



**MONTENEGRO**

**AUDIT AUTHORITY**

No: 3011-1-06-74

**ANNUAL AUDIT ACTIVITY REPORT**  
**OF THE AUDIT AUTHORITY**  
**FOR PROGRAMME**  
**AGRICULTURE AND RURAL DEVELOPMENT OF**  
**MONTENEGRO - IPARD II**

FOR THE PERIOD FROM 01 JANUARY UNTIL  
31 DECEMBER 2018

Podgorica, March 14<sup>th</sup>, 2019

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## **1. INTRODUCTION**

### **1.1 Details of the responsible audit authority and other bodies that have been involved in preparing the report**

The Audit Authority of Montenegro, as an independent audit body, was established by the Law on Audit of EU Funds (OG 14/12, 54/16, 37/17 and 70/17). The Audit Authority is responsible for audit of EU funds (IPA, Structural Funds after the accession of Montenegro to the European Union, and other EU funds). According to Article 3 of Law on Audit of EU funds, the AA is functionally and operationally independent of all of other stakeholders involved in the system of EU funds management and control.

The Law on Audit of EU Funds prescribes that auditees are public authorities and organizations, bodies and organizations of local government units, natural persons and legal entities receiving, using or managing EU funds.

The functions and responsibilities of the Audit Authority are set out in the Framework Agreement between Montenegro and the European Commission on the arrangements for implementation of Union financial assistance to Montenegro under the Instrument for Pre-accession Assistance (IPA II)- (OG MNE, No 5/2015) and in Commission Implementing Regulation (EU) No 447/2014 on the specific rules for implementing Regulation (EU) No 231/2014 of the European Parliament and of the Council establishing an Instrument for Pre-accession Assistance (IPA II).

The Audit Authority is responsible for verifying:

- the completeness, accuracy and veracity of the annual financial reports or statements and the underlying annual accounts;
- the efficient and effective functioning of the management, control and supervision systems;
- the legality and regularity of the underlying transactions.

This report has been prepared solely by the Audit Authority of Montenegro, following the Annex D Annual Audit Activity Report (AAAR) of the FWA.

### **1.2 Reference period (i.e. the year) and the scope of the audits (including the expenditure declared to the Commission for the year concerned)**

Pursuant to Article 3(f) of the Framework Agreement between Montenegro and the European Commission on the arrangements for implementation of Union financial assistance to Montenegro under the Instrument for Pre-accession Assistance (IPA II), reference period for this Annual Audit Activity Report is financial year and covers the period from 1<sup>st</sup> January to 31<sup>st</sup> December 2018.

The audit activities performed in the audit period for the financial year were governed by the Audit Strategy. Audit period began on 10<sup>th</sup> May 2018, and ended on 5<sup>th</sup> March 2019, when the

last audit report was issued together with the finalization of activities on audit verification of the management declaration, annual accounts and finalization of follow up activities.

For the reference period the following audit activities were performed: System audits, Audit of Accounts and Follow-up activities defined in the DG AGRI letter of closure with recommendations from 25<sup>th</sup> October 2017 for the purpose of defining status of implementation of DG AGRI findings and report on the status.

In the context of system audits, two system audits were performed:

- System Audit of MCS based on written procedures (test of procedures) in DMS (NAO/SO and NF) and IPARD Agency. In accordance with the Audit Strategy 2018-2020 following audit areas were examined:
  - Human Resources/administrative issues and internal organization - all bodies
  - Risk management – all bodies
  - Internal audit – all bodies
  - AMD – all bodies
  - Publicity and visibility – all bodies
  - Communication and reporting – all bodies
  - Irregularities – all bodies
  - Verifications by the NAO – NAO/SO
  - Financial management - NF
  - Bank accounts system – NF
  - Accounting – IA and NF
  - Authorization of projects-IA
  - Authorization of payments- IA
  - On the spot control-IA
  - Execution of payments-IA

This audit was limited by the fact that under the period covered (1<sup>st</sup> January 2018 – 31<sup>st</sup> October 2018), no projects have started and no actual transactions have taken place (neither was any contract signed). Consequently, AA have carried out examinations of the setup and the effectiveness and efficiency of the management, control and supervision system related to IPARD II based on written procedures and design of MCS as well as testing of operational effectiveness of the existing controls to the extent possible at that stage of implementation of programme.

- System Audit of effective functioning of the MCS in IPARD Agency. After issuing a draft report of first system audit by AA, IPARD Agency finalized procedure for signing 12 contracts with beneficiaries (December 2018), which allowed AA to perform audit on effective functioning of the part of control activities, i.e. key functions authorization of commitments and on the spot control.

During the reference period, no expenditures have been declared to the European Commission.

### **1.3 Identification of the sector/policy area(s) covered by the report and of its/their operating structure and management structure**

The report covers the Programme for the Development of Agriculture and Rural Areas in Montenegro (hereinafter: IPARD II Programme) for period 2014-2020.

The IPARD II Programme for Agriculture and Rural Development for Montenegro for 2014-2020 was adopted by Commission Implementing Decision C(2015)5074 of 20 July 2015 and the total indicative costs for the implementation, including EU, national and private contributions, amount to EUR 86.8 million for the period 2014-2020, while the indicative contribution of the EU is € 39 million.

The IPARD II Management and control system has been entrusted with budget implementation tasks under the following measures of the IPARD II Programme:

- Investments in physical assets of agricultural holdings;
- Investments in physical assets concerning processing and marketing of agricultural and fishery products.

Structures and bodies being part of the Management and control system for IPARD II Programme are, as follows:

- The National IPA Coordinator (NIPAC)
- The National Authorizing Officer (NAO)
- The Management Structure (DMS):
  - The National Fund
  - The NAO support office
- The Operating structure:
  - Managing Authority (MA)
  - IPARD Agency (IA)

### **1.4 Description of the steps taken to prepare the report and to draw the audit opinion**

To prepare the Annual Audit Activity Report, the Audit Authority processes, summarises and assesses the findings and recommendations included in the reports on performed audits and carries out a follow-up to assess the time proportional to implementation of action plans prepared on the basis of audit recommendations.

The Annual Audit Activity report sets out, inter alia, any deficiencies found in the management, control and supervision systems and any corrective measures taken or planned by the NAO, management structure and/or the operating structures concerned, and details of any substantial changes in the management and control system.

In accordance with Art.59 (2) of the Framework Agreement between the Commission and Government of Montenegro, for the Programme IPARD II the NAO has submitted the Annual

Management Declaration and Annual financial report for 2018<sup>1</sup> to the Commission with a copy to the NIPAC and AA.

With a view to drawing up an audit opinion, Audit Authority assessed results of audit activities from the performed audits of management and control system and assessed the consistency of the management declaration with regard to performed audit work.

Based on the available information the AA prepares the Annual Activity Audit Report and the Annual Audit Opinion.

The AA submits Annual Audit Activity report and Annual Audit Opinion to the European Commission and the Government of Montenegro with a copy to the NIPAC and the NAO by 15 March each year.

## **2. SUBSTANTIAL CHANGES IN MANAGEMENT AND CONTROL SYSTEMS**

During 2018, the NAO regularly informed the European Commission and Audit Authority about substantial and planned changes in the system.

Changes in management and control system during the reference period are as follows:

- **National IPA Coordinator – NIPAC and Deputy NIPAC**

On the session held on 22<sup>nd</sup> February 2018, Government of Montenegro issued consent to the resignation of the Minister of European Affairs who was also nominated to perform function of NIPAC.

On the session held on 24<sup>th</sup> May 2018, Government of Montenegro nominated Ms Ivana Glisevic Djurovic to perform function of NIPAC<sup>2</sup>.

On the session held on July 19<sup>th</sup> 2018, Government of Montenegro, nominated Ms Ivana Vujosevic for Deputy NIPAC<sup>3</sup>.

- **Manual of procedures**

IPARD Agency/Managing Authority MoP Version 1.1 with relevant annexes was approved and endorsed in May 2018.

- **Legal acts**

**Decree** on Amendments to the Decree on the Implementation and Procedure for the Use of Funds from the Instrument for Pre-Accession Assistance of the European Union (IPARD II Program), was published in the Official Gazette of Montenegro, no. 4/2018 on 26<sup>th</sup> January 2018.

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<sup>1</sup> On 15th February 2019 (Ref. 01-2235/1)

<sup>2</sup> NAO letter on changes no. 018997/1 from 31th May 2018

<sup>3</sup> NAO letter on changes no. 01/15591/1 from 05th October 2018

**Internal Rulebook on Organisation and Systematisation** of Ministry of Agriculture and Rural Development adopted in November 2018.

Taking into account that changes related to the manual of procedures and decree on the IPARD implementation had been endorsed before audit announcements, these changes were covered by audits performed. Change related to the NIPAC nomination has no impact on audit performed, while change of the Act of systematization was a positive change with a goal of increasing a capacity of IPARD Agency.

### **Exceptions applied in the approved procedures during the 2018**

1. DP – DPAP – 00 Manual of DPAP, Chapter 5. Description of the working procedure, Subchapter 5.4. Submission of application – Request for engagement advisors from other departments within the Sector for structural support<sup>4</sup>.

This exceptions is applied due to needs for increasing capacities in DPAP with the goal of more efficient process of authorisation of commitments and less capacity needed for authorisation of payments (there were no payments yet).

2. DPAP v. 1.1, General Costs, Chapter 1. The calculation of the value of a business plan development - Adoption of a new formula for calculation of variable part of business plan which will be used for evaluation of first IPARD II public calls for M1 and M3<sup>5</sup>.

This exceptions is applied due to AA finding (see finding no. 19 in Annex 1) related to formula for calculation of eligibility of general cost – business plan.

AA will take into account all exceptions during risk analysis within audit strategy 2020-2022 and during follow up process in FY 2019.

### **3. CHANGES TO THE AUDIT STRATEGY**

Not applicable. The Audit Strategy has not been changed in the reference period to which this report relates.

### **4. SYSTEMS AUDITS**

#### **4.1. Details of the bodies that have carried out system audit**

The audit body that has carried out system audits is Audit Authority of Montenegro. The Audit Authority of Montenegro, as an independent audit body, was established by the Law on Audit of European Union funds ("Official Gazette of Montenegro" N° 14/12, 54/16, 37/17 and 70/17). Audit Authority of Montenegro is responsible for carrying out the audit function for IPARD II Programme in line with the functions and responsibilities set out in Clause 5 of Annex A to the Framework Agreement.

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<sup>4</sup> NAO Approval on June 4<sup>th</sup> 2018

<sup>5</sup> Deputy NAO Approval on December 10<sup>th</sup> 2018

**4.2. Summary table of the audits carried out, with the indication of the authorities/bodies audited, the assessment of the key requirements for each authorities/body, issues covered and a comparison to the audit planning**

Audit period	1. Programme (CCI and title)	2. Audit Body	3. Audited Body(ies)	4. Date of the audit	5. Scope of the audit	6. Principal findings and conclusions	7. Problems of systemic character and measures taken	8. Estimated financial impact (if applicable)	9. State of follow-up (closed /or not)
01.01.2018.-31.10.2018.	Programme for Agriculture and Rural development of Montenegro - IPARD II No CCI: 2014ME0614NP001	Audit Authority of Montenegro	IPARD Agency Directorate for Management Structure	May – October 2018	MS (NAO/SO and NF) and IPARD Agency, following processes/key functions:  1. Human Resources/administrative issues and internal organization - all bodies 2. Risk management – all bodies 3. Internal audit – all bodies 4. AMD – all bodies 5. Publicity and visibility – all bodies 6. Communication and reporting – all bodies 7. Irregularities – all bodies 8. Verifications by the NAO – NAO support office 9. Financial management - NFD 10. Bank accounts system – NF 11. Accounting – IA and NFD 12. Authorization of projects-IA 13. Authorization of payments- IA 14. On the spot control-IA 15. Execution of payments-IA	1. Change of the Decree without prior consultation with the EC and its non - consistency with IPARD II Programme 2. Non-fulfilment of Annual Audit Plan 3. Assessing reasonableness of the costs 4. Inadequate sources for calculation of Reference price 5. Lack of staff 6. Sensitive work posts 7. Inadequate Workload analysis and Recruitment Plan 8. Identification of risks 9. Conclusions from RMP 10. Certificate for internal audit 11. Internal audit capacities 12. Inappropriate use of Key Performance Indicators 13. Deficiencies of reporting procedure 14. Shortcomings of the Manual of procedures 15. Deficiencies of bookkeeping procedure in IPARD Agency 16. Inadequate segregation of duties 17. Deficiencies of bookkeeping procedure in DMS 18. Code of applicant 19. Shortcomings in calculating price of eligibility of expenditures for a business plan development 20. Modification of the Manuals of procedures 21. Procedures related to Office and archiving work 22. Upgrading Manual of procedures 23. No audit trail for reconciliation of analytical accounts 24. Bridge financing 25. Non-compliance procedures between DMS and IA 26. Lack of trainings  * For more specific details for particular findings see Annex no. 1 – Findings and recommendations (point 1 to 26 )	/	/	/

01.11.2018. 31.12.2018.	Programme for Agriculture and Rural development of Montenegro - IPARD II	Audit Authority of Montenegro	IPARD Agency	January - February 2019	IPARD Agency, following processes/key functions: 1. Authorization of projects 2. On the spot control	27. Delivery note 28. Code of expenditures 29. Inadequate assessment of economic viability of enterprise 30. Deficiencies within on-the-spot control report  * For more specific details for particular findings see Annex no. 1 – Findings and recommendations			
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Considering the results of system audits and continuously observing the system's functioning during 2018, we conclude that the management and control system functions appropriately. During audit we identified 30 findings, out of which 3 findings are major, 20 findings are intermediate and 7 findings are minor. We have not identified any findings with financial impact and none of the findings indicate any problems of systemic nature. There were no changes in the audit strategy and audits are performed in accordance with audit plan.

### **4.3 Description of the basis for selection of the audits in the context of the audit strategy**

For the purpose of detailed defining of the scope of the audit, during the preparation of Audit Strategy for period 2018-2020 the Audit Authority performed a detailed risk assessment to determine the bodies and priority processes in conducting system audits.

The Audit Authority's methodology for risk assessment is based on the:

- International Standards on Auditing (and in particular ISA 300, 315, 320, 330, 500),
- EC Guidance document on a common methodology for the assessment of management and control systems in Member States and
- DG AGRI Guideline 2 IPARD II audit strategy.

Risk assessment approach is applied in order to understand and select the high risk areas for performing system audits. The AA carries out its own risk assessment to compose the annual audit plan of systems audits. The risk assessment results are used for prioritizing and selecting the bodies/processes/key functions to be audited.

During risk assessment, risks were identified and taken into account at the authorities and process level. Specific inherent and control risk factors were assessed for each body and process. Each risk factor, including inherent and control risks, was assessed as low, medium or high, considering both the significance and likelihood of the risk, and was evaluated in 5-points scale: the highest risk gets highest points and vice versa. In order to distinguish between the factors with varying importance, the weight were given to the specific risk factors. After assessment, all bodies and processes were ranked according to the total score.

According to the results of performed risk assessment, all processes and key functions within MS (NAO/SO and NF) and IPARD Agency were covered by the system audit.

For the purpose of compliance testing within system audit, sample for testing is based on professional judgment of audit team. Compliance testing was carried out on 10 contracts, out of 12 in total. The sample is oriented to cover a variety of transactions (different sectors, types and codes of investments) so relevant key functions were assessed under different circumstances.

### **4.4 Description of the principal findings and conclusions drawn from the audit work for the management and control system and their functioning**

As explained in chapter 1.2 during reference period two system audit were performed.

#### **1) System audit – test of procedures**

The audit was performed using the methodology prescribed in manual of procedures developed by the AA and based on the guideline 2 “Audit Strategy” issued by DG AGRI. The audit examined the set up and reviewed the documentation provided by the relevant bodies and the information that was available until the time of finalizing the report.

Verifications made by AA in IPARD Agency and DMS in respect of this system audit are as follows:

- We have verified that Manuals of procedures are in line with Framework, Sectoral and Financing Agreement as well as other appropriate national and EU regulation, and whether they are applied in practice;
- We have verified adequacy of staff actually in place for performing delegated tasks as well as whether organizational structure is adequate for the efficient and effective implementation of all tasks and responsibilities;
- We have verified that all employees have demonstrated commitment to integrity and ethical values;
- We have verified whether the H&R process functions effectively (WLA, organisational structure, job descriptions, AWP, recruitment plan, etc.);
- We have verified retention policy measures;
- We have verified responsibilities related to the irregularity procedures as well as procedures prescribed and number of recorded irregularities;
- We have verified whether anonymous reporting on irregularities is enabled and whether the “whistle-blowers” enjoy legal protection;
- We have verified appropriate assurance role from NAO/SO including timely preparation and execution of annual on-the-spot checks plan;
- We have verified whether appropriate publicity measures are taken and whether all information concerning the activities related to IPARD Programme 2014-2020 are published on the official website of the DP/ MARD and in the media;
- We have verified whether the internal control system for calculation of the economic viability of recipient (procedure for assessment of a business plan) and for checking of reasonableness of costs (including reference price database) is set up appropriately;
- We have verified whether the accounting procedures are established in accordance with the internationally accepted accounting standards as well as accountability and reliability the accounting system;
- We have evaluated accounting system within Department for Accounting and Budget (main accounting functions including process of recording of debts to be recovered and preparation of periodic summaries of expenditure as well as preparation of quarterly and annual declarations to the Commission);
- We have verified adequacy of the risk assessment process and implementation in practice;
- We have verified whether the reporting lines are established in a way that provides a good and efficient flow of information including procedures for collection of data for monitoring and reporting.

The outcome of the audit process is summarized in the Final system audit reports that provide findings and recommendations which were identified during the audit process in MS and IPARD Agency. Findings were categorized according to level of importance to major, intermediate and minor findings.

Detailed description of the principal findings and recommendations provided for correcting the findings detected as well as auditee’s response are laid down in Annex 1 “Findings and recommendations” as a part of this report.

## **2) System audit – Compliance testing**

During FY 2018, under IPARD II Programme 2014-2020, IPARD Agency published one call for applications for allocation of funds for measures 1, and one call for applications for

allocation of funds for measures 3. Taking into account a number of received applications, IPARD Agency did not have sufficient capacity to check applications during reference period which is identified in this report (finding no. 5 (4.1.1) within Annex 1). However, during December 2018 IPARD Agency signed 12 contracts with recipients under measure 3 which was a base for AA to perform compliance testing for FY 2018 on the part of the MCS.

The audit was performed using the methodology prescribed in manual of procedures developed by the AA and based on the guideline 2 “Audit Strategy” issued by DG AGRI.

To confirm the compliance of the IPARD Agency with the ICFR-3 Control activities, through compliance testing the AA performed different type of verifications on the functioning of the key functions authorization of commitments and on the spot control. The compliance test includes following:

- 1) Compliance test to confirm the functioning of controls and determine whether the undertaken activities are in compliance with the written working procedures and whether they have been performed in accordance with the set deadlines as well as to determine dynamics of the approval of applications process;
- 2) Compliance test to confirm eligibility of the recipients and investments;
- 3) Compliance test to confirm whether the templates and deadlines for issuing the documents by technical bodies have been respected.

For the purpose of testing effectiveness the AA followed DG AGRI Guideline No.2 - Audit strategy, according to which at least 10 items per population for the specific controls should be tested. Within the system audit in the IPARD Agency, AA performed testing on 10 concluded contracts, out of 12 in total, and tested all the performed work by the IPARD Agency in respect of authorization of commitments and on-the-spot controls before approval.

We tested the following elements of the procedures for authorization/approval:

- Verification whether application has been processed in accordance with procedural requirements:
  - verifying the project approval process - administrative controls concerning the timeliness, completeness and eligibility of application;
  - re-calculation of the approved items and re-check of the approved items with “List of eligible expenditure”;
  - verifying the process of evaluation of reasonableness of costs and its use in the process of administrative controls,
  - verifying the manner of performed evaluation of the business plan, and re-calculation of the approved general costs
  - verifying declarations of origin;
- Verifying administrative controls concerning issuing and signing the Contract for allocation of funds;
- Verification whether results arising from on-the-spot checks have been taken into account in processing the application and issuing Decision on allocation of IPARD Programme funds;
- Verifying whether:
  - segregation of duties is in place,
  - double check principle is respected,

- check lists and other appropriate sheets are adequately filled and signed by authorized persons,
- set time frames for executing activities are respected according to prescribed accredited procedure.

During our verifications of the process of project approval – authorisation of commitments we did not identify matters which have financial impact and there was no error or deficiency of systemic nature revealed.

Findings and recommendations from our assessment for this key functions are presented in Annex 1 (findings 27-30) of this report.

#### **4.5 Description of specific deficiencies related to the management of financial instruments**

Not applicable.

#### **4.6 Level of assurance obtained following the system audit (low/average/high) and jurisdiction**

For defining a level of assurance within this report we should take into account following circumstances:

- Process of implementation of IPARD Programme started at the beginning of FY 2018;
- No expenditures declared to the Commission during FY 2018, no payments authorised or/and executed by the IPARD Agency, or no payment claims submitted by recipient;
- Out of 434 applications received during 2018, only 12 contracts were signed in December 2018, and during reference year the AA was unable to test functioning key functions: authorization of commitments and on the spot control.

However, during audit AA performed comprehensive testing of written procedures defined in the audit scope as well as performed detail compliance testing on 83.3 % of contracts signed, which provides **high assurance** for **overall conclusion** obtained from the system audit and relevant MCS.

#### **Overall assessment – Matrices**

The overall conclusion on the ICS is derived from the assessment of the design and existence of controls and the evaluation of effectiveness of the implementation of the ICS and presented in the following matrices:

Matrices - IPARD Agency

		MATRIX - Assessment of the ICF (IPARD AGENCY)																							
		Assessment Component Procedure		Control environment						Risk management		Control activities				Information and Communication		Monitoring of the internal control framework				Evaluation at assessment criteria		General conclusion	
				Organisation		Human Resources		Delegation				Control activities		IT Security				Monitoring		Internal audit					
				Weighting / Scoring		S	T at 15%	S	T at 5%	S	T at 5%	S	T at 5%	S	T at 50%	S	T at 10%	S	T at 5%	S	T at 5%	S	T at 5%	W	T
Operations	Validation and authorization	Administrati ve controls	3	0.45	2.8	0.14			3	0.15	2.8	1.40	4	0.40	3	0.15	3	0.15	2.8	0.14	20%	2.98	0.60		
		On-the-spot controls	4	0.60	3	0.15			3	0.15	3.5	1.75	4	0.40	3	0.15	3.5	0.18	2.8	0.14	20%	3.52	0.70		
Payments	Execution of payments		4	0.6	3.5	0.175			3	0.15	4	2	4	0.4	3.6	0.18	4	0.2	2.8	0.14	20%	3.85	0.77		
	Accounting		4	0.6	3.6	0.18			3	0.15	3	1.5	3.5	0.35	3	0.15	4	0.2	2.8	0.14	20%	3.27	0.65		
	Advances (*)																				0%	0.00	0.00		
	Debts management		4	0.6	3.7	0.185			3	0.15	4	2	4	0.4	3.6	0.18	4	0.2	2.8	0.14	20%	3.86	0.77		
											General conclusion										3.49				
LEGEND:											Assessment of ICF					works (medium impact)									

LEGEND:

1	to	1.5	=	not working
1.51	to	2.5	=	working partially (significant impact)
2.51	to	3.5	=	works (medium impact)
3.51	above		=	works well (minor impact)

Overall conclusion on the ICS in IPARD Agency, based on the results of system audit, is Works (medium impact) with the score of 3.49. AA emphasizes that assessment of key function execution of payments, accounting and debt management is based solely on comprehensive test of design (written procedures) of the system, taking into account the status of implementation of IPARD II Programme.

Matrices -NF

Matrices - NF	MATRIX - Assessment of the ICF (NATIONAL FUND)								
	Assessment component  Procedure	Control environment			Risk manage ment	Control activities		Information and communicati on	Monitoring of the internal control framework
		Organisati on	Human resources	Delegation		Control activities	IT Security		
Managing functions	Management of IPA II accounts and financial operations	4	3.5	4	3.5	4	4	4	4
Paying functions	Authorisation and control of payments	4	4	4	4	4	4	4	4
	Accounting for commitment and payment	4	4		3.5	3	4	3.5	4
	Debt management	4	4	4	4	4	4	4	4
	Treasurv	4	3.5	4	4	4	4	4	4

Please introduce the scores in the table

Overall average	3.91025641
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LEGEND:

1	to	1.5	=	not working
1.51	to	2.5	=	working partially (significant impact)
2.51	to	3.5	=	works (medium impact)
3.51	above		=	works well (minor impact)

Overall conclusion on the ICS in National Fund, based on the results of system audit, is Works well (minor impact) with the score of 3.91. AA emphasizes that assessment of system is based solely on the comprehensive test of design (written procedures) of the system, taking into account the status of implementation of IPARD II Programme and the fact that there were not any payments toward recipients.

## Matrices -NAOSO

MATRIX - Assessment of the ICF (NAO SUPPORT OFFICE)									
	Assessment component	Control environment			Risk management	Control activities		Information and communication	Monitoring of the internal control framework
		Organisation	Human resources	Delegation		Control activities	IT Security		
Implementing functions	Procedure Provide assurance on the effective functioning of	4	3	4	3	3.6	4	4	3.5
Please introduce the scores in the table								Overall average	3.6375

### LEGEND:

1	to	1.5	=	not working
1.51	to	2.5	=	working partially (significant impact)
2.51	to	3.5	=	works (medium impact)
3.51	above		=	works well (minor impact)

Overall conclusion on the ICS in NAO Support Office, based on the results of system audit, is Works well (minor impact) with the score of 3.63. AA emphasizes that assessment of system is based solely on the comprehensive test of design (written procedures) of the system, taking into account the status of implementation of IPARD II Programme and the fact that there were not any payments toward recipients.

## 5. AUDITS OF SAMPLES OF TRANSACTIONS

Not applicable. No expenditure was declared to the Commission for the financial year 2018.

## 6. AUDITS OF THE ANNUAL FINANCIAL REPORTS OR STATEMENTS/ANNUAL ACCOUNTS

### 6.1 Indication of the authorities/bodies that have carried out audits of the annual financial reports or statements/annual account

The audit body that has carried out audit of the annual financial reports/annual accounts is Audit Authority of Montenegro. The Audit Authority of Montenegro, as an independent audit body, was established by the Law on Audit of European Union funds ("Official Gazette of Montenegro" N° 14/12, 54/16, 37/17 and 70/17). Audit Authority of Montenegro is responsible for carrying out the audit function for IPARD II Programme in line with the functions and responsibilities set out in Clause 5 of Annex A to the Framework Agreement and for issuing an annual opinion on the annual financial reports or statements and the underlying annual accounts for the preceding financial year, covering their completeness, accuracy and veracity.

### 6.2 Description of audit approach used to verify the elements of the annual financial reports or statements/annual accounts

Taking into consideration that during reference period there were no expenditures declared to the Commission and that during reference period Montenegro received advance payment for the respective program in the amount of 3.000.000,00 € on July 5<sup>th</sup> 2018, our audit was limited,

i.e. focused only on the volume of Union funds on the MF – NF IPARD Account and related procedure.

However, for the purpose of verification of completeness, accuracy and veracity of the annual financial reports or statements/annual accounts AA performed following reconciliations:

### **1) Reconciliation of Quarterly Declarations of Expenditure and Annual Declaration of IPARD Accounts for IPARD II**

In order to conclude on the completeness, accuracy and veracity of the Annual Accounts in accordance with the DG AGRI Guideline No 2 – Audit Strategy we check whether there were or not any differences between the expenditure and the revenues declared with the interim quarterly declarations (D1s) and the eligible expenditure declared with the Annual Declaration (D2) for the FY 2018 for IPARD II and we reconciled the Annual declaration (D2) with the interim quarterly declarations (D1s).

The reconciliation is presented in the table below:

	<b>Amount of expenditure declared</b>	
	<b>Public contribution</b>	<b>EU part only</b>
<b>Quarterly declarations</b>		
1st quarter	0,00€	0,00€
2nd quarter	0,00€	0,00€
3rd quarter	0,00€	0,00€
4th quarter	0,00€	0,00€
<b>Sum of quarterly declarations</b>	0,00€	0,00€
<b>Annual declaration (D2)</b>	0,00€	0,00€
<b>Difference</b>	0,00€	0,00€

We can confirm that there are no differences between the expenditure and the revenues declared with the interim quarterly declarations (D1s) and the eligible expenditure declared with the Annual Declaration (D2) for the FY 2018 and we reconciled the Annual declaration (D2) with the interim quarterly declarations (D1s).

### **2) Reconciliation of Annual Declaration of Expenditure with the expenditure paid recorded in the accounts of the Agency and the Management Structure for IPARD II**

We reconciled annual declaration (D2) with the list of payments provided by the NAO in line with Article 45(d) of the SA.

The reconciliation is presented in the table below:

	EUR (EU part only)
Amount of gross expenditure declared in the annual declaration D2	0,00€
Sum of payments stated in the list of payments	0,00€
<b>Difference</b>	0,00€

We can confirm that in FY 2018 there are no payments made and registered in the List of payments and no gross expenditure declared in the Annual Declaration (D2), so the Annual Declaration (D2) is reconciled with the List of payments.

### 3) Reconciliation of the amount declared in the annual declaration with the actual closing balance of the debtors' ledger

We checked whether the closing balance of the debtors' ledger declared in the D2 was equal to the closing balance of the actual debtors' ledger (balance on 31/12).

The reconciliation is presented in the table below:

	<i>Total (principal + interest)</i>	<i>EU part (principal)</i>	<i>EU part (interest)</i>	<i>National part (principal)</i>	<i>National part (interest)</i>
Amount declared in the annual declaration as the balance of the debtor's ledger on 31.12	0,00€	0,00€	0,00€	0,00€	0,00€
Balance of the debtor's ledger on 31.12	0,00€	0,00€	0,00€	0,00€	0,00€
<b>Difference</b>	0,00€	0,00€	0,00€	0,00€	0,00€

We can confirm that there are no differences between amount declared in the annual declaration as the balance of the debtor's ledger and balance of the debtor's ledger on 31/12/2018, so closing balance of the debtors' ledger declared in the D2 is reconciled with the closing balance of the actual debtors' ledger.

### 4) Reconciliation of the difference between gross and net expenditure and the total amount of overpayments, recoveries and written-off amounts visible from the movements of the debtors' ledger

Taking into account that there were no declared expenditures in Annual Declaration (D2) for the FY 2018, we can confirm that the difference between the gross and net eligible expenditures is not more than the amount of overpayments, written-off amounts and recoveries returned in the financial year.

The reconciliation is presented in the table below:

	EU part		EU part	
Gross amount of expenditure	0,00€		0,00€	Overpayments
	0,00€		0,00€	Recoveries-principal
Net amount of expenditure	0,00€		0,00€	Recoveries-interest
	0,00€	Difference	0,00€	Written-off amounts
<b>Difference</b>	0,00€	0,00€	0,00€	Sum

## 5) Roll forward of the debtors' ledger

We checked whether the closing balance of the debtors ledger was equal to its last year's opening balance plus the transactions (new debts, recoveries and written off amounts).

The reconciliation is presented in the table below:

Debtors' ledger year n	Amount EU part		
(a) Opening balance year n	0,00€	0,00€	Debtors' ledger - Closing balance year n-1
(b) New cases	0,00€		
(c) Recoveries	0,00€		
(d) Written-off debts	0,00€		
(e) Corrections	0,00€		
Closing balance year n a+b-c-d+/-e	0,00€	0,00€	Closing balance as declared in the annual declaration for year n

We can confirm that there are no differences between closing balance of the debtor's ledger and its last year's opening balance plus the transactions.

## 6) Reconciliation of the declared principal amount and interest of the IPARD Euro Account

On July 5<sup>th</sup> 2018 the Commission transferred to the IPARD II Euro Account amount of 3.000.000,00 € as Community contribution of pre-financing. On December 31<sup>st</sup> 2018, on the IPARD II Euro Account there was an amount of 5.400.000,00 €.

In the course of FY 2018 there was no interest, and balance of interest by December 31<sup>st</sup> 2018 was 0,00 €. The deposit account is not opened and therefore there is no realized interest income.

The reconciliation is presented in the table below:

	Principal amount (EUR)	Interest (EUR)
Opening balance of the IPARD Euro Account	2.400.000,00€	0,00€
Current account [account number]	2.400.000,00€ [907-0000000086001-40]	0,00€
Deposit account [account number]	n/a	n/a
Other amounts deposited in the banks for the purpose of accrual of interest	0,00€	0,00€
[Deposit number] / [due date]	n/a	n/a
[Deposit number] / [due date]	n/a	n/a

Transactions in the financial year	<b>3.000.000,00€</b>	<b>0,00€</b>
Amounts received from the Commission in the financial year	3.000.000,00€	
- for covering expenditure executed in the previous FY	0,00€	
- for covering expenditure executed in the current FY	0,00€	
Interest accrued on the IPARD Euro Account during the financial year		0,00€
Amount of expenditure	0,00€	<i>[this cell is to be filled in only if some part of EU expenditure has been bridge financed from interest ]</i>
Amount of national contribution financed from interest		0,00€
Recovered amounts	0,00€	
Written-off amounts	0,00€	
Other transactions (to be broken down in detail)	<b>0,00€</b>	<b>0,00€</b>
Expenditure excluded from the declarations of expenditure	n/a	n/a
- financial adjustments made by the NF	n/a	
Payment of financial corrections made by the Commission	n/a	
Bridge financing	n/a	n/a
- funds transferred from state budget	n/a	
- funds transferred to the state budget	n/a	
Closing balance of the IPARD euro account	<b>5.400.000,00€</b>	<b>0,00€</b>
Current account	5.400.000,00€	0,00€
Deposit account	0,00€	0,00€
Other amounts deposited in the banks for the purpose of accrual of interest	0,00€	0,00€
<i>[Deposit number] / [due date]</i>	n/a	n/a
<i>[Deposit number] / [due date]</i>	n/a	n/a

Taking into consideration performed verifications during the audit of accounts and statement of expenditures for 2018, we can confirm that the closing balance of the IPARD II Euro Account declared in the Annual Declaration (D2) reconciles with the cash flows through the IPARD II Euro Account.

**7) General reconciliation of data for the purpose of testing the correctness of the whole declaration (expenditure, debtors ledger and IPARD Euro account)**

General reconciliation of data is carried out to compare if several balances reconcile with each other. In this context it is vital to reconcile the transactions of the IPARD Euro Account with the amount of payments from the list of payments, amounts of recoveries and written-off debts to the Debtors Ledger.

By the audit of accounts in NAO/MS and in the IPARD Agency we made reconciliations of all data presented in the accounting records of the IPARD Agency and accounting records in NAO/MS and data presented in the Annual Accounts and Statement of Expenditure for FY 2018.

The reconciliation is presented in the table below:

	<b>IPARD Euro account</b>	
	<b><u>Principal amount</u></b> <b><u>(EUR)</u></b>	<b><u>Interest</u></b> <b><u>(EUR)</u></b>
Opening balance of the IPARD Euro Account	<b>2.400.000,00€</b>	<b>0,00€</b>
Current account [account number]	2.400.000,00€ [907-0000000086001-40]	0,00€
Deposit account [account number]	n/a	n/a
Other amounts deposited in the banks for the purpose of accrual of interest	0,00€	0,00€
[Deposit number] / [due date]	n/a	n/a
[Deposit number] / [due date]	n/a	n/a
Transactions in the financial year	<b>3.000.000,00€</b>	<b>0,00€</b>
Amounts received from the Commission in financial year	3.000.000,00€	
- for covering expenditure executed in the previous FY	0,00€	

- for covering expenditure executed in the current FY	0,00€				
Interest accrued on the IPARD Euro Account during the financial year		0,00€	Annual declaration amount of expenditure declared		Difference
Amount of expenditure	0,00€	<i>[only if some part of EU expenditure has been bridge financed from interest]</i>	0,00€		0,00€
Amount of national contribution financed from interest		0,00€	Debtors' ledger - EU part only		Difference
			Principal amount	Interest	
Recovered amounts	0,00€		0,00€	0,00€	0,00€
Written-off amounts	0,00€		0,00€	0,00€	0,00€
Other transactions [to be broken down in detail]	<b>0,00€</b>	<b>0,00€</b>			
Expenditures excluded from the declarations of expenditure	n/a	n/a			
- financial adjustments made by the NF	n/a				
Financial corrections made by the Commission	n/a				
Bridge financing	n/a	n/a			
- funds transferred from state budget	n/a				
- funds transferred to the state budget	n/a				
Closing balance of the IPARD Euro Account	<b>5.400.000,00€</b>	<b>0,00€</b>			
Current account	5.400.000,00€	0,00€			

Deposit account	0,00€	0,00€
Other amounts deposited in the banks for the purpose of accrual of interest	0,00€	0,00€
<i>[Deposit number] / [due date]</i>	n/a	n/a
<i>[Deposit number] / [due date]</i>	n/a	n/a

As results of the audit of the Annual Accounts, and the reconciliations made for IPARD II, no deviations were found regarding completeness, accuracy and veracity of the amounts, stated in the Accounts. There are no financial corrections that should be reflected in the Annual Accounts for FY 2018 as a result of our audits for IPARD II Programming period 2014 – 2020.

### **6.3 Indication of the conclusions drawn from the results of the audit**

On the basis of work performed we can conclude that annual financial reports were prepared in accordance with templates set out in the Financing Agreements and that the amounts declared in the accounts are true, complete, accurate and credible.

### **6.4 Indication of whether any problems identified were considered to be systemic in nature, and the measures taken**

Not applicable. AA did not identify any problem of systematic nature.

### **6.5 Review of Annual Management Declaration issued by NAO for 2018 for IPARD II Programme**

Pursuant to Article 9(4) of Commission Implementing Regulation (EU) No 447/2014 and Annex C from the FwA, by 15 February of the following FY, the NAO shall, with a copy to the NIPAC and the AA, provide the Commission with an Annual Management Declaration per programme drawn up in accordance with Annex C to the FwA and covering:

- the overall responsibility for the financial management of EU funds and for the legality and regularity of the underlying transactions;
- the responsibility for the effective functioning of the management and internal control systems under IPA II;
- the conformity of the system and the effective functioning of the management and control system in the previous year.

According to the submitted Annual Management Declaration for FY 2018 for IPARD II by NAO to EC, No. 01-2235/1 from 15 February of 2019, NAO declared that:

- the information in the Annual Financial reports or statements is properly presented, complete and accurate in accordance with Article 23 (1) (b) of Commission Implementing Regulation (EU) N° 447/2014;

- the expenditure entered in the Annual Financial reports or statements was used for its intended purpose, in accordance with Commission Implementing Regulation (EU) N° 447/2014, and the principle of sound financial management;
- the management and control system put in place for the programme gives the necessary guarantees concerning the legality and regularity of the underlying transactions;
- that operation of the internal control system relating to the implementation of IPA II and related to the Financing Agreement have been supervised.

We reviewed AMD and supporting documents issued by NAO. In this respect we made the following verifications:

- Results from on the spot checks and controls performed by Management Structure;
- Summary of the findings from the Internal Audit Reports;
- Information on the findings from the audit reports given by EC and follow-up actions in that respect;
- Information on irregularity policy and reporting;
- Information on risk management activities and mitigation measures;
- Exceptions from procedures requested;
- Overview of changes occurred in the financial and management control system;
- Staffing overview and statistics;
- Overview of the results from the Self-Assessment Questionnaires filled-by relevant IPA bodies within Operating Structure;
- KPI overview assessment;
- Assessment of the accounting system;
- Assessment of the contractual procedures;
- Assessment of the ex-post publication of information on recipients of IPA II assistance.

After performed verifications AA confirmed the following:

- The Annual Management declaration was submitted according to the article 59 (2) and Annex C of the Framework agreement for IPA II.
- The process of preparation of AMD was in line with NAO internal procedures – Effective functioning of the internal control system.
- Annual Management declaration was prepared and submitted to NAO by the Director of IPARD Agency for the period of implementation of IPARD II Programme with letter no. 320-2565/18-2 from 31/01/2019;
- Annual Management declaration was prepared and submitted to NAO by the Head of Managing Authority for the period of implementation of IPARD II Programme with letter No. 3202565/18-2 from 29/01/2019;

## **7. FOLLOW-UP OF PREVIOUS YEARS' AUDIT ACTIVITY**

Bearing in mind the fact that in reference period we conducted our first audits and submitted our engagement reports on 21<sup>st</sup> January 2019 and 5<sup>th</sup> March 2019, and that deadline for implementing recommendation is after the date of issuing this report, AA could not conduct any follow-up audit. However, AA is in constant communication with MS, and we can confirm that MS has already taken appropriate actions related to some of the findings presented. During audits related to the FY 2019 we will take into account status and level of efficiency of

implementation of findings identified as well as inform DG AGRI about their status in the following AAAR.

AA performed Follow-up on the remaining recommendations from DG AGRI Final Report in line with the letter of closure with recommendations from 25<sup>th</sup> October 2017 with cut-off date on 10/02/2019. The result is presented in Annex 2 of this report.

## 8. OTHER INFORMATION

Not applicable.

## 9. OVERALL LEVEL OF ASSURANCE

Not applicable.

The Audit Authority performed system audit for FY 2018 and did not perform audit of operations in the reference period since no expenditure was declared to the European Commission.

Regarding the abovementioned, the Audit Authority does not have all necessary elements to express overall level of assurance on the proper functioning of the management and control system. However, AA expressed level of assurance derived from system audit in chapter 4.6.

## 10. TABLE FOR DECLARED EXPENDITURE AND SAMPLE AUDITS

Not applicable. No expenditure was declared to the Commission for the financial year 2018.

Fund	Reference (CCI)	Programme	A Expenditure declared to the Commission in reference to the year	B Expenditure in reference to the financial year audited for the random sample	C Total number of units in the population	D Number of sampling units for the random sample	E Amount and percentage (error rate) of irregular expenditure in random sample	F Total projected error rate	G Corrections implemented as a result of the total error rate	H=F-G Residual total error rate	GI Other expenditure audited	JH Amount of irregular expenditure in other expenditure sample
				Amount %			Amount % %					
	2014ME0614NP001	Programme for Agriculture and Rural development of Montenegro - IPARD II	/	/ /	/	/	/ /	/	/	/	/	/

## 11. Abbreviation and Annexes

### Annex 1 – Finding and recommendations

### Annex 2 – Follow up on DG AGRI recommendations

#### List of abbreviation

AA	Audit Authority
AAAR	Annual Audit Activity Report
AAO	Annual Audit Opinion
AFCOS	Anti - fraud Coordination Service
AMD	Annual Management Declaration
AWP	Annual Work Plan
CFF	Cash flow forecast
CHU	Central Harmonization Unit
DAB	Department for Accounting and Budget
DAP	Department for Authorisation of Payments
DEP	Department for Execution of Payments
DG AGRI	Directorate-General for Agriculture and Rural Development
DMS	Directorate for Management Structure
DOSC	Department for On-the-spot control
DP	Directorate for Payments
DPAP	Department for Publicity and Authorisation of Projects
EC	European Commission
EU	European Union
FA	Financing Agreement
FY	Financial Year
FwA	Framework Agreement
HNFD	Head of National Fund Division
IA	IPARD Agency
IAD	Internal Audit Department
IPA	Instrument for Pre-accession Assistance
IPARD II Programme	Programme for the Development of Agriculture and Rural Areas in Montenegro
KPIs	Key Performance Indicators
LEE	List of eligible expenditures

MA	Managing Authority
MARD	Ministry of Agriculture and Rural Development
MCS	Management Control System
MF	Ministry of Finance
MIDAS	Montenegro Institutional Development and Strengthening project
MOP	Manual of Procedures
MPA	Ministry of Public Administration
NAO	National Authorising Officer
NAOSO	The NAO Support Office
NF	National Fund Division
NIPAC	National IPA coordinator
OG	Official Gazette of Montenegro
OTSC	On the spot control
RC	Risk Coordinator
RfF	Request for Funds
RM	Risk Manager
RMP	Risk Management Panel
RPD	Reference price Database
SA	Sectorial Agreement
SSOs	System Supervision Officers
WLA	Work Load Analysis