the Institution's future successful development. In the Peers' view it would be necessary to consider horizontal development tasks within Sectors. The development of horizontal development functions within Sectors is due to the evident endeavours of the Members and is considered a good solution at this stage of the Institution's development, but a lack of control and reporting regarding their implementation can be observed, particularly relating to problems in the implementation of changes needed to enhance the proficiency of the Institution as a whole.

Further consideration should therefore be given to the special role of the Senate in the management of the Institution and also the requirement that the President is bound by the continual reaching of an agreement between the Members of the Senate also as regards organisational issues. In order to enable a more efficient decision-making and management, it would be also necessary to define more clearly the role of the Secretary of the Institution.

Since a clear delineation of competences and a potentially different organisation would contribute towards a more efficient management of institution and a particularly easier implementation of audit tasks, it would be necessary to consider various options for the change in the organisation of operations of the Institution.

One of the options the Peers propose is the establishment of a special sector with horizontal functions, which could be led by the President and which would include the personnel developing the Institution's tasks (strategic issues of development and organisation, international cooperation, quality assurance) as well as the support services of the Institution (HR, IT, training, administration, internal communication and public relations, legal service, assessment of the Institution, budgeting, etc). To designate the Secretary as Head of Sector would be one of the possibilities. This would however require the amendment to the Rules of Procedures and a somewhat different role for the Members of the Senate, since in this way the President would participate as a Member of the Collegium only. Audit tasks could then be divided amongst the four remaining audit sectors.

As the second option there is a proposal that administrative issues should be concentrated within the work procedures of the Secretariat. This option would enable the Senate to more often focus on specific questions and dilemmas of audit reports. As the Secretariat should cover a broad scope of activities and be the driver of the change process, it would be important to strengthen the capacity of the Secretariat and an appropriate mandate should be given to the Sectors in the field of responsibility on horizontal issues.

- To provide the auditors with all the necessary legal advice during the audit, it would be important to establish a legal service or at least appoint a group of qualified persons in charge of legal issues, which come about during the implementation of audits.

- Each Member should have independent discretion when it comes to audit decision making while having transparent cooperation with other Members of the Senate. The Senate should adopt the fundamental objective of having access to the significant and substantial disclosures and positions of the Institution even before the final audit reports are issued. The Collegium rapporteur's report or the Head of the Sector's (i.e. the State Auditor appointed as Head of Sector) report should be the basis.

  For a successful limitation to the different approaches by the Members of the Senate within the audit procedures and to ensure quality management (which should by far be the most important work area of the Collegiums) the decision-making process and quality assurance of the Collegium should be consistently documented and the audit team members should be informed at the same time.

- A unified practice could be established through the encouragement of sharing good practices between Sectors and in forming audit teams with auditors from different Sectors. Such interconnectivity is of key importance in pursuing effective leadership. The staffs of a Supreme Audit Institution need to be flexible, and be able to work in new ways which reflect the ongoing changes to public services. Ad hoc audit teams from different Sectors may be set up to undertake specific audit projects.

  The National Audit Institution should start developing tools for internal communication, including regular staff meetings, developing intranet, and enhance staff rotation between sectors or audit teams. The Senate Members and Heads of Sectors (i.e. State Auditors as Head of Sectors) and auditors should be meeting regularly and the communication should be two-way, bottom-up and vice versa.

Medium term

- Due to the introduction of new types of audits (Performance Audit, IT, Environmental Audit) it will be necessary to consider the possibility of expanding the scope of sector audit within the Institution and it will also be necessary to define sector responsibility for auditing management and use of IPA funds and other international funds.

- The Institution should be more involved in advising the auditees, but has to ensure that in giving such advice it avoids any explicit or implied commitment that would impair the independent exercise of its audit mandate. It will be necessary to consider the possibilities of performing an advisory role as one of strategic policies and define advisory responsibilities (between the Senate and Members) as well as determine procedures for expressing advisory opinions.

4. Human Resources and IT

Introduction

One of the main assets of any institution is its human resources. It is one of the core values that ensure that the main goals of the Supreme Audit Institution (SAI) are reached in an effective and efficient way. The INTOSAI ISSAI 200 "General Standards in Government Auditing and Standards with Ethical Significance" state:

"1.3. The SAI should adopt policies and procedures to recruit personnel with suitable qualification."

"1.4. The SAI should establish, and regularly review, minimum educational requirements for the appointment of auditors".

The Lima Declaration states that "special attention shall be given to improving the theoretical and practical professional development of all members and audit staff of SAIs."

ISSAI 200 further states that:

"1.5. The SAI should adopt policies and procedures to develop and train SAI employees to enable them to perform their task effectively and to define the basis for the advancement of auditors and other staff.

1.6. The SAI should take adequate steps to provide for continuing professional development of its personnel, including, as appropriate, provision of in-house training and encouragement of attendance of external courses.

1.15. The SAI should adopt policies and procedures to support the skills and experience available within the SAI and identify the skills that are absent."

Observations on recruitment and qualifications

The existing Law and corresponding Regulations define the general procedure and recruitment requirements. The general rules for the recruitment process are stipulated by the "Law on State Auditors Institutions", in particular, Article 45 states that audit is performed by the State Auditors and they are employed on the basis of open competition. The Law also stipulates the minimum qualification requirements, such as a university degree, minimum five years of expert work experience and successful passing of the State Auditor Exam. According to the information provided by the Institution, as of 1 January 2011, there are 52 employees working at the Institution. At the time of the Peer Review, only 4 Senate Members were in place. Although one of the Senate Members resigned already a year ago, the Parliament has not appointed a new Member yet. As each Senate Member is responsible for the management of one particular sector, the Peers strongly believe that it is likely to affect the quality of work of the Sector in the near future. It should also be pointed out that the 52 employees of the Institution also include the five employees working at the Audit Authority. The Act on Internal Organization and Systematisation provides for 80 full time employment positions at the Institution.

The employee recruitment process at the Institution is organized in accordance with civil servant rules and procedures and is carried out by the Human Resource Management Agency (HRMA). To ensure transparency and

openness of the recruitment process in the hiring of state auditors, an open competition is held and a vacancy notice is published in newspaper. After evaluation of the CVs, the Institution conducts interviews and makes a decision. To a certain degree, the Institution has managed to ensure a balance between the central recruitment by the HRMA and the specific recruitment of the audit staff. However, the Senate has not developed and approved the human resources management strategy that would cover all questions related to training, appraisal and recruitment policy, as well as a detailed list of qualification criteria.

In accordance with the rules, all state auditors are obliged to pass the Civil Service and State Auditor exams. The Rulebook on State Auditor Exam Methodology (Official Gazette of the Republic of Montenegro, 23/07) describes the examination procedure as well as eligibility criteria. All in all 29 auditors (4 members of the Senate, 5 Heads of Sectors, and 17 State Auditors) as well as 3 employees of the Audit Authority had successfully passed the State Auditor exam as of 1 January 2011.

The Peers have noted that the Institution has produced the manuals and training materials to help auditors to prepare themselves for the State Auditors Exams. This has helped to gain them a good reputation among other regional countries, and a Member of the Senate is invited to sit in on these regional exams. The Peers feel that this is a good achievement.

The Act on Internal Organization and Systematisation also provides the staff of the Institution with job descriptions including the tasks and responsibilities of state auditors and their qualification requirements. At present, there are only two qualification requirements for auditors: senior and junior auditors. There are no more professional gradings, except two managerial positions – head of sector and head of department. At the moment, the qualification criteria are quite general and they state only the minimum requirements of qualification and experience. They do not include a more detailed overview of specific personal, professional, and social, as well as technical skills and abilities relevant for the auditor's job.

The current lack of recruitment strategy and necessary criteria for refined qualification at various grades can leave a lasting impact on the work and performance of the auditors.

Observations on the appraisal and training system

The staff appraisal process is organized in accordance with the Law on Civil Servants and State Employees. During the appraisal, an auditor fills in an evaluation form and is appraised in several aspects of his performance, but the evaluation criteria do not cover specific knowledge and skills of an auditor. Neither do they cover development potential nor training needs. The Head of the Sector and the responsible Member of the Senate give their assessment of professional performance. Finally, the employee is informed about the result of the appraisal evaluation and a discussion with the management is held if necessary. After that, the evaluation form is submitted to the HRMA. At the moment, the existing appraisal system is carried out as more of a formality. It is used neither as a management tool for the Institution nor as an instrument for gaining promotion. There is no consistency between the result of the appraisal and an employee's career or salary. The established appraisal system does not help the Institution identify the strengths or weaknesses of its employees or their missing knowledge or skills. Neither are the results of the appraisals evaluated on the whole to use them as a basis for developing a training strategy that would deal with individual weaknesses or furthering individual strengths.

In Montenegro, all training for the state employees is organized by the HRMA. A specific training programme has been developed for civil servants and the employees of the Institution have the possibility to take a part in this training. The Institution also offers some internal training. At the moment, training is mostly provided through the technical assistance project provided by GIZ. The Institution carried out a survey on training needs in 2009. In

2010, 5 seminars were held at the Institution with an average duration of 3-4 days each. In 2009, a training needs assessment was conducted at the National Audit Institution, but it still has not outlined a general policy in the field of training, including formal requirements for continued training, training programmes etc. To sum up, at present, there is no stable and permanent training system; training is mostly organized by GIZ; intersectoral training and exchange of experience has not been extensively developed yet.

Conclusions and recommendations

The Peers recognize that the Institution has developed the procedure for recruitment and assessment of the personnel. However, the Peers also consider that human resources management in the Institution could be improved to ensure that the Institution has a clear and transparent recruitment, appraisal and training systems aimed at its specific needs.

To ensure that the Institution is fully staffed with highly qualified employees and is able to conduct full audits in accordance with the law and internationally accepted audit standards, the Peers recommend developing a human resources management strategy that covers all the aspects related to training, recruitment and appraisal policy.

Medium term

As a medium term priority the development of a human resource management strategy is an important step to ensuring that staff is able to meet strategic objectives of the Institution. It is essential that the Senate ensures correlation between the Human Resource Management Strategy and the Strategic Development Plan. The Human Resource Management Strategy should be based on the agreed vision and mission of the Institution which includes amongst others:

- **Qualification criteria** for auditors including personal, professional, and social, as well as technical skills;

- **Recruitment, selection and placement procedure and mentoring system**: Special attention should be put on the mentoring system as it should also facilitate the staff appraisal process and help to identify missing competencies and skills at an early stage, and provide the necessary training and assistance;

- **Appraisal and training system:** The Peers consider that staff appraisal results and the acquired feedback are of high importance and needs to be assessed and generalized by the Institution itself. This helps to identify strengths and weaknesses or even gaps in the knowledge and skills of the employees and serves as a basis for developing further training programmes and workshops, thus ensuring consistency between appraisals and training systems. The Peers recommend reviewing the existing appraisal system and updating the system with a number of specific criteria that would allow assessment of the auditors' professional expertise, knowledge and achievements;

- **Career development:** As the Institution is a relatively new institution, it has not yet addressed another important factor of further staff development, that is, their qualification levels, career development and motivation. The Peers suggest that the Institution considers the qualification grading of senior auditors. This should promote their career and maintain motivation for further professional development.

To ensure continuous enhancement of the professional capabilities of auditors, the Peers suggest defining a minimum number of mandatory training days per year for the auditors and encourages using staff with appropriate experience and knowledge as facilitators and trainers for on-the-job training and in-house seminars. Consideration could also be given to ensure the furthering of knowledge of Senate Members so as to keep up with implementation of agreed audit standards and the implication this has to their own work, developments in the government, legislation, etc and its implication for the Institution

The Peers advise the strengthening of the human resources management function in the Institution, including the appraisal and training system, to ensure that the Secretariat or responsible sector plays an important role in the human resources management system for the Institution and is recognized as one of its driving forces.

Observation on the IT issue

In an Institution, the questions related to the use of IT systems are crucial in ensuring an effective and efficient use of resources. In accordance with the statutes of the Sectors, Sector V is responsible for two areas: IT applications in public sector audits and improvement of IT systems of the Institution. At the moment, the Institution employs two persons to deal with these issues. In addition to the state auditor for IT systems, there is an employee within the Secretariat responsible for functioning of the Institution's IT. To ensure an efficient management of audit files and documentation, a specific information system Document Management System (DMS) is being developed to automate the administration of documents needed for the audit process. At the time of the Peer Review, auditors were being trained on how to use this software. However, the system was not fully operational and has not been implemented yet. It must also be pointed out that training has been held on the use of specific software (IDEA) for collecting, analysing and sampling of the data necessary for audits. This software is used only in some sectors and not applied at all in others. No evidence is being collected or experience generalized about the advantages of this system in auditing.

All the Institution's computers have had the Catalogue of Regulations and the Catalogue of Municipal Regulations installed. The intranet as a tool of communication has not been established and is not being used at the Institution.

To bridge the statistical knowledge gap, the Institution invites an expert for consultation and data analysis. The only IT auditor employed can obviously not ensure the evaluation of all IT systems in the different institutions which come under the mandate of the Institution. During the discussions with the audit team, the Peers found that there was no established procedure for a preliminary evaluation of the general control of the IT system. Such tests to a certain degree can be also carried out by auditors without specific IT auditing skills, just as a part of the assessment of the control environment of the audited institution.

Observation on office space

The Institution is located in premises that belong to the Central Bank of Montenegro. The Bank is one of the auditees of the National Audit Institution. They have a lease and the Institution covers monthly maintenance cost. The limited office space, including the lack of conference and the meeting rooms could also influence further development of the Institution's efficiency and effectiveness in its work.

Conclusions and recommendations

Short term

- To further promote the use of IT software in auditing, the Peers suggest introducing the DMS system and the application of IDEA software in all sectors. To facilitate the introduction and use of IDEA software, it is important to establish three categories of users: a "help desk" (a person with excellent knowledge of the system); advanced users (who have good knowledge of the system) and general users. Specific seminars and exchange of good practices among the advanced users would provide a good forum for sharing the existing experience.

- As auditors collect the most important data from the IT supported systems, auditors should be sure that they can rely on the data provided and stored in the systems. It is important to carry on training auditors on how to evaluate the general controls of the IT system as a part of the overall assessment of the control environment.

- To ensure further development of the National Audit Institution, it would be important to address the questions related to the limited office space and a lack of conference space. The Senate should look into this question and start to find a more optimal office solution as soon as possible.

Medium term

- There is a particular need to strengthen the capacity of the IT function in the National Audit Institution to ensure that there is a strategy how the Institution can identify main IT systems in the government and ensure that all the necessary audits are performed in good time.

- The Peers believe that the use of the intranet as a communication tool could be developed. The intranet can contain and store all the important information used by the auditors: organisational and managerial information (information on Senate decisions, important events, internal regulations); information on the Human Resources System HRS (information on new employees, absence leave of employees, business trips, vacation leaves etc); information on audits, (including manuals, procedures, check lists); information on available training and seminars (including training materials, main outcomes from the exchange of experience seminars) etc.

5. Audit Programming and Planning

Introduction

Planning represents the first part of an audit procedure, which includes strategic, outline and detailed planning. The National Audit Institution has a wide remit, covering all entities that manage the State Budget or state property, local governments, state funds, and public companies or companies in which the State has a share. The mandate of the Institution includes all types of audits, which expands even more the need to choose amongst a huge range of potential audits. Against that background the programming and planning of audits becomes a challenge for any audit institution.

The current planning cycle of the National Audit Institution is restricted to an annual one, in which next to the mandatory annual audit of the financial statement of the State Budget a number of audits are selected for inclusion in the audit plan. The Institution has a number of instruments to guide this selection, especially in the Rules of Procedure which foresee the possibility for the Senate to adopt an audit strategy and guidelines for auditing.

The Annual Audit Plan for 2011 lists 17 audits, of which 11 are general audits (financial and compliance audits, including the mandatory annual audit of the financial statement of the State Budget), one is a cross-sectional audit, two control audits (follow up audits), one a combined general and performance audit, and two have a more restricted focus on regularity (selective audits). Duration of the audits varies from 45 to 140 days.

The Peers evaluated the audit cycle regarding planning in accordance with the principle in the INTOSAI Standard ISSAI 300 "Field Standards in Government Audit" which states:

"1.1. The auditor should plan the audit in a manner which ensures that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner".

To assess the practical application of the National Audit Institution's approach we chose four sample audits for a deeper evaluation of the audit process including the planning stage of the audit cycle. In the absence of the audit strategy and the multi-annual audit plan other bases for planning have been examined and opportunities for improvement identified.

Observations

Audit remit

The remit of the National Audit Institution is wide. It includes all entities that execute the State Budget or manage state property and all local self-governing units, state companies and companies in which the State holds a share, as well as receivers of the subsidies or state guarantees. However, entities receiving EU subsidies are not explicitly mentioned in the SAI law. Given the limited resources of the Institution, the actual audits carried out do not yet fully cover this wide remit.

The wide remit of the Institution could be addressed in several ways. Apart from selective programming and planning (see below), a possibility would also be to involve private sector auditors, either through direct sub-contracting or by laying down in law that municipalities and public enterprises should contract their own auditors from the private sector. This possibility is bound to necessary amendments of the SAI Law.

The Peers have also noted that the Institution does not have a system developed for monitoring the observation of recommendations, notably the response of auditees after the completion of audits. Such a system could feed the risk analysis and the preparation of the Annual Audit Plan. This is further discussed in the Chapter on Reporting and Follow-Up.

The Annual Audit Plan

The Institution's Annual Audit Plan sets out the individual audit activities planned for the coming budgetary year. It specifies the audit entity, description of the type of audit, subject of audit, assumed audit duration and appointment of the authorized sector and Collegium. The work programme for 2011 audits reveals that the subject of the audit is incorporated to a relatively narrow extent. Most frequently only the government's final accounts or final budget accounts of the auditee are the audit subject and the Annual Audit Plan does not describe the precise purpose of the audit apart from naming the type of audit. The Annual Audit Plan is not very detailed in terms of resources; rather, it is based on certain sequences of audits within each sector.

According to the SAI Law (Article 9), the Institution shall decide independently regarding the entities to be audited, subject matter, scope and type of audit, apart from the obligation to audit the Financial Statement of the Republic's Budget annually. Annual Audit Plans are prepared during the period 1st November to 10 January of the following year and are adopted by the Senate. The procedure to adopt the Annual Audit Plan is defined in detail in the Rules of Procedure (Article 31). By 1 November of the current year, the Heads of the Sectors shall submit proposals for the performance of audits that are to be included in the Annual Audit Plan for the following year to the responsible Members of Senate, according to the previously obtained suggestion of the State Auditors and then by 1st December of the current year, the Members of the Senate shall submit their draft Annual Audit Plans for the following year to the Senate.

Programming is largely bottom-up, where auditors come up with proposals which are discussed within the Sectors and then submitted to the Member responsible for further discussion and final approval in the Senate.

Currently, several criteria and circumstances affect the preparation of an Annual Audit Plan, i.e. pre-audits, not covered by previous audits, sector approach, and recommendations from the Senate, suggestions by the public as well as suggestions by the Parliament. Factors like materiality, risk, the practical usefulness of audits and the need to obtain adequate assurance on the legality of expenditure and revenue were not systematically used as selection criteria for the Annual Audit Plan.

It is particularly important that the Rules of Procedure stipulate in the Article 31 the obligation that the proposals should include an explanatory note including the overall expected effects of the audit, but this is not incorporated in the Annual Audit Plan.

Changes of the Annual Audit Plan during the year are possible but should be adopted following the same procedure with final adoption by the Senate. This enables the implementation of reasonable proposals from other institutions and necessary adjustments due to the internal reasons of the Institution.

Strategic plan or multi-annual audit plan

In the view of the Peers, all possibilities to set clear criteria for the selection of audits have not yet been explored. For instance, according to Article 34 of the Rules of Procedure:

> "The Senate could adopt long term (orientation) audit plan, development plans, plans for education, while sectors, depending on their authorisations, could adopt specific plans".

A first step towards developing a strategic audit plan or a multi annual audit plan would be to define the characteristics of the different areas of public spending, allowing for a differentiation in terms of importance, and the identification of risky areas of spending by individual groups of auditees. This will help in defining objectives and policies over a longer period of time. Members of the Senate should consider setting off in that direction by asking the Sectors to carry out such a risk assessment, and, on an annual basis, subsequently provide the criteria for the selection of audits.

The audit remit is huge for such a small institution. This has an important impact on resources available to audit the budget of the Republic. After seven years of existence the audit coverage of entities is still small; for example from amongst the 21 self-governing entities (municipalities) only a few have been audited so far (two are planned for the 2011 Annual Audit Plan) and the largest municipality of Podgorica has never been audited despite the geographical advantage. In spite of this, attempts have been made to develop methods for increasing the coverage of entities in this audit segment but so far no tangible conclusions on such as, for instance, a proposal for a cross-sectional audit on self-governing entities has been reached.

In the context of the audit of the Final Accounts of the Republic of Montenegro certain areas of risk should be further explored and explicitly included in the planning stage, i.e. expenditure for salaries, different kinds of special expenditure, public procurement, transfers. As a matter of principle, a rotation criterion should be set, for instance, that all users of public funds are audited within a period of 3-4 years using the risk analysis and on a rolling basis. In addition the Peers noticed that for some Sectors the precise scope of their audit responsibility is not clear and neither is the list of all potential auditees.

One of the possibilities of increasing the coverage of entities are cross-sectional audits as well as performance audits, which allow for a more focused approach on one or more issues covering a large number of entities. Such an approach is favoured by some auditors and Members. So far only two cross-sectional audits have been published (Public Procurement of ITC and Submission from Collection and Allocation of the Preliminary of Residence Taxes), but no such audit is included in the Annual Audit Plan for 2011. One performance audit is included in the 2011 Audit Plan.

Detailed audit planning

Detailed audit planning is given more attention by auditors. Procedures for adopting this plan are defined based on the Rules of Procedure as well as the role of the Collegium and the mandatory content of the plan. For further details on this stage of the planning process see the Chapters on Audit Standards and Methodology as well as the Audit Procedures and Quality Control.

Balanced work load

The Peers noted that there are two peaks in the work of the Institution, in autumn and spring. This is apparently related to the fixed one-year planning and the need to complete audits in the current year. In a multi-annual planning with regular updates a much better use of the existing resources would be possible, since auditors after completing their fieldwork would be able to quickly move on to the next audit without having to wait until the completion of the previous audit. For more efficient planning it would also be useful to define the availability of auditors on the number of man days rather than only audit days. As a reliable basis for time planning it would be necessary to verify -- based on experience so far – whether planned time in the past was a realistic estimate for the time actually spent on each audit.

In close consultation with the Ministry of Finance, opportunities to optimize timing of the audit of the final accounts of the State and the process of auditing these accounts should be seized. In addition, exploration of the possibility to also submit audit reports regularly to Parliament, and consideration of having the Annual Report correspond to a calendar year. This would mean that a synthesis of systemic control weaknesses in the Government's administration which were found during the year could be brought to the special attention of Parliament for follow-up.

Further suggestions on how to spread the workload more evenly over the year and ideas on how reporting to Parliament could be changed is discussed in the Chapter on Relations with Parliament and the Media.

The role of third parties in audit planning

During the interviews with the audit teams and auditees the Peers did not establish that in planning new audits the audit sectors did not take into account comments or suggestions from different interest groups. The SAI Law does not define the role of third party subjects (The Government, The Parliament, NGOs, etc.) in the process of adopting the Annual Audit Plan. Adoption and consideration of proposals would not affect the Institutions' constitutional independence; at the same time it would be advisable for Members of Parliament who are members of the relevant Parliamentary Committee's to have the possibility to suggest audit entities and topics for the Annual Audit Plan.

With such an instrument the Institution could obtain relevant proposals for the execution of its tasks and the proposals would not be binding. The Institution does not have explicitly defined instruments for the cooperation with non-governmental organisations or elaborated directions for treating the proposals of other proposers. This would however also provide an added value to the Institution's risk analysis.

Objective limitations

Flexibility of planning is however hampered by the small size of the Sectors, and the size of the Institution does not facilitate the growth of expertise at an adequate pace and to an adequate level. In the next short-term period, it is undoubtedly necessary to adapt planning to the availability of personnel, but at the same time promote the possibilities of intersectoral cooperation and formation of audit teams according to specific skills and knowledge as well as respecting motivational criteria for employees. Possible resource constraints can only be identified after this optimisation is exercised. For the moment it is also not possible to clearly identify the needed competency matrix of audit teams. With longer term planning and more detailed explanations of the purpose of the audit and also staff resource planning, the needed competency matrix of audit teams would become easier to establish.

Conclusions and recommendations

The Peers recognize that in its work so far the Institution has made considerable progress and that there has been continuous increase in the systematic approach of audit programming and planning. However, the Peers also consider that overall the framework for planning, awareness of the planning cycle and the need for monitoring follow-up as input for planning purposes could improve. It is thus necessary to strengthen this framework and take into account the availability of the Institution's resources, the needs and problems of the public sector and the expectations of the public even more closely. More efforts should be made to optimize the use of staff resources and strive for better coverage of risky entities and areas.

The Institution has not yet used all options for the more detailed planning that is needed. The audit planning topic should ideally be fitted into the SDP. However multi annual audit plans could already be started whilst awaiting the SDP. For example, the Senate could draw up some practical guidance for risk analysis to be used in the selection of audits. Orientations for the preparation of the Annual Audit Plan should be developed along this basis and relevant data or information should be collected for the multi annual planning. Also no written risk analyses at the level of the Sector could be found which could serve as a basis for proposals to both the multi annual audit plan as well as the Annual Audit Plan. As a basic principle for the audit plan the Peers recognise the ambition that all users of public funds should be audited within a period of 3-4 years on a rolling basis and on the basis of a sector risk analysis.

In the phase of the Annual Audit Plan the Institution should ensure to clearly define the objective and the scope of the audit and expected results, highlight special problems foreseen when planning the audit, identify staff requirements and a team for the audit.

Short term

- The SDP which the Institution is developing should, on the basis of the vision and mission of the Institution, define the strategic objectives for audit and set the priorities for a multi-annual programming on which basis annual audit plans can be prepared.

- An intermediate step towards this goal could be starting to develop and document sectoral risk analysis which identifies and categorizes risky areas of public sector spending, risky areas of management of public property and risky entities. Multi annual audit plans as well as annual audit plans could then be developed awaiting the approved SDP.

- As a short term objective and given the modest capacity of the Institution to carry out performance audits it should be determined how much to invest in training (at some cost in terms of current audit work) to build this capability for the future. At the stage of development of this type of audit and considering the experience gained so far, the Peers consider it too early to establish a separate Sector or Department with exclusive responsibility for performance audits. Instead the Peers recommend that the Institution determines which sectors should implement these audits, establish an informal functional working group of the auditors involved to foster their professional development, and set an overall objective for the allocation of resources to performance audits (for example 20 % as a long-term objective).

Medium term

- In the area of financial and compliance audits the Institution should move from the current selection approach, based largely on random selection combined with the principle of selecting entities that have not been audited before, towards a risk-based approach, a move which can already be observed in some of the Sectors. Such a risk-based approach would gain from guidance by the Senate on specific priorities and risks that should be taken into account before Sectors select preliminary audit topics.

- The Peers also recommend that an annual update of the risk analysis be undertaken before the compilation of an Annual Audit Plan. This should be the leading factor in the programming and in setting the frequency of financial management audits, particularly in respect of municipalities and public services area of public income and expenditure.

- Before deciding to include an audit proposal in the Annual Audit Plan, the Institution could carry out a "pre-audit" exercise to obtain more information about the audit subject, assess the risk involved and evaluate whether or not a planned audit would be worthwhile. Alternatively, the Annual Audit Plan could include a couple of "pre-audits" which would prepare for audits that could be undertaken during the next Annual Audit Plan.

- It is also suggested that the Annual Audit Plan should be prepared and agreed upon well in advance of 1 January of a particular audit year and according to detailed internal procedures.

- The Peers also recommend considering stating the grounds for carrying out an audit in the Annual Audit Plan and also in the introductory part of an audit report and to explore other possibilities to inform the auditee about the grounds for the initiation of an audit.

Long term

- As a long term objective the Peer's suggest that the National Audit Institution try to establish instruments for the co-operation with non-governmental organisations. A significant source of information would thus be gained, which would ensure appropriate participation in the control of public funds. It would also be necessary to establish the means for the promotion of initiatives given by citizens and users of public funds, whereby it would be advisable to make use of the existing Institution website.

6. Audit Standards and Methodology

Introduction

Audit standards and methodology is core to a Supreme Audit Institution as an Institution needs audit methods to enable it to carry out its work. These standards and methodology need to be appropriate to the role and mandate of the Institution as well as to the resources it has and the skills of its staff, and to be within the context in which it operates. A key component regarding methodology is related to issuing of audit opinions. Audit opinions are therefore also discussed in this Chapter.

For the National Audit Institution the development of the audit methodologies is an ambitious programme which is now underway and which is intended to provide guidance to audit staff with the aim of promoting consistency in audit work, compliance with relevant international standards and also efficient ways of working.

To ensure that ISSAIs are complied with a Supreme Audit Institution should interpret them to its local circumstances and express this interpretation in its own audit standards. Ideally the audit manual should include an interpretation for each requirement of the ISSAIs to ensure that all auditors apply the same standards in their work. The manual is also the theoretical foundation of how the audit standards are applied in the working papers. Training in those standards ensures that management and all auditors understand the objective of each standard and are able to identify any additional audit procedure required to achieve them.

The Peers have evaluated the draft audit standards and methodology in accordance with the principles stated in the INTOSAI standards, in particular ISSAI 1000 (Financial Audit Guidelines), ISSAI 3000 (Performance Audit Guidelines), ISSAI 4000 (Compliance Audit Guidelines), ISSAI 400:8 and ISSAI 1700.10-16 and 34-37(Audit Opinion on Financial Statement).

Observations

Audit methodology

The development of the audit methodologies is an ambitious programme which is now underway. The intention is that the outcome of this work should be compiled into audit manuals in the future. Some basic guidelines and some substantive audit procedures have been developed but they are not yet compiled into comprehensive documents. The audit manuals will provide the auditors with a set of guidance (methodology) for regularity audits and, in a second phase in a separate manual, efficiency and effectiveness audits.

At the moment not all elements of the audit process have, as yet, been fully considered when describing the audit methodology. For example, an audit process flow table covering the major components (e.g. pre-engagement activities, strategic planning of the audit, detailed planning, audit fieldwork, reporting, and quality control) would enhance the general understanding of the scope of work and its specific steps. Such a flow table would visualise these components and their logical sequence both while developing the manual and later on for the users of the manual.

Other elements that could be considered for elaboration on in the methodological context are the need for better understanding of the overall environment and general conditions wherein the auditee operates (e.g. strategic risks and key processes of the auditee). The audit teams pay attention in analysing the current terms and conditions that govern the activities of the audited body and this promotes a constructive dialogue with the auditee. However, audits related to efficiency and effectiveness usually calls for an in-depth understanding of the political and economic context of the operations of the auditees. This could be enhanced by making use of well elaborated guidelines on strategic risks in which the administration of the audited body operates and the understanding of key processes.

The Peers noted that a risk analysis model has been developed to assist in defining the materiality level to audits carried out by the Institution. The model has been developed and used in one Sector and it is available for the other Sectors but it seems they do not apply the model. The Peers find the model too sophisticated and detailed to be commonly applied and this might be the reason it is not in use in all Sectors. However, the peers recognize the need for further promotion and understanding of the concept of the materiality and the evaluation of risks in the ongoing development of the audit methodology and audit manuals. This is particularly important in striving for a more optimal use of resources and with the aim of enhancing the issuing of Audit Opinions. The need for firmer use of defined materiality levels is also discussed in the Chapter on Audit Procedures and Quality Control.

The Peers observed that it has not yet been decided if the audit manuals should be compulsory in all Sectors as well as to all Collegiums or not. Standardised audit processes and methodologies are however important because they enhance audit quality in the Institution. They also promote efficient learning.

Coherence of terminology

The Peers noticed that various terms for the audit types are used throughout documents applicable to the Institution. The mandate of the Institution includes compliance (regularity) audit and efficiency and effectiveness audit (Article 5 of the SAI Law). Financial audit is not explicitly referred to, although the terminology used in the SAI Law can be interpreted as including this element as well. The Institution's instruction on the methodology of work (Article 3) describes three main tasks, the regularity, financial and performance audit. In addition in the Annual Report of (October 2009- 2010, four different types of audit are mentioned:

- General audits,

- Cross section audits,

- Regularity, efficiency and effectiveness audits,

- Control audits.

The use of various terminologies in different documents gives ground for confusion. It is also unusual to combine "Regularity, efficiency and effectiveness audits "into one type of audit. By doing so the purpose of the different types of audits becomes unclear for all staff in the Institution as well as the audience the reports are aimed for.

It seems the approach to, as well as the focus and purpose of the different types of audit, varies. For example, general audits seem to be a combination of regularity, efficiency and effectiveness audit. There seems to be no common understanding in the Institution or clear instructions in the guidelines being developed for the future manual of the meaning of these terms. This indicates a lack of coherence in what types of audits are being carried out. In seeking for simplification of the Institution's work which would give room for rather specific audits such as, for example, IT audits, the question arises whether the term "general audits" is needed.

Control audits are follow-up audits of previous audits carried out with serious findings that merit special audit attention by the National Audit Institution. The purpose of cross section audits and control audits is fairly clear even if it is not spelled out or defined in the developed guidelines but there are no clear criteria when a control audit should be applied.

Audit opinion

The Institution is requested to audit whether the operations of audited entities comply with regulations and standards in respect of bookkeeping and of documenting revenues and expenditures (SAI Law Art. 5, second paragraph). This requirement, combined with the requirement from Article 6, first paragraph, that the audit is to "provide essential information on the audited entity's management of the budget, property and economic activities", could be understood as implying that the Institution is to express an opinion on the financial statements ("the financial statements give a true and fair view of the financial position of the entity").

The vagueness mentioned above, regarding the definition of the types of audit, is also mirrored in the way audit opinions are used, see Table 1 below. Among the individual audits in the Annual Report of October 2009- 2010, an "opinion" is generally provided but not always. Out of eight general audits an audit opinion has been expressed in five audits. One out of two regularity, efficiency and effectiveness audits was a combined general audit and regularity audit, efficiency and effectiveness audit and received an audit opinion as well. Audit opinions are the prerogative of the Members – Senior Auditors are currently not involved in the drafting of the opinions. Criteria for submitting opinions are planned to be included in the audit standards but this section has not been developed yet.

General Audits	Opinion issued	Comments
University of Montenegro	X	
National Tourism Organisation MNE		Auditee demanded to report back to the Institution.
Montenegrin National Theatre		Auditee demanded to report back to the Institution.
Bureau for the Care of Refugees	X	
Police Academy Danilovgrad	X	
Bureau for Enforcement of Criminal Sanctions		Final report with recommendations submitted but no wording on opinion
Public Enterprise »Airports of Montenegro«	X	
Municipality of Herceg Novi	X	

Cross-section audits		
Lending to entrepreneurs		Subject matter not financial statements
Collection and allocation of residence taxes		Subject matter not financial statements
Public procurements in IT sector		Subject matter not financial statements
Regularity, efficiency and effectiveness audits		
Bureau for International Scientific, Education-Cultural and Technological Cooperation	X	Combined general audit and regularity, efficiency and effectiveness audits.
Montenegrin Foreign Investment Promotion Agency		Combined general audit and regularity, efficiency and effectiveness audits.
Control audits		
Montenegrin Employment Agency		The control audit refers to a general audit in 2008. In the 2008 audit no opinion was given.

Table 1 Source: the Annual Report (October 2009- 2010)

Conclusions and recommendations

The Peers recognise that the Institution has put in a considerable effort in developing the audit standards and methodology which will later be compiled into audit manuals. In addition to the audit standards and methodology already developed the Peers suggest additional attention is paid to the components mentioned below. On the other hand, the Institution will face a challenge in the implementation of the methodological guidelines, given the current compartmentalization in the Institution. The proposed reorganisations of sectors discussed in the Chapter on Organisation and Management aims at addressing the need for internal decisions on which audit standards and procedures to follow and how to ensure a standardised picture of work carried out is presented, audit findings, expressions, etc which enhances the underlying processes of ensuring audit quality. The following Chapter on Audit Procedures also discusses the need for developing a model less sophisticated on materiality levels and provide for suggestions in harmonising audit planning and standard structures on working papers for audit evidence. In addition the insufficient training infrastructure and the suggestions on how to resolve this issue are discussed in the Chapter on Human Resources. Finally the need for streamlining audit reports and the recommendations for enhancing audit reports are discussed in the Chapter on Reporting and

Follow-Up. Similarly some of those recommendations merit further attention in the audit manual. On top of those recommendations the Peers also put forward the recommendations mentioned below.

Short term

- A key for quality assurance is a common understanding of the different audit types (general audit, cross -section audits, regularity, efficiency and effectiveness audits, and control audits). The Peers recommend that the Institution should consider adopting the terms financial, compliance and performance audit which are internationally recognised terms and align the so called general audits to those types of audit so as to reduce different interpretations. This would also improve communication vis-a-vis the auditee and the larger audience for reports made public.

- The Peers also recommend developing an overview of the different stages in the audit. Such a flow table would provide an overview of the major components in the audit process. We recommend that such an overview is compiled covering the financial, compliance and performance audit processes.

Medium Term

- Standardised audit processes and methodologies (for or each type of audit: financial, compliance and performance audit) would promote not only efficiency in the audit work in general but also efficiency in training. The use of methodology described in the audit manuals should be compulsory for all auditors and Senate Members. To facilitate the introduction and use of the appropriate methodologies, different types of expertise should be identified for specific seminars to foster exchange of good practices. Establishment of a forum for furthering the understanding of the manuals and sharing internal experiences of their usefulness would also contribute to consistency in the audits performed.

- Audit opinions are issued but there seem to be no criteria for when they should be issued. The development of audit opinions is a complex task. The Peers therefore suggest development of audit opinions as medium term priority. However they should be based on the short term priority proposed on audit decision making in the Chapter on Organisation and Management. Each Member should have independent discretion when it comes to making audit opinions while having transparent cooperation with other Members of the Senate. The Senate should adopt the fundamental objective of having access to the significant and substantial disclosures and positions of the Institution even before the final audit opinions are issued. The Collegium rapporteur's report and draft audit opinion or the Head of the Sector's report and draft audit opinion should be the basis. Clear criteria should therefore be developed for issuance of audit opinions and different templates should be drafted and included in the audit manual.

Long term

- Introduction of new audit methodologies (e.g. performance auditing) will gradually call for different techniques to understand the overall environment and general conditions wherein the auditee operates. The understanding of the operations of the auditee is an area that the Institution already pays attention to. However, one element that we recommend to be further developed in the audit standards is the appreciation of the more strategic challenges that the auditee faces. To develop

guidance on how to evaluate strategic risks and the key processes of the auditees could be a part of the audit manuals.

7. Audit Procedures and Quality Control

Audit procedures

To assess the application of audit methodology in practice, the Peers chose four sample audits for a deeper evaluation of the audit process: The Control Audit of the Employment Agency for 2009; the Cross-Section Audit of Public Procurements of Information Technologies for 2008; the Audit Report on the Final Budget Accounts of Montenegro for 2009; and the Report on the Audit of the Montenegrin Foreign Investment Promotion Agency for 2008. The Peers evaluated the audit cycle in accordance with the principles stated in the INTOSAI standards ISSAI 300: Field Standards in Government Auditing.

Audit Planning

Observation

In accordance with the standards, the field standards in government auditing are applicable to all types of audits. They state that the auditor should plan the audit in a manner which ensures that a high quality audit is carried out in an economic, efficient and effective way and in good time. They also point out that the auditors should study and evaluate the reliability of the internal control.

Before starting the audit, the Collegiums, by an auditing order, asks the Head of the Sector to prepare an audit concept or an audit plan by a define date. The Collegium announces the start of the audit to the entity to be audited at least 14 days before the start of the audit. On the basis of the discussions with the audit teams and the management of the auditee, the Peers note that in most cases good cooperation was established between both parties during the audit.

The Collegium takes a decision to start an audit and states a specific deadline by which the audit plan has to be approved. Based on the preliminary evaluation of the documents, the financial data and interviews carried out in the auditee, the Head of the Sector draws up an audit plan which is agreed on with the Collegium. The audit plan describes, amongst other things, the purpose of the audit, time framework, objectives of the audit, its scope and materiality level, as well as the assignment of the tasks, sampling procedures, etc.

The Peers noticed that some parts of the audit plan were too general and not outlined in great detail. Neither were they based on the information collected during the pre-planning stage. The plan lacked detailed information on the results of the evaluation of the internal control system in the auditee, as well as the risks identified at the level of the auditee.

The Peers also noted that there was no commonly agreed approach and criteria used to define the materiality level to audits carried out by the National Audit Institution. In the plan reviewed by the Peers, the information about the materiality by the value, context and nature was quite general and it seemed that there was no further connection between the materiality level stated and the sampling, as well as the evaluation of the errors found in the audits.

Development of the internal audit system in Montenegro is at an early stage and the budget institutions are gradually setting up arrangements for the introduction of internal audit units which would have an impact on the risk assessment and the materiality level of the National Audit Institution's audits. However, it seemed that the concept of the materiality as well as risk identification, evaluation and documentation of the internal control system (control environment) and internal audit was also at an early stage and has not had a real influence on the scope of the audit. Neither did the plan provide detailed information on the man days nor financial resources used for the particular audit, but just provided information on the time frame. The plan did not specify the number of necessary transactions to be tested, to get reasonable assurance that the financial statements are free from material error.

Conclusions and recommendations

In general, the Peers recognize the possibility for further improvement in the field of the audit planning process, with special attention being given to furthering the understanding of the concept of the materiality, evaluation of risks and control environment.

Short term

- To ensure a unified approach to performing audits, the Peers recommend the Senate consider the question of the materiality level to be applied at the National Audit Institution and adopt a decision on a common approach and criteria for identification of the materiality level for audits conducted by the Institution.

- To improve the applied methodology of audit planning in the Institution as a whole, the Peers suggest carrying on with further training of employees, identifying good internal examples and holding an experience exchange seminar. These good examples could also be compiled as reference material to improve the auditors' and the Members of the Collegiums understanding of the impact of materiality on the general performance of the audit and the assessment of the final results.

- To further improve effective use of the existing human resources in the future, the Peers recommend considering the possibility to pay more attention to a detailed planning of the necessary tests (substantive tests, analytical procedure) and define the specific amount of samples and, respectively, the necessary man days and financial resources.

- To ensure a more efficient use of audit resources, and therefore apply a risk-based audit approach and systems assessments in the future, the Peers suggest furthering the knowledge and skills in identifying risks and assessing the control environment for auditors and Members of the Collegiums. It is important to start the cooperation between an internal and external audit and develop the methodology for the evaluation of an internal audit function. We also recommend identifying good practices and use them for further training of auditors and, if necessary, attract support from external technical assistance.

Audit Evidence and Documentation

Observations

According to the field standards in government auditing, competent, relevant and reasonable evidence should be obtained to support the auditor's judgement and conclusions regarding the organisation, programme, activity or function under audit.

The Peers concluded that there was no common approach to documentation and maintenance of the audit evidence and information received during the audit. Some of the sectors have established a reasonably well developed and maintained audit filling system. In general an audit filing system consists of two parts: the permanent audit file and the field work file. The documentation is systematised with links to underlying documents. However, it should be pointed out the Peers did not find the same approach in all sectors.

The presented audit files gave an impression that a huge amount of documentation was evaluated and copies made to support the audit evidence, but there was no common template for the main working documents, such as audit check lists, audit programmes or minutes of the interviews held by the auditors. The most important document that provided information about the findings was the field report. To ensure quality of work and coherency, some of the Sector Heads have prepared audit guidelines and a template for the field report.

The Peers consider that common requirements for developing working documents would substantially improve supervision of audit work, ensure a transparent system and give assurance that the tests performed are sufficient and relevant for the Collegiums decision making and discussion in Senate meetings.

On the basis of the discussions with the audit teams, the Peers concluded that the audits performed were all based on transaction tests, whereas tests of internal control were not a general practice. Working documents contained a lot of copies with margin notes and it was very difficult to follow through what issues or audit assertions the auditors had checked on while making those tests. In addition, it was impossible to follow through whether tests performed corresponded to the amount of work defined in the audit plan. Neither did the Peers find a summary of all the identified errors and irregularities and their respective assessment and general conclusion on how they would affect the audit decision or the audit opinion.

Recommendations

Short term

- To ensure the quality of audit work and enable the management to supervise auditing procedures during the audit more efficiently, the Peers recommend introducing mandatory templates for the audit programmes, minutes and check lists, as well as for field reports. The standard working papers, amongst other things, should include information on the objectives, the scope of work (the criteria for sampling) and the conclusions reached. It is good practice that these documents are signed by the person who performed the test and the supervisor (the Head of the Sector or the Audit Team Leader).

- To ensure that an objective audit opinion is prepared, the Peers highly recommend developing common requirements for summarising all errors and irregularities that should substantially facilitate the general assessment of the impact these errors would leave on the financial report.

Medium term

- We also advise considering further training of auditors in applying specific methods and techniques of auditing, for example, practical application of control tests, sampling, evaluation of internal control system, etc.

- To ensure a more efficient use of the available human resources, the Peers suggest planning an audit in the category of audit man days and dividing them accordingly – a specific number of days for audit planning, field work and the reporting phase. That would be even more significant if a time recording system is introduced that should give an opportunity to assess how much time and how efficiently it is used on performing different tests.

- To ensure a unified approach in assessing similar systems within a similar scope by different sectors, the Peers suggest developing standardised checklists for reviewing general issues: expenditure for payroll and services, IT systems, procurements, revenue etc. Standardized checklists could include basic questions. However, more specific questions should be considered added when relevant based on identified risks in a specific audited institution.

Audit Quality Control

Introduction

The INTOSAI Standard on Quality Control, ISSAI 40, sets the requirements for Supreme Audit Institution's (SAI) to introduce and maintain policies and procedures to ensure that the SAI and its personnel comply with professional standards and applicable legal requirements and that reports that are issued are appropriate in the circumstances. It is based on ISQC-1, the International Standard for Quality Control, set by IFAC. The level of ambition of ISSAI 40 is high – and although it is part of the ISSAI framework, it is left to individual SAIs to state explicitly, whether they want to be compliant with ISSAI 40 or not. So, in practice, SAIs may deviate from ISSAI 40 if they are not (yet) in a position to fully comply with the standard.

For the National Audit Institution of Montenegro, even if it is a still young and small scale organisation, ISSAI 40 may nevertheless be used as a mirror to identify in which areas improvement in audit quality procedures are needed most. And other ISSAIs¸ such as ISSAI 200 1.25-1.30, ISSAI 300, 2.1-2.5, also set requirements for SAIs in the area of audit quality control, and the relevant parts of the guidelines for financial audit, for performance audit and for compliance audit (ISSAIs 1000, 1220, 1620, 3100 section 2.5, 4100 section 5.2 and 4200 section 5.2).

ISSAI 40 focuses on six principles: an internal culture that recognizes that quality is essential; reasonable assurance that the Supreme Audit Institution and all of its staff complies with ethical requirements; that the SAI is competent and has the capability to carry out an audit and that it has adequate resources to do so; that audits are carried out in accordance with the relevant standards; that consistency is ensured and responsibilities for

supervision and review clearly defined; and that the functioning of audit quality procedures is independently reviewed.

In this Chapter the Peers will focus on the latter two principles: ´the independent review of the functioning of audit quality procedures is often called "cold review". Cold, because the review takes place ex post, and at greater distance from the actual audit process. In a typical cold review, a sample of audits is selected which allows for general conclusions on the quality of audits and the functioning of quality control procedures. If these conclusions are positive, it gives assurance on the quality of audits and audit reports. On the contrary, "hot" review is the inbuilt quality control during the audit. It is to be applied during every audit that an audit institution or audit firm carries out. Hot review is closely related to supervision, but much more formalised and focussed.

Observations

The auditing guidelines for the Institution as developed so far do not contain specific provisions for quality control or quality assurance, although there is a module on documentation, which is a prerequisite for quality in the audit process. The Law foresees that state auditors perform the audit [Article 45 (1)], but also that the Institution is divided into sectors and that each Member of the Senate shall head (better term would be "supervise") one sector (articles 29 and 31). The rules of procedure and the Instruction on the Methodology of Work of the National Audit Institution set rules for the responsibilities of the Senate, Collegiums, member-supervisor and the head of the sector.

In the process of planning and executing an audit the head of sector plays an important role. The head of sector drafts the audit plan and the audit report, which need approval by the Collegium. In many cases the head of sector also participates in the actual audit itself. This seems to be in line with Article 13 (6) of the Instruction on the Methodology of Work of the National Audit Institution: "The Head of the Department can participate in the field work if necessary and in that case he shall manage the field work", although the Head of Sector is not mentioned specifically. Nevertheless, the Head of Sector is also responsible for the quality of the audit, and therefore reviews working papers to make sure that sufficient and reliable audit evidence is collected.

These different roles are difficult to reconcile, as participation in an audit makes it more complicated to ensure quality through review at the same time: one cannot review one's own work. It could be argued that this role is being played by the Collegiums, but in practice the Members of the Collegiums usually do not closely follow the audit field work, they focus on the important phases of the audit, planning and reporting. Therefore it can be concluded that the responsibilities of the Senate, Collegiums, the Member heading the audit, Head of Sector and State Auditor are not sufficiently defined to ensure that the quality of audits is looked at systematically. However, the fact that each audit is supervised by two Members of the Senate constitutes a certain guarantee that also the quality of the audit is being looked at the highest level, although this has not prevented the development of different routines and policies between sectors.

It should also be noted that a specific risk for the quality of audits arises in the application of professional judgement. This is particularly valid for the issuance of audit opinions, since no clear criteria for those have been developed so far, and both the substance and the precise wording are in the hands of the Collegiums. These criteria need to be established, and it would fit into their responsibility to task the Head of Sector with the preparation of such an opinion, for approval by the Collegium.

In view of the intention to submit individual audits in the form of special reports directly to Parliament, it should be kept in mind that according to Article 25 of the Rules of Procedure these reports will need to be approved by the Senate. This would imply that all reports will pass through the full Senate, which allows for revised

arrangements to control the quality of the audit and the coherence of the resulting reports and the opinions which are based on those results.

Ex post quality assurance by independent reviews of a sample of audits, amongst others, is absent in the Institution. The size of the Institution makes it difficult to establish such a function inside. A review by independent academics might be a solution in this case, but also other tools could complement this, for instance a survey amongst audited entities.

Recommendations

Short term

- The Senate should establish formal procedures for audit quality control, and have those included in both the Instruction and the Audit Manual. ISSAI 40 could serve as guidance, but given the size of the Institution some pragmatic compromises should not be excluded. These formal procedures should include the obligation to comment in writing and document these comments, and the responsibility of the President to ensure that these procedures are followed.

- As part of these procedures, the role of the Head of Sector should be more clearly defined. If the current practice of involvement of heads of sector in audits is to be continued, then consideration should be given to strengthening the role of the responsible member by intensifying his review of audit working papers and making documentation thereof mandatory.

Long term

- The Institution should contract out the review of a couple of audits carried out on annual basis to an appropriate academic institution or professional organisation.

8. Reporting and Follow Up

Introduction

Reporting and follow up procedures can be looked upon as a part of the broader issue of communication with citizens, parliamentarians and auditees. In addition reporting and follow up procedures also have an internal communication perspective since the Institution should base its decision-making on reliable, comprehensive and comparable information.

This Chapter deals with the Institution's reporting on performed audits. The Institution's reporting as a budget user to Parliament is discussed in the Chapter about Relations with Parliament and Media.

The review in this chapter focuses the on different types of audit reports (Annual Report, individual audit reports and so called special reports), and the format and language of the reports, especially those concerning recommendations to the auditee. To assess the application of reporting and follow-up the Peers chose four sample audits for a deeper evaluation i.e. the Control Audit of the Employment Agency for 2009; the Cross-Section Audit of Public Procurement of Information Technologies for 2008; the Audit Report on the Final Budget Accounts of Montenegro for 2009; and the Report on the Audit of the Montenegrin Foreign Investment Promotion Agency for 2008. The analysis has been carried out against the background of the INTOSAI international standards, in particular ISSAI 400 and ISSAI 1700.20-33 regarding requirements in audit reports.

Observations

Annual reports and special reports

The Law on the State Auditors Institution regulates procedures related to the Annual Report, audit reports as well as special reports. It also defines the content of an audit report; "The audit report shall include the findings, evaluation, conclusions and recommendations for the elimination of irregularities, which may possibly be found" (Article 12).

The intention behind this paragraph is well reflected in the reports the Peers evaluated and the Institution has to some extent developed a standard approach to its external reporting procedures. Assessments, findings, conclusions and recommendations are normally provided even if they are labeled in a bit of a different way in different reports (see below) and sometimes the term "Assessment" is replaced with "Opinion".

The Annual Report includes excerpts from the individual audits but it is not clear to what extent the full report on individual audits is also submitted to Parliament separately. The Peers have also noticed that there is no further analysis of systemic control weaknesses found during the year in the government's administration that would need the special attention of Parliament's in improving the internal control system.

The Peers have also noticed that the reporting period of the Annual Report does not correspond to the calendar year but from the end of October one year to the end of October the following year. If individual audit reports are not submitted to Parliament this timing has the disadvantage that for some of the audits the results are not discussed in Parliament until it deals with the Institution's Annual Report which may be up to a year late. The

timeliness of the information might in some cases then have been lost. The Peers notice that there is a significant amount of duplication of information provided in the Annual Report and the Report on the government's final accounts. That could create confusion for an external reader, taking in to account the time table of both these reports.

When it comes to the Senate's decision-making procedure the Peers have noticed that there is a difference between individual audit reports compared to the Annual Report and special reports. (Individual) audit reports are decided by the Collegium responsible for the audit. However the Senate approves the annual report and special reports. The special reports are aimed at the Institution informing Parliament or the Government on a special issue.

Audit report on the government's final accounts

The Peers observed that the timing of the submission of the Annual Report, which includes the report on the government's final accounts, does not allow for much analysis by Parliament before the discussion on the draft budget of n+2 year. By bringing the submission of the Annual Report forward the report could serve Parliament much better. The Ministry of Finance sees a possibility for optimizing the timing and process for preparing the draft Final Account of the State Budget and the Final Accounts of the municipal budgets. The Ministry of Finance also believes that spending units could produce the financial statements earlier as they do not involve a significant amount of work and all the information needed for the preparation of the financial statements for spending units is in place already by mid February. In short, the Ministry of Finance might be ready to reconsider the timing and process of preparing the government's final accounts, to optimise the flow of information to Parliament. However, the Ministry of Finance admits it could be difficult to significantly reduce the time for preparing the draft financial statements.

In the context of the audit of the government's final accounts it is also important to address the issue of providing audit opinions. This is discussed in the Chapter about Audit Standards and Methodology.

Audit reports and follow up procedures

The audit reports are drafted by the Heads of Sectors who are in close co-operation with the auditors during the entire audit process. It is the duty of the Head of Sector to manage the audit work, supervise the work of the auditing team, and prepare the audit report based on the auditors' protocol of the audit. The Collegium adopts the draft report, transmits it to the audited entity for comments within 15 days, and adopts the final report after considering the potentially disputable facts. Furthermore the reports are reviewed for adequacy, conclusiveness, properness, readability etc. by the Collegium, which is independent of the audit team.

When it comes to the underlying support for the findings described in the report the Peers found it difficult to follow through what issues the auditors had checked on while making tests. Neither was it possible for the Peers to follow the logic between the identified errors or irregularities and the conclusions presented in the audit report. These observations indicate to the Peers that there might be shortcomings regarding to what extent all audit findings have been evaluated as to their materiality, legality and factual evidence and if all relevant material findings are included in the audit reports.

As for follow up procedures the Peers observed that it is unclear who within the Institution (or within each sector) is responsible for the systematically monitoring of follow up on audit reports and recommendations. Also there is no timetable agreed for reporting back the implementation of the recommendation and actions agreed.

In case the recommendations are not implemented or not implemented in due course the Institution should ensure that this is documented and the auditee should be requested to explain why recommendations have not been implemented. This can prove to be useful for the risk analysis and the annual planning.

Recommendations in audit reports

The communication with the auditee largely focuses on irregularities and the subsequent recommendations. The audit focuses on individual transactions rather than internal control systems but given this limitation the outcome of the audit normally results in detailed findings. Despite this clarity the recommendations sometimes appear to have a passive nature which reduces the potential added value of the audit. Auditees sometimes have problem in appreciating an opinion or recommendation, because they can be read and understood in fragments and not as a whole.

In some cases the recommendation simply reads that the auditee should "follow the law "even if the auditor appears to have a deeper understanding of the problem identified. This insight is not taken care of in the way the recommendations are phrased. A general observation is that the findings and conclusions provided in the reports would allow for more distinct recommendations.

Regarding recommendations related to efficiency the Peers have noted that that there are probably reasons to be extra cautious in its communication with the auditee so as to ensure unambiguous reports.

The Article 5 on the Law on State Auditors Institution defines efficiency as:

> "The audit of efficiency shall examine whether the planned goals have been achieved with minimum investment of funds."

In practice this definition implies an intention that cost reduction is achieved through a combination of efficiency programmes and crude budget cutting. However efficiency gains can either be cashable or non-cashable. Cashable gains involve reducing the inputs without affecting the quality of service. Non-cashable gains represent increased output or quality of service from the same level of input. It is likely to assume that the auditees define efficiency in terms of both cashable and non-cashable gains since economic efficiency is normally measured by the relationship between the value of the ends and the value of the means. If the Institution defines efficiency only as cashable gains this could create a source of misunderstanding between the auditor and the auditee.

Format and coherence of terminology

The overall impression of the structure applied in the individual audit reports is that the format diverts from each other in the way assessments, findings, conclusions and recommendations are presented. Out of 14 individual audit reports presented in the Annual Report of 2010 the Peers noted that seven different structures were used:

- Assessment of the established facts and recommendations,
- Opinion, findings and recommendations
- Assessments, findings and recommendations**,**
- Assessment of established factual state with recommendations,

- Audit opinion with proposal of measures and recommendations

- Assessments, conclusions and recommendations,

- Opinion with the overview of determined facts and given recommendations.

When addressing the coherence of terminology the Peers have also noticed that the term "Individual Audits" is also used in the 2010 Annual Report. This term does not seem to be used elsewhere which could create confusion for an external reader.

The individual reports divert from each other also in terms of language and tone. There is also a tendency that the text is categorical because it sometimes describes things in "black or white". It is "wrong or right" even in cases where it could be argued what the objective opinion would be of the cases identified. Lack of incorporation of comments from the auditee might be a reason why the reports appear be less balanced in this sense. In one audit report reviewed by the Peers there is a summary in the report but this is apparently not the standard procedure.

Communication with the auditee

Another aspect of the communication with the auditee relates to how the audit as such is appreciated by the subject of the audit. Our observations indicate that there are often good contacts after finalised audits at working level. Some auditees however complain that auditors only report negative findings and that their own comments are not seriously considered by the Institution and in some cases auditees complain there is no written or even oral feedback from the Institution at the final stage of the audit.

This might indicate a weaknesses in the capability of the audit team to view the audit not only from the perspective of being held to account for the way the auditee uses public money but also, and equally important, to help public service managers improve performance and service delivery. Nevertheless, the auditees we met consider the auditors to be experts in certain areas especially in the fields of financial management and accounting.

The Peers were informed that the auditees sometimes read other audit reports and compare these reports with their own. At times they then conclude that others are facing similar problems in their administration as well. This indicates that there is a reason for the Institution to make cross- examinations of audit reports especially within environments where institutions and operations might overlap.

Conclusions and recommendations

The Peers conclude that standardisation of reporting and follow up procedures could be further developed in a number of different areas. We also conclude that the standardisation of audit reporting procedures is a way to strengthen the collective responsibility of the Senate and harmonise audit practices in general. A follow-up of recommendations is also a useful tool to consider in planning the new audits. This is discussed in the Chapter on Audit Programming and Planning.

Short term

- Concerning the format and language of reports the Peers recommend developing the standardisation of financial and compliance audit reports by splitting the reports into only four major standard components: summary, findings, conclusions and recommendations.

- Bringing all reports to the attention of the Senate would also promote the establishment of formal procedures for audit quality control which is also discussed in the Chapter on Audit Procedures and Quality Control. With the objective of issuing more balanced reports the Peers propose also to consider, when appropriate, more frequently expressed positive conclusions regarding the performance of the auditee.

- The Peers also recommend clarifying the roles and responsibilities when it comes to follow up procedures of audits and how to best ensure that audit reports are effectively considered in the risk analysis in the annual audit planning.

- Regarding the report on the audit of the government's final accounts the Peers recommend that it should be considered if the audit report could be submitted earlier than now to ensure timely reporting to Parliament compared to the analysis and discussion of n+2year proposed budget. This could be feasible if individual audit reports were submitted as special reports to Parliament as soon as they are finalised and no longer wait for the Annual Report. This would mean that a synthesis of systemic control weaknesses in the Government's administration which were found during the year could be brought to the special attention of Parliament for follow-up in the Annual Report. Further recommendations linked to reporting are also dealt with in the Chapters on Audit Programming and Planning as well as Relations with Parliament.

Medium term

- Regarding the Institution's recommendations in audit reports, the Peers propose to always consider providing distinct recommendations with a set of realistic time frames for implementation. This can be done if the findings and conclusions of the auditor are thoroughly analysed through a perspective of not only the identified irregularity, but also by considering the perspective and views of the auditees on why the problem so far has not been resolved.

- The Peers conclude that clear recommendations are vital in the communication with auditees. For instance when applying efficiency measures, it is important to establish a mutual understanding of the definition and relevance of the indicator. Equally important is that recommendations related to efficiency measurements are developed in the full contextual environment wherein the indicator provides indications (i.e. not facts). The process requires careful thought, iterative refining, and collaboration with the auditee and consensus building before issuing the recommendations. In the light of this Article 5 of the SAI Law could be revised as suggested in the Chapter on the Legal framework. Further linked issues are also discussed in the Chapter on Audit Standards and Methodology to take into account the general need for harmonisation of terms of the different types of audits carried out.

Long term

- We also suggest that the Institution should monitor general political and economic developments thereby creating an overview to come up with proposals for structural solutions when operations from different auditees overlap or when they have similar kinds of findings in their respective audit reports. To establish such an overview it is recommended to allocate resources for ongoing surveillance of political and economic development of certain selected areas of main concern.

9. Relations with Parliament and the Media

Introduction

Given its non-judicial character, the National Audit Institution is dependent on others to have impact. Apart from direct result from audits through appropriate response from auditees, the Institution needs the support and enforcing power or influence from Parliament and the general public. Publication of audit reports is essential, but not sufficient. The Institution should use all possible instruments to convey its messages, have those understood, and maximise its impact. ISSAI that the Institution could use as an overarching guiding principle in this respect is section 16 of the Lima Declaration (ISSAI 1).

Fundamentally, relations between the Institution and Parliament are governed by the Constitution and the SAI Law. Members of the Senate are appointed by Parliament, the President is appointed by Parliament, the Annual Report is submitted to Parliament and discussed by Parliament, and the Draft Budget of the National Audit Institution is submitted to Parliament for approval. Parliament can appoint an external auditor for auditing the financial statement of the Institution. These provisions imply that the Institution is accountable towards Parliament. Within Parliament it is the Committee for Economy, Finance and Budget that has the closest contacts with the Institution. This Committee reports to the Plenary on the Draft Law on the Final Accounts, for which it substantially uses the Annual Report from the National Audit Institution submitted to Parliament. This Committee report contains many recommendations drawn from the audit report. The President of the Institution presents the Annual Report to the Committee, and the Minister of Finance introduces the Draft Law on the Final Accounts. Only the Institutions Annual Report is submitted to Parliament. So far, special reports have not been submitted separately. The Administrative Committee in Parliament is the Committee that deals with the preparation of decisions by Parliament on appointment and dismissal of Members of the Senate.

Observations on relations with Parliament

In practice, the professional relationship between the Institution and the Committee for Economy, Finance and Budget is limited to the annual exercise of the submission of the Annual Report and the debate which follows, leading to the adoption by Parliament of the Committee Report which repeats and supports the conclusions and recommendations from the Institution. The Committee has a broad mandate, and time for dealing with audit reports is limited. However, this is partly due to the manner in which the Institution reports: only through the obligatory submission of the Annual Report, with summaries of individual audits that were published on the website during the course of the year. This implies that the workload for the Parliamentary Committee is very much concentrated into a short period of time in the month of November, after the submission by the end of October of the Annual Report and the adoption by the Plenary of the Final Accounts before the year end. A separate submission of special reports as and when these are final – which would be perfectly in compliance with the SAI Law - could help to spread the workload more evenly. Also, an earlier submission of the Annual Report – which would imply a change in the time table for the preparation of the accounts as well – would help in using this report in preparing the following year's budget.

Personal relations between the Senate Members and Members of the Parliamentary Committee are good. The basis is a mutual recognition of each others' role and responsibility in strengthening public financial control. The Parliamentary Committee is positive about the usefulness of the Institution in exercising their duties, and about

the overall quality of the reports from the Institution. The Committee actively supports suggestions to strengthen the position of the Institution, for instance, by reinforcing its independence. The Committee is also considering the establishment of a specialised Committee within Parliament dealing only with audit reports. Consideration has then to be given to the necessary Committee staff, as the current staff of the Committee for Economy, Finance and Budget does not have the capacity to substantially prepare for the discussion on audit reports.

Other Committees in Parliament hardly use audit reports in their discussions with government. In the report by the Institut Alternativa, "The State Audit Institution in Montenegro – The Influence Strengthening Proposal" (November 2010) a whole series of examples is given of debates between sector committees and government where relevant audit reports from the Institution were not used. There are no parliamentary procedures in place to involve the sector committees in the debate on audit reports.

The fact that in Montenegro a Member of Parliament is a part time function, implies that Members have other jobs as well – and some Members of Parliament have responsibilities as Heads of state bodies, and thus of audited entities. In the Committee on Economy, Finance and Budget sometimes Members participate in debates on audit reports whilst they are Directors of the audited entity under scrutiny. This implies an unfortunate, not to say unacceptable, mix of responsibilities which may negatively affect the position of the Institution.

The Annual Report does not contain an independent overview of the follow up on earlier audit reports. It does contain a section in which, at the request of the Institution, the Minister of Finance gives an overview of what follow up has been given on the conclusions stemming from the debate on the Draft Law on the Final Accounts and the corresponding report from the previous year. The Institution does not assess the reliability of this information.

For the Institution to deserve its independence and financial autonomy it is important to fully account for its use of public funds and the activities carried out through audited accounts and a full annual Activity Report. The annual Activity Report is now part of the Annual Report, which does not necessarily lead to the attention that it should have from Parliament. The Institution's accounts have not been audited so far, since Parliament has never appointed external auditors to so. This is an unfortunate situation, which the Institution should try to resolve itself if Parliament remains incapable of appointing external auditors itself. Ideally the Institution should submit a separate annual Activity Report, with the audited accounts as an Annex. On that basis Parliament should separately discuss the activities and results with the Institution. This could serve as input for the approval of the Institution's budget for the following year. The discussion could also serve as a vehicle for suggestions to the Institution for audit topics to be covered in the future. The Institution should of course remain independent in the adoption of its work programme, but suggestions from Parliament might help in choosing the most relevant topics with potentially the most impact.

Recommendations

Short term

- The Institution should submit individual audit reports as special reports separately to Parliament as soon as they are finalised, and no longer wait for the submission of the Annual Report on the governments' final accounts. It should consider how to communicate these reports to Parliament, for instance by organizing briefings for the competent or interested Parliamentary Committees.

- The Institution should separate its annual Activity Report from the Annual Report on the governments' financial accounts and submit the annual Activity Report to Parliament together with the Institution's accounts.

Medium term

- The Institution should consult with the parliamentary Committee for Economy, Finance and Budget on the improvement of parliamentary procedures for dealing with separate audit reports, including the possibility to establish a separate body in Parliament and the abstention of heads of audited entities who are Members of Parliament from the debate on the audit report, and the involvement of sector committees in dealing with audit reports. This consultation should also pay attention to the possibility for Parliament to make proposals for audit topics.

- The Institution should make an effort to submit the Annual Report earlier, and coordinate with the Ministry of Finance the steps needed to achieve that. The Annual Report would win in value if the Institution would include an assessment of the follow up measures taken by auditees since the previous report. A precondition is that the Institution makes an effort to improve the relevance and usefulness of its recommendations.

Observations on communication and relations with the media

Since there is no Strategic Development Plan, there is no communication strategy either. A communication strategy would cover objectives and tools on how the Institution would want to achieve its strategic objectives in the sphere of communication. The general public might be reached through the website of the Institution, but communication with the general public is to a large extent through the media. Also Members of Parliament will be more inclined to pay attention to results of audits if these are covered prominently by the media. Good contacts with the media and the provision of information that is tailored to the needs of the media are therefore essential. These contacts should help to set the correct image of the National Audit Institution of Montenegro as the external audit institution, not as an institution that is primarily dealing with fraud and corruption in the public sector. This is an important issue, as the impression sometimes exist that the primary role of the Institution is to combat fraud and corruption and to identify misdemeanours in the use of public funds in state bodies.

According to the report mentioned above from Institut Alternativ, the press coverage of audit reports is quite good, although diverse. Different newspapers lay different accents in what they report. The President of the Institution is often interviewed by TV and newspapers. Audit reports are not easily understandable for the press, let alone for the general public. Press releases are not issued, neither are summaries of the reports apart from those that appear in the Annual Report. A press conference is held only for the Annual Report, not for individual reports. Here are lots of opportunities to raise the profile of the Institution and further enhance the impact of its work.

The website is quite good, and contains all relevant legal documents and all reports issued. However, it is not always updated in time. There is also an English language version, but of course most documents are available only in Montenegrin. The website could be used to provide more general information about the role and mission of the Institution.

Recommendations

Short term

- The Institution should develop a communication strategy as a component of its Strategic Development Plan. The Institution should issue easily readable and understandable summaries of its reports, and use those for press releases, and make an effort to also draft the reports themselves in a language understandable for the different audiences the reports are aimed for. The Institution should also test the interest of media for press conferences on special reports.

Medium term

- The Institution should define its precise role in fighting fraud and corruption, and in doing so consult with the relevant authorities, and communicate its role with all stakeholders in Montenegro.

Annex 1

List of persons met during the Peer Review

National Audit Institution

Miroslav Ivanisevic, *President and Senate Member*

Milan Dabovic, *Senate Member*

Branislav Radulovic, *Senate Member*

Dragisa Pesic, *Senate Member*

Gaga Gagaj, *Secretary*

Marija Zugic, *International Relations*

Semiha Djukic, *Legal Adviser*

Sector I

Vladan Perovic, *Head of Sector*

Mr Urosevic, *Auditor*

Mr Milovic, *Auditor*

Mrs Brajkovic, *Auditor*

Mrs Matovic, *Auditor*

Ms Kovacevic, *Junior Auditor*

Ms Licina, *Junior Auditor*

Sector II

Sonja Raicevic, *Head of Sector*

Sector III

Stana Besovic, *Head of Sector*

Mrs Boljevic, *Auditor*

Mr Popovic, *Junior Auditor*

Ms Aleksic, *Auditor*

Ms Jovicevic, *Junior Auditor*

Sector IV

Slavka Tomic*, Head of Sector*

Mrs Mihailovic, *Auditor*

Mr Cadjenovic, *Auditor*

Sector V

Nikola Vukičević, *Head of Sector*

Biljana Bulatovic, *Auditor*

Parliament

Aleksandar Damjanovic , *Member of Parliament: President of the Committee for Economy, Finance and Budget*

Zarija Franovic, *Member of Parliament: Deputy Chair of the Committee for Economy, Finance and Budget*

Nadja Vukicevic, *Member of Parliament: Secretary of the Committee for Economy, Finance and Budget*

Dragoslav Scekic, Member *of Parliament: Member of the Committee for Economy, Finance and Budget*

Demir Mujevic, *Adviser in the Committee for Economy: Finance and Budget*

Employment Agency

Zoran Jelic*, General Manager*

Vesna Dragutinovic, *Deputy General Manager*

Zorica Cupic, *Deputy General Manager for Finance*

Information Society and Telecommunications

Sandra Veličković, *Secretary of the Ministry*

Ministry of Finance

Mihailo Pejovic, *Deputy Assistant Minister*

Stanimirka Misovic, *Advisor, Treasury*

Dusanka Rudovic, *Advisor, Treasury*

Montenegrin Foreign Investment Promotion Agency

Petar Ivanović, Director

Blagota Radovic, Trainee

GIZ

Barbara Dulzer, *Team Leader*

Natalie Boljevic, *Project Assistant*

Annex 2

Recommendations

2. Legal Framework

Although there is no urgent need for amending the Constitution or the SAI Law, there are a couple of possible improvements that might be considered when the Constitution or the SAI Law are amended in the near future. Following on from the observations and the assessment above, the Constitution might be amended to ensure the name of the Institution is coherent within that document as well as throughout the legal framework governing the Institution.

For the SAI Law, amendments may be considered on the following issues:

- A provision could be included to secure the functional immunity of Members of the Senate, similar to the immunity of judges. However, such a functional immunity should be very precisely worded, so as to cover only immunity for liability for decisions of the Members of the Senate in respect of audit reports and audit opinions.

- Care should be given in Article 2 of the English version of the SAI Law to the use of the word "autonomous". This should be changed to reflect the text of the Constitution which uses the word "independent". The independence of the Members could be further strengthened by inserting a provision which sets the requirements for members when exercising their duties. For instance, Members of the Senate exercise their duties impartially, objectively and with integrity. Although such a provision will not be easily enforceable, it allows for the Senate as a whole to discuss individual behaviour internally on the basis of legal principles.

- It might be considered to explicitly mention in Article 5 the mandate of the Institution to carry out financial and certification audits. Article 5 and Article 7 (1, sub 4) might be reworded slightly so as to include economy and effectiveness instead of only efficiency. Article 4 is the best place to insert a provision that also entities managing, using and reporting of EU funds (and funds from international financial institutions) are within the remit of the National Audit Institution.

- In Article 9 review of the date before which the Annual Audit Plan needs to be adopted might be considered. It would be advisable to have the plan finalised before the year end. Article 10 could be extended so as to include the obligation of all entities under the remit of the Institution to submit any information requested by the National Audit Institution, also outside the context of an announced audit. In order to make a report by an audited entity on the follow up of recommendations obligatory, it might be considered to insert such a provision in Article 25. In Article 34 the retirement age should preferably be mentioned, although it has to be ensured it is compatible with the Law on Civil Service and consideration should be given to link the reasons for dismissal to the incompatibilities mentioned in Articles 35 and 41.

- Although in principle the National Audit Institution should follow the rules in the public sector for budget users when implementing the budget, it cannot be excluded that this may in practice run counter to the autonomy required for the discharge of its duties. This might necessitate amendments to the Civil Service Law and the Budget Law, to allow for exceptions for the National Audit Institution - as is the case for Parliament and the Central Bank. In terms of resources, the Institution should consider how, apart from increasing the number of staff, outsourcing and use of alternative audit arrangements could be used (e.g. private sector auditors public auditing companies, and the National Audit Institution relying - on their results and applying the relevant professional standards).

- As long as Parliament does not appoint an external auditor for the National Audit Institution's financial statements, the Institution should initiate an external audit of those on its own, for instance, by contracting a private sector audit firm.

- The Senate should consider developing a professional Code of Ethics for Members, and include in the current Code of Ethics for State Employees a clearer provision allowing for disciplinary measures in case of non-compliance. The Code of Ethics is not enforceable as such but it would allow for the discussion mentioned under the suggestion related to Article 2 above.

3. Organisation and Management

Short term

- The Institution should define its mission and vision in order to provide a basis for its SDP. By doing so the management indicates to employees of the Institution as well as outside stakeholders that it has a clear mission and vision for a given period of time and highlights the strategic audit areas and how it aims to achieve them. This would also constitute a good step forward in strengthening the Institution's capacity to contribute to the building of a sound public finance base in Montenegro and to ensure the validity and efficacy of accountability mechanisms.

- A competent replacement for the Senate vacancy should be designated enabling the Institution to operate in its full legal composition and enabling equal distribution of tasks and responsibilities between Senate Members. The Institution should do its utmost to convey to Parliament the necessity of the designation of the fifth Member.

- In order to more clearly delineate the responsibilities of the Senate between its audit responsibilities and current organisational issues, it would be advisable to adopt the Rules of Procedure of the Senate and define the role of the Members of the Collegium, the manner of solving the discord between them and define the role of the Senate rapporteur. In addition, in order to highlight more operative functioning of the Institution and its Secretariat it would be reasonable to once again question the additional competencies of the Senate in accordance to the Rules of Procedures (hiring an external expert, new or additional employment, international cooperation, etc.).

- For the further development of the Institution it would be advisable to keep taking advantage of possibilities for the implementation of personal development tasks and objectives of the Members of

the Senate (types of audit, methodological issues, organisational issues), who seem to be willing to contribute towards further development of the Institution as a whole.

- From observations in this and other Chapters further on in this report it can be concluded that also the lack of clarity in the separation of duties between various sectors and the Secretariat can be considered a complication in the Institution's future successful development. In the Peers' view it would be necessary to consider horizontal development tasks within Sectors. The development of horizontal development functions within Sectors is due to the evident endeavours of the Members and is considered a good solution at this stage of the Institution's development, but a lack of control and reporting regarding their implementation can be observed, particularly relating to problems in the implementation of changes needed to enhance the proficiency of the Institution as a whole .

  Further consideration should therefore be given to the special role of the Senate in the management of the Institution and also the requirement that the President is bound by the continual reaching of an agreement between the Members of the Senate also as regards organisational issues. In order to enable a more efficient decision-making and management, it would be also necessary to define more clearly the role of the Secretary of the Institution.

  Since a clear delineation of competences and a potentially different organisation would contribute towards a more efficient management of institution and a particularly easier implementation of audit tasks, it would be necessary to consider various options for the change in the organisation of operations of the Institution.

  One of the options the Peers propose is the establishment of a special sector with horizontal functions, which could be led by the President and which would include the personnel developing the Institution's tasks (strategic issues of development and organisation, international cooperation, quality assurance) as well as the support services of the Institution (HR, IT, training, administration, internal communication and public relations, legal service, assessment of the Institution, budgeting, etc). To designate the Secretary as Head of Sector would be one of the possibilities. This would however require the amendment to the Rules of Procedures and a somewhat different role for the Members of the Senate, since in this way the President would participate as a Member of the Collegium only. Audit tasks could then be divided amongst the four remaining audit sectors.

  As the second option there is a proposal that administrative issues should be concentrated within the work procedures of the Secretariat. This option would enable the Senate to more often focus on specific questions and dilemmas of audit reports. As the Secretariat should cover a broad scope of activities and be the driver of the change process, it would be important to strengthen the capacity of the Secretariat and an appropriate mandate should be given to the Sectors in the field of responsibility on horizontal issues.

- To provide the auditors with all the necessary legal advice during the audit, it would be important to establish a legal service or at least appoint a group of qualified persons in charge of legal issues, which come about during the implementation of audits.

- Each Member should have independent discretion when it comes to audit decision making while having transparent cooperation with other Members of the Senate. The Senate should adopt the fundamental objective of having access to the significant and substantial disclosures and positions of the Institution even before the final audit reports are issued. The Collegium rapporteur's report or

the Head of the Sector's (i.e. the State Auditor appointed as Head of Sector) report should be the basis.

For a successful limitation to the different approaches by the Members of the Senate within the audit procedures and to ensure quality management (which should by far be the most important work area of the Collegiums) the decision-making process and quality assurance of the Collegium should be consistently documented and the audit team members should be informed at the same time.

- A unified practice could be established through the encouragement of sharing good practices between Sectors and in forming audit teams with auditors from different Sectors. Such interconnectivity is of key importance in pursuing effective leadership. The staff of an Supreme Audit Institution needs to be flexible, and be able to work in new ways which reflect the ongoing changes to public services. Ad hoc audit teams from different Sectors may be set up to undertake specific audit projects.

The National Audit Institution should start developing tools for internal communication, including regular staff meetings, developing intranet, and enhance staff rotation between sectors or audit teams. The Senate Members and Heads of Sectors (i.e. State Auditors as Head of Sectors) and auditors should be meeting regularly and the communication should be two-way, bottom-up and vice versa.

Medium term

- Due to the introduction of new types of audits (Performance Audit, IT, Environmental Audit) it will be necessary to consider the possibility of expanding the scope of sector audit within the Institution and it will also be necessary to define sector responsibility for auditing management and use of IPA funds and other international funds.

- The Institution should be more involved in advising the auditees, but has to ensure that in giving such advice it avoids any explicit or implied commitment that would impair the independent exercise of its audit mandate. It will be necessary to consider the possibilities of performing an advisory role as one of strategic policies and define advisory responsibilities (between the Senate and Members) as well as determine procedures for expressing advisory opinions.

4. Human Resources and IT

Human resources

Medium term

As a medium term priority the development of a human resource management strategy is an important step to ensuring that staff are able to meet strategic objectives of the Institution. It is essential that the Senate ensures correlation between the Human Resource Management Strategy and the Strategic Development Plan. The

Human Resource Management Strategy should be based on the agreed vision and mission of the Institution which includes amongst others:

- **Qualification criteria** for auditors including personal, professional, and social, as well as technical skills;

- **Recruitment, selection and placement procedure and mentoring system**: Special attention should be put on the mentoring system as it should also facilitate the staff appraisal process and help to identify missing competencies and skills at an early stage, and provide the necessary training and assistance;

- **Appraisal and training system:** The Peers consider that staff appraisal results and the acquired feedback is of high importance and needs to be assessed and generalized by the Institution itself. This helps to identify strengths and weaknesses or even gaps in the knowledge and skills of the employees and serves as a basis for developing further training programmes and workshops, thus ensuring consistency between appraisal and training systems. The Peers recommend reviewing the existing appraisal system and updating the system with a number of specific criteria that would allow assessment of the auditors' professional expertise, knowledge and achievements;

- **Career development:** As the Institution is a relatively new institution, it has not yet addressed another important factor of further staff development, that is, their qualification levels, career development and motivation. The Peers suggest that the Institution considers the qualification grading of senior auditors. This should promote their career and maintain motivation for further professional development.

- To ensure continuous enhancement of the professional capabilities of auditors, the Peers suggest defining a minimum number of mandatory training days per year for the auditors and encourages using staff with appropriate experience and knowledge as facilitators and trainers for on-the-job training and in-house seminars. Consideration could also be given to ensure the furthering of knowledge of Senate Members so as to keep up with implementation of agreed audit standards and the implication this has to their own work, developments in the government, legislation, etc and its implication   for   the   Institution.

- The Peers advise the strengthening of the human resources management function in the Institution, including the appraisal and training system, to ensure that the Secretariat or responsible sector plays an important role in the human resources management system for the Institution and is recognized as one of its driving forces.

IT

Short term

- To further promote the use of IT software in auditing, the Peers suggest introducing the DMS system and the application of IDEA software in all sectors. To facilitate the introduction and use of IDEA software, it is important to establish three categories of users: a "help desk" (a person with excellent knowledge of the system);   advanced users (who have good knowledge of the system) and general

users. Specific seminars and exchange of good practices among the advanced users would provide a good forum for sharing the existing experience.

- As auditors collect the most important data from the IT supported systems, auditors should be sure that they can rely on the data provided and stored in the systems. It is important to carry on training auditors on how to evaluate the general controls of the IT system as a part of the overall assessment of the control environment.

- To ensure further development of the National Audit Institution, it would be important to address the questions related to the limited office space and a lack of conference space. The Senate should look into this question and start to find a more optimal office solution as soon as possible.

Medium term (IT)

- There is a particular need to strengthen the capacity of the IT function in the National Audit Institution to ensure that there is a strategy how the Institution can identify main IT systems in the government and ensure that all the necessary audits are performed in good time.

- The Peers believe that the use of the intranet as a communication tool could be developed. The intranet can contain and store all the important information used by the auditors: organisational and managerial information (information on Senate decisions, important events, internal regulations); information on the Human Resources System HRS (information on new employees, absence leave of employees, business trips, vacation leaves etc); information on audits, (including manuals, procedures, check lists); information on available training and seminars (including training materials, main outcomes from the exchange of experience seminars) etc.

5. Audit Programming and Planning

Short term

- The SDP which the Institution is developing should, on the basis of the vision and mission of the Institution, define the strategic objectives for audit and set the priorities for a multi-annual programming on which basis annual audit plans can be prepared.

- An intermediate step towards this goal could be starting to develop and document sectorial risk analysis which identifies and categorizes risky areas of public sector spending, risky areas of management of public property and risky entities. Multi annual audit plans as well as annual audit plans could then be developed awaiting the approved SDP.

- As a short term objective and given the modest capacity of the Institution to carry out performance audits it should be determined how much to invest in training (at some cost in terms of current audit work) to build this capability for the future. At the stage of development of this type of audit and considering the experience gained so far, the Peers consider it too early to establish a separate Sector

or Department with exclusive responsibility for performance audits. Instead the Peers recommend that the Institution determines which sectors should implement these audits, establish an informal functional working group of the auditors involved to foster their professional development, and set an overall objective for the allocation of resources to performance audits (for example 20 % as a long-term objective).

Medium term

- In the area of financial and compliance audits the Institution should move from the current selection approach, based largely on random selection combined with the principle of selecting entities who have not been audited before, towards a risk-based approach, a move which can already be observed in some of the Sectors. Such a risk-based approach would gain from guidance by the Senate on specific priorities and risks that should be taken into account before Sectors select preliminary audit topics.

- The Peers also recommend that an annual update of the risk analysis be undertaken before the compilation of an Annual Audit Plan. This should be the leading factor in the programming and in setting the frequency of financial management audits, particularly in respect of municipalities and public services area of public income and expenditure.

- Before deciding to include an audit proposal in the Annual Audit Plan, the Institution could carry out a "pre-audit" exercise to obtain more information about the audit subject, assess the risk involved and evaluate whether or not a planned audit would be worthwhile. Alternatively, the Annual Audit Plan could include a couple of "pre-audits" which would prepare for audits that could be undertaken during the next Annual Audit Plan.

- It is also suggested that the Annual Audit Plan should be prepared and agreed upon well in advance of 1 January of a particular audit year and according to detailed internal procedures.

- The Peers also recommend considering stating the grounds for carrying out an audit in the Annual Audit Plan and also in the introductory part of an audit report and to explore other possibilities to inform the auditee about the grounds for the initiation of an audit.

Long term

- As a long term objective the Peer's suggest that the National Audit Institution try to establish instruments for the co-operation with non-governmental organisations. A significant source of information would thus be gained, which would ensure appropriate participation in the control of public funds. It would also be necessary to establish the means for the promotion of initiatives given by citizens and users of public funds, whereby it would be advisable to make use of the existing Institution website.

6. Audit Standards and Methodology

Short term

- A key for quality assurance is a common understanding of the different audit types (general audit, cross -section audits, regularity, efficiency and effectiveness audits, and control audits). The Peers recommend that the Institution should consider adopting the terms financial, compliance and performance audit which are internationally recognised terms and align the so called general audits to those types of audit so as to reduce different interpretations. This would also improve communication vis-a-vis the auditee and the larger audience for reports made public.

- The Peers also recommend developing an overview of the different stages in the audit. Such a flow table would provide an overview of the major components in the audit process. We recommend that such an overview is compiled covering the financial, compliance and performance audit processes.

Medium Term

- Standardised audit processes and methodologies (for or each type of audit: financial, compliance and performance audit) would promote not only efficiency in the audit work in general but also efficiency in training. The use of methodology described in the audit manuals should be compulsory for all auditors and Senate Members. To facilitate the introduction and use of the appropriate methodologies, different types of expertise should be identified for specific seminars to foster exchange of good practices. Establishment of a forum for furthering the understanding of the manuals and sharing internal experiences of their usefulness would also contribute to consistency in the audits performed.

- Audit opinions are issued but there seem to be no criteria for when they should be issued. The development of audit opinions is a complex task. The Peers therefore suggest development of audit opinions as medium term priority. However they should be based on the short term priority proposed on audit decision making in the Chapter on Organisation and Management. Each Member should have independent discretion when it comes to making audit opinions while having transparent cooperation with other Members of the Senate. The Senate should adopt the fundamental objective of having access to the significant and substantial disclosures and positions of the Institution even before the final audit opinions are issued. The Collegium rapporteur's report and draft audit opinion or the Head of the Sector's report and draft audit opinion should be the basis. Clear criteria should therefore be developed for issuance of audit opinions and different templates should be drafted and included in the audit manual.

Long term

- Introduction of new audit methodologies (e.g. performance auditing) will gradually call for different techniques to understand the overall environment and general conditions wherein the auditee operates. The understanding of the operations of the auditee is an area that the Institution already pays attention to. However, one element that we recommend to be further developed in the audit

standards is the appreciation of the more strategic challenges that the auditee faces. To develop guidance on how to evaluate strategic risks and the key processes of the the auditees could be a part of the audit manuals.

7. Audit Procedures and Quality Control

Audit Planning

Short term

- To ensure a unified approach to performing audits, the Peers recommend the Senate consider the question of the materiality level to be applied at the National Audit Institution and adopt a decision on a common approach and criteria for identification of the materiality level for audits conducted by the Institution.

- To improve the applied methodology of audit planning in the Institution as a whole, the Peers suggest carrying on with further training of employees, identifying good internal examples and holding an experience exchange seminar. These good examples could also be compiled as reference material to improve the auditors' and the Members of the Collegiums understanding of the impact of materiality on the general performance of the audit and the assessment of the final results.

- To further improve effective use of the existing human resources in the future, the Peers recommend considering the possibility to pay more attention to a detailed planning of the necessary tests (substantive tests, analytical procedure) and define the specific amount of samples and, respectively, the necessary man days and financial resources.

- To ensure a more efficient use of audit resources, and therefore apply a risk-based audit approach and systems assessments in the future, the Peers suggest furthering the knowledge and skills in identifying risks and assessing the control environment for auditors and Members of the Collegiums. It is important to start the cooperation between an internal and external audit and develop the methodology for the evaluation of an internal audit function. We also recommend identifying good practices and use them for further training of auditors and, if necessary, attract support from external technical assistance.

Audit Evidence and Documentation

Short term

- To ensure the quality of audit work and enable the management to supervise auditing procedures during the audit more efficiently, the Peers recommend introducing mandatory templates for the audit programmes, minutes and check lists, as well as for field reports. The standard working papers,

amongst other things, should include information on the objectives, the scope of work (the criteria for sampling) and the conclusions reached. It is good practice that these documents are signed by the person who performed the test and the supervisor (the Head of the Sector or the Audit Team Leader).

- To ensure that an objective audit opinion is prepared, the Peers highly recommend developing common requirements for summarising all errors and irregularities that should substantially facilitate the general assessment of the impact these errors would leave on the financial report.

Medium term

- We also advise considering further training of auditors in applying specific methods and techniques of auditing, for example, practical application of control tests, sampling, evaluation of internal control system , etc.

- To ensure a more efficient use of the available human resources, the Peers suggest planning an audit in the category of audit man days and dividing them accordingly – a specific number of days for audit planning, field work and the reporting phase. That would be even more significant if a time recording system is introduced that should give an opportunity to assess how much time and how efficiently it is used on performing different tests.

- To ensure a unified approach in assessing similar systems within a similar scope by different sectors, the Peers suggest developing standardised checklists for reviewing general issues: expenditure for payroll and services, IT systems, procurements, revenue etc. Standardized checklists could include basic questions. However, more specific questions should be considered added when relevant based on identified risks in a specific audited institution.

Audit Quality Control

Short term

- The Senate should establish formal procedures for audit quality control, and have those included in both the Instruction and the Audit Manual. ISSAI 40 could serve as guidance, but given the size of the Institution some pragmatic compromises should not be excluded. These formal procedures should include the obligation to comment in writing and document these comments, and the responsibility of the President to ensure that these procedures are followed.

- As part of these procedures, the role of the Head of Sector should be more clearly defined. If the current practice of involvement of heads of sector in audits is to be continued, then consideration should be given to strengthening the role of the responsible member by intensifying his review of audit working papers and making documentation thereof mandatory.

Long term

- The Institution should contract out the review of a couple of audits carried out on annual basis to an appropriate academic institution or professional organisation.

8. Reporting and Follow Up

Short term

- Concerning the format and language of reports the Peers recommend developing the standardisation of financial and compliance audit reports by splitting the reports into only four major standard components: summary, findings, conclusions and recommendations.

- Bringing all reports to the attention of the Senate would also promote the establishment of formal procedures for audit quality control which is also discussed in the Chapter on Audit Procedures and Quality Control. With the objective of issuing more balanced reports the Peers propose also to consider, when appropriate, more frequently expressed positive conclusions regarding the performance of the auditee.

- The Peers also recommend clarifying the roles and responsibilities when it comes to follow up procedures of audits and how to best ensure that audit reports are effectively considered in the risk analysis in the annual audit planning.

- Regarding the report on the audit of the government's final accounts the Peers recommend that it should be considered if the audit report could be submitted earlier than now to ensure timely reporting to Parliament compared to the analysis and discussion of n+2year proposed budget. This could be feasible if individual audit reports were submitted as special reports to Parliament as soon as they are finalised and no longer wait for the Annual Report. This would mean that a synthesis of systemic control weaknesses in the Government's administration which were found during the year could be brought to the special attention of Parliament for follow-up in the Annual Report. Further recommendations linked to reporting are also dealt with in the Chapters on Audit Programming and Planning as well as Relations with Parliament.

Medium term

- Regarding the Institution's recommendations in audit reports, the Peers propose to always consider providing distinct recommendations with a set of realistic time frames for implementation. This can be done if the findings and conclusions of the auditor are thoroughly analysed through a perspective of not only the identified irregularity, but also by considering the perspective and views of the auditees on why the problem so far has not been resolved.

- The Peers conclude that clear recommendations are vital in the communication with auditees. For instance when applying efficiency measures, it is important to establish a mutual understanding of the definition and relevance of the indicator. Equally important is that recommendations related to efficiency measurements are developed in the full contextual environment wherein the indicator provides indications (i.e. not facts). The process requires careful thought, iterative refining, and collaboration with the auditee and consensus building before issuing the recommendations. In the light of this Article 5 of the SAI Law could be revised as suggested in the Chapter on the Legal framework. Further linked issues are also discussed in the Chapter on Audit Standards and

Methodology to take into account the general need for harmonisation of terms of the different types of audits carried out.

Long term

- We also suggest that the Institution should monitor general political and economic developments thereby creating an overview to come up with proposals for structural solutions when operations from different auditees overlap or when they have similar kinds of findings in their respective audit reports. To establish such an overview it is recommended to allocate resources for ongoing surveillance of political and economic development of certain selected areas of main concern.

9. Relations with Parliament and the Media

Relations with Parliament

Short term

- The Institution should submit individual audit reports as special reports separately to Parliament as soon as they are finalised, and no longer wait for the submission of the Annual Report on the governments' final accounts. It should consider how to communicate these reports to Parliament, for instance by organizing briefings for the competent or interested Parliamentary Committees.

- The Institution should separate its annual Activity Report from the Annual Report on the governments' financial accounts and submit the annual Activity Report to Parliament together with the Institution's accounts.

Medium term

- The Institution should consult with the parliamentary Committee for Economy, Finance and Budget on the improvement of parliamentary procedures for dealing with separate audit reports, including the possibility to establish a separate body in Parliament and the abstention of heads of audited entities who are Members of Parliament from the debate on the audit report, and the involvement of sector committees in dealing with audit reports. This consultation should also pay attention to the possibility for Parliament to make proposals for audit topics.

- The Institution should make an effort to submit the Annual Report earlier, and coordinate with the Ministry of Finance the steps needed to achieve that. The Annual Report would win in value if the Institution would include an assessment of the follow up measures taken by auditees since the previous report. A precondition is that the Institution makes an effort to improve the relevance and usefulness of its recommendations.

Relations with the media

Short term

- The Institution should develop a communication strategy as a component of its Strategic Development Plan. The Institution should issue easily readable and understandable summaries of its reports, and use those for press releases, and make an effort to also draft the reports themselves in a language understandable for the different audiences the reports are aimed for. The Institution should also test the interest of media for press conferences on special reports.

Medium term

- The Institution should define its precise role in fighting fraud and corruption, and in doing so consult with the relevant authorities, and communicate its role with all stakeholders in Montenegro.

Annex 3

Overview of Sector Responsibilities

Sector I

Audit responsibilities:

Annual audit of the final budget accounts of Montenegro,

Entities include: The Ministry of Finance; The Commission for the Control of Public Procurement Procedure; The Commission for the Distribution of Lottery Revenues and Tax Administration; Real Estate Directorate; Customs Administration; Directorate for Anti-corruption Initiative; Administration for the Prevention of Money Laundering; Statistical Office of Montenegro; Compensation Fund.

- Cross section audits of the entities under its competence with the special obligation to follow up application of regulations related to current revenues and budget expenditures, reserves, receipts and budget costs on the basis of loaning, credits, debts and rules of the State Treasury work with the exception of expenditures and receipts under the competence of other sectors.

Horizontal support:

International relations, Government and Parliament relations, PR

Sector II

Audit responsibilities:

Annual audit of the Central Bank account of Montenegro and the Development Fund of Montenegro;

- Entities include: the President of Montenegro; the Parliament of Montenegro including the Electoral Commission of Montenegro and funds to the work of parliamentary parties; the Government of Montenegro; including the Economic and Social Council; the Pension System Improvement Project of Montenegro; Gender Equality Office of Montenegro; the Foreign Investment Promotion Agency of Montenegro; the National coordinator for Anti-Trafficking; the Office for Sustainable Development; the Ministry of Defense; the Ministry of Foreign Affairs ; the Ministry of Tourism and Environmental Protection including Hydrological and Meteorological Service of Montenegro and the National Tourism Organization; National Security Agency of Montenegro; the Agency of Montenegro for Economic Restructuring and Foreign Investments; and the Privatization Council of Montenegro.

- Cross section audits of entities under its competence with the special obligation to follow up application of regulation related to the privatization procedures and budget revenues from the sale of property.

Horizontal support:

Audit standards and audit processes

Sector III

Audit responsibilities:

- Audit of the Annual Financial Report of the Fund for Pension and Disability Insurance of Montenegro; the Fund for Health Care Insurance of Montenegro; the Employment Agency of Montenegro; and the Institution's Public Pharmacy Montefarm.

- Entities include: the Ministry of Health, Labour and Social Welfare including the Health Systems Improvement Project; the Center for Social Work of Montenegro; Transfer for Funds; the Agency for Medicines and Medical Resources of Montenegro; the Ministry for Education and Science including the University of Montenegro; the Bureau for Educational Services; the Ministry of Agriculture, Forestry and Water Management including the related administrations; ; and the Montenegrin Commissariat for Internally Displaced Persons, the Red Cross Society of Montenegro; the Refugee Center of Montenegro.

- Performing cross section audits of entities under its competence with the special obligation to follow up application of regulations related to gained revenues of Funds and their business operations and budget expenditures on the basis of the transfer for the social care.

Horizontal support:

Training, scientific work and state audit exams

Sector IV

Audit responsibilities:

- Audit of the final statement of the budget and financial reports of the regulatory agencies.

- Entities include: the Courts; the Prosecutor's Office ; the Ministry of justice; the Ministry of internal affairs; public administration; the Ministry of culture, sports and media; the Ministry for Protection of Human and Minority Rights including the Office for Criminal Sanction Execution; the Police Academy;; State Archives of Montenegro; Montenegrin National Theatre;; the Montenegrin Olympics Committee; the Montenegrin academy of sciences and Arts; the Protector of Human Rights and Freedoms; the Commission for Investigation of Conflict of Interests; the Secretariat for Legislature of Montenegro; the Secretariat for European Integration; the State Property Office; the Administration for Joint Services of state bodies including funds for residential settlement; the Human Resources Management Authority; the Public Procurement Directorate; the Republic protocol; the Commission for Concessions; Non-governmental organizations.

- Cross section audits of entities under its competence with the special obligation to follow up application of regulations related to public procurement, concessions, capital expenditure of budget and transfers to the institutions, individuals, nongovernmental and public sector, as well as budget receipts on the basis of donations and transfers.

Horizontal support:

Legal and anticorruption efforts

Sector V

Audit responsibilities:

-Audit of the final statement of the budget of local self-governments,

- Entities include: the Ministry for Economic Development including affiliated bodies;; the Directorate for Public Works; the Directorate for Development of small and medium sized enterprises; the Ministry of Maritime Affairs, Transportation and Telecommunication including the Maritime Safety Department; the Department of Civil Aviation; the Directorate of Transportation; public enterprises whose owner is Montenegro and integral ecosystem management of Skadar Lake; public enterprises whose owner is the Municipality of Montenegro and public societies in which the state has a stake and donations to Municipalities and Equalization Fund.

-Cross section audits of entities under its competence with the special obligation to follow up application of regulations related to gained receipts, expenditures, and other sources for financing local self-government.

Horizontal support:

Information technology