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**POLICY PAPER**

**Financial Control in Publicly Owned Companies**

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**May, 2023**

The document was drafted in the framework of the C1-EU-NPA Project, supported by the Embassy of the Kingdom of the Netherlands in Albania

*Findings, Opinions or Recommendations present in this document represent the views of the experts and the organization AIS and don’t necessarily reflect the position of partners and supporters of said project.*

# List of Abbreviations

IA Internal Audit

EU European Union

DG Budget Directorate General, European Commission

DH/IA Directorate of Harmonization, Internal Audit

DH/FMCA Directorate of Harmonization on Financial Management, Control and Accounting

IFAC International Federation of Accountants

INSTAT Institute of Albanian State Statistics

IAC Internal Audit Committee

PIFC Public Internal Financial Control

IC Internal Control

EC European Commission

SSA State Supreme Audit

MFE Ministry of Finance and Economy

SE State Owned Enterprise (SOE)

OECD Organization for Economic Cooperation and Development

#### NBC National Business Center

#### SIGMA Support for Improvement in Governance and Management

#### UNDP United Nations Development Program

DCM Decision of the Council of Ministers

# Introduction

Governance broadly refers to the mechanisms by which economic entities are controlled, directed and made to be transparent. Good governance leads to good management, good performance, a good stewardship of public money, public involvement and thus, a good overall end result. Mechanisms that guarantee good governance consist of three key elements: *internal rules and constraints*, such as: internal audit and accounting systems, independence of the judiciary and the central bank, regulations on civil service and budgeting; "*voice*" the right to vote and partnership, such as the consultation council with the participation of the private business, the use of the feedback instrument for assessing the performance of the public service, and; *competition*, for example, competitive systems concerning the provision of services to the public, the participation of private businesses in the construction of public infrastructure, the use of alternative mechanisms as well as the carrying out of privatization for several activities that are performed better under market constrains.

In a representative democratic system, government institutions and officials interact in function of the interests and to serve the interests of the public. In such a constitutional system, the Parliament is the representative forum of the public and has full legitimacy from the public, on whose behalf it is elected, and acts by defining the legal and institutional framework of the country. In this context, the Parliament or the legislature has the responsibility to promote and implement the integrity, transparency, accountability and managerial accountability of the executive or the administrators, who exercise the right to manage public assets. These main democratic principles constitute the foundations and are reflected in concrete forms based on the respective fields, which in the current context of the integration processes in the EU, are subject of evaluation and standardization in accordance with the *acquis communitare* and with the best European practice,s established as a benchmark by the European Commission.

A detailed analysis of the aspects of financial control in Albania, compared to the aspiring standards required by the integration processes, as per chapter 32 "Financial control", is presented through the policy paper "Financial control and the process of opening negotiations for the Chapter 32”[[1]](#footnote-1)￼ (AIS, 2022). However, the analysis of alignment with European law and practices in relation to the Internal Financial Control (IFC) implemented in public enterprises from the standpoint of fulfilling the criteria based on Chapter 32 has its own specifics. In general, these criteria are related to the adoption of internationally recognized frameworks and standards, as well as good practices mainly on PIFC[[2]](#footnote-2), aiming at the construction and operation of a healthy public financial system. Despite the fact that for the areas included in the PIFC there is no *acquis* that can be reflected in the national legislation, for Albania, as a candidate country, all components of the PIFC must be effectively implemented for all entities of its public sector.

For that precise purpose, in order to identify the concrete condition of the legal and sub-legal infrastructure that is in force, in relation to the financial control of public enterprises, the existence and functionality of the instruments that enable the full and effective implementation of said legal framework, as well as the appropriate institutional infrastructure (relevant) this document was drafted. Likewise, based on the findings identified in the reality of the Albanian public enterprises, conclusions and recommendations addressed to stakeholders are generated.

# General principles of governance in publicly owned companies

Governance is a very complex concept and as such, it cannot be fully conveyed through a single definition. Systematically, since the early 90s, researchers, policy makers and civil society have addressed various aspects of corporate governance and governance as a whole, broadly referring to "the structures, processes and mechanisms that ensure accountability, transparency, responsibility, law enforcement, stability, equity and inclusion, empowerment and broad-based participation”[[3]](#footnote-3). The philosophy of this document is based on the factors that condition the actors involved in the governance of an economic entity, basing the argument on the public governance approach[[4]](#footnote-4). The governance system of an economic entity consists of the rights and duties of directors, as well as the rules on decision-making and managerial responsibilities.

Various researchers (such as Blair, 1995; World Bank, 1996) have defined corporate governance as the monitoring and control, mainly by the owners, over the management and performance of the economic entity. This is about establishing rules to share decisions and control rights between parties, who are motivated and have the necessary information to use resources in the most efficient way possible. From this point of view, corporate governance refers to the instruments that guarantee that the actions, assets (assets) and agents (managers) of the corporation aim to achieve the corporate objectives set by the shareholders.

Governance mechanisms address the agency problem, which is related to the characteristic of separating ownership from control. In this context, Boot and Macey (1999) argue that the governance of the economic entity should seek to reduce the costs of the contract, ensuring the protection of the ownership rights of the shareholders, which should be clearly defined, ensure the mandatory implementation of the rules. Furthermore, the governance system should promote investment and entrepreneurial activities, which should have a positive impact on long-term performance as a result of the motivation to minimize costs and a faster response to changes in market conditions.

It is widely accepted theoretically and evidenced by empirical data that the main mechanisms of governance, which force administrators/managers not to follow their narrow interest but the interest of the owner, are competition in the product markets, in the **managerial** labor markets, the mechanisms of voting and going out of business. In addition to these mechanisms that address the agency problem, independent auditing and accounting, along with auditing standards are essential to identify potential fraudulent arrangements and similar misappropriations of shareholder assets by corporate managers. The information that managers must provide to shareholders must be regulated very strictly, through standards mandated by law and sectoral regulations[[5]](#footnote-5).

Governance as a concept defines who has power, who makes decisions, how other actors are listened to and how managerial accountability is controlled. In this context, according to the World Bank, governance is the way they "exercise economic, political and administrative authority to manage the country at all levels", aiming for a high quality of public services and legal safeguards, which have historically been a important prerequisite for the economic success of countries. Therefore, international organizations, such as the OECD, the World Bank, the European Commission, UNDP, etc., have invested in studies and identified the best practices of public governance by building standards and guidelines for good public governance.

The public sector plays a vital role for society [IMF (2019)][[6]](#footnote-6). In most economies, public spending constitutes an important part of the total gross product, whereas public sector entities are important stakeholders in the capital market, goods-services market, as well as in the labor market (IFAC, 2013). The public sector determines, through the political process, the results that are intended to be achieved and the form of intervention in the market. Forms of intervention in the market include establishing the legal and regulatory basis; the supply of goods and services; income redistribution through mechanisms such as taxes and levies.

The OECD, based on its studies of the best practices, has defined good governance instruments, which consist of:

**Strategy,** which includes strategic and operational planning, organizational structures and clearly defined rules and responsibilities. More specifically, at the macro level, reforms have been undertaken to reorganize the public administration, aiming to strengthen the local government in the direction of strengthening the autonomy and accountability of public units, including dependent SOE’s [Organization of public administration: agency governance, autonomy and accountability (oecd-ilibrary.org)[[7]](#footnote-7). Meanwhile, at the micro level, the executive managers of SOE’s must draw up strategic development plans with clear objectives, which are also part of the supervisory processes carried by the control and audit structures.

**Performance**, which refers to effectiveness and efficiency achieved via reporting and monitoring the performance and evolution of systems and processes, both at the individual and sectoral level. Ownership responsibility for SOE’s in Albania is partly exercised by the central government, i.e. partly the ministries and partly by the local government, and there is no unified platform on performance indicators, based on which it might be possible to carry out evaluation and monitoring or decision-making on the side of the owner.

**Responsibility and accountability** that includes the realization of statutory duties and other commitments, through internal and external audit, delegation of authority, having policies, processes and plans for the management of finance, risk, human resources as well as ethics, equal opportunities, security and keeping records of obligations. SOE’s are entities that are obliged to prepare financial reports based on the accounting rules which are standardized, as well as subject to the commitments of the independent external auditor. Also, these public units must publish audited reports, as well as make transparency regarding the operation of internal control systems audited by internal auditors. Auditors, as direct supervisors of the internal control systems of the economic entity, perform a particularly important function in influencing those aspects of governance that are crucial for promoting the reliability, equity, accountability and responsibility of public sector officials, minimizing the risk of public corruption.

Also, these documents[[8]](#footnote-8) recommend that the state act as an active and informed owner. In the domain of increasing transparency and information practices, - state-owner [[9]](#footnote-9) may (1) develop a transparency and oversight policy for the enterprises it owns; (2) define and monitor the mandates and objectives of the SE; (3) set up regular systems to monitor, audit and evaluate the performance and compliance of the SOE's activity; and (4) ensure dialogue with external auditors and other public oversight bodies.

SOE ownership policy requires a balance between active government engagement and delegation to SOE supervisory and management boards. As several researchers[[10]](#footnote-10) point out that inappropriate interventions, including politically motivated ones, can cause the reduction and lack of accountability of managers and in a weaker financial and operational performance in meeting the objectives of the public economic entity. Monitoring the performance of SOE’s requires the presence of appropriate financial control and audit instruments and competencies in all links of the unit that exercises the right of ownership to ensure the effectiveness and efficiency of the supervision process, operation and interaction with the unit of the internal audit of and with external public or private auditors.

An effective financial control activity in accordance with international public sector standards strengthens governance, by materially increasing the ability of citizens to hold their public sector unit accountable. In a historical overview of internal audit, initially it was considered as a "watchdog" monitoring and controlling function of the organization, subsequently IA was defined by COSO[[11]](#footnote-11) as a procedure which enables, not only essential guarantee for the credibility of financial transactions, but also defines criteria for evaluation and management in relation to the organization's control system[[12]](#footnote-12). Whereas, at the beginning of the 2000s, the activity of IA included not only the assessment, but constituted added value for the improvement of risk management, control and governance of the organization, by way of consultative role, which increased the effectiveness and profitability of the economic entity.

It is now generally accepted that the correlation between internal auditing and corporate governance affects all types of economic activity and that the implications and perceived consequences of this interaction have changed considerably in recent years. Internal auditing and corporate governance have now become a matter of public concern. In this perspective, the Board of Directors or the Council of Administration has been defined as a key factor for corporate governance by the regulators and guides of international institutions. Also, another important aspect of the governance of the economic entity is considered the Audit Committee, which through internal audit contributes to corporate governance by: identifying the best practices regarding internal controls and risk management processes in the audit committee; providing information about any fraudulent activity or irregularities[[13]](#footnote-13); conducting annual checks and reporting the results to the audit committee; encouraging the audit committee to conduct periodic reviews of its activities and practices against current best practices to ensure that the IA's activities are based on best practices and professional standards[[14]](#footnote-14).

# Legal and institutional framework for financial management and control in publicly owned companies

State Enterprises[[15]](#footnote-15) constitute an important part of a country's economy. They operate in a vital sector of the economy and perform vital services for the public, with very important effects for the economy and society. Depending on whether they are profitable or loss-making, SOE’s are very important and have an impact on the country's fiscal budget. For this reason, it is important that these economic entities function efficiently, transparently and in the same way as private enterprises. This sector directly benefits from considerable budget subsidies and support from the budget in the form of loans for financing investment projects and covering liquidity needs, as well as being the bearer of debt risk. about 6-7% of the total number of employees in the country are employed in the private sector (IMF, 2019)

Referring to data from INSTAT, there are a total of 193 extra-budgetary public units and public enterprises, organized in the form of joint stock companies and limited liability companies, of which 56% are administered by local government (mainly municipalities and some of them from counties) which are mainly water and sewerage, football clubs and waste treatment companies. While the enterprises administered by the central government are mainly administered by the Ministry of Finance and Economy, about 50% of them, the are administered by the Ministry of Infrastructure and Energy, the Ministry of Education, Youth and Sports, the Ministry of the Interior (2 of them) and the Ministry of Culture (1 of them). A more detailed information can be found in the Open Corporates Albania web-database, which has a dedicated Category to State-Owned Companies[[16]](#footnote-16)

In reference to the sectoral distribution of SOE’s belonging to the central government, they are concentrated in the field of transport (25% of SOE’s in keeping with the number of employees in the sector and 13% based on the number of enterprises), in energy and gas (39% based on the number of employees and 4% based on the number of enterprises) and in the primary sector (9% according to the number of employees and 4% based on the number of enterprises), while 13 SOE’s are in the process of bankruptcy (liquidation). Although most sectors have been liberalized after 1990 in our country, SOE’s remain dominant in the energy market, from which ¾ of the total consumption is generated (European Commission, 2019). Therefore, as evidenced by the distribution in accordance with the type of activity, SOE’s are important enterprises to the public interest[[17]](#footnote-17) and as such, their economic-financial performance has an important effect, not only economically, but has an impact on the quality of life of the public.

Public economic entities, as well as private ones, in Albania, are legally required to make **transparency on the financial statements** audited by authorized accounting experts, which must be submitted to the KIC and made public. These enterprises transparency of the performance is important for the public to exercise control and decide whether they are acting in the public’s best interest.

Also, publicly owned commercial companies, like all public entities, are subject to the law on f**inancial management and control**[[18]](#footnote-18). This law specifies the managerial responsibility of the holder[[19]](#footnote-19)and of the authorizing officer[[20]](#footnote-20); financial management and control components based on the COSO model[[21]](#footnote-21),as well as defines in detail the monitoring processes, which are the responsibility of the MFE.

Also, SOE’s must build internal control systems, internal audit units and their activity must be supervised by the audit or by the audit units of the subordinate ministries. These principles are also reflected in the legal and regulatory framework that is in force, regarding the financial control of public companies and their auditing. The effective implementation of the legal and sub-legal framework, which guarantees the basic principles of corporate governance in the public sector and transparency, are key elements to improve responsibility and accountability in the use of public funds invested in SOE’s.[[22]](#footnote-22).

From the assessment of the legal and sub-legal framework carried out by SIGMA (2021) it is stated that, in relation to the IC and IA of the SOE, a complete legal and operational framework has been formally built, which has been improved in relation to the delegation and external quality assurance for the IA[[23]](#footnote-23). SOE’s are subject to the Law "On Commercial Companies" as well as the Law on Auditing, but as public entities these enterprises are also subject to the legal and regulatory framework that modulates the organization, functions and way of organization of IA in the public sector.

The basic principles of the construction and operation of the internal audit in the public sector, including SOEs, are reflected in the law no. 114/2015, dated 22.10.2015, "On internal audit in the public sector", article 3. The law recognizes the right of a unit included in the organizational structure of the public entity to perform the internal audit function; if there is no such, the internal audit function is performed by the internal audit unit of the superior body, or that of another central unit (based on the agreement between the holders), or through the internal audit service contract. Hence, the construction of the internal audit unit in the SOE is conditioned by the size of the enterprise. Thus, according to DCM no. 83, dated 03.02.2016, "On the approval of the criteria for the creation of internal audit units in the public sector", point 1, letter "b", which states that "A Joint Stock Company must have as part of its structure a Unit of the Internal Audit in case the structure of the institution has 300 employees during the last three years". In order to guarantee the independence of the audit unit and the real impact of its service for SOEs, a decision of the government was drafted[[24]](#footnote-24) regarding the mode of operation, the powers and composition of the Internal Audit Committee in public entities.

The PIFC policy document for the years 2021-2022 aims to implement the PIFC throughout the public sector and covers three main principles: 1) decentralized managerial accountability, supported by financial management and control systems, 2) functional independent internal audit and 3) centralized harmonization of methodologies and standards related to MFC and IA. Both documents – the MFC Strategy and the PIFC Policy Paper aim to achieve a fully functional financial control system at all levels of governance in the public sector.

The legal infrastructure related to IA in the public sector has been completed with Instruction No. 42, dated 27.10.2020 "On the follow-up of the implementation of recommendations given by the internal audit in the public sector", which focuses on the structuring of IA recommendations, classification based on acceptance, implemented and not implemented; documenting and reporting on the level of their applicability. This manual constitutes a methodological instrument to increase transparency and accountability for the implementation of IA recommendations in SOEs, by management teams and unit holders.

In addition, the drafting and improvement of the Audit Manual (2016, revised in January 2020), which consist in the completion of the typology of the IA services, detailing activities related to the strengthening of the IA contribution in the governance, in the strategic and operational plan, communication and coordination of activities with CA or KD; for the increasing attention over the level of professional training of auditors and the due professional care; the use of the "Audit Card" document as a security and counseling service identification document; structuring of the general opinion; declaration of conflict of interest; the formalization of the IA reporting structure and the accentuation of the findings and the presentation of recommendations, as well as the entire audit process, including observations.

From a broad consultation with all guidelines and reports on the experiences of other Central and South-East European countries published by the OECD, the World Bank and SIGMA as a specialized program for the financial management and control of public companies, we can conclude that, in general, in Albania it is being implemented a complete legal, sub-legal and regulatory framework from the standpoint of the general framework, but there are several issues, which we are presenting in the next section.

# Issues concerning the use of legal instruments in the financial control of publicly owned companies, findings of the SSA, case studies

The legal and regulatory framework that supports internal audit, as well as the law on financial management and public internal control underwent a revision process[[25]](#footnote-25), which will affect the improvement of the internal audit activity, by deflecting several limitations related to the implementation of the requirements of the law in practice. Also, it will enable the MFE and mainly, the General Directorate of Harmonization, to strengthen the role and impact as methodological leaders, including IC and IA in public societies.

Systematically, in the SIGMA Program Monitoring Report[[26]](#footnote-26) it is underlined that, from the assessment of the general legislative framework, the implementation of the legal and sub-legal infrastructure related to IC and IA in the institutional framework is yet to be concluded. Also, in an analysis carried out by the WB (2019) regarding reporting and auditing standards, it is concluded that Albania should harmonize the legal framework on the requirements for audit committees, including the law on commercial companies, the law on the audit and the laws regarding the public sector, with EU legislation. The law on commercial companies allows supervisory boards and/or administrative boards to create special committees, including the audit committee, composed of members of the supervisory/administrative boards. The audit law requires that audit committees be composed of non-members, with at least one member independent from the audited entity, therefore, the lack of coherence in the regulatory system affects the level of applicability of legal safeguards, which guarantee the efficiency of financial control and IA in SOE.

Another aspect identified as problematic for the basic principles of operation for SOEs is related to the monitoring processes and the assessment of their performance by the government units that also exercise the role of the owner. In our country, there is no detailed report on the performance of the SOE sector published by the government as a whole, or on the realization of their activities in relation to the public interest.

As discussed in the previous section, SOEs are subject to the financial management and control law, but the process of monitoring the SOE's internal audit performance is not consolidated and systematic. If we refer to the inspection of the process at the DH/IA General Directorate of Harmonization and Audit, the Internal Audit departments of the largest public companies, such as KESH (Albanian Energy Company), OSSH (Distribution System Operator), Albanian Post Office, Albanian Railways, AlbGaz, Student Residences, etc., report on their annual activities, as well as provide evidence on the annual and mid-term plan, but the performance evaluation process of these entities is not unified. The latter fails to enable a systematic comparative evaluation of the SOE internal audit units performance, as well as an assessment on the effects of its recommendations.

Some of the main issues concerning financial control in SOE’s, identified by SIGMA and PIFC Reports[[27]](#footnote-27) consists in: **delegation processes** within organizations and risk management; **management of payment arrears;** procedures to address possible irregularities and arrangements for **administrative accountability** between ministries and subordinate units.

Aspects of the implementation of the required standards, pertinent to the experience in the field, professionalism and certification in IA, by the holders of the units, in the recruitment of auditors, is a problem observed both by the international supervisors assessing the reform and by SSA[[28]](#footnote-28) in other cases, during the auditing carried out in the SOE’s. Despite the downward trend, the ratio of IA employees fulfilling the legal certification criterion is not favorable, undermining the quality of IA service. Meanwhile, improvement in the quality of IA is required, as SIGMA's analysis of audit activities, carried out by IA units, on a sample consisting of IA’s of different entities, shows that they have not clearly demonstrated that IA’s can improve the functioning of the public entities in which they serve (SIGMA, 2021).

Based on the findings of the SSA regarding the auditing of IA departments/directorates activities within the SOE’s, during the last three years, problems have mainly been identified which, if categorized, consist of:

Cases of **non-implementation of the criterion of certification** of the personnel working in the IA and the application of non-proportional financial remuneration, factors that affect the level of independence of internal auditors in the fulfillment of their audit activity and in the expression of their opinion;

There are violations found, but which are **not addressed with recommendations** or cases of non-implementation of audit processes in the central administration, a fact that hides problems with respect to the independence in exercising of the audit mission, as well as in the genuine impact the IA units have within the SOE’s;

**Failure to comply in keeping with the assigned competence, to carry out controls** based on the principles of the internal control system (ex-ante versus ex-post[[29]](#footnote-29)), according to which the functional departments conduct controls throughout the work process, aiming to eliminate fraud (ex-ante), whereas the IA unit audits are performed ex-post;

Aspects that **affect good governance instruments** such as; functional independence and reporting, a problem derived from the discrepancy between the IA operative regulation in the public entity and the relevant legal framework[[30]](#footnote-30); lack of implementation of the legal stipulations for the construction and operation of IA units within the SOE’s; not taking into consideration the findings and recommendations from the entity’s directorate or appointing the auditor under circumstances that construe a conflict of interest; the heads of the public units and especially, of local self-government units, have a low level of awareness and knowledge about the role of Audit Committees[[31]](#footnote-31).

Aspects that **affect the quality of the auditing performance** and consultation services by the IA unit; The Directorate of IA has not adhered to the methodological requirements addressed by the General Directorate of Harmonization in MFE, regarding the drafting of the strategic and annual plan, defined in the approved regulatory framework on the systems and areas assessed as high risk; non-compliance with mission and reporting quality standards, eg, lack of audit trail, non-compliance with deadlines and receiving observations; failure to respect the links of the reporting chain within the deadlines, undermining the quality of the service.

**The non-functioning of the strategic management groups** in the state ownedenterprises is a finding that seriously affects the functioning of the management system of public companies, since the managers or directors are selected based on political affiliation and consider themselves connected to the mandate of the governing majority in charge. The lack of transparent processes, the criteria system for assessing candidacies, such as for members of the management councils, the main manager or the chairman of the internal audit committee, constitute a high risk for the distortion of the objective and stimulation of these bodies, instead of encouraging the better performance of the enterprise, which end up being guided by personal interest, blind service to political influences that guarantee longevity in the position.

# IV. CONCLUSIONS AND RECOMMENDATIONS

By presenting the philosophy behind the importance of the effective operation of financial control, the respective legal and regulatory framework, as well as the identified problems, several main considerations can be produced throughout this document.

If the government would play the role of a proprietor that is interested in the efficiency and effectiveness of public property under its administration, by serving the public with wholesomeness, it would use all the instruments at its disposal to motivate and encourage SOE managers to set clear objectives and increase the public property use performance. As a consequence, by way of the transparency, responsibility and accountability standards, as well as through a clear system of measuring and monitoring the performance of public companies, the state would have all the right information to make efficient decisions. However, "political" interventions, used as workforce factory to appease political supporters, or for very short-term pragmatist policies, distort the essence of the relationship between the owner-state and the managers of SOEs. This context is expressed in the way the members of the governing councils/boards, the executive directors and the KIA chairmen are selected, a fact which affects the efficiency of the internal control systems and the IA activity in public companies.

One of the instruments that produces and guarantees good governance in the interest of the public is financial control and internal audit in SOEs. For this reason, the activity of IC and IA must be strengthened to allow them to act with integrity and to provide reliable services which brings about real impact. The items presented in the previous section underline that improvement is a required to improve the quality of IA, including the legal, regulatory framework, guidelines and process manuals.

The legal and regulatory framework enables organizational independence, which presumes that the IA performs the activity without interference from the entity under control. Along with objectivity, organizational independence contributes to the accuracy and effectiveness of internal auditors' work. Independence is greatly influenced by how the head of the IA unit is appointed and reports. The best international practices and the Albanian legal framework state that the IA must report to the management board and its administrative position subordinate to the main leader of the public company. Important parts of the independence are the ability of the IA leader to protect himself from management or political interference or retaliation, a result of performing its duties lawfully and in accordance with the established standards. He/she should also be free to control the activity of the IA without interference from management or excessive political influence from public officials.

There have been drawbacks observed, in relation to the process of monitoring the fiscal risks concerning the SOE’s payment of arrears and outstanding balance, mainly due to their unsystematic follow-up and lack of reporting based on factual data.

## 

## **Recommendations**

The election, by **transparent procedures** and **based on merit,** of independent, non-political and competent members of the board/management and supervisory boards, executive managers, as well as members of the internal audit committee (employed with competitive salaries) is a vital condition for an effective system of IC and IA. These procedures must be clearly expressed in the main body of laws, which regulate the functioning of the SE and IA in public companies. The role of central government as owner and regulator should be separated. The lack of clear objectives and measurable performance from the state as owner creates the perfect opportunity for politicization.

**Empowering the supervisory boards** to perform the functions defined in the whole legal and regulatory framework, to continuously supervise the strategy, to appoint the executive director (or the management board, in two-level boards) and to supervise the administration, free from political pressure and interference. Strengthening the autonomy and independence of the board requires the non-involvement of politicians in these bodies, the establishment of clear and professional criteria in their selection, as well as increased care for potential conflicts of interest of board members. A culture must be fostered to encourage decision-makers to be steered not by political objectives, but by corporate efficiency. Accountability and performance should be directly tethered to the head of the budget unit, as the main link of internal control.

Creating an **inter-ministerial commission or involving private agencies in the recruitment** of board members or executive managers of SOEs can be used as potential instruments.

Creating professional and independent management council/supervisory boards. The board/management council should be required to consist of a majority of independent members, with clear criteria for their independence. **Appointment procedures must ensure that the SOEs members of the supervisory board,** majorly and fully owned, be selected based on their professional qualifications and be subject to a transparent and competitive process. The state board member recruitment policy and practices should ensure that it is able to attract and retain qualified professionals of the respective labor market.

Completion of the **amendment process in respects to the MFC** legislation and Audit for the public sector, by the legislative branch. However, the improvement and development of an adequate legal and methodological framework[[32]](#footnote-32) , for the internal audit, based on an in-depth analysis of the audit activity, ensuring compliance with the *acquis communautaire*, best practices, standards and recommendations of SIGMA and the European Commission.

The General Directorate of Harmonization in MFE should build the **performance evaluation and reporting system** for MFC and for public companies, just as it has been implemented and reported for budget units.

Create **independent audit committees** within the SOE’s. Internal audit committees, mainly in large public companies, must have qualified members in the field of accounting and finance and an independent chairman, that is, independent from the executive directors of the company and the state shareholder. No state representative (civil or contract employees) should serve as chairman of the control committee.

Creation of an **effective network of communication** with and between public units and continuous monitoring, to ensure that the internal audit service is carried out in all units of general government and in accordance with the requirements of the legal framework, accepted International Standards and good professional practices.

Maintaining a dialogue with the internal and external auditors and the SSA. The effective supervision of the performance of SOEs requires that this dialogue take the form of regular exchange of information, meetings or discussions when specific issues arise. The technical secretariat, built as a form of cooperation between the MFE and the SSA, should have part of its own agenda, as well as address the problems identified by the audit missions of the SSA. In addition, the auditors of the SSA covering public companies must have, as part of their audit programs, the state owned enterprises IA activity, as well as the assessment of the internal control system of said public companies.

The Ministry of Finance and Economy should strengthen the monitoring and reporting processes of SOE outstanding balance and arrears, as well as design and implement policies to limit the fiscal risk, deriving from their debts. It is possible to build a unit for monitoring the performance and fiscal risk of the SOE’s, in the MFE or within the budget directorate, with well-defined objectives and resources in function of such task.

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