

2014

Ministry of Finance

Public Internal Financial
Control Department

**ANNUAL REPORT
FOR THE FUNCTIONING OF THE PUBLIC INTERNAL FINANCIAL CONTROL FOR
2014**

Skopje, July 2015

SUMMARY

The Annual Report on the Functioning of the Public Internal Financial Control for 2014 is a report on the functioning of the financial management and control and internal audit in the public sector in the Republic of Macedonia for 2014. It was prepared in accordance with Article 48, line 11 of the Public Internal Financial Control Law ("Official Gazette of the Republic of Macedonia " No. 90/2009, 12/2011 and 188/2013) and the Rulebook for the form and content of reports and statement of the quality and condition of the internal controls of the annual financial report ("Official Gazette of the Republic of Macedonia" No. 147/2010, 34/2011 and 113/2014).

Obligation for submission of Annual Financial Report for 2014 are fulfilled by 77% public sector entities on central level and 69% of public sector entities on local level, that compared with 2013 represents a decrease of 10 percentage points on central and 3 percentage points on local level.

From data submitted annual reports for the financial management and control and records in the Central Harmonization Unit (CHU), in 2014 was found next progress: 6 units of local self government established new units for financial affairs, in 3 entities at central level and 3 units of local self government are appointed managers of the financial affairs units, 3 entities at central level and in one unit and the local self government are appointed persons responsible for irregularities and in 6 entities on central level are appointed responsible accountants.

Obligation for submission of Annual Report on performed audits and internal audit activities in the 2014 fulfilled 44,5% of public sector entities on central level and 47% of public sector entities on local level.

From data submitted annual reports for internal audit and records in the Central Harmonization Unit (CHU), in 2014 was found next progress: increased number of established internal audit units by 3% on central level and 9% on local level, increased the number of auditors for 4% on central level and 4,7% on local level, increased the number of performed audits on central level for 22%, and increased the number of given recommendations for 9,2% on central level and lower the number of audit days spent on audit by 9% on local level.

During the first cycle of the project "Training of internal auditors in the public sector" are included 65 auditors of which 45 successfully completed the training and passed the exam which gained CIPFA certificate for internationally certified internal auditors. During the second round are included 35 auditors.

1. INTRODUCTION

The Annual Report on the Functioning of the Public Internal Financial Control for 2014 is prepared on the basis of the submitted annual financial reports by the entities in accordance with Article 48, paragraph 11 of the Public Internal Financial Control Law ("Official Gazette of Republic of Macedonia" no. 90/2009 and 188/2013).

This report, Ministry of Finance not later than the end of July current year for the previous year is submitted to the Government of the Republic of Macedonia, after its consideration and adoption, its general part, without conclusions and annexes are published on the website of the Ministry of Finance and submitted to DG Budget of European Commission.

Republic of Macedonia implemented reforms in public finances management, in which important part are establishment and development of the public internal financial control system. The aim of this reform is the development of a comprehensive system of internal financial controls in the public sector, which will enable the introduction of sound financial management of public funds. It is a part of the preparation process for the successful implementation of EU accession of Chapter 3.32 Financial control.

The establishment of the Public Internal Financial Control System is the task of the heads of public sector entities. Ministry of Finance or CHU as a central harmonization unit is responsible for coordinating the development, establishment, implementation and maintenance of public internal financial control system.

The implementation of this reform is not just for met the requirements for membership in the European Union, but also promoting the management and control systems with public funds, by that will ensure better use of IPA funds and as a future member state would willingly to deal with the challenges of membership.

Purpose of the Annual Report is informing the Government of the Republic of Macedonia for the activities that are carried out in 2014 in the area of development on internal financial controls, as well as the current situation and future directions in the development of this system.

2. SUBMITTED ANNUAL FINANCIAL REPORTS FOR 2014

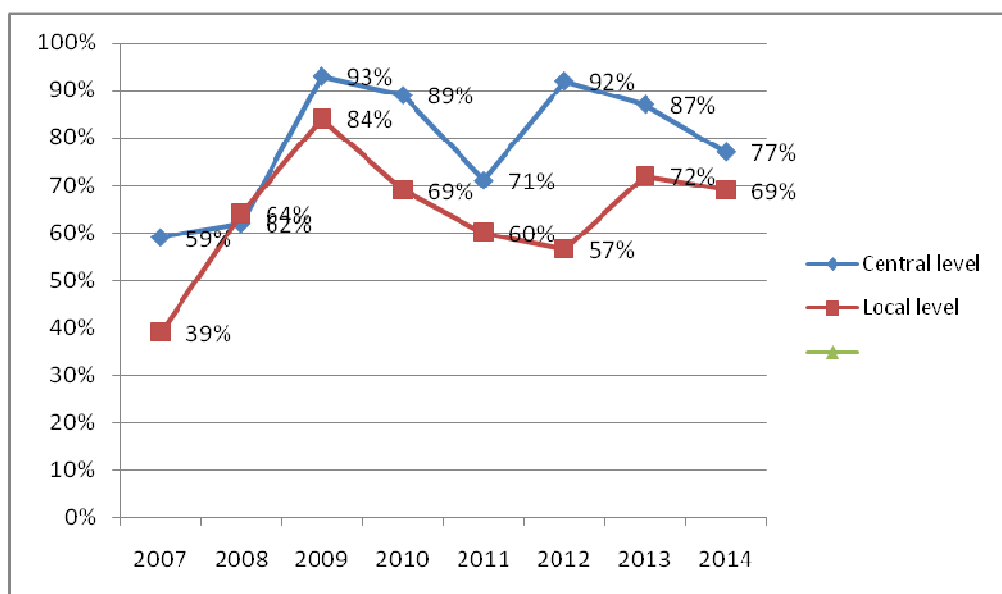
According to Article 47 of Public Internal Financial Control Law ("Official Gazette of the Republic of Macedonia " no. 90/2009 and 188/2013) and the Rulebook on the form and content of reports and the statement about the quality and condition of the internal controls of the annual financial report ("Official Gazette of the Republic of Macedonia " no. 147/10, 34/11 and 113/14) the head of first line budget user of the legislative, executive and judicial powers (except the State Audit Office) funds, municipalities and the City of Skopje is obliged to submit to CHU an annual financial report no later than May 10 of the current year for the previous year. Annual Financial Report contains:

- Report for planned and spent funds by items (comparative overview tables)

- Report for realized programs, projects and contracts
- Annual accounts and consolidated annual account
- Report for performed self-assessments (results of self-assessments that are not entirely positive, comments of the head of the entity referring to the recommendations of the self-assessments and opinion for the financial management and control)
- Statement for the quality and condition of the internal controls,
- Report for the activities of the establishment and development of financial management and control and
- Report for performed audits and internal audit activities.

The total number of budget users that are obliged to submit an annual financial report is 171 of which 90 are on central and 81 on local level (80 municipalities and the City of Skopje). From total 171 entities on central and local level, the annual financial report submitted 73% or 125 entities (of which 69 on central (77%) and 56 on local level (69%).

By years from 2007 to 2014 the percentage of submitted annual financial reports on central and local level is as follows:



From total 90 entities on central level, or 23,3% or 21 entities didn't submit a statement and annual financial report. From total 81 local self government units 31% or 25 municipalities didn't submit an annual report (Annex I/1 Review of entities on central and local level which haven't submitted annual financial report).

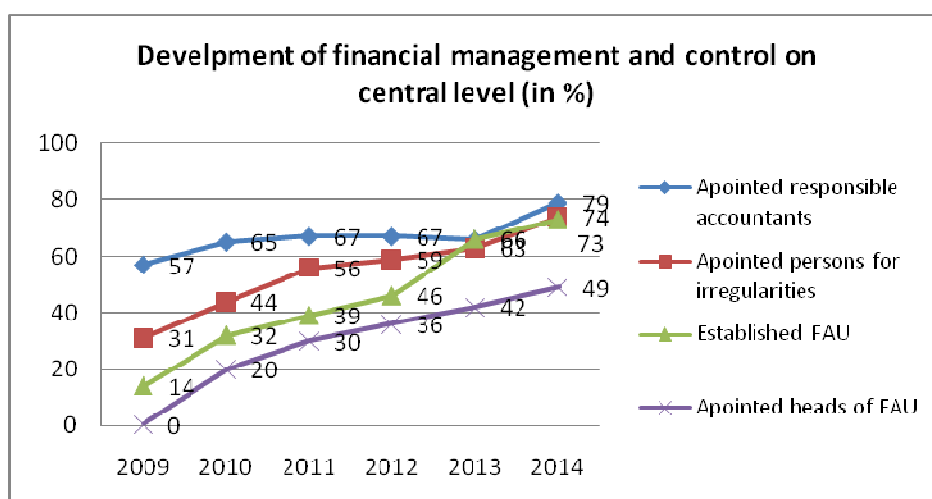
3. REPORT FOR QUALITY AND THE STATE OF FINANCIAL MANAGEMENT AND CONTROL

3.1. The state on financial management and control on central level

The state on the financial management and control at 91 direct budget users - entities from central level to the end of 2014 is as follows:

- 73% from the entities on central level (66) are established Financial Affairs Units (departments /units);
- 49% from the entities on central level (45) are appointed heads of the units for financial management and control;
- 79% from the entities on central level (72) are appointed responsible accountants, in accordance with the Accounting at Budgets and Budget Users Law;
- 74% from the entities on central level (64) are appointed person in charge of irregularities in accordance with Article 50 of the Public Internal Financial Control Law;
- 38,5 % from the entities on central level (35) are adopted risk management policy papers in accordance with the Article 15, paragraph 2 of the Public Internal Financial Control Law (as of 31.07.2015). (Annex I/2 Review on entities of central level that are adopted risk management policy papers).
- 25,3% from the entities on central level (23) are prepared Risk registers (as on 31.07.2015). (Annex I/3 Review of entities on central level that are prepared Risk registers).

By years from 2009 to December 2014 the state of financial management on central level is as follows:

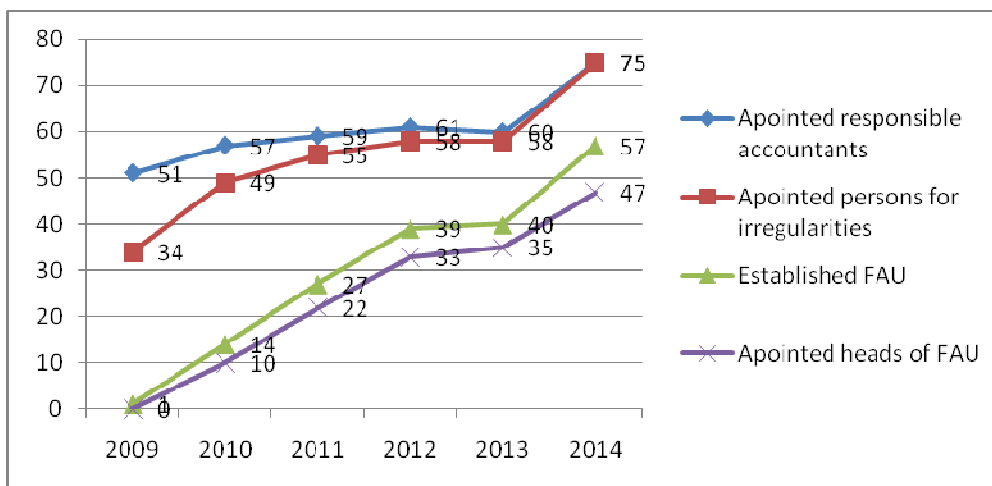


3.2. The state in financial management and control on local level

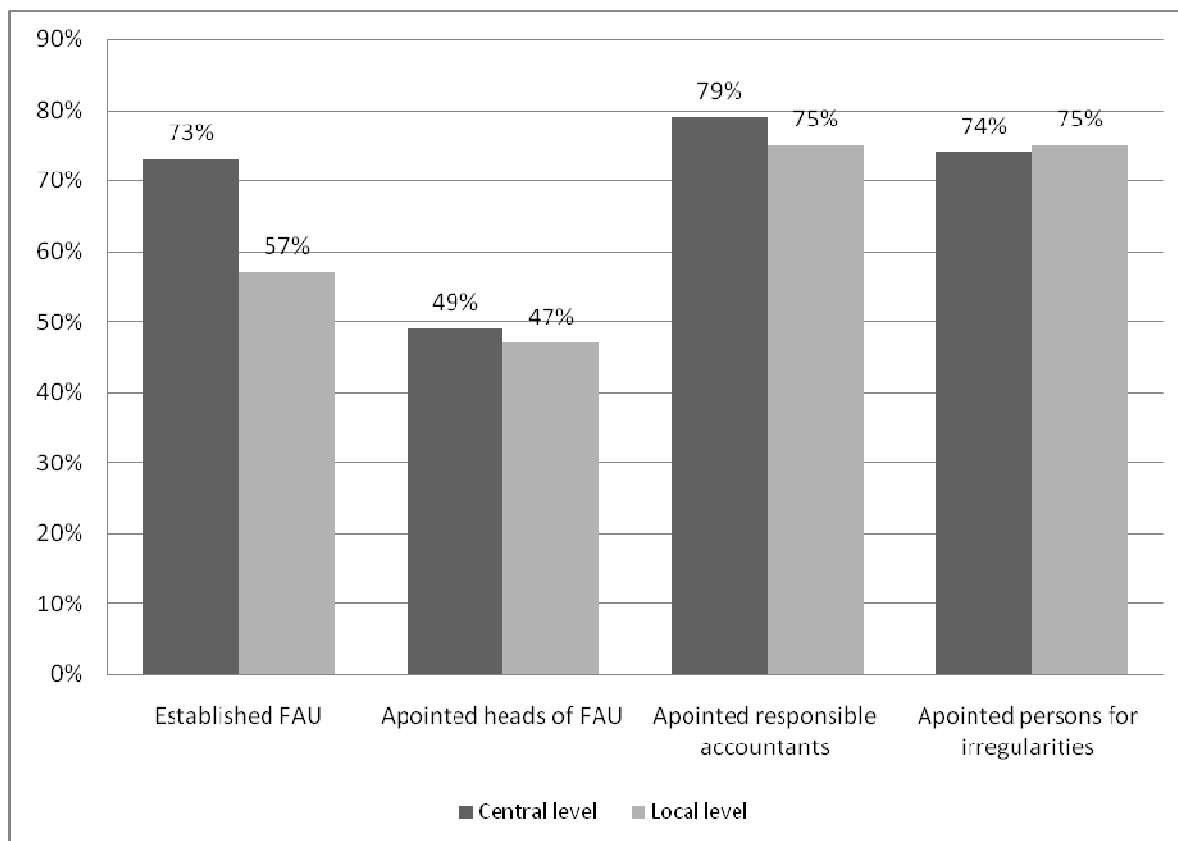
The state in financial management and control in 81 units of local self government at the end of 2014 is as follows:

- 57% of local self government units (46) are established Financial Affairs Units (departments/units);
- 47% of local self government units (38) are appointed head of units for financial management and control;
- 75% of local self government units (61) are appointed responsible accountants, in accordance with the Accounting at Budgets and Budget Users Law;
- 75% of local self government units (60) are appointed person in charge of irregularities in accordance with Article 50 of the Public Internal Financial Control Law;
- 24,7% of the entities on local level (20) are adopted risk management policy papers in accordance with the Article 15, paragraph 2 of the Public Internal Financial Control Law (as of 31.07.2015). (Annex I/4 Review on entities of local level that are adopted risk management policy papers).
- 16% of the entities on local level (13) are prepared Risk registers (as on 31.07.2015). (Annex I/5 Review of entities on local level that are prepared Risk registers).

By years from 2009 to December 2014 the state of financial management on local level is as follows:



The state in financial management and control compared to central and local level as of December 2014 is shown in the following graph:

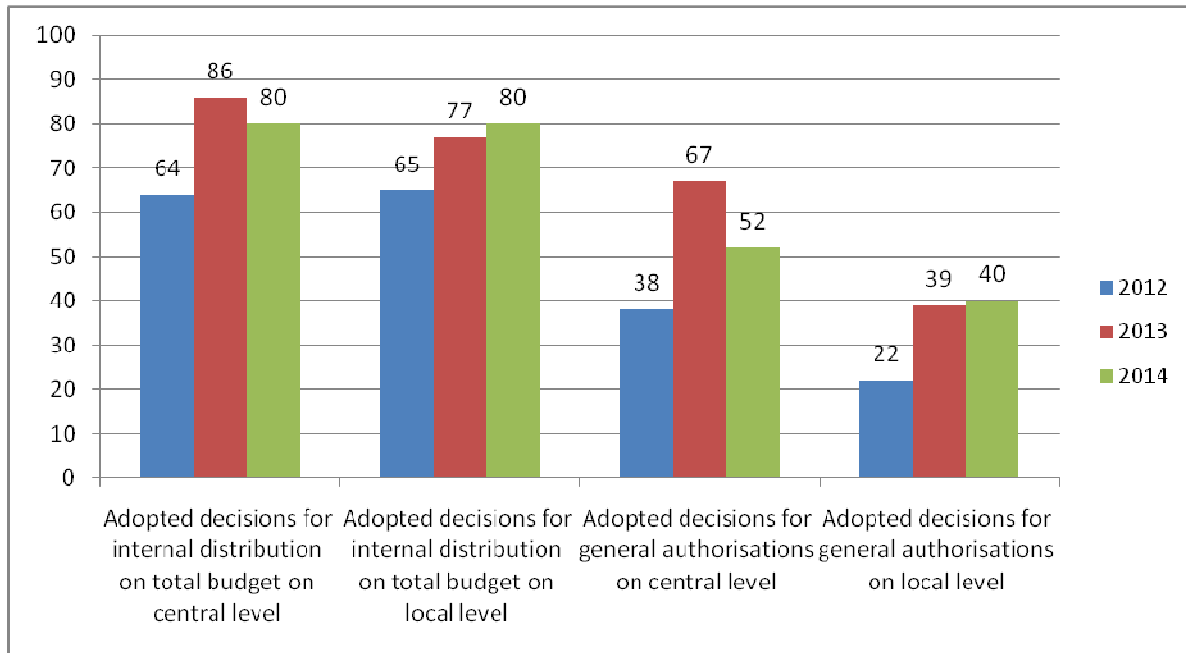


3.3 Establishment of decentralized system of financial management and control

The state in the establishment of a decentralized system of financial management and control as of December 2014 is as follows:

- 80% of the entities on central level (73) and 80% of municipalities and the City of Skopje (65) are adopted decisions for internal distribution of the total approved budget.
- 52% of the entities on central level (47) and 39% of municipalities and the City of Skopje (32) are adopted decisions for general authorizations.

The state in the degree of decentralization of the financial management and control system on central and local level through the decisions made for internal distribution of the total approved budget and adopted decisions for general authorizations, as of December 2014 the percentage of implementation is shown in the following graph:



3.4 Results from the performed self-assessment of the financial management and control components

Within the annual report on the activities for establishment and development on financial management and control for 2014, 69 entities from central level and 56 local self government units made self-assessment on financial management and control system.

Summary results of performed self-assessment on implemented financial management and control components are presented in the following table:

Components of Financial Management and Control	Central level%	Local level %
I. Control environment	59.5	59.1
a) Ethics and integrity	39.9	35.7
b) Governance and management style	72.2	78.6
c) Planning approach to work	70.4	62.7
d) Organizational structure, mandates and responsibilities, reporting system	58.7	54.0
e) Development of human resources	56.5	64.7
II. Risk Management	50.7	47.2
III. Controls	73.2	87.3
IV. Information and communication	65.3	76.5
V. Monitoring (monitoring and evaluation of the system)	47.0	57.9
Total average	59.1	65.6

The weakest results that have been observed:

- the component "control environment" - the area of "Ethics and Integrity", because 94.2% of the entities on central level and 96,4% on local level haven't appointed a person (a trustee) for ethics, and 76,8% of entities on central and local level haven't clear rules (internal regulations) that define the conditions for a potential conflict of interests and the handling;
- the component "control environment" - the area "Governance and management style," because 82,6% of entities on central level at the meetings on the highest level of management not participate heads of bodies within entity;
- the component "control environment" - the area "Planning approach to work (mission, vision, goals)," because 94,2% of central level institutions in the preparation of strategic documents don't include the second line budget users;
- the component "control environment" - the area "Development of human resources (planning the operation and monitoring the success of the achieved results)," because 74% of institutions from central level and 68% of local self government units in annual work plans of organizational units aren't assigned tasks/activities individually per employee;
- in component "Risk management" because:
 - 74% of institutions from central level and 88% of local self government units haven't established system for reporting on the most important risks;
 - 78% of institutions from the central level and 93% of local self government units haven't appointed risk coordinators in the organizational units;
 - 88% of institutions from the central level and 66% of local self government units, budget users within the entity aren't informing for main risks;
- in component "controls" because:
 - 71% of institutions from central level and 68% of local self government units haven't written internal procedures (rulebooks, instructions, guidelines) that as continuation of more detailed regulations are regulate the process of preparation and implementation of strategic plan;
 - 83% of institutions on central level haven't written internal procedures (rulebooks, instructions, guidelines) that as continuation of more detailed regulations are regulate the process of collection of own revenues;
 - 80% of institutions on central level haven't written internal procedures (rulebooks, instructions, guidelines) that as continuation of more detailed regulations are regulate the process of recovery of unjustified spent or wrongly paid appropriations;

- 71% of institutions from central level and 82% of local self government units haven't written internal procedures (rulebooks, instructions, guidelines) that as continuation of more detailed regulations are regulate the procedure for implementing additional (ex-post) controls;
- 93% of institutions from central level and 80% of local self government units haven't written internal procedures (rulebooks, instructions, guidelines) relating to the preparation and implementation of strategic plans, preparation and realization of the financial plan/budget, procurement and contracting, additional control etc. and contains instructions on the manner of cooperation and activities that are expected of second line budget users;
- 97% of institutions from central level and 80% of local self government units haven't findings to what extent second line budget users have established control activities in the processes of preparation and implementation of financial plans/budgets, procurement and contracting, property management etc;
- in component "Information and communication" because:
 - 94% of institutions from central level and 71% of local self government units second line budget users, not prepared other reports except prescribed financial reports that submitted to the first line budget user;
 - 90% of institutions from central level and 50% of local self government units haven't realized network connection with the second line budget users;
- in component "Monitoring (monitoring and evaluation system)" because:
 - 94% of institutions from central level and 61% of local self government units there aren't appropriate reporting systems established by first-line budget users that provide monitoring of the functioning of the system of financial management and control in second line budget users.

3.5 Achieved progress in financial management and control in 2014

From data submitted in annual reports for financial management and control and records in CHU in 2014 is ascertained the following progress:

- 6 local self-government units are established new financial affairs units;
- 3 entities on central level and 3 local self-government units are appointed heads of financial affairs units;
- 3 entities on central level and in one local self-government unit are appointed persons in charge of irregularities in accordance with Article 50 of Public Internal Financial Control Law and
- 6 entities on central level are appointed responsible accountants.

3.6 Identified weaknesses

Weaknesses in the establishment and functioning of financial management and control are:

- 24 of the entities on central level and 31 local self government units haven't established financial affairs units (Annex I/6: Review of entities on central and local level which haven't established a separate financial affairs unit);
- 43 of entities on central level and 40 local self government units haven't appointed heads of financial affairs units; (Annex I/7: Review of entities on central and local level which haven't appointed heads of financial affairs units);
- 24 entities on central level and 20 municipalities are appointed persons in charge of irregularities in accordance with Article 50 of Public Internal Financial Control Law (Annex I/8: Review of entities on central and local level which haven't appointed a person responsible for irregularities);
- 18 entities of central level and 20 municipalities haven't appointed responsible accountants, according to obligation of Accounting for Budgets and Budget Users Law (Annex I/9: Review of entities on central and local level which haven't appointed a responsible accountant);
- 55 of entities on central level and 61 local self government units are not adopted the Risk Management Policy Paper (Annex I/10: Review of entities on central and local level that haven't adopted the Risk Management Policy Paper);
- 67 of the entities on central level and 68 of local self government units haven't prepared risk register (Annex I/11: Review of entities on central and local level which haven't prepared a risk register);

3.7 Individual reports

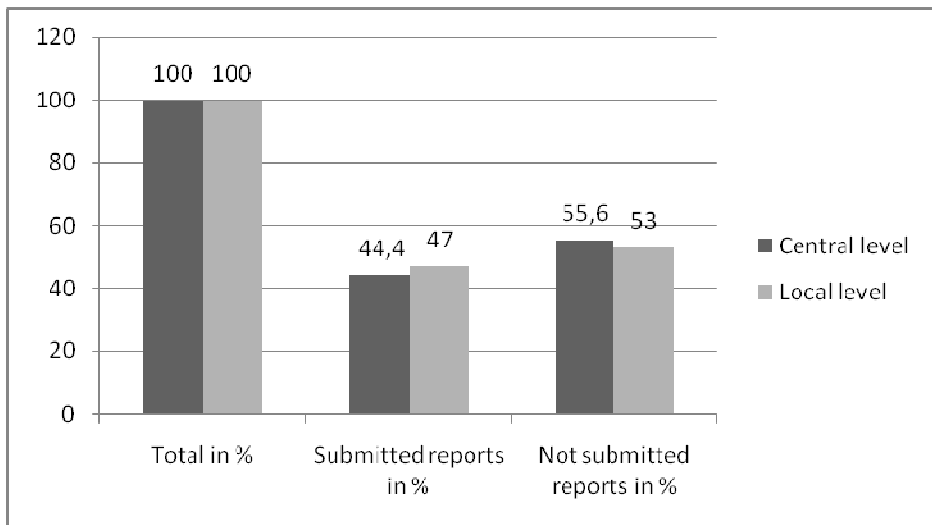
Based on the submitted annual reports for the quality and condition of the financial management and control of 2014, the Ministry of Finance - Public Internal Financial Control Department, prepared individual reports for entities on the central and local level (Annex II/1 Individual reports for quality and condition of the financial management and control of entities on central level and Annex II/2 Individual reports for quality and condition of the financial management and control of entities on local level).

4. Report for performed audits and internal audit activities in 2014

4.1 Submitted reports for performed audits and internal audit activities on central and local level

The total number of budget users that are obliged to submit a report for performed audits and internal audit activities is 171 of which 90 are on central and 81 on local level (80 municipalities and the City of Skopje). From total 171 entities on central and local level,

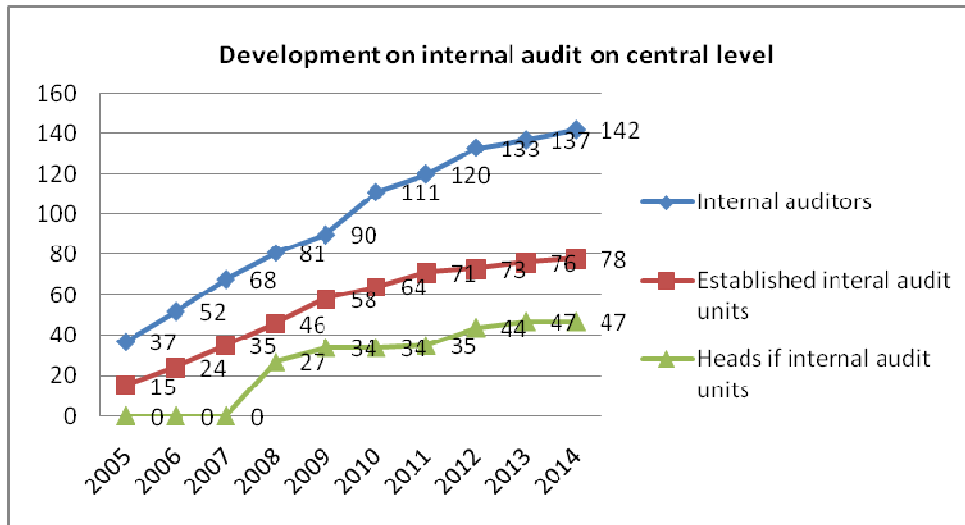
reports submitted 46% or 78 entities (including 40 on central (44,5%) and 38 on local levels (47%).



From total 90 entities on central level, 55,6% or 50 entities haven't submitted a report for performed audits and internal audit activities. From total 81 local self government units 53% or 43 municipalities haven't submitted an annual report (Annex I/12 Review of entities on central and local level which haven't established yet a functioning internal audit and haven't submitted a report for performed audits and internal audit activities.

4.2 Total condition of internal audit at the entities on central level

As of 31.12.2014 in the public sector entities on central level were established 78 internal audit units in which are employed 142 internal auditors, of which 47 are heads (33%), and 13 public sector entities have agreement for performing internal audit with internal audit unit of another entity. The number of established internal audit units, internal auditors and appointed heads by years on central level is shown in the following graph:

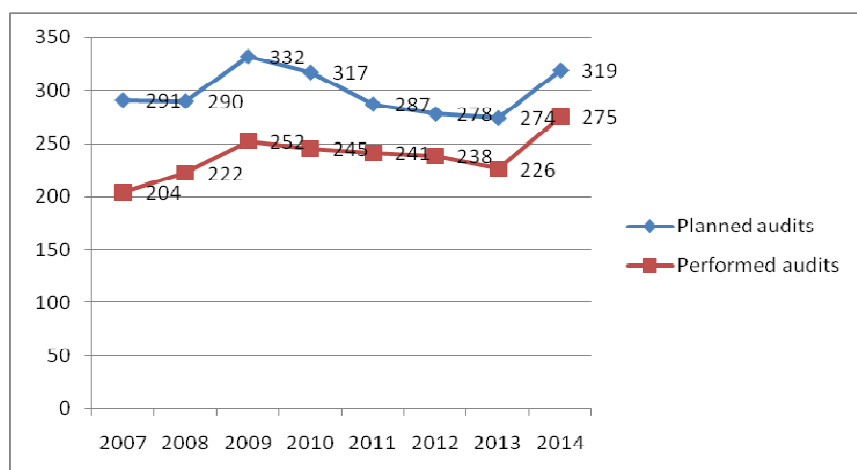


The entities of the central level which submitted a report (54), 47 entities have established internal audit unit in which are systematized 310 jobs, and are completed 118 (38%).

According to the Annual Plans for 2014 is planned execution of 274 audits in the public sector entities on central level. On the request of the heads of entities are planned 45 additional (ad hoc) audits, and the total number of planned audits is 319. In 2014 on central level are performed 275 audits (86,2% of total planned) for which are issued final audit reports in 44 public sector entities that submitted report.

Twenty-five public sector entities that submitted a report are using EU funds or participate in the management and implementation of EU programs and 21 of them performed audits related to EU programs.

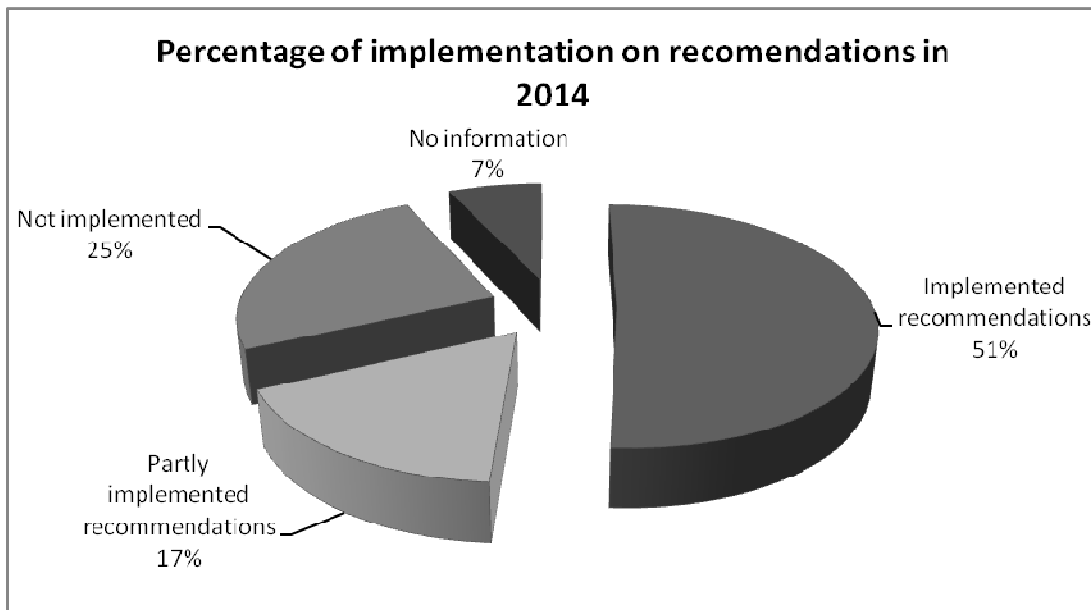
By years planned and performed audits are as follow:



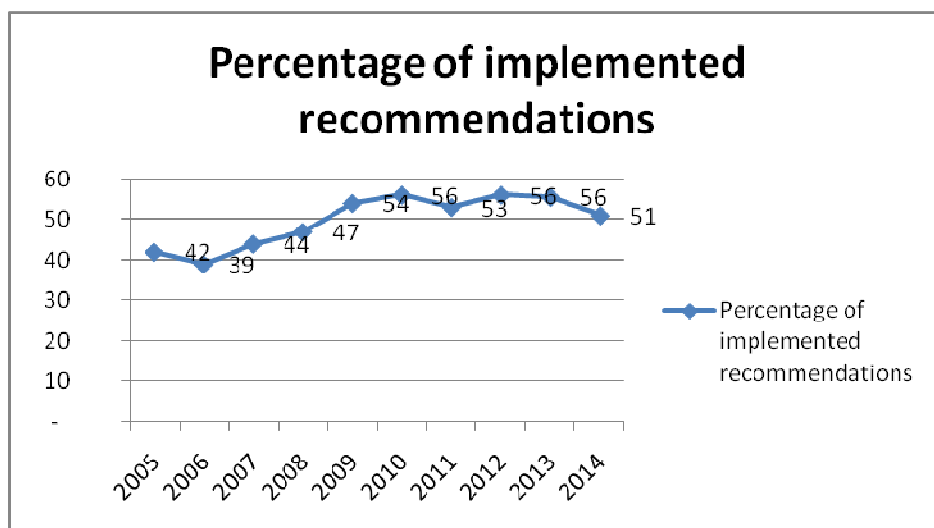
From performed 275 audits 34% are systems audits (94), 35% are compliance audits (95), 1% are performance audits (4), 2% are financial audits (6), 11% are audit for following on recommendation (29), and 17% are combined audits (47).

In 2014 for performed audits have given 1.114 recommendations, of which 51% are implemented (571), 17% are partially implemented (193), 25% are not implemented (276) and 7% of the recommendations there is no information on their implementation (74).

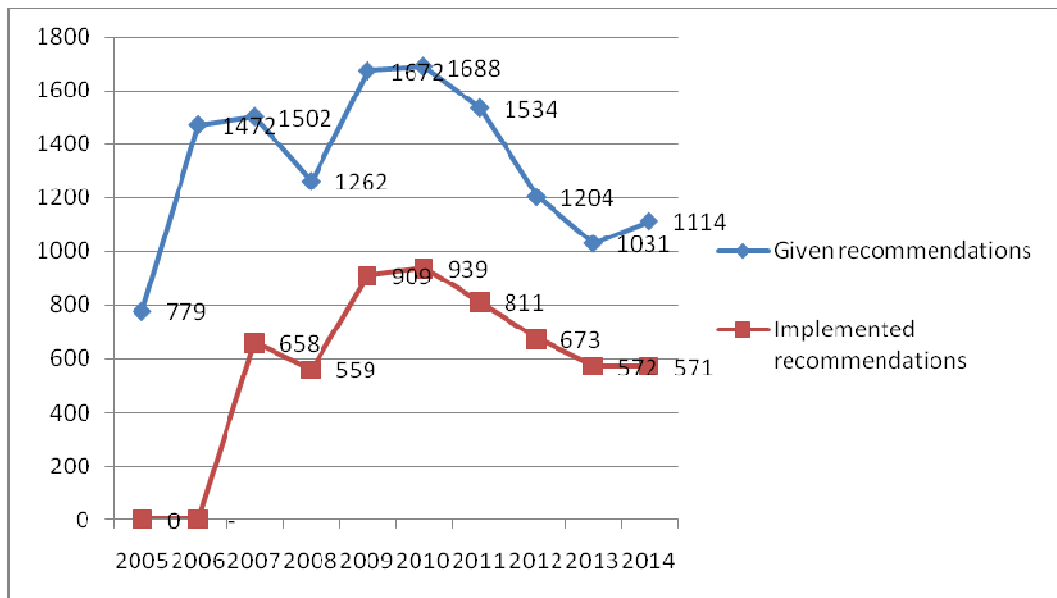
The percentage of implementation of the recommendations in 2014 is shown in the following graph:



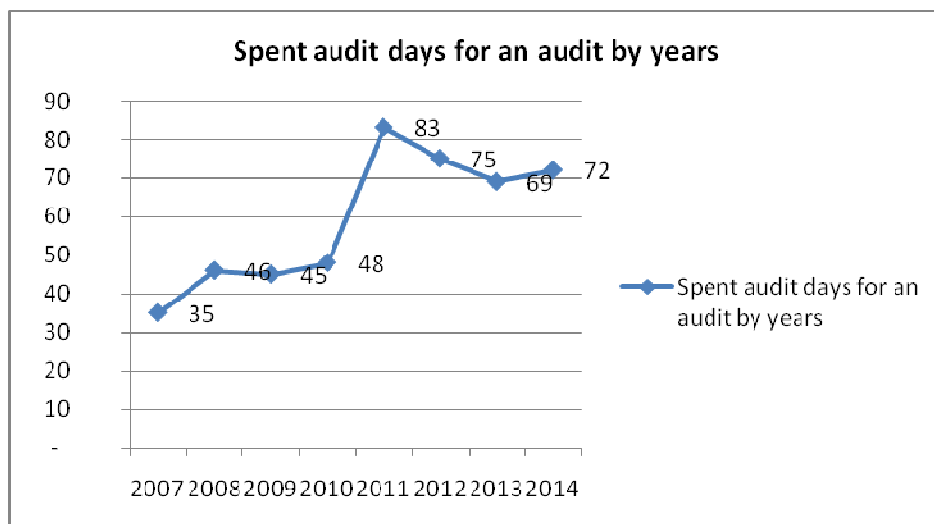
The percentage of implemented recommendations by year is shown in the following graph:



Given and implemented recommendations by year are presented in the following graph:



The internal audit units on central level in 2014 are planned 11.391 audit days to carry out internal audits and spent 19.615 audit days to perform 275 audits, or average 72 audit days for perform an audit.



From the data in the graph we can see that the number of spent audit days for an audit in 2014 is increased compared to the number of spent audit days for an audit in 2013.

4.3 Achieved progress in Internal Audit in 2014

From data of submitted annual reports for internal audit and records of CHU, in 2014 is ascertained the following progress:

- Increasing the established internal audit units by 3% (from 76 to 78);
- Increasing the number of auditors for 4% (from 137 to 142);
- Increased the number of performed audits for 22% (from 226 to 275) and as a result of that, the number of recommendations is increased (from 1.031 to 1.114)
- The number of audits performed is greater than the number of planned audits (planned 274, performed 275);
- Reduced the number of entities that submitted a report and that have an annual plan but didn't perform audits for 12% (from 8 to 7);
- Reduced the number of entities that haven't an annual plan but didn't perform audits for 30% (from 10 to 7);
- Reduced the number of recommendations for which there is no information for 1%.

4.4 Identified weaknesses

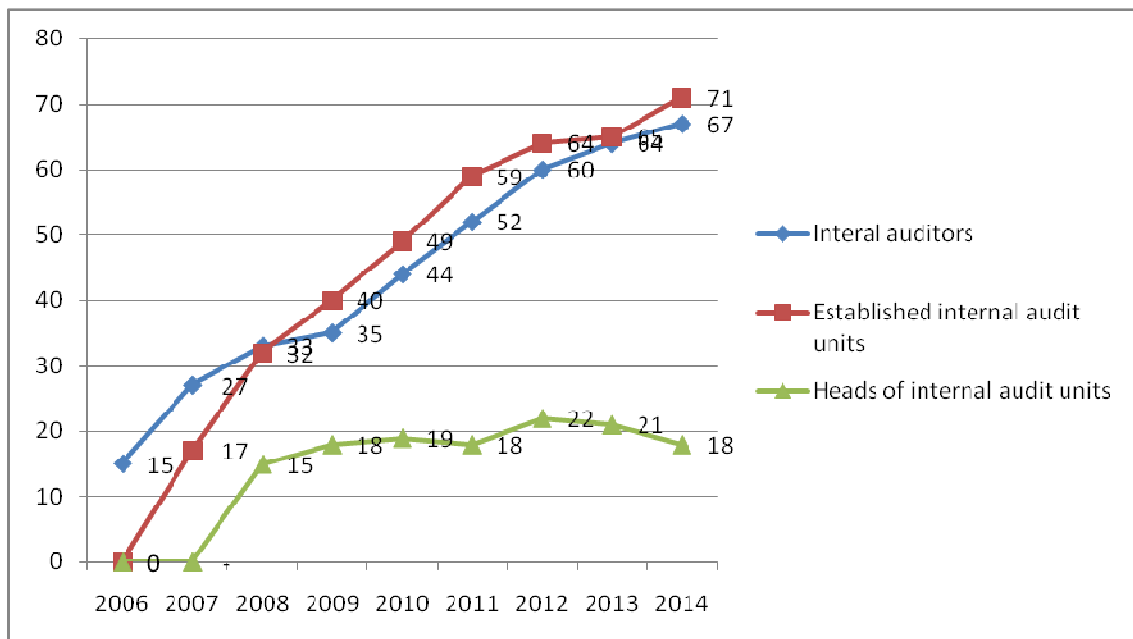
Weaknesses in the establishment and operation of internal audit are:

- Reduced the number of reports submitted by public sector entities on central level by 3% (from 60 to 58);
- Increasing the percentage of unimplemented recommendations for 14,4 percentage points (from 10,6% to 25%);
- Reducing the percentage of partially implemented recommendations by 8,7 percentage points (from 26% to 17,3%)
- Increasing the number of audit days required to carry out an audit for 4% (from 69 audit days to 72);
- Increasing the number of additional (ad hoc) audits (from 30 to 45).

The number of appointed heads of internal audit units is unchanged, i.e. are appointed 47 heads in the entities on central level.

4.5 Total condition of the internal audit in the entities on local level

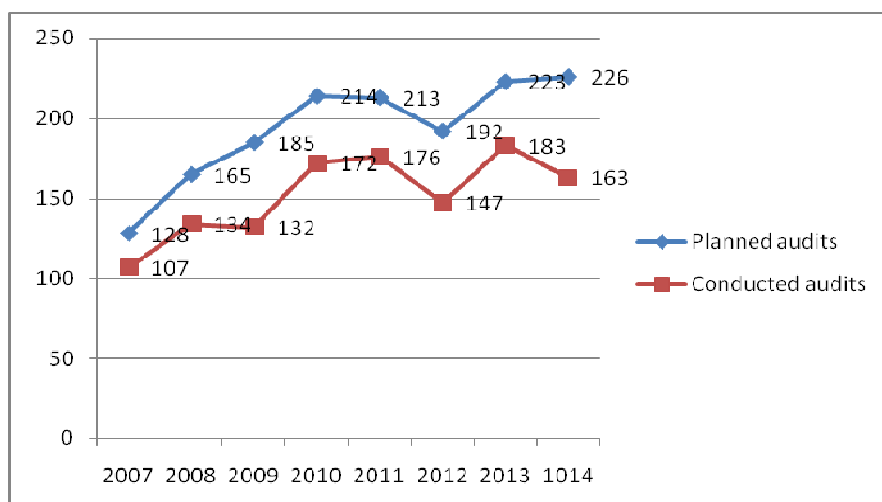
As of 31.12.2014 in the public sector entities on local level are established 71 internal audit units in which are employed 67 internal auditors, of which 18 are heads (27%) and 24 municipalities have contracted with another municipality. The number of established internal audit units, internal auditors and heads appointed by years on local level is shown in the following graph:



From the entities on local level that submitted a report (48), 34 entities have established internal audit unit in which are systematized 171 jobs, and completed are 50 (29%).

According to the Annual Plans for 2014 is planned execution of 211 audits in the public sector entities on local level. At the request of the heads of entities are planned 15 additional (ad hoc) audits, that the total number of audits is 226. In 2014 on local level are performed 163 audits (72% of total planned) for which is issued the final audit reports.

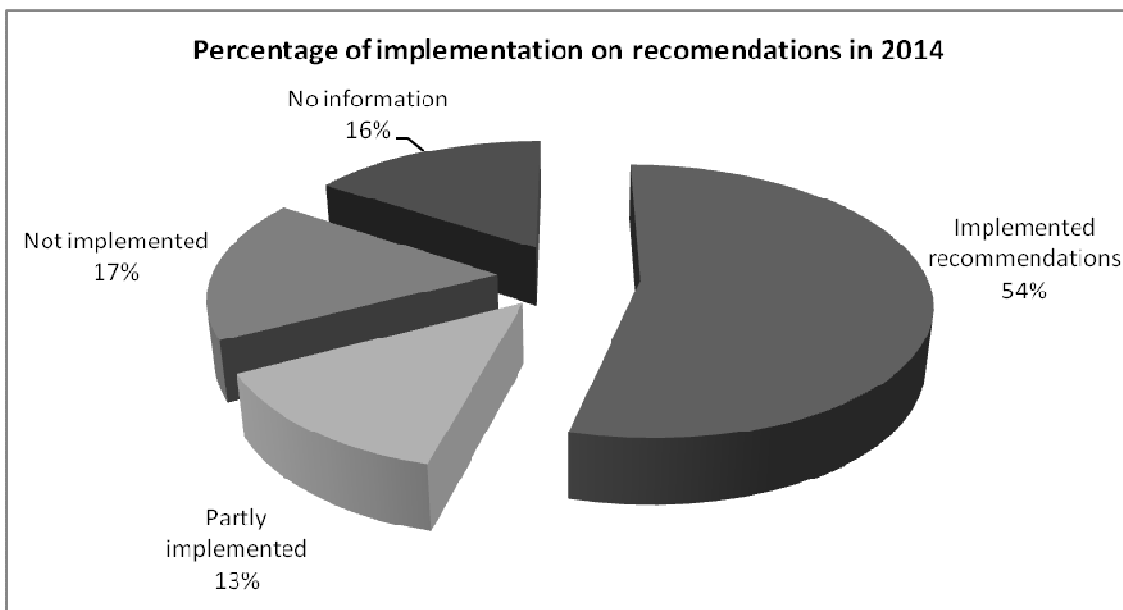
By years planned and performed audits are as follow:



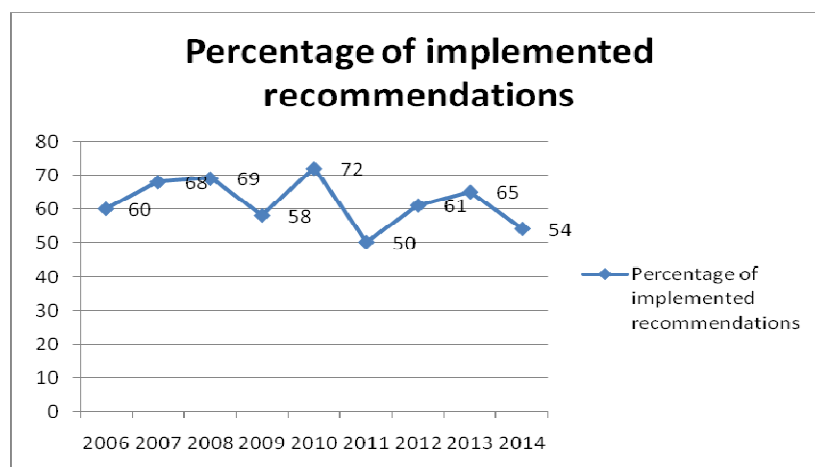
From performed 163 audits 24% are systems audits (39), 41% are compliance audits (67), 1,2% are performance audits (2), 20% are financial audits (33), 4,9% are follow-up audits (8), and 7,9% are combined audits (13).

In 2014 of performed audits were given 981 recommendations, of which 54% was implemented (526), 13,3% are partly implemented (131), 17% were not implemented (165), and for 15,7% of the recommendations there is no information on their implementation (159).

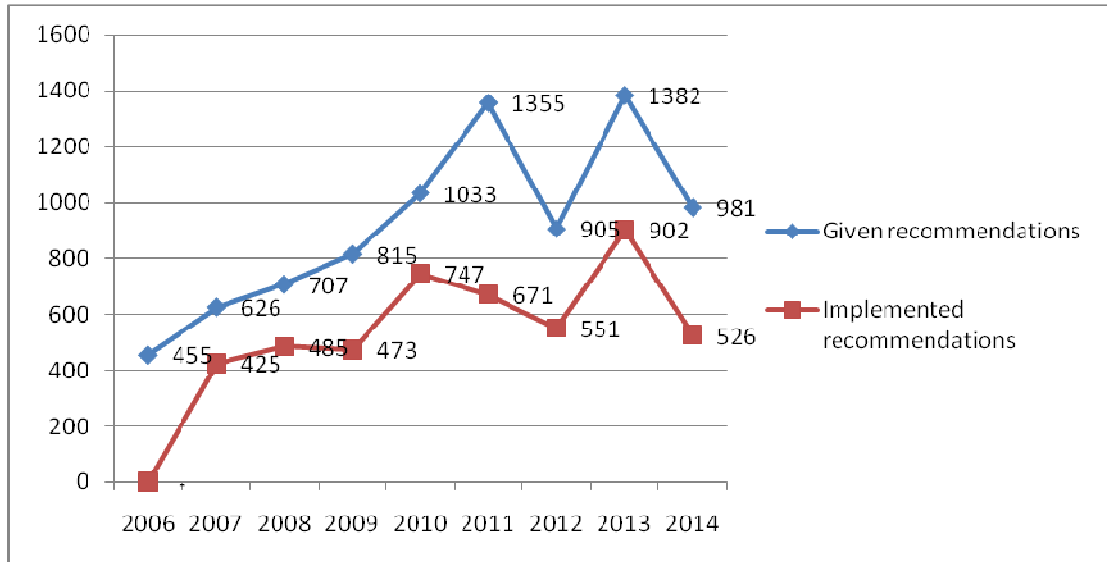
The percentage of implementation of the recommendations in 2014 is shown in the following graph:



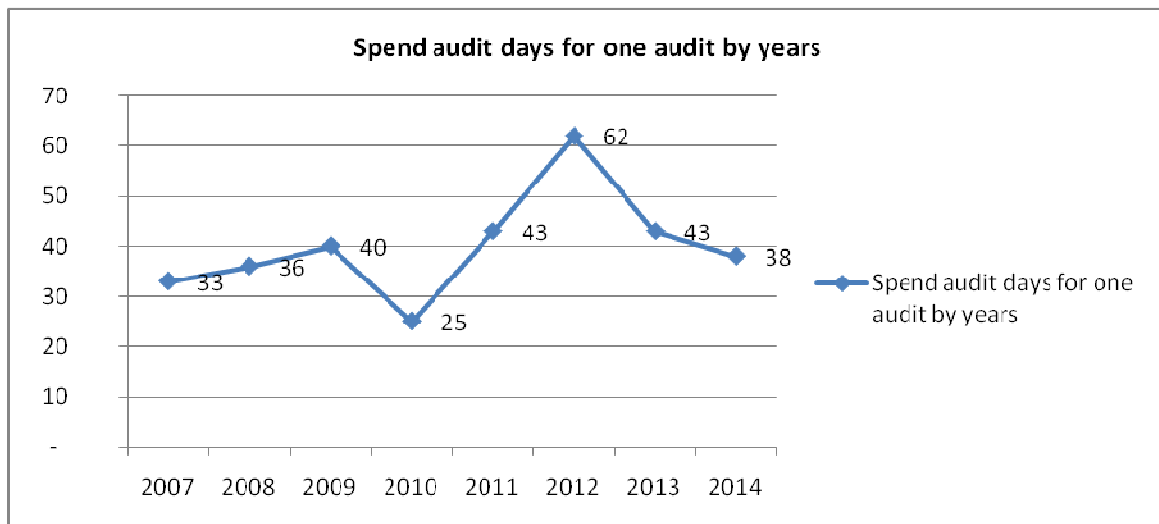
The percentage of implemented recommendations by year is shown in the following graph:



Given and implemented recommendations by year are presented in the following graph:



In 2014 internal audit units on local level are planned 5.539 audit days to carry out internal audits and spent 6.170 audit days for perform 163 audits, or average 38 audit days to perform an audit.



From the data in the graph we can see that the number of spent audit days for an audit in 2014 was lower compared to the spent audit days for an audit in 2013.

4.6 Achieved progress in the internal audit in 2014

From data submitted in annual reports for functioning of internal audit and records in CHU in 2014 is noted following progress:

- Increased the number of established internal audit units by 9,2% (from 65 to 71);
- Increased the number of internal auditors by 4,7% (from 64 to 67); and
- Reduced the number of spent audit days for an audit by 9% (from 43 to 38 days)

4.7. Noted weaknesses

Weaknesses in the establishing and functioning of internal audit are:

- Reduced the number of heads of internal audit units on local level by 8,6% (from 21 to 18)
- Reduced the number of entities that submitted reports on performed audits by 9,2% (from 52 to 48);
- Reduced the number of performed audits by 11% (from 183 to 163)
- Reduced the number of given recommendations by 29% (from 1.382 to 981) and the number of implemented recommendations by 41,7% (from 902 to 526) and
- Reduced the percentage of implemented recommendations for 9 percentage points (from 65% to 54%);

4.8 Performed certification of internal auditors

On October 21, 2014 was held the Conference on the occasion of the official closing of the first cycle and the opening of the new cycle of the project "Training of internal auditors in the public sector" in the Republic of Macedonia, funded by the governments of the United States and the Republic of Slovenia. Ministry of Finance it implemented in cooperation with the Center of Excellence in Finance from Slovenia and the Chartered Institute of Public Finance and Accountancy with headquarters in London.

During the first cycle are included 65 auditors of which 45 successfully completed the training and passed the exam which gained CIPFA certificate for internationally certified internal auditors. During the second cycle are included 35 auditors.

4.9. Individual reports

Based on the submitted annual reports for performed audits and internal audit activities, the Ministry of Finance - Public Internal Financial Control Department prepared individual reports for public sector entities on central and local level (Annex II / 3: Individual annual reports on performed audits and internal audit activities on central level and Annex II / 4: Individual annual reports on performed audits and internal audit activities on local level).