

## **32 Annex - Financial Control**

### **260. LAW ON PUBLIC INTERNAL FINANCIAL CONTROL SYSTEM**

---

**LAW**  
**ON PUBLIC INTERNAL FINANCIAL CONTROL SYSTEM**

**I. GENERAL PROVISIONS**

**Article 1**

This Law shall regulate 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**

For the purpose of this Law, the public sector shall refer to: the users of the Budget of Montenegro, budgets of municipalities, state funds, independent regulatory bodies, stock companies and other legal entities in which the government or municipalities have a majority ownership (hereinafter referred to as: Entity).

**Article 3**

The public internal financial control system shall consist 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 referred to in the Article 2 of this Law (hereinafter referred to as: the Head of the Entity) shall establish the internal financial control system in public sector referred to in 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 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 objectives of the entity;
3. **Reasonable Assurance** means satisfactory degree of security referring to expenses, benefits and risks related to defined objective or specific issue;
4. **Risk** means a possibility for the occurrence of events that may have a detrimental impact on the accomplishment of defined objectives of the entity;
5. **Prior (ex ante) controls** mean preventive controls established by the head of the entity that are necessary for making decisions on the collection and usage of funds, undertaking of obligations, conducting procedures of public procurement, conclusion of contracts and related payments and return of incorrectly made payments;
6. **Audit trail** means 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 and assist an entity in achieving its objectives by providing a systematic, disciplined approach to the evaluation and improvement of risk management efficiency, 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 standards determined by the Guidelines for Internal Control Standards in 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** mean materially significant activities, pointing out the existence of elements of offence, or criminal offence, or errors on the basis of which may be concluded that there is an intentional or wrong representation of material or financial facts.

## **II. FINANCIAL MANAGEMENT AND CONTROL**

### **1.Purpose of financial management and control**

#### **Article 5**

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

- 1) Compliance of operations with legislation, secondary and internal acts, contracts and placed procedures,
- 2) The provision of reliable, complete and timely financial and commercial reporting,
- 3) Proper, economic, efficient and effective use of funds,
- 4) Protection of assets, liabilities and other resources against losses that may be caused by inappropriate management, unjustified spending and use, as well as against irregularities and fraud.

The Financial Management and Control shall include all financial and non financial processes and activities in the operation of the entity.

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

### ***ELEMENTS OF FINANCIAL MANAGEMENT AND CONTROL***

#### **Article 6**

The financial management and control shall be carried out in compliance with internationally accepted standards for internal control, through the application of the following, inter-related elements:

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

#### ***Control environment***

#### **Article 7**

Control environment referred to in the Article 6, item 1 of this Law includes:

- 1) Personal and professional integrity and ethical values of heads and employees;
- 2) Method of management and 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 is a procedure of identification, assessment, control and monitoring of potential circumstances that may have an adverse impact on the achievement of defined goals of the entity and undertaking necessary measures for the purpose of reducing risk to the level of reasonable assurance that the goals will be achieved.

Risk management referred to in the paragraph 1 of this Article shall be performed on the basis of the risk management strategy to be annually adopted by the head of the entity.

### ***Control activities***

#### **Article 9**

Control activities shall be established to achieve defined objectives of the entity by reducing risk to an acceptable level applying written rules, principles and procedures.

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

Control activities shall cover in particular:

- 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 the entity;
- 2) Providing clear and precise guidelines and instructions to employees on their role and responsibilities regarding financial management and control of the entity;
- 3) Documenting all business processes and transactions, including system descriptions, through flow diagrams, accounting and filing system intended for the preparation of appropriate audit trail;
- 4) Development of effective, timely and reliable reporting system, including reporting levels and timeframes, 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 adequacy of its functioning and providing timely updating.

System monitoring and assessment referred to in the paragraph 1 of this Article, shall be performed by continuous monitoring, self-assessment and internal audit.

***RESPONSIBILITY OF THE HEAD OF THE ENTITY***

**Article 12**

The head of the entity referred to in the Article 2 of this Law shall be accountable for achieving the objectives of the entity, by managing funds of the entity in a regular, economical, efficient and effective manner.

**Article 13**

The head of the entity shall be 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 programmes for achieving those objectives;
- 3) Identification, assessment and management of risks that may affect achievement of the objectives of the entity, and the introduction of adequate controls for risk management 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 referred to in the paragraph 2 of this Article shall not exclude 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 that are put in place in organizational units under their responsibility.

**Article 14**

The head of the entity shall appoint a person employed with the entity 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 performed 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 and implementation of the financial management and control system.

## **REPORTING ON FINANCIAL MANAGEMENT AND CONTROL**

### **Article 15**

The head of the entity shall submit annual report to the Central harmonization unit of the Ministry of Finance on implementation of planned 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 content and form of reporting referred to in the paragraph 1 of this Article.

## **III. INTERNAL AUDIT**

### **ROLE AND TASKS OF INTERNAL AUDIT**

#### **Article 16**

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

Internal audit shall help the entity in achieving its goals by applying a systematic and disciplinary 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 improvement of the financial management and control system.

Internal audit may provide consulting services for special unplanned tasks initiated by the head of the entity, which objective is to create added value and improve the management process, risk management and control, while internal auditors shall not be responsible for the implementation of recommendations provided.

The scope and objective of consulting services referred to in 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 phases:

- 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 shall be 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.

## **ESTABLISHMENT AND INDEPENDENCE OF INTERNAL AUDIT**

### ***Internal audit establishment***

#### **Article 18**

Internal audit within the entity shall be established 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 own internal audit units established.

Internal audit units of the entities shall coordinate the work of the internal audit units of users referred to in the paragraph 2 of this Article that have established internal audit units.

The manner and the criteria for the establishment of internal audit referred to in the paragraph 1 of this Article shall be determined by an act of the Government of Montenegro (hereinafter referred to as: "the Government").

Internal audit unit shall employ at least three internal auditors with the head of internal audit unit.

#### **Article 19**

The head of the entity shall be responsible for the provision of conditions for functioning of internal audit including, in particular for:

1. The appointment of a Head of Internal Audit after consultation with the Ministry of Finance;
2. The signing of an Internal 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. Submitting 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 separated from other organizational units of the entity.

Functional independence shall be established through independent planning, implementation and reporting on performed 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 job position or dismissed due to the disclosure of facts or making recommendations in the report on performed internal audit.

## **INTERNAL AUDIT STANDARDS AND METHODOLOGY**

### **Article 22**

Internal audit shall be carried out in accordance with legislation regulating internal audit and International internal audit standards.

In their work, internal auditors shall adhere to the internal audit charter, the Code of Ethics of internal auditors, internal audit working methodology, guidelines and instructions.

Methodology, guidelines and instructions referred to in the paragraph 2 of this Article shall be determined on the basis of the act to be adopted by 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 shall be 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 shall be developed on the basis of strategic plan and shall be adopted by the end of the current year for the next year.

Individual audit shall be performed on the basis of the plan of individual audit and shall describe in details the subject matter, objectives, duration, distribution of resources, audit access, techniques, types and coverage of audit examinations.

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

### **Article 24**

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

A draft audit report shall be developed for each audit performed, 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 referred to in the paragraph 3 of this Article shall have the right to present objections to the draft audit report, which shall 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 from the date of receiving the draft audit report.



After consultation with the responsible person of the entity that was subject to audit and after stating opinion on the draft report, the internal auditor shall make the final audit report with a proposal for an action plan for the implementation of recommendations and shall submit 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 referred to in the paragraph 5 of this Article, within thirty days from the date of reception of the final audit report and about the actions taken to implement the recommendations.

Ministry of Finance shall adopt an act regulating in more detail manner and procedure of work of the internal audit.

## **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 head and internal auditors shall have a right to:

- 1) Free access to heads, employees and resources of the entity who are relevant for to conducting of audit;
- 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 referred to in the Article 25 of this Law, internal audit unit head shall have a right to:

- 1) Report to the head of the entity on all major remarks regarding the conduct of an individual 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 shall be responsible to carry out planned internal audits and other activities of the internal audit unit, in particular including:

- 1) Preparation and submission of the draft internal audit charter to the head of the entity for approval ,
- 2) Preparation and submission of the Strategic and annual internal audit plans to the head of the entity for endorsement ;
- 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 of plan for the continuous professional training and development of internal audit staff to the head of the entity for approval..

#### **Article 28**

Internal audit head shall 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 with all major findings and recommendations for the improvement of operation of the entity;
- 3) Periodic reports on the implementation of internal audit annual plan;
- 4) Reports on limitations that internal audit head and internal auditors have confronted in conducting internal audit;
- 5) Report on adequacy of 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 identifying fraud indications, internal audits shall stop the audit process and inform the internal audit unit head without delay, who shall notify the head of the entity without delay in writing.

Upon receiving the notification referred to in the paragraph 2 of this Article, the head of the entity shall undertake necessary actions and inform authorized public authorities.

#### **Article 30**

Internal audit unit head and internal auditors shall keep the documents and confidentiality of data and information accessible to them during the audit conduct.

#### **Article 31**

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

#### **Article 32**

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

The content of the annual report and the manner of reporting referred to in the paragraph 1 of this Article shall be prescribed by the act to be adopted by the Ministry of Finance.

#### **Article 33**

Internal auditor shall suspend all activities regarding an audit and inform, without delay, a head of the internal audit unit about the existence of the conflict between his/her personal and business interests, as well as about the activities he/she was engaged in during the year preceding the year of audit and related to the subject of the audit.

### **REQUIREMENTS FOR INTERNAL AUDIT UNIT HEAD AND INTERNAL AUDITORS**

#### **Article 34**

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

- 1) university education;
- 2) at least two years work experience in auditing, financial control or accounting – financial operations;

3) passed the examination for authorised internal auditor.

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

Examination referred to in 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 only a person who, in addition to requirements referred to in 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 shall perform internal audit tasks with a certain title.

Titles of internal auditors shall be determined by the Government.

### **INTERNAL AUDIT OF EU FUNDED PROGRAMMES AND PROJECTS**

#### **Article 37**

Entities referred to in the Article 2, of this Law, using the EU funds, shall also apply requirements defined by the European Commission, when defining financial management and control and internal audit activities regarding those funds.

The internal audit units of the entities referred to in the Article 2, of this Law, shall conduct internal audit for entities and other beneficiaries implementing programmes and projects entirely or partly 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 shall be carried out in accordance with internationally accepted audit standards, provisions of international agreements for the use of such funds and appropriate regulations in the area of management and control of all EU funds.

### **IV. CENTRAL HARMONIZATION UNIT**

#### **Article 38**

The Central Harmonization Unit shall be established within the Ministry of Finance for the following activities:

- 1) preparation of professional basis for development of laws and secondary legislation 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) continuous professional advancing of 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, secondary legislation 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 shall prepare annual consolidated report on the system of internal financial controls, based on the Report referred to in the Article 15 and 32 of this Law, which shall be submitted to the Government by the end of March of the current year for the previous year.

The report referred to in the paragraph 2 of this Article shall contain data on financial management and control, relevant material findings and recommendation of internal audit and relevant activities undertaken by the head of the entity for the purpose of improving internal financial control system.

## **V. TRANSITIONAL AND FINAL PROVISIONS**

### **Article 39**

Secondary legislation for the implementation of this Law shall be passed within 9 (nine) months from the date of entry into force of this Law.

### **Article 40**

Pursuant to provisions of Article 18 of this Law, users of the funds of the Budget of Montenegro and the Capital City shall establish internal audit within 12 months and other entities referred to in the Article 2 of this Law within 24 months, from the date of entry into force of secondary legislation referred to in the Article 39 of this Law.

### **Article 41**

Persons who have not passed examination for authorized internal auditor, and meet conditions referred to in the Article 34 hereof, may perform duties of authorized internal auditor without passed examination for a maximum of 2 years from the date of entry into force of the programme for taking the examination for authorised internal auditors.

### **Article 42**

Provisions of the Article 35 of this Law shall apply from 1<sup>st</sup> January 2012.

### **Article 43**

Provisions of Chapter «IX INTERNAL AUDIT», Articles 56, 57 and 57a) of the Law on Budget (Official Gazette of the Republic of Montenegro 40/01, 71/05 and Official Gazette of Montenegro 12/07) shall be repealed on the date of entry into force of this Law.

### **Article 44**

This Law shall enter into force on the eighth day following that of its publication in the Official Gazette of Montenegro.