

LAW
ON PUBLIC INTERNAL FINANCIAL CONTROL SYSTEM

I. GENERAL PROVISIONS

Article 1

This Law governs the system of internal financial control in the public sector in Montenegro (hereinafter referred to as: "the Public Sector"), including financial management and control and internal audit and sets forth the methodology and standards and other issues important for establishment, development and carrying out the public internal financial control system.

Article 2

The public sector under this Law shall refer to: the users of the Budget of Montenegro, budgets of municipalities, state funds, independent regulatory bodies, shareholders companies and other legal entities in which the government or municipalities have a controlling stake (hereinafter referred to as: Entity).

Article 3

The public internal financial control system consists of:

- Financial management and control,
- Internal audit and
- Central unit for the harmonization of financial management and control and internal audit.

A Head of the budget user, or a head of the legal entity from the Article 2 of this Law (hereinafter referred to as: the Head of the Entity) shall be responsible for the establishment of the public internal financial control system from the paragraph 1, item 1 and 2 of this Article.

Ministry of Finance shall coordinate the establishment and development of public internal financial control system.

Article 4

Individual terms used in this law have the following meaning:

1. **Internal control system in the public sector** means the system of financial and other controls, including organisation structure, working methods and procedures and internal audit, established and implemented by the head of the entity, aimed at successful management and accomplishment of tasks of the entity in a transparent, proper, economic, efficient and effective manner.
2. **Financial management and control** means the comprehensive internal control system that is established by and is the responsibility of the head of the entity, and which, together with risk management, provides reasonable assurances that the Budget and other public funds will be used properly, economically, efficiently and effectively in the accomplishment of relevant objectives of the entity.
3. **Reasonable Assurance** means satisfactory degree of security referring to specific issue being considered with respect to expenses, benefits and risks.

4. **Risk** means a possibility for the occurrence of events that may have a detrimental impact on the accomplishment of objectives of the entity.
5. **Prior (ex ante) controls** established by the head of the entity and are necessary for taking decisions on the collection and usage of funds, undertaking of obligations, conducting procedure of public procurement, conclusion of contracts and related payments and return of incorrectly made payments.
6. **Audit trail** is a documented flow of financial and other transactions from their commencement to the completion and vice-versa, aimed at facilitating the reconstruction of all individual activities and approvals thereof.
7. **Internal audit** means an independent, objective assurance and advisory activity, aimed at providing added value and improving the operations of entity, which assists an entity in achieving their objectives by providing a systematic, disciplined approach to the evaluation and improvement of risk management, controls and management processes.
8. **Internal audit charter** means an internal act signed by the internal audit unit head and the head of the entity, setting out the purpose, authorities and responsibilities of internal audit and the head of the entity in relation to internal audit.
9. **Code of Ethics** refers to the Code of Ethics of The Institute of Internal Auditors (IIA).
10. **International internal control standards** mean the Guidelines for Internal Control Standards for the Public Sector, of the International Organisation of Supreme Audit Institutions (INTOSAI).
11. **International internal audit standards** mean the international standards of the Institute of Internal Auditors (IIA).
12. **Fraud indications** means materially significant activities, pointing out the existence of elements of offence, or criminal offences, or errors on the basis of which may be concluded that there is an intentional or wrong representation of material and financial facts.

II. FINANCIAL MANAGEMENT AND CONTROL

1. Purpose of financial management and control

Article 5

Financial management and control shall be implemented for the purpose of improving financial management and decision making in achieving objectives of the entity, especially including:

- 1) Compliance of operations with legislation, regulations, internal policies, contracts and procedures,
- 2) The provision of reliable, complete and timely financial and commercial reporting,
- 3) Economic, efficient and effective use of funds,
- 4) Protection of assets, liabilities and other resources against losses caused by mismanagement, unjustified spending and use, and against irregularities and fraud.

The Financial Management and Control relates to both financial and non financial processes and activities in the operation of the entity.

Financial management and controls are carried out in all organisational units and at all levels of the entity, and cover all resources of the entity, including EU funds.

2. Financial management and control components

Article 6

The financial management and control shall be based on the internationally accepted standards on internal control, through the application of the following, inter-related components:

- 1) Control environment;
- 2) Risk management;
- 3) Control activities;
- 4) Information and communication;
- 5) System monitoring and assessment.

Control environment

Article 7

Control environment from the Article 6, item 1 of this Law includes:

- 1) Personal and professional integrity and ethical values of heads and employees;
- 2) Management and method of governance;
- 3) Setting missions and goals;
- 4) Organizational structure, hierarchy in assignment of responsibilities and authorities, rights and obligations, and reporting levels;
- 5) Written rules and human resource management practices;
- 6) Competence of employees.

Risk management

Article 8

Risk management represents a procedure for identification, assessment, control and monitoring potential events and situations that may have an adverse impact the achievement of established goals of the entity and undertaking necessary measures for the purpose of reducing risk and obtaining reasonable assurance that the goals will be achieved.

Risk management from the paragraph 1 above, shall be performed on the basis of risk management strategies annually adopted by the head of the entity.

Control activities

Article 9

Control activities shall be established with the aim to reduce risk to an acceptable level applying written rules, principles and procedures.

Control activities need to be appropriate to operations or activities of the entity, timely and costs of their introduction must not exceed the expected benefits.

Control activities cover shall especially include:

- 1) Authorisation and approval procedures;
- 2) Segregation of duties in a manner that does not allow the same person to be simultaneously responsible for authorization, implementation, recording and control;
- 3) Double signature system whereby no commitment may be undertaken and no payment may be made without signatures of the head of the entity and a financial service head or other authorised person;
- 4) Access to funds and information
- 5) Prior control of legality performed by ex-ante financial controller or other person appointed by the head of the entity;
- 6) Procedures for full, correct, regular and updated recording of all business transactions;
- 7) Assessment of transaction effectiveness and efficiency;
- 8) Procedure oversight;
- 9) Human resource management procedures and reporting;
- 10) Documenting all transactions and operations related to activity of the entity in accordance with established rules.

Information and communication

Article 10

Business Information of the entity must be appropriate, updated, accurate and accessible for:

- 1) Effective communication at all hierarchical levels of entities;
- 2) Development of appropriate information system that enables all employees to have clear and precise guidelines and instructions in their role and responsibilities regarding financial management and control;
- 3) Documenting all processes and transactions, including system descriptions, through flow diagrams, accounting and filing system intended for the preparation of appropriate audit trail;
- 4) Establishment of effective, timely and reliable reporting system, including reporting levels and time frames, types of reports submitted to management and manner of reporting in case of detected errors, irregularities, misuse of funds and information, deceit or non-allowed actions.

System monitoring and assessment

Article 11

The head of the entity shall be accountable for monitoring and assessment of the financial management and control system for the purpose of assessing its adequacy and functioning and providing timely updating.

System monitoring and assessment from the paragraph 1 of this Article, is performed by continuing monitoring, self-assessment and internal audit.

3.Management responsibility

Article 12

The managers of the entities under Article 2 shall be accountable for achieving the objectives of the entities by managing public funds in a legal, economical, efficient and effective manner.

Article 13

The head of the entity is responsible for:

- 1) Putting in place adequate system of financial management and control;
- 2) Setting the objectives of the entity managed by him/her; preparation and implementation of strategic and other plans, and action programmes for achieving those objectives;
- 3) Identification, assessment and management of risks that may prevent achievement of the objectives of the entity, and the introduction of adequate controls to manage those risks in accordance with this law and international internal control standards;
- 4) Lawful, economic, efficient and effective use of available funds;
- 5) Effective human resource management and maintaining needed level of expertise;
- 6) Keeping and protecting resources and information from losses, disclosure, unauthorized use and misuse;
- 7) Segregation of duties with respect to decision making, implementation and control;
- 8) Comprehensive accurate and timely recording of all transactions;
- 9) Documenting all transactions and operations within the entity;
- 10) Monitoring and updating of the financial management and control system and undertaking measures for the improvement of the system, in accordance with recommendations of internal audit and other assessments;
- 11) Reporting on the development and the adequacy of the financial management and control system;
- 12) Introduction of internal rules, procedures and guidelines for financial management and control systems;

On the basis of Internal Systematization and Organization Act, the head of the entity may delegate individual duties and responsibilities or authorizations to other employees within the same entity.

The delegation of authorizations and responsibilities from the paragraph 2 above does not eliminate the accountability of the head of the entity.

Internal organisational unit heads are responsible to the head of the entity for financial management and control activities put in place in organizational units under their responsibility.

Article 14

The head of the entity shall appoint a person to be responsible for the establishment, implementation and development of financial management and controls.

The establishment of the financial management and control system shall be done on the basis of the plan for the aforementioned and methodology for the implementation of the plan determined by the head of the entity.

The Ministry of Finance shall adopt a regulation on the manner and procedure for the establishment of the financial management and control system.

4. Financial management and control reporting

Article 15

The head of the entity shall be responsible to submit to the Central harmonization unit of the Ministry of Finance annual report on activities related to the establishment and development of financial management and control, by the end of January of the current year for the previous year.

Ministry of Finance shall adopt a regulation on the form and the content for reporting referred to in paragraph 1 above shall be prescribed by the.

III. INTERNAL AUDIT

1. Role and tasks of internal audit

Article 16

Internal audit shall be carried out in order to provide objective and expert opinion and advice on the adequacy of the financial management and control systems with the objective of providing improvement in the operation of the entity.

Internal audit helps the entity in achieving its goals by applying a systematic and disciplined approach in evaluating operation of the entity involving:

- 1) The planning of audit work through the identification and assessment of the nature and level of risk relating to each activity in the entity;
- 2) Assessment of the adequacy and efficiency of financial management and control system with respect to:
 - a) Risk identification, assessment and management by the head of the entity;
 - b) Compliance with laws and other regulations, operational guidelines, internal policies and contracts;
 - c) Accurate, reliable and complete financial and other operational information;
 - d) Efficiency, effectiveness and economy of operations;
 - e) Protection of resources and information;
 - f) Implementation of tasks and achievement of goals;
- 3) Making recommendations to the entity for improvements to the financial management and control system.

Internal audit may provide consulting services for special unplanned tasks initiated by the heads of the entity, which objective is to create added value and improve the management process, risk management and control, without being responsible for the implementation of its recommendations.

The scope and objective of any consulting services engagement from the paragraph 3 of this Article shall be harmonized between the head of the entity and the head of the internal audit unit.

Article 17

The work of Internal Audit involves the following elements:

- risk assessment,
- planning,
- audit implementation,
- reporting and
- follow-up on the given recommendations.

The Internal audit types are: system audit, compliance audit, successful operation audit (performance audit), financial audit and information technology audit.

Internal audit is carried out through objective evaluation of evidence by internal auditors, aimed at giving an objective, independent opinion or conclusion related to the process, system or other area covered by the audit.

2. Establishment and independence of internal audit

Internal audit establishment

Article 18

Entities are obliged to establish internal audit in one of the following ways:

- 1) By organizing an independent organizational internal audit unit within the entity which will report directly to the head of the entity;
- 2) By organizing a joint internal audit unit upon proposal of two or more entities, subject to the prior approval of the Ministry of Finance;
- 3) By agreement that internal audit shall be performed by the internal audit unit of another entity or local government unit, subject to the prior approval of the Ministry of Finance.

Internal audit units of the Entities shall perform internal audit of the units that are the users of budget funds within budget funds of the entity, if they do not have their units established.

Internal audit units of the Entities shall coordinate the work of the internal audit units of users from the paragraph 2, of this Article that has established the internal audit units.

The manner and the criteria for the establishment of internal audit from the paragraph 1, of this Article shall be determined on the basis of the regulation of the Government of Montenegro (hereinafter referred to as: "the Government").

The number of employees in the internal audit unit shall be at least three internal auditors, including the head of internal audit unit.

Article 19

The head of the entity is responsible for the provision of conditions for functioning of internal audit including:

1. The appointment of a Head of Internal Audit after consultation with the Ministry of Finance;
2. The signing of an Audit Charter;
3. The provision of resources to enable internal audit to function effectively;
4. Endorsing the strategic and annual plans of internal audit;
5. The implementation of agreed internal audit recommendations;
6. Recording non-agreed recommendations on the basis of internal audit report;
7. Providing an annual report on internal audit activities to the Ministry of Finance.

The Head of the entity, having established an independent internal audit unit, may establish an audit committee in accordance with International Internal Audit Standards, as an advisory body for internal control and internal audit issues.

Internal audit independence

Article 20

Internal audit unit must be functionally and organizationally independent from other organizational units of the entity.

Functional independence is established through independent planning, implementation and reporting of completed internal audits.

Internal audit head and internal auditors may perform only internal audit.

Article 21

The head of the internal audit unit shall be independent in his/her work and may not be reassigned to other work position or dismissed due to the disclosure of facts or making recommendations in the internal audit report.

3. Internal audit standards and methodology

Article 22

Internal audit is carried out in accordance with legislation governing internal audit and International internal audit standards.

In their work, internal auditors must adhere to the internal audit charter, the ethical code of internal auditors, internal audit working methodology, directions and instructions.

Methodology, directions and instructions from the paragraph 2 of this Article shall be determined on the basis of the regulation of the Ministry of Finance.

The Internal audit unit of the Entity may, due to the complexity of work and tasks of the entity, develop additional methodological instruction and guidance for performing internal audit, specifying in more details methods to be used in the process of audit.

Internal audit planning, conducting and reporting

Article 23

Internal audit shall be conducted on the basis of:

- 1) strategic plan
- 2) annual plan and
- 3) individual audit plan.

Strategic and annual internal audit plans, shall be prepared by the internal audit unit head on the basis of objective risk assessment, and will be endorsed by the head of the entity.

The strategic plan is adopted for the next three-year.

The Strategic plan shall be reviewed against risks and audit scope at least once a year.

The annual internal audit plan, developed on the basis of strategic plan, shall be adopted by the end of the current year for the next year.

Individual audits are performed on the basis of the plan describing in detail the subject matter, objectives, duration, distribution of resources, techniques, types and coverage of audit examinations.

Internal audit unit head approves the individual audit plan and related programmes, describing in detail the audit procedures.

Article 24

The audit is performed by direct review of the documentation, determining, analysing, assessing and documenting data that are sufficient for giving an expert opinion on set goals of the entity.

Any completed audit must result in a draft audit report containing summary, goals and scope of audit, findings, conclusions and recommendations.

Draft audit report shall be submitted to the responsible person of the entity that was subject to audit for the purpose of stating its opinion on the statements from the draft audit report.

The responsible person from the paragraph 3, of this Article shall have the right to object to the draft audit report, which will be included in the final report. Objections to the draft audit report and proposal of the activity plan for implementation of accepted recommendation shall be submitted to the head of the internal audit unit within eight days following the day of receiving the draft audit report.

After consultation with the responsible person of the entity that was subject to audit and after stating its opinion on the draft report, the internal auditor finalises the audit report with a proposal for an action plan for the implementation of its recommendations and sends it both to the Head of Internal Audit and the Head of the Entity.

The Head of Entity shall inform the internal audit unit in writing about the adoption of the action plan from the paragraph 5, of this Article, within thirty days after the presentation of the final audit report and about the actions taken to implement the recommendations.

Ministry of Finance shall adopt a regulation on more detailed manner and procedure of work in the internal audit.

4. Rights and responsibilities of internal audit unit head and internal auditors

Rights of Internal Audit Unit head and internal auditors

Article 25

Internal audit unit heads and internal auditors have a right to:

- 1) Free access to heads, employees and resources of the entity who are related to the conduct of audits;
- 2) Free access to all information, as well as all available documents and records, including electronic ones, which are needed for the conduct of audits;
- 3) Demand from responsible persons any necessary data, statements, opinions, documents or other information needed for the conduct of audits.

Article 26

In addition to the rights specified in Article 25 above, internal audit unit head has a right to:

- 1) Report to the head of the entity on all major remarks regarding the conduct of a particular audit;
- 2) Propose to the head of the entity to hire experts whose special knowledge and skills are needed during the audit.

Responsibilities of Internal Audit Unit head and internal auditors

Article 27

Internal audit unit head is responsible to carry out planned internal audits and other activities of the internal audit unit, especially including:

- 1) Preparation and submission to the head of the entity for approval of the draft internal audit charter,
- 2) Preparation and submission to the head of the entity for endorsement of the Strategic and annual internal audit plans;
- 3) Organization, coordination and distribution of work assignments to internal auditors in accordance with their knowledge and skills;
- 4) Approval of conduct of individual audit plans;
- 5) Monitoring of the implementation of annual internal audit plans and application of internal audit methodology based on international internal audit standards;
- 6) Monitoring of the implementation of internal audit recommendations;
- 7) Professional and overall performance of internal audit.
- 8) Assessment of new financial management and control systems;

- 9) Preparation and submission for approval to the head of the entity of a plan for the continuous professional training and development of internal audit staff.

Article 28

Internal audit head is obliged to submit to the head of the entity:

- 1) Annual report on the work of internal audit and assessment of adequacy and effectiveness of financial management and control system;
- 2) Report on the results of each individual audit and all major findings and recommendations for the improvement of operation of the entity;
- 3) Periodic reports on the implementation of internal audit annual plans;
- 4) Reports on all cases where activities of internal audit head and internal auditors have been confronted with restrictions
- 5) Report on adequate resources for the conduct of internal audit.

Article 29

Internal audit unit head and internal auditors must possess appropriate knowledge in order to be able to recognise indications of fraud.

When fraud indications have been identified, internal audits shall be obliged to discontinue the audit process and immediately report to the internal audit unit head, who will immediately notify the head of the entity in writing.

Upon receiving the notification from the paragraph 2 of this article, the head of the entity shall be responsible to undertake all necessary actions and inform responsible public authorities.

Article 30

Internal audit unit head and internal auditors shall be obliged to keep the documents and data and information made available to them during the audit confidential.

Article 31

Internal audit unit head and internal auditors are obliged to cooperate and coordinate their work with Central Harmonization Unit of the Ministry of Finance, with the objective to receive recommendations and instructions necessary for their work.

Article 32

The head of the entity shall be obliged to submit to the Central Harmonization Unit of the Ministry of Finance annual report on the work of internal audit, by the end of January of the current year for the previous year.

The content of the annual report and the manner of reporting from the paragraph 1 of this Article shall be prescribed by the regulation of the Ministry of Finance.

Article 33

Internal auditor shall be obliged to suspend all activities regarding an audit and inform, with no delay, a head of the internal audit unit about the existence of the conflict between his personal and business interests, as well as about the activities he was engaged in during the year preceding the year of audit, which are related to the subject of the audit.

5. Requirements for internal audit unit head and internal auditors

Article 34

In addition to general requirements defined by the Law, an internal auditor must have:

- 1) university education;
- 2) at least two years work experience in auditing, financial control and accounting – financial operations;
- 3) passed the examination for authorised internal auditor.

Examination for authorized internal auditor from the paragraph 1, item 3 of this Article is taken on the basis of curricula prescribed by the Ministry of Finance.

Examination from the paragraph 2, of this Article shall be conducted in front of the Commission established by the Ministry of Finance.

The manner of conducting the examination for authorized internal auditor shall be prescribed by the Ministry of Finance.

Article 35

Internal audit unit head may be a person who in addition to requirements from the Article 34, paragraph 1, item 1 and 3, has at least five years of work experience, of which a minimum of two years in auditing.

Article 36

Internal auditor performs internal audit tasks with a certain title.

Titles of internal auditors shall be determined by the Government.

6. Internal audit of EU funded programmes and projects

Article 37

Entities from the Article 2, of this Law, using the EU funds, when defining financial management and control and internal audit activities, shall be obliged to apply requirements defined by the European Commission.

The internal audit units of the entities from the Article 2, of this Law, shall be obliged to conduct internal audit for entities and other beneficiaries implementing programmes and wholly or partially financed from the EU funds, including all other participants that have received funds on account of EU programs and projects.

The audit of EU programmes and funds is carried out in accordance with internationally accepted audit standards, provisions of international agreements for the use of such funds and appropriate regulation in the area of management and control of all EU funds.

IV. CENTRAL HARMONIZATION UNIT

Article 38

The Central Harmonization Unit with the Ministry of Finance shall be established for the purpose of:

- 1) preparation of professional basis for development of laws and enabling regulations in the area of financial management and control and internal audit;
- 2) development of methodology and work standards in financial management and control and internal audit;
- 3) preparation, organising and running training programs for taking examinations for authorised internal auditors;
- 4) ensuring a continuing professional development plan for authorised internal auditors;
- 5) preparing, organising and running training programmes and training of persons responsible for and involved in financial management and control and internal audit;
- 6) coordination of establishment and development of internal financial management and control and internal audit;
- 7) maintaining register of: internal audit units, internal audit charters, authorized internal auditors and persons included in financial management and control;
- 8) monitoring of the implementation of laws, enabling regulations and internal rules, standards for financial management and control and internal audit, ethical code of internal auditors, instructions and methodologies for financial management and control and internal audit;
- 9) review of quality of the financial management and control system and internal audit with entity, with the objective of monitoring over implementation of recommendations for the purpose of collecting information for the improvement of work methodologies and standards;
- 10) cooperation with professional bodies and institutions in the area of financial management and control and internal audit.

Central harmonization unit prepares an annual consolidated report on the system of internal financial controls, based on the Report from the Article 15 and 32 of this Law, and delivers to the Government by the end of March of the current year for the previous year.

The report referred to in paragraph 2 above contains data on financial management and control, material more significant findings and recommendation of internal audit and relevant activities undertaken by the head of the entity for the purpose of improving internal financial control systems.

V. TRANSITIONAL AND FINAL PROVISIONS

Article 39

Enabling regulations for this Law shall be passed within 9 (nine) months of the effective date of this Law.

Article 40

Pursuant to provisions of Article 18 above, users of the funds of the Budget of Montenegro and the Capital City are obliged to establish internal audit within 12 months and other entities from the Article 2 of this Law within 24 months, after the effective date of the regulation from the Article 39, of this Law.

Article 41

Persons who have not passed examination for authorized internal auditor, and who meet other conditions from Article 34 above, may perform duties of authorized internal auditor without passed examination for a maximum of 2 years after the date of adoption of the programme for taking the examination for authorised internal auditors.

Article 42

Provisions of the Article 35 of this Law shall be effective from 1st January 2012.

Article 43

On the effective date of the Articles 39 and 40 of this Law, chapters: «IX. INTERNAL AUDIT» and Articles 56, 57 and 57(a) of the Law on Budget («Official Gazette of RoM», No. 40/01, 44/01, 71/05 and 12/07) shall cease to exist.

Article 44

This Law becomes effective on the eighth day upon its publication in the "Official Gazette of Montenegro".