



MONTENEGRO
AUDIT AUTHORITY

No: 3011-4-06-328

ANNUAL AUDIT ACTIVITY REPORT
OF THE AUDIT AUTHORITY FOR
IPA COMPONENT III – REGIONAL DEVELOPMENT

OPERATIONAL PROGRAMME REGIONAL DEVELOPMENT 2012-2013

(CCI 2012ME16IPO001)

FOR THE PERIOD FROM 01 OCTOBER 2016
UNTIL 30 SEPTEMBER 2017

Podgorica, December 2017

Contents

1. INTRODUCTION	3
1.1. Operational programme of IPA covered by the report.....	3
1.2. Bodies involved in the preparation of this report	4
1.3. Steps taken for the preparation of the report	4
1.4. Audit scope.....	5
1.4.1. System audits.....	5
1.4.2. Follow-up.....	6
1.5. Period covered by this report.....	6
2. SUMMARY OF FINDINGS	7
2.1. Summary of findings from system audits.....	7
2.2. Summary of findings from audit of operations	9
2.3. Conclusion on the functioning of the system	9
3. CHANGES IN MANAGEMENT AND CONTROL SYSTEMS	10
3.1. Changes in the MCS since last AAAR.....	10
3.1.1. Personal changes.....	10
3.1.2. Organizational changes.....	10
3.2. Changes in the MCS from 01 October until mid-December 2017	11
4. CHANGES TO THE ANNUAL AUDIT WORK PLAN (AAWP)	11
5. SYSTEMS AUDITS	12
5.1. Basis for selection of the audits.....	12
5.2. Follow-up activities	13
5.2.1. Follow-up approach - general.....	13
5.2.2. Follow-up approach in 2017	14
5.3. Principal findings /Follow-up /Corrective measures applied or recommended and Conclusion.....	14
5.4. Financial impact on findings	23
6. AUDITS OF SAMPLE OF OPERATIONS	23
7. COORDINATION BETWEEN AUDIT BODIES AND SUPERVISORY WORK OF THE AUDIT AUTHORITY	23
8. FOLLOW - UP OF PREVIOUS YEARS' AUDIT ACTIVITY	23
9. RESOURCES USED BY THE AUDIT AUTHORITY	25

Annex A: Annual Audit Work Plan from 01 October 2016 until 30 September 2017

Annex B: List of findings from system audits and audit of operations

Annex C: Summary list for system audits carried out from 01 October 2016 until 30
September 2017

Annex D: Summary list for declared expenditure and sample audits carried out from
01 October 2016 until 30 September 2017

List of abbreviations

AA	Audit Authority
AAO	Annual Audit Opinion
AAAR	Annual Audit Activity Report
AAWP	Annual Audit Work Plan
BROP	Body responsible for Operational Programme
BRPM	Body responsible for Priority/Measure
CAO	Competent Accrediting Officer
DG REGIO	Directorate General for Regional and Urban Policy
DEU	Delegation of European Union in Montenegro.
DMS	Directorate for Management Structure
DPW	Directorate for Public Works
EU	European Union
EC	European Commission
ER	End Recipient
FIDIC	International Federation of Consulting Engineers
HOS	Head of Operating Structure
IAD	Internal Audit Department
IB	Implementing Body
IPA	Instrument for Pre-Accession Assistance
IT	Information Technology
IS	Information System
MCS	Management and Control System
MoP	Manual of Procedures
MSDT	Ministry of Sustainable Development and Tourism
MTMA	Ministry of Transport and Maritime Affairs
NAO	National Authorizing Officer
NFD	National Fund Division
NIPAC	National IPA Coordinator
OG	Official Gazette
OP	Operational Programme
OS	Operating Structure
OTSC	On the spot check
PRAG	Practical Guide to Contract Procedures for EU External Actions
RAF	Risk Alert Form
RMP	Risk management panel
RMC	Risk Management Coordinator
RDOP	Regional Development Operational Programme
Rulebook	Rulebook on internal organization and systematization
SAP	System Applications Product
SoA	Statement of Assurance
WLA	Work Load Analysis

1. INTRODUCTION

1.1. Operational programme of IPA covered by the report

This report covers the Operational Programme Regional Development 2012-2013 (hereinafter Programme or RDOP) co-financed from the Instrument for Pre-Accession Assistance on Montenegro 2007-2013. European Commission issued Decision C (2012) 9309 on adopting Operational Programme (CCI 2012ME16IPO001) on 7 December 2012.

The RDOP 2012-2013 is divided into three priority axes and the global objective of priority axes shall be implemented through four measures. The total cost of the RDOP, expressed in terms of eligible public expenditure, is estimated at 26.159.626 EUR (EU Contribution 22.235.679 EUR and National Public Contribution 3.923.947 EUR).

According to the European Commission (EC) Decision (C(2014) 2635) from 25 April 2014 on conferring management powers relating to the Programme, the following structures, bodies and authorities are responsible for the management and implementation of the Programme:

1. **National Authorising Officer**, State secretary within Ministry of Finance (which was appointed as NAO by Decision on the appointment of the NAO, issued by CAO -Minister of MoF, on the 09 October 2017) bears overall responsibility for the financial management of EU funds in Montenegro and the regularity and legality of the underlying transactions. Until then Director General of Directorate of the State Treasury within Ministry of Finance was NAO.
2. **National Fund** was within Directorate of the State Treasury in Ministry of Finance until the end of October 2017. Namely, by new Rulebook on internal organization and systematization of the Ministry of Finance which was adopted on 26 October 2017, Division for national fund is established within newly established Directorate for managing structure.
3. **Operating Structure** which encompasses:
 - Ministry of Sustainable Development and Tourism, Division for EU and other funds management under Directorate for EU integration and international cooperation:
 - as the Body responsible for the Operational Programme;
 - as the Body responsible for Priority axis 1 (to upgrade the environmental management Systems) and Priority axis 3 (to support RDOP implementation)
 - Ministry of Transport and Maritime Affairs, Directorate for international cooperation and EU Funds (former Department for European Integration and International Cooperation) as the Body responsible for Priority axis 2 (to improve the transport system, promoting environmentally friendly transport modes, with special emphasis on improving the rail infrastructure in order to provide better services)
 - Directorate for Public Works, as the Implementing body for Priority axes 1, 2 and 3.

1.2. Bodies involved in the preparation of this report

This Annual Audit Activity Report has been prepared solely by Audit Authority of Montenegro.

Audit Authority (hereinafter: AA) as an independent audit body was established by Law on Audit of EU Funds (“Official Gazette of Montenegro”, No 14/12, 54/16, 37/17 and 70/17).

The AA is responsible for audit of EU funds (IPA, Structural Funds after the accession of Montenegro to the European Union, and other EU funds).

The functional independence of the AA is adequately ensured. According to Article 3 of Law on Audit of EU funds, the AA is functionally and operationally independent of all actors in EU funds management and control system.

In terms of the organisational setup this means that the AA is set up as a functional independent body that has in no way any functional relation(s) with the bodies in the operational setup of the management and control system(s) for the execution of EU funded programs in general and the IPA III component.

The functions of the AA are set out in the Framework Agreement between the Government of Montenegro and the Commission of the European Communities concluded on 15 November 2007, and in Commission Regulation (EC) No 718/2007 from 12 June 2007 Implementing Council Regulation (EC) No 1085/2006 establishing an instrument for pre-accession assistance (IPA) and other agreements between the European Commission and Montenegro.

The AA is responsible for verifying the effective functioning of the management and control system in the bodies responsible for management and implementation of the OPRD 2012-2013.

The AA should submit an Annual Audit Activity Report (AAAR) and Annual Audit Opinion (AAO) following the model set out in Annexes C and D of the Framework Agreement, on the basis of the audit activities carried out from 01 October 2016 until 30 September 2017.

1.3. Steps taken for the preparation of the report

The AAAR was prepared as a result of audit activities carried out during the 2017. During 2017 the AA carried out system audit and follow-up of the findings and recommendations given in the course of audit conducted in the period covered by this report as well as follow-up of the findings and recommendations given in the course of previous audits. The follow-up was performed as a part of another audit engagement and as a separate activity before issuing the Annual Audit Activity Report and opinion.

In this AAAR the overall overview of activities carried out in 2017 is provided.

The AA prepared the AAAR on its own, taking into consideration that the AA does not rely on the work of other audit bodies in carrying out its functions.

1.4. Audit scope

In 2017 the Audit Authority carried out the following activities:

- System audit and
- Follow-up.

In the period covered by this report, the AA was not in a position to perform audit of operations, because in the period from 1 January 2016 until 31 December 2016 as well as in the period covered by this report, there were no declared expenditures to EC.

In the period November – December 2017 the AA performed follow-up of the findings and recommendations given in the course of audit conducted in the period covered by this report, as well as follow-up of the findings and recommendations given in the course of previous audits. Follow-up was performed as separate activity before issuing the AAAR and the AAO.

1.4.1. System audits

In carrying out the system audits the audit scope was to examine the compliance of the MCS with the requirements set out in the IPA Implementing Regulation, i.e. accreditation criteria provided in the Annex of the EC Regulation 718/2007, the Framework Agreement and the requirements set out in other agreements and regulations, and to check whether the established system functions effectively. Also, the follow up of the findings and recommendations given in the course of previous audits was included in the system audit engagement.

For the purposes of preparing the Annual Audit Work Plan, we performed risk assessment for operational program Regional Development 2012-2013 at the level of each body of OPRD at the key requirement/process/function level (further: process level). We identified and assessed issues and processes that are significant for the audit and that could be common for all or several bodies that are participating in management and implementation of operational program. Results of the risk assessment at the horizontal process level in all bodies of MCS showed that the riskiest processes were: human resources and internal organization; process of planning, assessment and approval of changes in MCS; financial management and risk management.

Additionally, results of the risk assessment at the specific process level showed that the riskiest processes were: contract implementation and on-the-spot (IB, BRPMs); accounting (IB, NF) and management verifications (MSDT/BROP).

Also, on the basis of analysis of gathered documentation during preparation of engagement plan for this system audit, as well as of professional judgement we additionally decided that process of functioning of internal audit in all bodies dealing with IPA component III, as well as process of issues of SoA in National Fund, will be audited.

Therefore, based on the level of implementation of OPRD, available AA's resources and all the collected information and documentation as well as the results of risk assessment, the following audit areas were examined:

- Human resources and internal organization- all bodies
- Process of planning, assessment and approval of changes in MCS-all bodies
- Financial management-all bodies

- Risk management-all bodies
- Internal audit- all bodies
- Contract implementation and on-the spot - IB (DPW) and BRPMs (MSDT and MTMA)
- Accounting – IB (DPW) and NF
- Management verifications (MSDT/BRPM) and
- Statement of Assurance (NF)

Also, in each body follow up of the findings and recommendations given in the course of previous audits was included in the system audit engagement.

1.4.2. Follow-up

In 2017 the Audit Authority performed follow-up of the findings and recommendations given in the course of previous audits and follow-up of the findings and recommendations given in the course of audit conducted in the period covered by this report. Follow-up was performed as a part of another audit engagement as well as separate activity before issuing the AAAR and the Annual Audit Opinion (AAO).

For detailed information of our follow-up approach, please see Section 5.2 (Follow-up approach of the AA) of this AAAR.

1.4.2.1. Follow-up as a part of another audit engagement

As already mentioned in Section 1.4.1 during system audit the follow-up of findings and recommendations from previous audit is performed, which is then a constituent part of system audit report from 31 August 2017.

1.4.2.2. Follow-up as a separate activity before issuing the AAAR and AAO

In December 2017 the AA performed follow-up of the implementation of recommendations from previous audits and follow-up of the findings and recommendations given in the course of audit conducted in the period covered by this report.

Follow-up was performed as a separate activity before issuing the AAAR and the AAO and encompassed the following bodies:

- Ministry of Sustainable Development and Tourism (BRPM/BRPM)
- Ministry of Transport and Maritime Affairs (BRPM)
- Directorate for Public Works (IB) and
- National Fund (NF).

Follow-up covered the results of the audits in all bodies from operational programme in which the AA carried out audits in the previous period. After the Follow-up, we prepared separate Audit Recommendations' Status Report for each body which is kept in our audit file.

Results of follow-up activities are described in Section 5.3 and in Section 8 of this Report.

1.5. Period covered by this report

This report covers the 12-month period which ended on 30 September 2017. Audit activities, on the basis of which this AAAR is prepared, were conducted during 2017.

2. SUMMARY OF FINDINGS

As it was already mentioned in Section 1.4 Audit scope, during 2017 the AA carried out system audit and follow-up. The summarized description of the findings identified during the audit is given below.

The outcome of the audit process is summarized in this final audit report that provides findings and recommendations which were identified during the audit process in each body of operating structure and in National Fund.

Findings were categorized according to the level of importance to major, intermediate and minor findings. During this audit engagement we identified in total 11 findings: 1 of them is major, 9 are intermediate and 1 is minor.

A detailed list of all findings, categorised by their level of importance (major, intermediate and minor) is given in Annex B of this Report.

2.1. Summary of findings from system audits

During 2017 the system audit of Functioning of Management and Control System for Operational programme “Regional development 2012-2013” (encompassed MSDT (BROP/BRPM), MTMA (BRPM), DPW (IB) and NF) was carried out with the general assessment of MCS - works, but some improvements are needed. We identified in total 11 findings: 1 of them is major (9,09%), 9 are intermediate (81,81%) and 1 is minor (9,09%). Number of system audit findings per audited area/process with body/ies concerned by the finding is given in the table below.

Table 2: Number of system audit findings per audited area/process

Audited area/process	No of findings	Body/ies concerned by the finding
Human recourses and internal organization	1	NF/MSDT/MTMA/DPW
Process of planning, assessment and approval of changes in MCS	0	-
Financial management	4	DPW/NF
Risk management	1	NAO/NF/MSDT/MTMA/DPW
Internal audit	1	MSDT/MTMA/MoF(NF)
Contract implementation and on-the- spot control	1	DPW/ MSDT/ MTMA
Accounting	2	DPW
Management verifications	1	MSDT /BROP
SoA	0	-
Total	11	

By the insight into the foreseen number of job positions in the acts on internal organisation and systematisation and the needed number of employees given in WLAs in all IPA bodies dealing with OPRD 2012-2013, during our audit engagement we determined **lack of staff**. Improvements are needed in terms of recruitment of staff as soon as possible, as well as appropriate implementation of retention policy in practice in order to prevent loss of quality staff.

Starting from the fact that lack of respect of procedures, relating to **planning and implementation of changes in MCS**, in the previous period caused significant problems in system functioning, during this audit we audited again this audit area and on that occasion we spotted the frequency of changes (especially a great number of personnel changes on the key positions in the system in relation to the size of the system itself). During this audit engagement we determined that the progress is made in respecting prescribed procedures related to changes in the system.

The most of findings were identified within audit area of **financial management** (which refers to payments to contractors, interim payment application, information system and read and approved visa). The total number of findings in this audit area is four, one of them is major, two are intermediate and one is minor finding. The major finding relate to delays in payments to the contractors caused by significant change in the MCS occurred within Operating Structure (organisational changes in DPW/IB).

Namely, we identified that DPW (IB) did not execute any payment to the contractors in period of two months, even for this period they received invoices from Contractors. Some delays of payments were more than 50 days which provided opportunity to Contractors to receive financing charges (compounded monthly on the amount unpaid during the period of delay) and delays in payments have impact on delays of implementation of projects. Taking into account the fact that the EU funds for OPRD 2012-2013 are available until the end of 2017 there is significant risk on realization of this programme and possible de-commitment of funds.

When it comes to the other findings we identified that NF had not sent Payment Application to the European Commission since 30 December 2015, even during this period IB executed payments to Contractors for the contracts signed and this amount could be subject of payment application. In addition written procedures related to financial management are not aligned with new information system and some of the contracts were not recorded in that system which does not allow employees of IB to conduct monthly reconciliation within IB.

Related to **risk management** we noticed that the requirements and controls regarding the risk management described in the MoP, are not completely implemented in practice and some improvements are needed in terms of more serious approach related to risk management activities by all actors in the system, proper fulfilment of Risk Alert Form, attendance in all Risk Management Panel as well as additional trainings.

When the **internal audit** is concerned there is lack of capacities within IADs in all IPA bodies and this fact may have an impact on the quantity and/or quality of audits that are envisaged in annual audit plans. There is a risk that some of the systems, processes or procedures with high impact on overall system will not be subject of the audit, and that top managers would not have additional assurance about functioning of their systems nor independent review on effectiveness and efficiency of the system.

According to our audit engagement in process of **contract implementation and on the spot control** audited in IB and BRPMs we identified that IB (DPW) performed on the spot controls related to the work and service contracts and there is adequate audit trail. These controls are usually related to the 1st interim payments and there was no civil work yet. However, when it comes to the supply contracts IB should follow procedures for on the spot control for every contract and not issue provisional acceptance of goods without clear evidence of output

delivered. BROP/BRPM should check all supporting documents before countersigning a provisional acceptance of goods in line with the procedures prescribed.

During our audit related to **accounting** in IB and NF we determined that new Information system (IPA SAP) which includes contracting, financial management and accounting became operative. However, in order to ensure complete, accurate and transparent accounting following internationally accepted accounting principles, in DPW improvements are needed. Namely, accounting software should be able to provide separate recording of expenditure which cannot be financed from EU funds (but they are in accordance with the signed contracts). Recording of this kind of expenditure in the same way as eligible expenditure from the part of national co-financing ultimately brings to unrealistic presentation of the amount of national co-financing for eligible expenditure in the accounting system. Also, fact that operations/transactions have not been recorded timely and that Financial Agreement has not entered the amount, for which it is signed, leads to the fact that full and transparent accounting is not completely ensured. Additionally, since the accountant left his position and new accountant has not got previous experience in accounting jobs, intensive trainings are necessary.

During review of **management verification in BROP/MSDT** we identified that responsibility of the HOS for carrying out management verifications are defined in the National IPA Decree, in the Implementing Agreement between NAO and HOS and in the Operational Agreement between HOS and OS bodies. Moreover, procedures for carrying out management verification responsibility by the HOS are set up in the MoP. Since the timely implementation of on-the-spot checks should ensure supervision of the management and internal control systems throughout the financial year and to obtain adequate assurance for the declarations by HOS, we noticed tha some improvements in this audit area are needed in terms of performing of planned OTSC by Annual OTSC Plan.

A detailed description of the principal findings identified and of accompanying recommendations provided, as well as results of follow-up activities are presented in the Chapter 5 - Systems audits (Section 5.3).

2.2. Summary of findings from audit of operations

N/A See point 1.4

2.3. Conclusion on the functioning of the system for period ended on 30 September 2017

The findings identified during the course of our audit were system findings without financial impact.

Our conclusion on the functioning of the management and control system (MCS) for the period ended on 30 September 2017 (reference period) is based on the audit work carried out during 2017 (audit period). In that period AA carried out system audit and follow-up of the findings and recommendations given in the course of this audit, as well as follow up findings and recommendations given in previous audits. Also, during 2017 AA continuously collected the information on the changes in the system.

As a result of our system audit and taking into account the result of the follow-up activities, we can conclude that the management and control system established for OPRD for the period 01 October 2016 – 30 September 2017 has functioned effectively. Consequently, for period ended on 30 September 2017 we will issue an unqualified opinion

3. CHANGES IN MANAGEMENT AND CONTROL SYSTEMS

In our last AAAR, we reported on significant changes in the management and control systems (MCS) in the period from 01 October 2015 until 30 September 2016 and in the period from 1 October until mid- December 2016.

3.1. Changes in the MCS since last AAAR

3.1.1. Personal changes

- Head of National Fund Division Mrs Dunja Nelević left her position in March 2017.
- At the session of the Government of Montenegro held on 18 May 2017, Director of Directorate for Public Works (Head of IB) Mr Milan Martinović was replaced by Mr Almer Kalač.
- Government of Montenegro at the session held on 16 June 2017 appointed Ms Emina Mujević Kara as Acting Director of Directorate for international cooperation and EU Funds (Head of BRPM). Former Head of BRPM Ms Danijela Kapa becomes implementing officer.
- Government of Montenegro at the session held on 14th September 2017 adopted Decision on termination of the mandate of the Ms Marija Vukčević, former Director General of the Directorate for EU integration and International Cooperation within Ministry of Sustainable Development and Tourism who performed function of Head of Operating Structure f (HOS) for IPA Component III. Based on official authorization made by Minister of MSDT, this function has been taken over by Mr Saša Radulović, State Secretary in charge of policies in the area of environment.

NAO informed the EC (with a copy of notification to the AA) about all personal changes.

3.1.2. Organizational changes

- In March 2017 the Government of Montenegro adopted Amendments of Decree on changes and amendments of the Decree on the public administration and manner of work (OG MN 19/2017) by which the Directorate of Public Works (DPW) is organised as a separate body within Ministry of Sustainable Development and Tourism.
- Rulebook on internal organization and systematization of the Ministry of Sustainable Development and Tourism was adopted in April 2017. By the new Rulebook MSDT in part related to DPW/IB (separate body within MSDT), internal organizational units of DPW are: Sector for planning and preparation of projects, sector for contracting and financing projects and sector for monitoring of projects realization. Overall number of systematized job positions for carrying out activities from the scope of competence of the Directorate of Public Works is 50. 30 out of 50 job positions have been envisaged for IPA activities. By the same Rulebook in part related to Division for EU and other funds management (BROP/BRPM-MSDT) there were minor changes related to job description of some work posts and professional requirements for certain work posts within Division for EU and other funds management (BROP/BRPM). There were no changes in envisaged number of work posts.

- The Government of Montenegro on its session held on March 30th 2017 adopted a new Rulebook on internal organization and systematization of the Ministry of Transport and Maritime Affairs. Comparing the previous and the new Rulebook we determined that Department for Management of EU Funds, which functions as the BRPM, becomes Directorate for international cooperation and EU Funds. Envisaged numbers of job positions are raised from 3 to 7 including Director of Directorate (Head of BRPM).

NAO informed EC (with a copy of notification to the AA) about these changes.

3.2. Changes in the MCS from 01 October until mid-December 2017

- **Change of NAO**

Government of Montenegro at the session held on 21st September 2017 adopted Decision on appointment of Mr Nemanja Katnić as State secretary within Ministry of Finance, who was appointed as NAO by Decision on the appointment of the NAO, issued by Minister of MoF, on the 09 October 2017. The NAO informed the EC (with a copy of notification to the AA) on 11th of October 2017 (letter No 01-17646/1) and on 1st of December 2017 (Letter No 01-21222/1).

- **Change of position of National Fund Division within Ministry of Finance**

The National Fund was established as a separate unit within the Directorate for State Treasury at the Ministry of Finance, under direct responsibility of the General Director in charge of the Directorate for State Treasury - National Authorising Officer. By new Rulebook on internal organization and systematization of the Ministry of Finance which was adopted on 26 October 2017, Division for national fund is established within newly established Directorate for managing structure. Within this Directorate there are two divisions: Division for supervising of system (envisaged number of work posts are 5) and Division for national fund (envisaged number of work posts are 5). Government of Montenegro at the session held on 16th November 2017 appointed Ms Ivana Maksimović as Acting Director General of Directorate for Managing structure in Ministry of Finance. NAO informed EC by: Letter No 06-1970/1 from 13th April 2017; Letter No 06-3882/1 from 3rd August 2017; Letter No 06-3883/1 from 4th August 2017 and Letter No 01-21222/1 from 1st December 2017.

- **Change of Rulebook on organization and systematization of the Ministry of Sustainable Development and Tourism**

New Rulebook on internal organization and systematization of the Ministry of Sustainable Development and Tourism was adopted in October 2017. Comparing the previous and the new Rulebook we determined that envisaged number of work posts within Division for EU and other funds management (BRPM/BROP) was increased for one work post, and now envisaged number of job positions is 9 including HOS. About this change NAO has not informed EC, yet.

4. CHANGES TO THE ANNUAL AUDIT WORK PLAN (AAWP)

AAWP for the period 01 October 2016 – 30 September 2017 was prepared in September 2016 and was sent to EC-DG REGIO with copy to NAO on 29 September 2016.

According to the plan we carried out system audit. By this plan we planned conducting audit of operations on the expenditure declared in 2016.¹ However, since there was no declared expenditure in the 2016 and bearing in mind that in 2018 closure of programme will follow, at the beginning of 2017 we decided to perform planned audit of operations on the expenditure declared until 30 September 2017 without changes of AAWP.

On the basis of Certificate and statement of Expenditure and application for Interim Payment No.2 submitted by EC in September 2017, we started audit of operations (Preparatory phase) at the end of September 2017 with intention that this audit engagement should be completed by December 2017 and that results of this audit engagement will be included in this report. However, in the mid-October we received the notice by the NAO/National Fund that for administrative reasons, NAO withdrew already submitted Application for Interim Payment No.2 for IPA III OP RD 2012-2013 (CCI 2012 ME 16I PO 001), which was submitted to the EC by regular post on 25/09/2017 as well as through SFC2007.

In view of the new circumstances this occurred situation reflected on the carrying out of planned audit engagements of the Audit Authority. Having in mind that basis for audit of operations is expenditure declared to the EC and that the NAO withdrew submitted Certificate and statement of Expenditure and application for Interim Payment No.2, we stopped further carrying out of this audit engagement. Auditor General of AA informed competent services DG REGIO on this issue by e-mail on 31th October 2017.

Having in mind the above mentioned the change in the AAWP for the period 01 October 2016 until 30 September 2017 was not possible.

Annual Audit Work Plan is laid down in Annex A.

5. SYSTEMS AUDITS

This AAAR is prepared by the AA and all activities in the course of 2017 were performed by the AA.

See Annex C to this AAAR.

5.1. Basis for selection of the audits

We performed our activities in accordance with the AAWP for period 01 October 2016 – 30 September 2017.

During preparation of AAWP for 2017 for the System audits risk assessment was performed for operational programme Regional Development 2012-2013 at the level of each body (organisations) participating in the management and control systems within the IPA Component III, at the key requirement/process/function level (further: process level). We identified and assessed issues and processes that are significant for the audit and that could be common for all or several bodies that are participating in management and implementation of operational program. Risk factors which were identified and taken into account during risk

¹ According to Audit Authority's Manual of Procedures (Version 2.1) in the context of its audit work, the Audit Authority reports on the basis of work carried out during the period from 01/10/year N to 30/09/year N+1 as at 31/12/year N+1. The audits of operations are carried out on the expenditure declared to the Commission in year N.

assessment at the process level of a particular body were as follows: Results of previous audits (number and level of findings and weaknesses from the previous AA reports), Staffing (sufficiency, competence and experience in the field), Compliance requirements (complexity of rules, number of accreditation criteria related to process, existence of clearly defined written procedures and responsibilities), Changes from the previous audits (organisational, procedural, key staff/other employees) and Status of implementation of process.

In order to distinguish between the factors with varying importance, we gave the weight to the specific risk factors and calculated the total score for each process in each body. First we identified horizontal processes in all bodies and we calculated the total score for each identified horizontal process at the level of individual body. Second, we identified specific processes in each body and calculated the total score for those processes in each body. After that, we calculated the total score for each horizontal and specific process within OP.

After that, first we ranked all horizontal processes within OP according to the total score for each horizontal process. Second, we ranked specific processes in OP according to the total score for each specific process.

Results of the risk assessment at the horizontal process level in all bodies of MCS showed that the riskiest processes were: human recourses and internal organization; process of planning, assessment and approval of changes in MCS; financial management and risk management. Additionally, results of the risk assessment at the specific process level showed that the riskiest processes were: contract implementation and on-the-spot (IB, BRPMs); accounting (IB, NF) and management verifications (MSDT/BROP).

Furthermore, we defined the approach for performing the audit of the selected processes. In the audit period the riskiest horizontal processes (human recourses and internal organization, process of planning, assessment and approval of changes in MCS, financial management and risk management) as well as specific riskiest processes (contract implementation and on-the-spot characteristic for IB and BRPMs; accounting (IB, NF) and management verifications (MSDT/BROP)) were covered through audit engagement by the AA in all bodies within the MCS in OPRD.

Also, on the basis of analysis of gathered documentation during preparation of engagement plan for this system audit, as well as on professional judgment we additionally decided that process of functioning of internal audit in all bodies dealing with IPA component III, as well as process of issuing of SoA in National Fund, have been within scope of this system audit.

5.2. Follow-up activities

5.2.1. Follow-up approach - general

According to the AA's Manual of Procedures "The objective of the follow-up process is to determine whether the issues rose in the audit have been adequately addressed and the audit report recommendations are implemented in a timely manner. In general, the follow-up of the audit findings and errors shall be performed annually and the information provided in the Annual Audit Activity Report. The follow-up can be performed as a part of another audit engagement, or as a separate activity before issuing the Annual Audit Activity Report, opinion (and report) on the management and control systems, and the opinion (and report) on the statement of expenditure. Follow-up by AA is defined as a process by which it determines the adequacy, effectiveness, and timeliness of actions taken by management on reported errors and audit findings, including corrective and preventive measures applied, application of any financial adjustments and remedial action plans. AA should ascertain that actions taken

on audit findings remedy the underlying conditions. The same standards for audit evidence shall be applied to follow-up work as those used for documenting original audit work. The results of the follow-up shall be documented in the “Audit recommendation status report”.

5.2.2. Follow-up approach in 2017

During performance of system audit in 2017, Audit Authority carried out follow-up of findings and recommendations from audits performed in previous years. Results of follow-up are covered in the system audit report.

Also, in December 2017 we carried out follow-up of the findings and recommendations given from the performed system audit in 2017 as well as follow-up of findings and recommendation from audits performed in previous years. This Follow-up was performed as separate activity before issuing the AAAR and the Annual Audit Opinion (AAO).

For the purpose of carrying out the follow-up we have conducted a set of activities:

- At the end of November 2017 we sent to all bodies, Table with the summary of findings and recommendations from previous audits. We informed them that we needed the follow-up for the preparation of the AAAR which should be submitted to the EC, CAO and NAO by the end of December 2017. Therefore, we requested from all bodies to include into the Tables their Management response on the status of the individual recommendation with the appropriate explanation, regardless of whether deadline for implementation of recommendation has expired or not. We also informed them that they should prepare the evidence on the fulfilment of the individual recommendation which will be provided to us.
- In mid-December 2017 we received all the information we requested from all bodies. After the analysis of the received responses and documentation collected, we assessed the status of the individual recommendation with the respective explanation and we prepared a separate Audit Recommendations’ Status Report for each body. We informed all auditees about the results of our follow-up activities.

Finally, the results of our Follow-up activities shall be described in this AAAR in the following way:

- a) For the audit which the AA performed in 2017, the results of the Follow-up shall be described in Chapter 5, Section 5.3, to ensure the continuity, i.e. in order to have the insight into the implementation of the recommendations given. In other words, the most important findings identified during the audit which was performed during 2017 and recommendations given accordingly will be presented briefly in the beginning, and will be followed by results of the follow-up which was performed in December 2017.
- b) For the audits carried out in previous periods the results of the follow-up shall be described in Chapter 8 – Follow up of previous year’s audit activity.

5.3. Principal findings / Follow-up / Corrective measures applied or recommended and Conclusion

Further below there is a description of the most important findings (major and intermediate) identified and conclusions reached through audit per audit areas. Recommendations provided

for correcting the findings detected as well as information on the measures undertaken for the purpose of eliminating the findings are laid down.

- **Human Recourses and Internal organization**

In this audit area we identified one intermediate finding, but it refers to all bodies dealing with IPA component III (MSDT/MTMA/DPW/NF).

By the insight into the foreseen number of job positions in the acts on internal organisation and systematisation and the needed number of employees given in WLAs in all IPA bodies dealing with OPRD 2012-2013, during our audit engagement we determined lack of staff. We noticed that employees from our last audit engagements in IPA bodies to half of June 2017 from key positions left their position (e.g.: Deputy of Head of DPW; Head of National Fund Division, Head of IB and Head of BRPM /MTMA).

Apart from the above stated, having in mind size of MCS we determined a significant employees' turnover during 2016 and 2017 in all IPA bodies, which ultimately leads to the fact that particular IPA bodies function based on substitution plans while at some of them, because of the insufficient number of staff it is impossible to apply substitution plan in order to respect segregation of duty. Namely, the fact that the job position Head of Division for EU and other funds management in MSDT has been vacant since July 2016, that one task manager has been on a continuous sick leave since February 2017, as well as that one programming manager left his job position, makes it hard to perform daily activities with a satisfying quality and it can lead to overload of the existing staff.

When it comes to MTMA, leave of programming manager (also officer in charge Irregularity officer, mop coordinator and IT coordinator) and transfer of Head of BRPM to the position of implementing manager, led to situation that in the period from May to mid-June 2017 (by the time new Head of BRPM is appointed) in this body all activities were performed by two implementing managers, which means that there was no possibility of providing adequate segregation of duty.

In financial division within DPW/IB one employee has Decisions on allocation on work posts at position for financial controller. Due to the fact that four eyes principle must be ensured, according to substitution plan one more employee is included in the financial issues, for whom financial issues are defined as additional activities. Bearing in mind importance of position and scope of activities, particularly during 2017 when most of the payments should be executed, there is a risk of possible errors and irregularities due to work overload of employees who are dealing with financial issues.

When it comes to the NF, according to systematization 2 work posts for financial manager and 1 work post which can cover different positions including financial manager are envisaged. We identified that head of NF left organization and one financial manager is on maternity leave for longer period which results in insufficient number of employees for substitution.

Bearing in mind current status and phase of implementation of OPRD, lack of staff on some job positions, caused by their vacancy or absence of employees due to sick leave, can have greater impact on the quality and continuity of business operations.

Therefore, we recommended that actions should be taken as soon as possible in order to ensure necessary number of employees in line with the results of WLAs, and it is especially necessary to fill in the following key positions urgently:

- MSDT/BRDP: Head of Division for EU and other funds management
- DPW/IB: Financial controller
- NF: Head of National Fund Division, as well as to implement adequate retention policy.

Results of follow-up

We determined through follow-up that OS bodies as well as NFD have actively participated in implementation of recommendations and have taken corrective actions. The following key positions are filled: MSDT/BRDP- Head of Division for EU and other funds management (long term employment contract); DPW/IB-Financial controller (temporary employment contract) and NF-Head of National Fund Division (long term employment contract).

Apart from that, number of employees dealing with OPRD 2012-2013 has increased from our audit engagement as stated in table below:

Auditee	Determined during audit			Determined during follow-up in December 2017	
	Envisaged Work post related to IPA jobs by Rulebook	Result of WLA/2017*	Employed	Envisaged Work post related to IPA jobs by Rulebook	Currently employed
MSDT	8 – including HOS	8	6 (5-LTEC; 1-TEC)	9-including HOS	9 (7-LTEC; 2-TEC)
MTMA	5-Including Head of BRPM	7	3 (LTEC)	5-Including Head of BRPM	5 (LTEC)
DPW	30-Including Director (Head of IB)	27	22 (21-LTEC; 1-TEC)	30-Including Director (Head of IB)	21 (20-LTEC; 1TEC)
NF	8-including NAO	10	7 (LTEC)	12-including NAO	8 LTEC

*WLAs take into consideration activities relating not only to OPRD implementation but also to activities from the competence of these bodies related to programmes from IPA II perspective as follows: MSDT as PIU for 1 action, MTMA as PIU for 2 actions, DPW as IB for one action and NF for all action (11).

According to information obtained from DMS during follow-up certain steps in finding the best model for retention and motivation policy for IPA staff, at high management level have been undertaken.

We consider that significant progress was made in implementation of this recommendation. Having in mind new challenges which follows in the next year (closure of programme) this finding is partially closed. Further implementation of this recommendation will be followed during follow-up activities planned in the next year.

- **Financial management**

Regarding this audit area we identified one (1) major, two (2) intermediate and one (1) minor finding.

Finding with major level of priority which refers to payments to the contractors is identified in DPW (IB) and NF.

Namely, during audit we identified that DPW (IB) did not execute any payment to the contractors in period between 29th March and 2nd June 2017, even for this period they received twelve invoices from Contractors. During the same period, for six invoices, according procedure prescribed DPW (IB) proceed Request for Funds with supporting documents to the HOS, and

HOS after their control proceed to the NF for approval. NF approved these RfFs and in period between 12th May 2017 and 29th May 2017 arrange transfers of funds from IPA “MF-NF III RD OP 2012-2013” account to the Main Treasury account in total amount of 1.267.786,22€. However, contractors did not receive funds at the same day when the transfer between IPA account and Main Treasury was executed what is not in line with article 154 of the Directions on State Treasury Operations (OG MN No. 20/14). First payments toward contractors are executed at 2nd June 2017 which results in significant delays in payments of contractual obligations.

Identified deficiencies are caused by the legal and organisational changes of DPW. Namely, during audit we also determined that at the moment of adoption of the annual Budget Law for 2017 (OG MN No) DPW was organised as a separate body within Ministry of Transport and Maritime Affairs (Decree on changes and amendments of the Decree on the public administration and manner of work (OG MN No 73/2016)), but after the change of its legal and organisational status at the end of March 2017 (Decree on changes and amendments of the Decree on the public administration and manner of work (OG MN No 19/2017), the DPW is moved as a separate body within Ministry of Sustainable Development and Tourism) which caused problems in implementation of annual Budget Law for 2017 in terms of inability of making payments on behalf of DPW.

For the purpose of solving this issue amending annual Budget Law was planned for the end of April 2017. Since this amendment was not adopted in a planned period, Government of Montenegro at the session from 28 April 2017 adopted a Conclusion in which the Government of Montenegro gives authority to Minister of Ministry of Sustainable Development and Tourism to dispose of part of the budget of the Ministry of Transport and Maritime Affairs which refer to budget of DPW, approved by the annual Budget Law of Montenegro for 2017.

However, even with this Conclusion of the Government transient solution for carrying out payments was found (until the adoption of amending Budget Law for 2017) by 2nd June 2017 no payments had been carried out.

Obvious omissions in the system in sense of failing to take appropriate and timely measures as well as failure to comply with regulations and procedures led to delay of payments of the due contracted obligation and provide opportunity to Contractors to receive financing charges (compounded monthly on the amount unpaid during the period of delay) which would lead to the increasing obligation from national sources. Additionally, delays in payments will impact on delays in implementation of projects because without payments Contractors staff could leave the construction site and the contracts could be terminated.

Taking into account the fact that the EU funds for OPRD 2012-2013 are available until the end of 2017 and bearing in mind above mentioned there is significant risk on realization of this programme and possible de-commitment of funds.

Based on the above mentioned it was recommended:

- IB must ensure continues and smoothly payments to the Contractors, in line with Contract conditions and FIDIC rules in order to avoid unnecessary charges and delays in implementation;
- If there are significant changes or risks which could impact on payments system, IB must notify HOS and NAO and in line with their responsibilities for IPA funds they shall take necessary steps to avoid or mitigate risks and find solutions which would ensure timely payments and not lead to any delays and
- National Fund and IB shall ensure that funds – EU part should be transferred to the Contractor account at the same day as they are transferred from IPA Central bank account to the Main Treasury account in line with the Directions on State Treasury Operations (OG MN No. 20/14) and in case that specific situation arise and funds are not transferred to the account of Contractor, NF should initiate procedure for withdrawal of funds to the IPA account.

Apart from this finding in this audit area we determined that NF did not send to the European

Commission a Payment Application since 30 December 2015, and we recommended that Payment application should be sent to the Commission at least three times per year according to the Financing Agreement in order to ensure adequate liquidity and continues and smoothly payments to contractors.

Also, it was determined that bodies within MCS (IB and NF) have been using new information system (IS-IPA SAP) since January 2017 which covers contracting, financial management and accounting and is linked within and between IB and NF. Procedures within this system related to the financial management are not aligned with MOP chapter financial management which is in usage during audit. When it comes to the monthly reconciliation between different departments within IB, there are no supporting documents for reconciliation of signed contracts. Missing documents include accounting records and necessary information from IS, which is basic for conducting of reconciliation. This deficiency is caused by the fact that IB (contract managers) did not record all signed contracts in IS.

We recommended alignment of procedures with new information system is necessary in order to avoid potential errors and irregularities, as well as all contracts, after signing should be immediately recorded in the information system, in order to ensure conducting of monthly reconciliation as a kind of control of correctness of information between different departments within IB.

Results of follow-up

Regarding implementation of our recommendations in this audit area certain activities have been taken by auditees.

Interim Payment Application was sent by NAO to EC on 14th November 2017. EC transferred the funds related to this Payment Application on 6th December 2017 and we closed finding related to the Payment application.

The finding related to the payment to contractors, in period from our audit engagement NFD and IB ensured payments to the contractors in accordance with deadlines defined in the Contract conditions and FIDIC rules. Also, transfers from IPA Central bank account to the Main Treasury account are performed in line with the deadlines defined in Directions on State Treasury Operations (OG MN No. 20/14), which means that evident progress is made. Having in mind that payment process to the contractors is still ongoing this finding remains open, but taking into account progress made, priority level is downgraded to intermediate.

When it comes to the finding related to the alignment of procedures with the new Information system, IB and NF initiate changes of procedures and submitted to the NAO new MOP for approval. Having in mind that new MOP is not yet approved; we consider this finding remains open.

- **Risk management**

Finding concerning risk management in all audited bodies was based on that management of risks relating to IPA Component III is not satisfying. As the last RMP was held in December 2016, obvious risks which appeared in the first and in the second quarter of 2017 were not adequately managed. Namely, as at the moment of adoption of the Budget Law for 2017 (OG MN No) DPW was organised as a separate body within Ministry of Transport and Maritime Affairs (Decree on changes and amendments of the Decree on the public administration and manner of work (OG MN No 73/2016)), the change of its legal and organisational status at the

end of March 2017 (Decree on changes and amendments of the Decree on the public administration and manner of work (OG MN No 19/2017), by which the DPW is organised as a separate body within Ministry of Sustainable Development and Tourism) caused problems in implementation of Budget Law for 2017, in terms of inability of making payments on the grounds of contracted obligations for implementation of projects during April and May 2017. Relating to the above mentioned, the Action plan for corrective measures was adopted and sent to the EC on 10 March 2017. Risk of implementation of Annual Budget Law for 2017 was identified in this action plan because of which the activity of amending Annual Budget Law was planned for the end of April 2017. However, the risk of inability of making payments in the period by the adoption of amending of Annual Budget Law was not identified.

In this specific case, inadequate risk management finally leads to increasing obligations from national sources which refer to the fact that Contractor shall be entitled to receive financing charges compounded monthly on the amount unpaid during the period of delay, as well as initiating contract termination by contractor.

Also, since the outflow of trained staff, both at managing and operative level was identified at the very beginning of OPRD 2012-2013 implementation and it has been constantly present in all institutions up to now, it has been determined on that basis that no adequate measures have been taken with a view to conducting retention policy. Inadequate management of this risk led to outflow of staff with the proper knowledge and experience during the most important period in the program implementation.

Apart from the above mentioned we also determined that the way of filling the Risk Alert Form in NFD and in MSDT was not in line with procedures. MSDT- BROP/BRPM as well as NF has one cumulative RAF for risky situations they identified in period under review. Such form of RAF does not provide an adequate audit trail, since there is no information when and by whom each risk is identified. Also, representative of MTMA and DPW did not attend RMPs (MTMA- RMP held in July 2016, DPW –RMP held in December 2016). Additionally by examining the Training register of MTMA we noticed that Risk manager in MTMA did not attend any training related to the RM area during 2016 and 2017.

Bearing in mind that the process of risk management is one of the key processes in organisation because of its role in achieving objectives of organisation, we recommended more serious approach related to risk management activities, in terms of inter alia that they may take action for example: “In case of urgency, RMC may also convoke ad-hoc RMP meetings, in order to discuss about newly detected risks that may have severe impact on the effective functioning of the management and control system and to propose relevant corrective actions at system level” or holding of RMP IPA (overall) with attendance of CAO; NAO/NF RM; NIPAC/NIPAC Office/NIPAC Office RM and all HOSs.

Also, we recommended: filling the RAF in line with procedures, that Risk Manager or his/her substitution attend all RMPs and that new Risk manager in MTMA should be provided with the trainings for performing his tasks.

Results of follow-up

During performed follow-up we determined that, progress was made in implementation of our recommendation.

Based on the review of documentation, we determined that the first Risk Management Panel in 2017 was held on 6th October in which Risk managers i.e. their substitution from all OS

OPRD 2012-2013 bodies participated. We also determined that at the end of October DPW had identified and assessed risks at the level of each individual contract and thereof had informed NF. Also, DPW informed HOS at the beginning of December on risks concerning project “Rehabilitation of unsanitary dumpsite Čafe” in the Municipality of Bar. Relating to that, DPW in coordination with HOS and NAO, took certain corrective measures for mitigating those risks in terms of signing annexes i.e. addendum of the contracts with contractors (with the approval of DEU) for the projects which were not implemented in the contracted deadline.

According to auditee's response, awareness of the risks is raised to a higher level. In order to discuss risks identified in the system they believe that mechanisms of coordination and communication should be improved. This issue is considered and it is decided to introduce at least quarterly meeting at the top management level which shall be formalised through amending the Decision on appointment of persons responsible for decentralised and/or indirect management of EU funds as well as proposal for the ad hoc meetings upon need.

Apart from the above mentioned, we determined that RAFs were still filled cumulatively as well as that in MTMA new Risk Manager had been appointed in December 2017. Having in mind all of the above, the finding remains open.

- **Internal audit**

During audit we identified that there is obvious lack of capacities within IADs in all IPA bodies and this fact may have an impact on the quantity and/or quality of audits that are envisaged in annual audit plans. There is a risk that some of the systems, processes or procedures with high impact on overall system will not be subject of the audit and that managers would not have additional assurance about functioning of their systems nor independent review on effectiveness and efficiency of the system.

In order to ensure timely and effective execution of internal audit function described in their procedures and plans, our recommendation was related to increasing capacities of internal audit with a view to increasing coverage of audit areas which has a high impact on implementation of IPA funds which will provide management with additional assurance of functioning of the IPA MCS.

Results of follow-up

During follow up we identify that capacities of internal audit didn't increased. This finding remains open.

- **Contract implementation and on the spot**

According to our audit engagement in process of contract implementation and on the spot control audited in IB and BRPMs we identified that IB issued provisional acceptance of goods for supply contract “Supply of office furniture and equipment” without performing on the spot control which is defined within procedures in the MOP chapter contract implementation and on the spot control. Furthermore BROP/BRPM countersigned provisional acceptance of goods for even there wasn't any supporting document. In addition on the spot check for this contract is not envisaged in the annual on the spot check plan.

Our recommendation was that IB should follow procedures for on the spot control for every contract and not issue provisional acceptance of goods without of clear evidence of output delivered. BROP/BRPM should check all supporting documents before countersigning a provisional acceptance of goods in line with the procedures prescribed, as well as that Annual on

the spot check plan should be updated 15 days after each quarter in order to reflect every change in implementation of projects.

Results of follow-up

In period from our audit engagement interim payments for supply contracts were executed. On the spot control was performed by IB and provisional acceptance of goods is issued with adequate evidence. BROF/BRPM perform check of supporting documents before countersigning a provisional acceptance of goods. It is evident that implementation of recommendation is in progress. However, having in mind that process of implementation of supply contracts is still ongoing this finding remains open.

- **Accounting**

This process was audited in DPW-IB and in NF. Two intermediate findings relating to this audit area are identified in DPW and concern the Recording of transactions in IS (IPA SAP) and Accounting record of expenditure which cannot be financed from EU funds.

During the audit we noticed that recording of transactions in IS (IPA SAP) – part of accounting is not timely. There are no accounting entries for certain contracts either because all signed contracts are not registered in IS - IPA SAP (4 out of 24 signed contracts) by contract managers in charge or because recording of transactions is not timely performed by accountant. Namely, accounting system is the part of IS (IPA SAP which includes contracting, financial management and accounting) which means that the main precondition for accounting entries is that all signed contracts are recorded in that system. Regarding that, we determined that, as above mentioned, all signed contracts are not recorded. Apart from that, we noticed that all contract managers are not authorized to access to the IS which may lead that in case of not timely registration of contracts, possible errors and irregularities, responsibility of contract managers cannot be recognized. By the insight into IS we determined that Financial Agreement is not entered in the amount, for which it is signed.

Also, we determined that expenditures which cannot be financed from EU Funds, (but they are in accordance with the signed contract) are paid from national funds. However, as established accounting system does not foresee separate recording of this category of expenditure, these expenditures in accounting are recorded in a same way as eligible expenditure from the part of national co-financing. Recording of this kind of expenditure in this way ultimately brings to unrealistic presentation of the amount of national co-financing for eligible expenditure in the accounting system, as well as inaccurate presentation of the amount by which financial agreement is decreased in off balance records.

It was recommended to DPW to ensure that operations/transactions are recorded timely and properly in order to provide complete, accurate and transparent accounting following internationally accepted accounting principles as well as to provide authorized access for contract managers in charge. Regarding expenditures which cannot be financed from EU Funds, (but they are in accordance with the signed contract) we recommended that accounting software should be able to provide separate recording of this category of expenditure.

Results of follow-up

During this follow-up we noticed that from our audit engagement until December 2017 operations/transactions have been recorded timely. The part of findings which is related to providing authorized access for contract managers in charge is not implemented.

With regard to the separate recording of expenditure which cannot be financed from EU funds

(but they are in accordance with the signed contracts) responsible body has not taken the steps necessary to implement our recommendation.

Therefore, having in mind that operations/transactions have not been finished yet, those findings remained open and will be followed with special attention by AA during the audits of operations planned in 2018.

- **Management verification**

Responsibilities of the HOS for carrying out management verifications are defined in the National IPA Decree, in the Implementing Agreement between NAO and HOS and in the Operational Agreement between HOS and OS bodies. Moreover, procedures for carrying out management verification responsibility by the HOS are set up in the MoP.

According to the MoP I, Chapter Management Verification, the Annual on-the-spot checks plan is the base for timely implementation of on-the-spot checks in order to ensure proper supervision of the management and internal control systems throughout the financial year and to obtain adequate assurance for the declarations by HOS. The Annual on-the-spot checks plan shall be prepared at the latest by the end of December, for the following year. The Annual on-the-spot checks plan shall be subject to review and update on a semi-annual basis (if applicable). Further, MoP prescribed that On-the-spot checks by the BROP/HOS Office shall be included in the Annual on-the-spot checks plan based on risk assessment analysis.

During the audit we determined that BROP did not carry out 3 on the spot check verifications which by Annual OTSC plan for 2016 were predicted to be performed within III quarter 2016. Also, until now the BROP has not carried out on the spot check verifications planned in Annual OTSC plan for 2017. Furthermore, we noticed that Annual OTSC Plan for 2017 has not been based on risk analysis and sample selection and until now has not been updated.

Since it was evident that need for updating of Annual OTSC Plan for 2017 appeared, we recommended updating of the above mentioned plan as soon as possible, which will be based on risk analysis. We also recommended conducting on-the-spot checks in accordance with the Plan.

Results of follow up

Having an insight into documentations, during follow-up we noticed that BROP updated Annual OTSC Plan for 2017. Also, work plans for conducting planned on-the-spot checks are prepared. Since those planned OTSC are not finished until time of preparation of this report and bearing in mind importance of this process during closure of programme, finding remained open.

- **Conclusion of follow-up activities**

During follow-up carried out in December 2017 we determined that some progresses in implementation of recommendations had been made. We would like to stress that based on the follow up we determined that IPA bodies, dealing with OPRD 2012-2013 had actively participated in implementation of recommendation and had taken corrective actions related to finding Lack of staff. Therefore, this finding is partially closed. As far as financial management is concerned, finding relating to Interim Payment is closed. Identified shortcomings related to payments to the contractors were solved, and we downgraded level of priority to intermediate. Bearing in mind that payment process to the contractors is still ongoing, this finding remains open.

Although we noticed that progress has made, findings related to the risk management,

contract implementation and OTSC, capacity of internal audit, accounting as well as management verification remained open. Recommendations provided will be further followed up in the upcoming period.

5.4. Financial impact on findings

On the basis of the information collected and findings identified in the course of carrying out the system audit, there is no financial impact of findings.

System audit report was submitted to DG REGIO on 1st September 2017.

6. AUDITS OF SAMPLE OF OPERATIONS

Not applicable – see point 1.4.

7. COORDINATION BETWEEN AUDIT BODIES AND SUPERVISORY WORK OF THE AUDIT AUTHORITY

The AA does not rely on the work of other audit bodies in performing its functions and responsibilities.

8. FOLLOW - UP OF PREVIOUS YEARS' AUDIT ACTIVITY

Follow-up approach of the AA was in details described in Section 5.2.

Results of the follow-up for the audits carried out in previous periods are described in this Section of the Report.

Follow up covered the results of the audits from previous years (2015 and 2016) in all bodies of OS and NF.

Once again we would like to stress that during system audit the follow-up on recommendations from previous audits is performed, which is then a constituent part of System Audit Report. Also, in December 2017 Audit Authority performed further follow-up of those findings and recommendations.

Summarized overview of the status of all findings which have not been closed in December 2016 (Last AAAR) identified in previous audits in all bodies of OS and NF in December 2017 is given in table below:

No	Finding	Level of priority*	Status in December 2017
Findings identified during system audits in 2016 and 2015			
Directorate for Public Works - IB			
Findings identified in 2016			
1	Written procedures related to IT Policy	Intermediate	Open
2	Business continuity plan	Intermediate	Open
3	Written Procedures related to chapter Irregularities	Intermediate	Open
4	Recording of exceptions	Intermediate	Closed
5	Agreements with end recipients	Intermediate	Closed
6	Check lists related to Contract procedures	Intermediate	Closed
7	Segregation of duties (Evaluation Committee)	Intermediate	Closed
8	Project Information System (PIS) as basis for financial quality control and reconciliation procedure	Intermediate	Closed
9	Accounting	Intermediate	Closed
10	Training of accountant	Intermediate	Closed
11	Coordination meetings	Intermediate	Closed
12	Trainings related to irregularities	Minor	Closed
13	Establishing of escalation procedures	Minor	Closed
14	Request for clarification requiring communication with the tenderers during the evaluation process	Minor	Closed
15	Written Procedures related to Contract procedures	Minor	Open
16	Written Procedures related to chapter Contract implementation and OTSC control	Minor	Open
17	Trainings - OTSC	Minor	Closed
18	Written Procedures related to Financial Management	Minor	Open
19	Internal meetings	Minor	Closed
Ministry of Sustainable Development and Tourism – BROP/BRPM			
Findings identified in 2016			
1	Process of approval of changes in the management and control system concerning the Operating Structure	Major/Intermediate	Closed
2	Financial Management	Major	Open
3	IT Policy	Intermediate	Partially closed
4	Business continuity plan	Intermediate	Open
5	Written Procedures related to chapter Irregularities	Intermediate	Open
6	Recording of exceptions	Intermediate	Closed
7	Recording and correction of internal control weaknesses	Intermediate	Closed
8	Preparation of Operational Identification Sheet	Minor	Closed
9	Written procedures related to Contract implementation and OTSC control	Minor	Open
10	Follow-up on the spot verification	Minor	Closed
11	Lack of Evaluation plan	Minor	No longer applicable
Findings identified in 2015			
1	Inadequate audit trail relating to performed on-the-spot checks and management verification in tendering	Intermediate	Closed
Ministry of Transport and Maritime Affairs-BRPM			
Findings identified in 2016			
1	IT Policy	Intermediate	Open
2	Business continuity plan	Intermediate	Open
3	Written Procedures related to chapter Irregularities	Intermediate	Open
4	Recording of exceptions	Intermediate/Minor	Open
5	The budget planning process	Intermediate	Closed
6	Written Procedures related to chapter Contract implementation and	Minor	Open

	OTSC control		
7	Written Procedures related to Financial Management	Minor	Open
Findings identified during 2015			
1	Handover procedures	Intermediate	Closed
2	Inadequate premises and equipment	Intermediate	Partially closed
3	Risk management / Delay in implementation - project from OPRD 2012-2013	Intermediate	Closed
4	Capacity in Internal audit unit	Intermediate	Closed
NATIONAL FUND (NF)			
Findings identified during 2016			
1	Changes in the Management and Control system	Major /Intermediate	Closed
2	Written Procedures related to the Irregularities	Intermediate	Open
3	Business continuity plan	Intermediate	Open
4	Internal Control Weaknesses	Minor	Open
5	Lack of holding internal meetings at the level of NF	Minor	Closed
Findings identified during 2015			
1	Preparation of Statement of Assurance	Minor	Closed
2	Incompatibility of decisions on employment with the Rulebook on internal organization and systematization	Minor	Closed
Finding identified during audit of operations in 2016			
DIRECTORATE FOR PUBLIC WORKS			
1	Signing of particular conditions of contract	Intermediate	Closed

*Initial and level of priority after follow-up

Based on the results of follow-up activities performed related to the findings from previous year which have not been closed in December 2016 (Last AAAR) we concluded that 28 recommendations out of 50 were implemented; 1 is no longer applicable; 2 are partially implemented and 19 not implemented. Also, we would like to stress that only one finding from 2015 is still open as well as that 12 out of 21 (57%) open/partially closed findings relate to the written procedures. Bearing in mind that implementation of programme is not finished and the procedures will be used also during the next year (closure of programme) these findings remained open.

9. RESOURCES USED BY THE AUDIT AUTHORITY

The AA carried out all activities in 2017 with its own resources.

Audit Authority currently employs 19 employees (including Auditor General and Deputy).

New Rulebook adopted in November 2016 foresees four organisational units as follows:

- 1) Department for audit of the program – building institutions and strengthening capacities; social and economic and regional development; employment, social policies, education, promotion of gender equality and development of human capacities;
- 2) Department for audit of the program of the regional and territorial cooperation;
- 3) Department for audit of the program of agriculture and rural development;
- 4) Administrative and Professional Service of Audit Authority

System Audit and follow-up activities in the framework of OPRD 2012-2013 of IPA Component III were performed by 6 auditors from the Department for audit of the program – building institutions and strengthening capacities; social and economic and regional

development; employment, social policies, education, promotion of gender equality and development of human capacities and by 2 auditors from other Departments.

ANNEX A: ANNUAL WORK PLAN FROM 01 OCTOBER 2016 UNTIL 30 SEPTEMBER 2017

AAWP for the period from 01 October 2016 until 30 September 2017 was prepared and submitted to the EC with copy to NAO in September 2016. In this respect, overview table of planned audit activities containing activities planned in period 01 October 2016 – 30 September 2017 are enclosed in the attachment.

PLANNED AUDIT ENGAGEMENTS						
N O.	NAME OF THE AUDIT (AUDIT OBJECT)/ AUDIT ACTIVITY	OBJECTIVE OF THE AUDIT	AUDITEE	INDICATIVE DEADLINE OF THE AUDIT REPORT AND AUDIT TIMING	AUDIT TYPE	REMARKS
1.	Audit of operations	Verify the legality and regularity of expenditure and the reliability of accounting information provided to the Commission	Bodies within the MCS in OPRD	September-November 2016	Audit of operations	Completion of audit of operations commenced in September 2016 (AAWP 2015-2016)
2.	System audit of Management and Control system of the Operating Structure of IPA Component III and National Fund	Verify whether the established MCS in the OS bodies and NF is in accordance with the requirements set in IPA Implementing Regulation, Framework Agreement and Financing Agreement and whether these established systems function effectively	Directorate of Public Works –IB Ministry of Transport and Maritime Affairs (BRPM) Ministry of Sustainable Development and Tourism (HOS, BROP/ BRPM) National Fund/NAO	January-May 2017	System audit	On the basis of the results of risk assessment the following processes will be audited: human recourses and internal organization, process of planning, assessment and approval of changes in MCS, financial management and risk management as horizontal processes in all bodies of MCS and contract implementation and on-the-spot (IB, BRPMs); accounting (IB, NF) and management verifications (MSDT/BROP) as specific processes in particular bodies.
3.	Audit of operations	Verify the legality and regularity of expenditure and the reliability of accounting information provided to the Commission	Bodies within the MCS in OPRD	May-September 2017	Audit of operations	
OTHER ACTIVITIES						
4.	Follow-up	Follow-up of previous audits AA's for the purposes of issuing the AAAR and AAO	Directorate of Public Works –IB; Ministry of Sustainable Development and Tourism (HOS, BROP/BRPM); Ministry of Transport and Maritime Affairs (BRPM) and National Fund.	November-December 2016	Follow-up	-
5.	Reporting (AAAR and AAO)	Preparing AAAR and AAO for OP within IPA Component III	-	December 2016	-	-
6	Planning (AAWP)	Preparing AAWP for OP within IPA Component III for the following reference year (1.10. 2017 – 30.09.2018)	-	September 2017	-	-

MCS – Management and Control Systems

OP – Operational Programme

HOS – Head of Operating Structure

BROP - Body responsible for the Operational Programme

BRPM - Body responsible for Priority/Measure

IB - Implementing Body

ANNEX B: LIST OF FINDINGS FROM SYSTEM AUDIT

In accordance with Chapter 2 - Summary of Findings, a List of findings is provided regarding single report on the system audit

No	Finding	Body/ies concerned by the finding	Priority level	Reference to Section of Report
1	Lack of staff and retention policy	NF/MSDT/MTMA/DPW	Intermediate	4.1.1
2	Payment to the contractors	DPW/NF	Major	4.2.1
3	Interim Payment Application	NF	Intermediate	4.2.2
4	Information system for financial management	DPW	Intermediate	4.2.3
5	Financial management-Read and approved visa	DPW/MSDT	Minor	4.2.4
6	Risk management	NF/MSDT/MTMA/DPW	Intermediate	4.3.1
7	Internal audit capacities	NF/MSDT/MTMA/DPW	Intermediate	4.4.1
8	On the spot control	DPW/MSDT/MTMA	Intermediate	4.5.1
9	Recording of transactions in IS (IPA SAP)	DPW	Intermediate	4.6.1
10	Accounting record of expenditure which cannot be financed from EU funds	DPW	Intermediate	4.6.2
11	Preparation and Realization of Annual OTSC Plan (BROP)	MSDT	Intermediate	4.7.1

ANNEX C: SUMMARY LIST FOR SYSTEM AUDITS CARRIED OUT FROM 01 OCTOBER 2016 UNTIL 30 SEPTEMBER 2017

Date of performance of the systems audit*	Programme / system audited	Auditing entity	Expenditure declared in reference year**	Total cumulative expenditure declared	Basis of selection of the programme²
January – August 2017	OPRD 2012ME16IPO001/ MSDT-BROP/BRPM; MTMA-BRPM; DP W– IB/M; National Fund- NF	Audit Authority	N/A	1.585.227, 45 €	Risk assessment

* Date of performance of the systems audit – the above mentioned period covers the period from the beginning of the audit until the submission of the final report on the audit carried out to the auditee(s)

** In the reference year there was no declared expenditure

² Within IPA Component III there is one programme Operational Programme Regional Development 2012-2013 Risk assessment was performed in purpose of determining audit areas at the level of each body of OPRD at the key requirement/process/function level.

ANNEX D: SUMMARY LIST FOR DECLARED EXPENDITURE AND SAMPLE AUDITS CARRIED OUT FROM 01 OCTOBER 2016 UNTIL 30 SEPTEMBER 2017

Fund	Reference (CCI no)	OP	Expenditure declared in ref. year	Expenditure in ref year audited for the random sample		Amount and percentage (error rate) of irregular expenditure in random sample (3)		Other expenditur e audited (4)	Amount of irregular expenditure in other expenditure sample	Total expenditure declared cumulatively*	Total expenditure <i>audited</i> cumulatively as a percentage of total expenditure <i>declared</i> cumulatively	Materiality level (%)	Confidence level (%)
				1.	2.	Amount	%						
IPA	CCI2012ME16IPO001	RD	/	/	/	/	/	/	/	1.585.227, 45 €	100%	/	/

* In the framework of the OPRD 2012-2013, there was one Certificate and statement of Expenditure and application for Interim Payment submitted to the EC in December 2015. In 2016 AA performed audit on 100% of those expenditure (results of this audit is included in AAAR for the period 01 October 2015 until 30 September 2016)