Financed by the
European Union

Concept note on development of an effective internal control and audit environment in the public sector in Moldova

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7 April 2017

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Executive Summary

Moldova established the legislative framework for Public Internal Financial Control (PIFC) in 2010 and the public administration has since then been implementing the PIFC development programmes, including the last one covering the period 2014-2017. As an evaluation of PIFC in Moldova[1] indicated that the implementation of PIFC is lagging behind, the EU delegation in Chisinau, Moldova assigned us to identify the current hurdles to an effective implementation of internal control and internal audit in the public sector in Moldova.

This report, the concept note, presents a set of hurdles. These hurdles have been identified with the help of many interviews and workshops with key stakeholders in Moldova. And from studying most policy and evaluation documents produced. The report presents furthermore a set of recommendations for how the identified hurdles may be overcome and discuss also how the way forward to effective internal control and audit systems may best be designed. The report will be used to define further EU assistance to Moldova in the PIFC area.

Eight hurdles, which have negatively influenced the implementation and development of PIFC in Moldova, are presented in the report. It is also underlined that two more factors are important to take into account when designing the way forward as they in different ways influence the development of PIFC.

The identified eight hurdles are:

1. Tone at the top. Managers do not take any, or very limited, direct interest in how the implementation of PIFC proceeds.
2. Lack of strategic perspective for the implementation. The main driver of the PIFC reform, the PIFC Council that advises the Minister of Finance on PIFC issues, lacks strategic thinking and has limited impact.
3. Work in silos. There is a lack of co-ordination, co-operation, and communication between key-players involved in many ongoing reforms.
4. Reforms demand specialists, but supply of specialists is limited. Entities implementing the reforms in the financial area are struggling to find and to keep specialists such as auditors, accountants and financial management, over time.
5. Lack of understanding in entities and among staff at all levels what Financial Management and Control (FMC) and Internal Audit (IA) is about. The introduction of FMC is understood as a technical reform and not as a management reform, while IA is not understood as a link in a wider internal control system focused on how effective the risks and the processes in organisation are managed.
6. Lack of sanctions related to PIFC. There is a lack of specific tools / mechanisms to hold officials accountable when they are not fulfilling their legal obligations.
7. Incomplete legal framework. Due to a lack of criteria there are many small IA units of 1 or 2 positions. And due to a lack of low entrance level IA staff lack educational and/or professional experience in public finance and auditing.
8. Too many reforms in parallel. All reforms ask for management's attention and require much work of implementation. The result is that managers do give other reforms more priority than the PIFC reform.

The concept note also underlines that two additional factors (not hurdles per se) are important to take into account when designing the way forward as they may in different ways and dependent of how they are managed influence the development of PIFC. One such factor is the operations of the Financial Inspection. A second factor is the complex structure of entities and companies linked to /owned by the public sector. The operation of Financial Inspection is sometimes regarded as a vital cause for the non-development of IA. The complex public sector structures have as a consequence that the internal control and audit arrangements that are supposed to

[1] Baseline Measurement, SIGMA, 2015

safeguard the public resources and objectives, sometimes formally are set out of play or even deliberately circumvented.

The concept note put forward many recommendations for the short as well as the longer term in order to better overcome identified hurdles and for how to speed up the implementation of FMC and IA in order to achieve sustainable results. A step-wise approach to the way forward is probably preferable. Many recommendations have a potential to give positive results quickly. The experts suggest that efforts should first be concentrated on the latter type of recommendations with the ambition to rather quickly create some good results that may be useful for many. These results should then be widely disseminated to stake-holders.

However, in order to overcome the defined hurdles and to well manage the mentioned two factors there is a need that first of all the political level of the government, but also the managers at all concerned central and local levels of the public administration, take a clear and constant lead in order to breathe new life into the PIFC reform.

This active lead should always be based on updated overall strategic perspectives. The FMC and IA reforms must fit well into the objectives of, and be carefully timed with, all other ongoing related PFM activities. Different activities within the reforms should to the extent possible not compete for the same rather limited personnel and other resources the Government has at its disposal. The implementation must be actively monitored and the administrative structures need to co-operate closely. The Court of Accounts may contribute positively by annually reporting on the progress made on the FMC and IA reforms based on analyses of its recent audit activities. There should be readiness in all entities to quickly take actions in order to manage every potential (old or new) hurdle. The work must be based on an effective cooperation (including time planning) between all concerned parts of the Government under the lead of the Ministry of Finance. There must also be a close co-operation and communication between Government and donors in order to make sure the different but interacting donor activities are clearly related over time to the work plan of the Government.

The experts underline that the defined hurdles are all hurdles which can be overcome by taking relevant measures within much reasonable demands on resources. However, these measures will require full attention over time of the Minister of Finance and sometimes even the clear support from the Government as a whole. Active support by the donor community is also a prerequisite. The very positive feedback received from most of the stakeholders when discussing the hurdles and factors during interviews and workshops gave us the assurance that most of the staff of the public sector organisations are not only willing but also motivated to contribute to the necessary actions for an effectively implementing the PIFC reform. Commitment from the top, a clear steering process and a realistic prioritisation of measures to be taken is all that is needed.

1 Introduction

The global objective of the project is to assist the EU Delegation to the Republic of Moldova to formulate an action plan to support the development of an effective internal control and internal audit system in public sector.

Specifically the project has to:

1. identify current hurdles to an effective implementation of internal control and internal audit in public sector in Moldova;
2. develop a concept note on development of an effective internal control and internal audit environment in public sector;
3. prepare the twinning fiche for an EU-funded twinning project to support the practical implementation of this concept at central level and in the municipality of Chisinau.

The objective of this report is to present recommendations for overcoming identified hurdles to the effective implementation of internal control and internal audit in the public sector of Moldova, where possible with references to good practice in EU Member States and Candidate and European Neighbourhood countries.

As a starting point the experts studied the provided documents such as existing laws, policy documents and annual reports. The experts had also a nine days mission to Moldova in January 2017 in order to get the views of a wide representation of stakeholders in the given time-frame. Interviews were arranged with persons responsible for Financial Management and Control (FMC) or Internal Audit (IA) matters. The persons represented different policy or operational institutions at central and local level in the public sector. Interviews were as well carried out with two NGOs of which one represents internal auditors working in the public sector (see annex for list of interviewed people).

Following these attempts to collect the views and opinions of key players in the Public Financial Control (PFIC) area, an informal meeting was arranged with the PIFC Council to discuss the type and importance of the hurdles identified and to complement the overall picture with aspects, or hurdles, which had eventually been missed.

This report has been drafted by Johannes Vrolijk (Netherlands), team leader of the project and Kjell Larsson (Sweden), expert. A draft report was discussed in a seminar with key players on 9 March 2017. The comments received, where regarded needed and possible, are reflected in this final report. In addition to this report the experts have contributed to the drafting of a twinning fiche.
The experts would like to thank the management and staff in the institutions we visited for their kind and fruitful cooperation. We feel indebted to Mrs. Ekaterina Yakovleva and Mrs. Natalia Burciu for organising our meetings during our on–site visits to Moldova.

Chapter 2 of this report describes the progress made during the last six years after adoption of the law on PIFC. As there is hardly any or very limited progress in the implementation of PIFC, Chapter 3 is used to describe the main reasons ('identified hurdles') put forward in the interviews and mentioned in different documents. Chapter 4 describes possible solutions for overcoming these hurdles and setting the implementation of PIFC in motion. The experts' conclusions on what should characterise a positive way forward for the stalled implementation are summarised in Chapter 5.

2 Progress in implementation of the PIFC law after 6 years? Hardly any!

In 2010 the Law on Public Internal Financial Control was adopted. Since then the Central Harmonisation Unit (CHU) of the Ministry of Finance (MoF), established in 2009, has worked to create conditions for the introduction and implementation of PIFC as described in article 29 of the 2010 PIFC law.

The EU supported the introduction of PIFC in 2011-2013 through a twinning project. The twinning focused on enhancing the capacity of the CHU to oversee the implementation of PIFC in Moldova, updating legislative and normative framework, and strengthening FMC and IA capacity.

There is a current PIFC strategy[2] and Action Plan with 66 actions for the MoF and other organisations with responsibility for implementing PIFC. Every year on the first of July the MoF reports on the progress of the action plan in an annual report to the Government. This report is largely based on self- assessment reports submitted by IA units, and collected by the CHU, at the two top levels of budget organisation (State Budget, Mandatory Social and Health Insurance, and Regions), which have established IA-units. The reliability of the information is not checked. Local Government organisations (almost 900), which are required to implement FMC according to the 2010 PIFC law, are not subject to any monitoring.

During the period of twinning, the secondary legislation and methodology for FMC and IA were developed and guidance material was amended and developed. For example; a PIFC communication strategy was drafted (2013), methodological norms on internal audit in public sector were amended (September 2013), a regulation on the reporting of the IA activity was adopted (November 2013) and the format for a good governance statement was approved (April 2012). Furthermore, the IA National Standards of 2007 were replaced (October 2012), the functioning of the PIFC Council was regulated (October 2012), the procedure for certifying internal auditors in the public sector was regulated (June 2013) and manuals for FMC and IA were approved (2013).

In the years after the twinning the CHU continued with drafting new legislation or amending existing guidance material. For example in July 2015 the Government issued a Decree reorganising, standardising and modernising the Departments of Economy and Finance of central and local public authorities. In November 2015, the MoF approved the new National Internal Control Standards, integrating planning and risk management and incorporating fraud and corruption risks. In December 2015 the MoF issued the revised FMC Manual. In much of this the CHU was assisted by a bi-lateral cooperation project with the Dutch Ministry of Finance.

The launching of the documents was accompanied by awareness raising events (FMC) and training (IA), organised by the twinning partners and later by the CHU, and pilots in FMC and IA.

All in all, there have been many efforts made to improve the conditions for implementing FMC and IA. The 2015 SIGMA Baseline Assessment[3] concluded that the operational framework for FMC and IA has been in place for some time. However, SIGMA also concluded that the development of FMC at an organisational level is lagging behind the development of the overall framework. One of the main principles underpinning FMC is managerial accountability, which foresees delegated

[2] Public Internal Financial Control Development Program for 2014 - 2017

[3] http://www.sigmaweb.org/publications/Baseline-Measurement-Moldova-2015.pdf

management responsibility within the hierarchical framework of the organisation. The implementation of this principle in the Moldovan public administration is difficult, despite the CHU awareness raising events. Public financial management in Moldova is still highly centralised, which leaves not much scope for FMC on lower level in the public sector.

SIGMA concluded that the framework for IA is better established than FMC but also that there are still obstacles for an implementation according to the international IA standards. For example specific provisions for ensuring appropriate internal audit coverage among smaller public organisations are not in place. Further, not all public organisations are required to have internal audit and some of those who are required have not yet established internal audit. It is also often mentioned that existing IA units have a high turnover of staff. Many IA units have only one single internal auditor. This may be understandable from a resource / cost point of view. However, based on experiences it is generally not seen as being conducive to an efficient and effective IA service.

The MoF regards the centralised ex-post controls by Financial Inspection (FI) as a main reason for the slow implementation of IA. FI predates IA in Moldova and has more resources and more power than IA, including the ability to impose sanctions. Most of its work focuses on compliance and suspected irregularities. The FI controls would overlap with IA and the aim of FI to detect irregularities and to punish perpetrators for mistakes would hinder the development of IA.

As explained in Chapter 1 the aim of this project is to identify the existing hurdles which are perceived by many stakeholders in Moldova to have been slowing down or even in some cases stopping the much needed implementation of FMC and IA in the public sector of the Republic. The aim is furthermore to, based on this information, suggest how the perceived hurdles may be overcome in order to create an environment that facilitates an effective and efficient implementation of FMC and IA.

After reviewing relevant documents and interviewing key players and discussing with the members of the PIFC Council, the experts well recognise the above picture and conclude that the implementation of FMC and IC are severely lagging behind set objectives and time-schedule. It should be noted though that much of the laws, policy documents, manuals etc. exists. There are at least eight hurdles which together are seen as the major explanation to the very slow implementation at an operational level. The conclusion is also that each of the hurdles has had, individually, a clearly negative impact on the implementation process. Taken together this explains why coordinated and well planned actions are needed with some urgency in order to eliminate or lower the hurdles to the extent possible and in that way create a positive base for the implementation of both FMC and IA.

The hurdles found and discussed with PIFC Council are:
1. Tone at the top: managers are not interested in PIFC;
2. Lack of strategic perspective for the implementation;
3. Work in silos;
4. Reforms demand specialists, but supply of specialists is limited;
5. Lack of understanding in entities and among staff at all levels what FMC and IA is about;
6. Lack of sanctions related to PIFC;
7. Incomplete legal framework;
8. Too many reforms in parallel.

The Ministry of Finance has already recognised some of these hurdles and therefore included in its 2017 Action plan the following activities:

- to amend the PIFC Law and develop and adopt criteria for establishing Internal Audit Units with sufficient number of auditors;
- to develop and approve a new PIFC programme;
- to draft certification programmes for Internal Auditors, Procurement Officers, and Accounting Officers;
- to ensure organisational solutions for effective Public Financial Management, Internal Audit Units with a remit following their respective minister and strengthened procurement functions once ministries are restructured;
- to improve the annual PIFC assessment report to the government and make it more "analytical";
- to reorganise Financial Inspection function;
- to carry out pilot-audits in some ministries.

3 Why very limited progress in implementation of PIFC?

Although the design of the PIFC framework has been established after the PIFC law has been approved in 2010, the implementation of this concept in the Moldovan public administration is lagging behind. The reasons for this lagging behind the experts explored during their on the site visit. Eight main hurdles were mentioned quite often and were unanimously underlined during the PIFC Council round table meeting. However, although they were not experienced as hurdles, the experts were also confronted with two factors, which might influence the development of PIFC too. This chapter elaborates on all eight hurdles and describes separately the two factors with influence on the development of PIFC.

3.1 Hurdles[4]

3.1.1 *Tone at the top*

It has been underlined by many that managers as well as ministers and state secretaries often are seen to not take any, or very limited, direct interest in how the implementation of FMC or IA proceeds. Or in the results of these reforms, or in internal controls or accounting or other financial specialities. For sure and as a positive note, accountability and PFM are identified for actions in the current PAR agenda. However, the general picture seems to be a rather common "active disinterest" for these activities, starting high up. Responsibilities for FMC and IA activities are often more or less informally delegated down in the organisation (for example to the IA unit). But the execution of the delegation is seldom followed-up. However, it has also been pointed out that the value for the respective entity and the managers of these controllers and auditors are not at all clear or seen as convincingly higher than their visible costs. And not much seems to have been done to prove the opposite.

The Minister of Finance[5] is to report on progress made in the implementation of PIFC. So far the CHU of the MoF evaluates annually the answers to a questionnaire that is submitted to budget organisations. The budget organisations base their answers on the results of a self –assessment of sub-ordinated units. This process of evaluating progress of the implementation of PIFC in budget organisations does not lead to satisfactory results. Partly because the quality of the questionnaire is regarded not adequate, but also because state secretaries or management of budget organisations are not actively interested or involved in the process (internal audits are responsible for the co-ordination of the answers on the questionnaire). More importantly, the causes of the weaknesses in FMC are not well-addressed in the report of the MoF. And there are few clear incentives for the top managers to really invest themselves into this. All this together consequently means that the implementation or use of these reforms does not get the attention from the ministries or managers the reforms need for guaranteeing a successful end.

3.1.2 Lack of strategic perspective for the implementation of PIFC

Besides the above annual reporting on FMC and IA, how the implementation of PIFC develops, and why, in the different budget organizations, it is not followed up and it is not systematically monitored. Which means that it is much up to the individual ministries and entities whether they

[4] Starting with the most commonly mentioned hurdles but in no absolute order of importance. There are of course several Inter-linkages between the hurdles. Why one is a cause to a hurdle may well be an effect seen from another angle.

[5] Article 29 of the PIFC law

may or may not invest themselves in implementing FMC and IA. The Ministry of Finance has the overall responsibility for developing the strategic as well as the tactical perspective[6] with the help of the PIFC Council and the CHU.

Article 30 of the 2010 PIFC law regulates the establishment of a PIFC Council as a consultative body under the MoF. The tasks of the PIFC Council are endorsing acts and the annual consolidated report on PIFC and reviewing problematic issues related to the functioning of the PIFC system and submission of proposals on their settlement. The Council is chaired by a Vice-Minister of Finance and consists of representatives of the MoF, internal audit units of public entities, academic staff with scientific degrees and other specialists in the field.

In practice the Council has a limited impact. In 2016 there were four meetings and those meetings did not lead to conclusions and proposals on settlement of issues discussed (the law also is not clear who has to settle). All of the hurdles mentioned in this chapter are more or less discussed during the last few years but no systematic actions are noted. The strategic impact of some of the problems discussed is not taken into account. Most of the discussions concern internal audit, although the Council also should deal with FMC issues. There is no representation of finance departments of ministries or agencies in the Council. Currently the MoF uses the Council to locate problems with implementing PIFC but does not analyse the causes of those problems and defines measures to solve these problems. Furthermore, the Association of Internal Auditors has criticised the PIFC Council because it does not fully perform all its regular tasks, does not hold meetings as required by its Rules of Operation and is not, in their view, impartial, objective and transparent.

Another reason for the lack of strategic perspective on the implementation of PIFC is that the 2014-2017 PIFC Programme, developed during the twinning, is not fully aligned with the PFM strategy which was developed in 2013 and should form the umbrella strategy for PFM related topics such as debt management, accounting taxes but also FMC and IA. The principles of managerial accountability are mentioned in both documents but the steps to be taken, needed for the implementation of those principles in practice, are not aligned. The 2016 Public Administration Reform (PAR) defines managerial accountability too, but the reform does not define strategic choices needed for introducing managerial accountability in the PFM area.

As the introduction of FMC should be understood as a management reform, and not just a technical financial control reform, the implementation of FMC should be closely related to public administration and PFM reform.

3.1.3 Work in silos

There has been, and still is, a lack of co-operation, communication and co-ordination between key players. This limited or no co-operation is said to, with some clear exceptions, characterise the links between ministries as well as between the Court of Accounts (CoA), CHU, FI, Treasury, Prosecutors, and the National Anti-Corruption Centre (NAC) and also among the IA units. The lack of co-operation is sometimes said to have its roots in the weak interest for control matters at management level (point 1). The non-alignment of the PFM and PIFC strategies and the lack of PFM aspects as a base for other reforms may possibly also be explained by a tendency to work in silos. However, it is also explained as a consequence of a tradition where co-operation and communication between budget entities have been very rare.

[6] Article 29 2010 PIFC law

3.1.4 Reforms demand specialists but supply of specialists is limited

The success of FMC and IA reforms is dependent on an easy access to very varied specialists competencies (e.g. auditors, accountants and financial management specialists). Today it seems that several of the entities implementing the reforms in the financial area are struggling to find and to keep such specialists over time. The turn-over of specialists is rather high. One reason is the salary level. Another, and probably growing, reason is that such specialist competencies will be more sought after in all sectors when the economy grows. The level of specialisation and competence is for the moment very varied even when it comes to internal auditors that have passed the certification programme. Many of these need more and high-level training in order to reach a specialist level. And most specialists need further training in order to continue as specialist. The IA training is provided by the CHU of the MoF. Several other entities have engaged themselves in trying to find ways to deliver the training needed. However, there are many reforms and several different specialist competencies are needed therefore the need for training normally goes well beyond what the entities' resources allow.

3.1.5 Lack of understanding in entities and among staff at all levels what FMC and IA is about

One thing is what is said in some policy documents. Another, and different matter, is the personal experiences.

Central to improving FMC is managerial accountability, but as managerial accountability is still lacking the strengthening of FMC depends on the introduction of this accountability concept in a wider context. As the introduction of FMC should be understood as a management reform, and not just a technical financial control reform, there also needs to be co-ordination with public administration and PFM reform (see point 2). For example, risk management is the responsibility of the manager of a budget entity. If the manager of that entity does not have clear objectives, does not have a budget and is not authorised to make necessary decisions, the introduction of the risk management concept will fail. However, the interrelation with the annual and multi-annual budget planning will also have impact on the degree to which the FMC is strengthened. The implementation of FMC is very much about setting the mind-set of the staff, and especially the managers.

In Moldova, managerial accountability on the level of budget entity is regulated in the 2016 Law on Public Finance and Fiscal Responsibility[7] and 2010 PIFC law. However, delegation of authority to make financial decisions within the budget entities is not regulated in these laws[8]. But even if it should have been regulated, the experts have been told that it is too early for introducing delegation of decision making authority within budget entities in Moldova. The 'culture' within the Moldovan public administration would not be ready for such a step.

In order to fulfil its responsibilities for budget preparation and budget execution as laid down in the 2016 Law on Public Finance and Fiscal Responsibility, the management of budget entities will have to be supported by a finance department that assist the management in analysing internal budget proposals and monitoring budget execution. In practice, finance departments have been established in budget organisations but in practice are these departments mostly used for keeping financial records. Not for analysing internal budget proposals or to regularly sum up the budget outcome or exploring more efficient ways to carry out services. Managers seem still to see the finance departments as bookkeepers.

IA is for sure more widely and better known than FMC. Not least in the entities where there are operational IA units. However, it seems to be a wide-spread misunderstanding that IA is a stand-alone activity and not really a link in a wider internal control system focused on how effective the

[7] Article 21 of this law

[8] However, article 15 of the PIFC law implicitly regulates the right of management to delegate responsibilities and duties.

risks and the processes in organisation are managed. A rather common view is also that internal audit is, and should be, a control of only to what extent staff is following set rules and directives. And that IA will act on every eventual deviation found irrespective of its magnitude.

What is now said points to a need for continued and further developed communication and training efforts. And perhaps also to a need to find alternative ways to deliver these. Not least when FMC and IA activities are about to be introduced.

3.1.6 Lack of sanctions related to PIFC

The lack of a systematic and overall type of monitoring of how the implementation process develops is often mentioned as a hurdle. As is the low implementation rate of recommendations from IA and the CoA. Even more so is the lack of specific tools / mechanisms to hold officials accountable when abstaining from supporting the progress of the PIFC reform. There are some potentially applicable sanctions specified in the laws on Civil Service and in the Labour Law. However, these laws have not been tested in these situations. The situation today is that the 2010 PIFC law[9] prescribes that managers has to organise FMC and IA in their institutions. However, the law does not contain any clauses for the case a manager is not fulfilling his/her legal obligation. That means that the law leaves it very much up to the individual manager to decide whether to start seriously implementing the PIFC law or just wait and see or choose to do nothing. Other matters of low importance for the entity but of interest to the manager may instead get the priority and resources. Such an outcome may not be liked. However, it is likely there will be no negative consequences for the manager because of this as there are no such consequences clearly defined in the 2010 PIFC law.

3.1.7 Incomplete legal framework

During the last six years the primary, secondary and tertiary legislation has been developed and regularly fine-tuned. It was therefore a surprise to get the clear message from the PIFC Council round table and the individual meetings with internal auditors, that one main hurdle for effective internal control and audit work is several incompleteness's of the legal framework[10].

The 2010 PIFC law lacks indeed some clauses which should define concisely the scope of IA. The law does not define criteria for the establishment of an IA function and IA units. Managers of public entities on central and second level local government are responsible for organising the establishment of an IA function[11]. As public entities are quite broadly[12] defined in the 2010 PIFC law, the implementation of this article in practice has led to many small IA units of 1 or 2 internal auditors. Another effect is that there are no IA functions established in most of local government level 1 (almost 900 entities) and State and Municipal Enterprises.

The 2010 PIFC law does not contain requirements to be eligible for being appointed as internal auditor and Heads of IA units, such as PIFC laws in other countries normally have. There are only requirements for being eligible to be appointed as an internal auditor mentioned in the Law on Classification of Public Functions and they are perceived as minimal. In practice, the lack of knowledge and/or skills related to IA or public finance requirements leads to appointing staff with hardly any experience in the public finance and auditing.

[9] Articles 8 and 14 of the 2010 PIFC law describe responsibility and ways of implementing FMC and article 19 how IA should be organised

[10] 2010 PIFC law no. 229 and the law on Classification of Public Functions no. 1515

[11] Article 19.1 of the PIFC law

[12] Article 3 of the PIFC: public entity is a central or local public administration authority, public institution or autonomous authority/institution, managing funds from the national public budget;

There were also other issues on the current legal framework but for overcoming these, the 2010 PIFC law will not have to be changed. For example, the certification programme needs to be improved and Heads of IA units need to be certified too (no requirement at the moment) but these issues can be arranged by secondary legislation. Article 29 of the 2010 PIFC law gives the MoF the authority to formulate and develop mechanisms for certification of internal auditors.

Other issues which were mentioned[13] as obstacles in executing the IA function are:

- the lack of Audit Committees (the proposal is that public entities whose annual budget exceeds the amount of 1 billion lei, should have an internal audit committee);
- the National IA Standards (NIAS) should be updated and practical interpretations of NIAS should be developed;
- methodological guidelines for the most complex and difficult issues applicable to internal audit activity are missing.

The legal status of 1 and 2 persons IA units and the minimal entrance requirements have certainly had a negative effect on the development of IA in the public sector of Moldova. The other issues raised are all more related to the need for continuous updating and improvement of professional guidance material than to an incomplete legal framework.

Not only is an incomplete legal framework an obstacle for the development of PIFC, also compliance with existing PIFC legislation is an obstacle. Internal procedures and process descriptions are sometimes / often missing, although the 2010 PIFC law[14] prescribes the development and the FMC manual presents templates for them. Furthermore, the CHU of the MoF has in its annual report clearly signalled that internal procedures of budget entities are insufficiently developed. This signal has apparently not led to any actions taken by the responsible authorities.

Internal auditors also experience other difficulties in their work. According to a letter[15] of the Association of Internal Auditors to the MoF:

- auditors are forced to perform operational tasks, which are within their audit remit, affecting the independence and, objectivity of the auditors;
- auditors are not presented / or are presented with enormous delays required documents, which affects the timeliness and quality of the internal audit activity;
- auditors are not given access to certain resources that are necessary to achieve the objectives of internal audit activity;
- auditors may fear having problems when they reflect findings in audit reports about the public entities' poor management. These breaches of the PIFC law[16] have been reported by the CHU in its annual report but no real measures have been taken to improve this situation.

After discussing the 2015 CC Report, the Committee on Economy, Budget and Finance of the Parliament of Moldova decided that, within six months, the government will have to initiate and finalize amendments to Law no. 229 on PIFC in 2010, including the scope of IA on public companies and the status and salary of internal auditors.

3.1.8 Too many reforms in parallel

The Moldovan Government has prioritised a few big structural changes: the number of ministries will be reduced to nine ministries and control will be decentralised to budget organisations and municipalities. In addition the Association Agreement between the EU and the Moldovan

[13] Mainly by the Association of Internal Auditors
[14] Article 14 of the 2010 PIFC Law
[15] Letters to the MoF September and December 2016
[16] Articles 23.1b, 25.2 and 27.2.1 on access to information, respectively ensuring independence and the prohibition for internal auditors to carry out operational tasks

Government foresees reforms in many areas[17] and, related to this project, a Public Administration Reform, a Public Financial Management Reform, an Anti-Corruption reform and the PIFC reform are programmed.
But also agreements with international organisations such as the World Bank or bi-lateral co-operation agreements with EU Member States envisage reforms or are contributing to recently defined or on-going reforms.

All in all, many reforms in Government and in independent institutions such as the CoA are ongoing in parallel. Lack of ownership and of sustainability in Government are important confounding factors; ministers have been replaced and staff are frequently changing positions. Furthermore, counterparts of external experts are often understaffed units with one or two staff members.

The many reforms in parallel ask for much of the management's attention and they require much work of implementation. The absorption capacity of the Moldovan public administration is limited. The effect is that management involved in reforms are not really interested in the PIFC reform: there are more important reforms to deal with, mostly related to their operational tasks. The implementation of PIFC is thus regarded as a MoF problem.

Attention for managing changes is lacking in reform plans. As indicated before, a successful introduction and implementation of FMC and IA requires a change of mentality ('culture'), knowledge and experience. This change will take time and requires co-ordination with related reforms. For example, the reduction of regional offices of the Public Procurement Agency (PPA) and the Treasury will have impact on the ex-ante control of commitments and expenditures. The introduction of E-Procurement will result in only ex-post controls. The effect of the abolishment of ex-ante controls by PPA and Treasury and the decentralisation of these controls to Local Government has already led to visible effects: local budget organisations delay paying their tax and social security bills but use funds for other purposes. Taking time for introduction of reforms and thinking through their consequences during the transition period should be a part of the reform plans, including how to finance the reforms. However, pressure of donors and ambitious Government plans to start new reforms may lead to incomplete reforms and poor evaluations of implemented reforms. There is a lack of engineering at the Government level to evaluate the risks of the suggested reforms. The question is if all reforms are that important and urgent that they all have to be carried out at the same time within a short time period.

3.2 Factors that influence the development of PIFC

During the meetings the experts observed factors, which could have influence on the development of PIFC. Interviewees did not directly define those factors as concrete hurdles but the experts would like to address these factors in this report too because their existence can be regarded as additional elements of importance for slowing down the development of FMC and IA on central and level II budget organisations.

3.2.1 Factor 1: operations of Financial Inspection function

A centralised financial inspection is an ex-post control function which finds its origin in the former socialist plan economy. In Moldova this type of control is carried out by the FI, which is positioned under the MoF and has a budget for 135 staff members. The objective of financial inspection is to check the observance of the regulatory framework in the budgetary, economic and financial areas and to identify breaches/damages made by entities /staff subject to financial inspection. The results

[17] Procurement, Tax and Custom policy, Tax administration, Custom administration, Public debt, Public accounting and reporting; in addition, reforms linked to the SOEs. Partly some of these reforms are also related to the WTO

of financial inspection services are orders for correcting the identified irregularities and to recover damages by means of administrative or criminal procedures.

During the meetings with key-players the experts received several comments on the functioning of the FI. There were views that said that FI is the root cause of the non-development of IA. These views find (correctly) their base in the principle that the work of the FI does not really fit into the PIFC concept. A concept which promotes managers to take responsibility for delivering services in a legal, efficient and effective manner and to be accountable for the delivered results. In carrying out their tasks these managers can then be supported by an internal audit function. However, the FI activities necessitate managers to focus on delivering services in a legal manner by complying with laws and regulations. In a highly legalistic environment there will be no or very limited room for managers to manoeuvre in order to arrange activities in an efficient and effective manner. Punishment will eventually be the reward.

It is correct to state that a well-functioning FMC and IA do not need an ex-post function as the FI currently is carrying out. However, in Moldova FMC and IA are not functioning well yet. The implementation of PIFC in Moldova is lagging well behind what the 2010 PIFC law and the 2014-2017 PIFC Programme envisage.

Except from a few IA units, since 2010 the FI was the only Government control function that reported on mismanagement and irregularities. (To be complete: the external audit institution CoA also reported on malfunctioning of the public sector organisations in that period). Law enforcement bodies and Parliamentarians are very positive about the functioning of FI and view the FI indispensable for fighting fraud and corruption. Not least because of the limited impact IA has had since its establishment on improving operations and exposing such malfunctions in the budget organisations. FI has during these years functioned as the last beacon in the administrative control chain. As long as the FMC, internal and external audit do not function according to international standards there seems to be a need for an ex-post control function such as the FI when it comes to raising the quality of Law enforcement entities investigations of financial matters and for improving operations of budget organisations. However, there may exist several alternative solutions for how to best achieve this.

Having said this, there is of course always a need to make sure that the mandate and resources of such an inspection body reflect the most important needs. The question is if FI should continue all its current activities and with the same approach. During the last 20 years the FI has on request of then Governments and Parliamentarians taken on several partly new tasks. Tasks that in other countries usually are executed by other Government inspection type of services. For example, the FI inspects the prices of certain socially important goods. In other countries such inspections are often carried out by specific government bodies working for the respective ministry or agencies in charge.

The FI also functions as a specific type of external auditor of Local level I Government, a task that normally is the responsibility of and is carried out by a Supreme Audit Institution at central or regional level (equal to the CoA of Moldova). In this case the FI is replacing the audits following an informal co-ordinated planning with the CoA which is lacking necessary resources. Furthermore, FI also operates on request of the President of the Republic of Moldova, the Prime Minister, Government, Members of Parliament, citizens and do inspections of activities and persons pointed out by these requesters. In other countries, where FI institutions also work on request, Members of Parliament do not address requests to a Government institution such as the FI but to the CoA or other services at the level of Parliament.

The requests for inspections are even increasing over the years. For example Law enforcement bodies more and more ask the FI for help to look into the financial related parts of their pre- or criminal investigations. A limitation of the number of requests seems to be needed as the demand on capacity is quite high. A common solution for managing such requests is also to have specific institutions to look into such requests.

From the discussions on the possible future position of the FI the experts learned that a complete abolishment of the FI institution for the time being would not be in the interest of the Moldovan society but also that the tasks of FI should be limited and brought in line with the need to support the development of FMC and to compliment the IA function.

3.2.2 Factor 2: structures of entities and companies linked to /owned by the public sector are complex

The current internal control and audit solutions for the public sector cover, seen in a PIFC perspective, only a part of the sector. Namely only the State budget entities and the Local level II part. This is not a hurdle in itself but a reality that has partly contributed to the slow implementation process of internal control and audit up until now. The reality is about the complex organisational structure of the public sector and how this structure is regulated. The structures in use quite often have as a consequence that the internal control and audit arrangements that are supposed to safeguard the public resources and objectives are set out of play or even deliberately circumvented.

An effective internal control and audit of the public sector is needed in order to create the necessary public trust in, and citizens willingness to contribute to, the effective functioning of the sector. In order to build up this trust, it will be necessary for the Government to, at some point in time, make sure all organisations involved in producing public goods or services are covered by effective and transparent internal control and internal as well as external audit arrangements. This is also a requirement for meeting European good standards as well as internationally accepted standards for good financial management and internal as well as external audit. However, much work based on careful analyses and communications with all stake-holders are needed to achieve these requirements.

Moldova has currently a public administration with rather many entities with different levels of autonomy, legal bases and judicial forms. But also with fundamental differences in economy and staffing for setting up the control functions needed. However, many entities do fully or partly produce or deliver public services. Besides the 16 ministries and about 38 so-called Independent Institutions there are some 900 local authorities at local level 1 with elected majors. Due to size three of these are defined as municipalities. Level II consists of 35 regions. Level I and II entities are autonomous to a considerable extent. The organisational picture becomes more complex as several enterprises are producing / are part of producing public services. These enterprises may be state owned / partly state owned or owned by Local authorities.

The MoF is currently, in partnership with the World Bank, analysing how to enhance good governance solutions for State Owned Enterprises (SOEs) in Moldova. The work is based on the OECD Guidelines on Corporate Governance of SOEs (revised version, 2015)[18]. The World Bank in its first report “Support to State Owned Enterprises in Moldova, 2016” estimates (these numbers vary considerably between different registration authorities) there are 189 (261 according to other sources) SOEs and about 41 (111 according to other sources) so called Joint Stock Companies (JSC). The report shows that SOEs in Moldova play a major role in the national economy as significant owners, operators and employers in key sectors.

[18] http://www.oecd.org/daf/ca/OECD-Guidelines-Corporate-Governance-SOEs-2015.pdf

The number of enterprises and other entities associated to local authorities are, according to various sources, estimated to be more than 300. Most of them seem to have a low turn-over. Some of these companies are producing public services. Others are said to have been established with the primary objective to pay civil servants better salaries (as Member of Boards, advisors etc.). This is also said about some of the enterprises at central and local level II.

For all levels it seems that the systems, levels and quality of internal control used in these different entities vary considerably. As do the systems for internal audit in cases such audit exists at all.
The external audit of Level I organisations is the responsibility of the CoA. However, the CoA has limited resources and has therefore an arrangement with the FI for them to carry out inspections as a substitute. No external financial audits based on INTOSAI or IFRS standards are done of these entities.

The legal forms of partly/fully state owned SOEs and JSC differ in requirements and governance practices. The founding line ministry is responsible for the SOEs strategic management while the Public Property Agency is responsible for some ownership functions including assessment of their performance. The MoF is responsible for the monitoring of the financial performance of all fully state owned enterprises plus the JSCs owned by the state to 50% or more.

Statutory financial audit of all individual SOEs Annual Financial Statements are now being introduced.

The World Bank sums up its analyses of the SOEs saying that the quality of financial information prepared by SOEs is not reliable for economic decisions. The Bank notes also that there exist significant risk factors for resource leakages and that the quality of the audits done of SOEs is “very weak”.

4 How to overcome the hurdles? Possible solutions

In this chapter the experts will present possible solutions to overcome the hurdles defined in Chapter 3. The recommendations made are not limitative. For a successful implementation of PIFC at all levels of the public sector of Moldova the experts regard the implementation of the presented recommendations as indispensable; so the aim is to first of all raise the level and effectiveness of internal control and audit, also at the Local levels I and II. This Chapter also present possible solutions for the factors, mentioned in Chapter 3, which influence the development of PIFC and the overcoming of the hurdles

4.1 Tone at the top: managers are not interested in PIFC

It has been underlined by many that managers at all levels often are seen to not take any direct interest in implementing FMC or IA or other financial matters. There is a rather common “active disinterest” for these activities. Responsibility for FMC and IA is often informally delegated down in the organisation but seldom followed up.

As indicated in Chapter 3, the MoF yearly issues a report (article 29 of the 2010 PIFC law) on progress made in the implementation of PIFC. However, the weaknesses in FMC including IA and their causes are not clearly addressed in this report and the overall quality of the report is commonly judged to be inadequate and not possible to build firm decisions on.

The MoF – or the Prime Minister – has no obligation to, and has not, put forward this annual report to any regular meeting of ministers. Neither is this report used by the Minister of Finance in formal discussions on the current status of FMC with the respective fellow ministers. No other overviews of the status of implementation of FMC and IA have, to our understanding, been discussed in a formal meeting of the ministers or with state secretaries.

It is of course likely that the very fact that there are no reactions on the status of the implementation of FMC and IA from the government as such, or the individual ministers, is, wrongly, taken as an indication of the low importance attached to the implementation. If this, as it seems, rather widely spread view is ever to be changed, the change must be visible and include the ministers of the government, the state secretaries and their administrative support. Procedural actions should and could be taken to remedy the situation in the shorter as well as longer time perspective taken into consideration the eventual forthcoming restructuring of the government organisation.

We recommend as actions to take in the short term (given what is said below on actions concerning among others the PIFC Council, quality of the MoF Annual Report and Good Governance Declarations):

- Every year the Minister of Finance presents the Annual Report officially in a Government meeting together with an Action Plan for the coming 1-2 years;
- The Government decides upon the Action Plan and concerned ministers should complete actions within a set time-line;
- The Minister of Finance presents the approved Annual Report and the Action Plan to the Parliament for information. And makes it public on the MoF website;

- The MoF (PIFC Council) follows up the action plan every six months and presents current status on the respective action to the Prime Minister in a Government meeting;
- The conclusions on the Action Plan and its current status are summed up in the next Action Plan;
- A half day seminar arranged on the overall objectives for FMC and IA and on the value for the minister and the ministry. Good examples are presented. And also, how to meet the challenges when implementing FMC and IA to be arranged exclusively for ministers in place. Compulsory participation. Prime Minister to be invited to the final summing up;
- A similar half day / a day seminar arranged for the state secretaries;
- Two pilot audits in two ministerial sectors of varied complexity to be carried through. Focus on the final quality and usability for decisions on the external consolidated financial reporting by the MoF. And how this quality is dependent on the inputs from all involved sub-ordinated entities. With recommendations on how the quality and usability for the entire data managing chain up to the state secretary and minister could be improved.

We recommend for the longer term:
- Careful consideration of how the structure for each ministry should best take into account the need for an active involvement in the policy development and implementation including monitoring and operation of FMC and IA;
- A series of 2-3 seminars to be arranged for all ministers and state secretaries on objectives, ambitions and background of FMC and IA after the restructuring of the ministries. Including their respective obligations / responsibilities for monitoring, supporting and taking actions on potential deviations etc. And the tools they could use for this;
- A routine is instituted for the state secretaries to have regular meetings and exchange of experiences among themselves on good policies and practices when implementing FMC and IA (and other policy and administrative matters of high importance);
- A system for annual financial audit of the Annual Financial Statements of each ministry is decided and designed. Court of Accounts does the audits as an external auditor. Audit reports to the Parliament. This audit system could be prepared and tested at an early stage by doing pilot audits of a few annual Financial Statements.

4.2 Lack of strategic perspective for the implementation

The lack of impact of the annual reporting on the development of FMC and IA is only recently defined as a problem by the MoF. The PIFC Council[19] has to endorse the annual report and to review problematic issues related to the functioning of the PIFC system and submit proposals on their settlement. In practice, the strategic impact of some of the problems discussed is not taken into account. The impact of the PIFC Council is limited. Mostly IA issues are discussed. FMC is not represented in the PIFC Council.

The PIFC reform is also not closely linked to related reforms such as PFM and PAR. The roles and responsibilities of State Secretary, finance departments and operational departments in budget organisations are determined in those reforms. The 2010 PIFC law assumes roles and responsibilities for FMC, which might be contradicted by new ideas about roles and responsibilities of managers presented in the PFM and PA reforms. The current PIFC Programme focuses on the technical aspects of introducing PIFC in isolation and has not any relation with other reforms. Managerial accountability cannot successfully be introduced if basic conditions are not present in the public administration.

[19] Article 30 of the PIFC law

We recommend as actions to take in the short term:

- The PIFC Council needs to be transformed into an advisory body to the Minister of Finance on short and long term strategic FMC and IA issues. This could be done while basing itself on monitoring results and practical experiences of the Council members. The Council should furthermore include representatives of budget organisations of all levels in the field of FMC and IA and the academic world. Decision making should be formalised, a Vice-Minister of Finance, responsible for the development of PIFC, will be chair and the CHU operates as secretariat of the Council. The PIFC Council should also have the right to invite IA and Executive Managers in Public Institutions and to discuss PIFC issues with them;
- Analyse actual functioning of the PIFC Council and explore the possibilities to improve its impact in two directions. First, how to influence decision making regarding development of PIFC at the top level. Second, how to best support the development of FMC and especially IA in reality in real and practical terms;
- Align the process of updating the PIFC strategy with processes of updating PAR and PFM strategies and ensure that in PAR and PFM discussions about the role and tasks of a Finance Department as provider of budget execution and performance information are included.

We recommend for the longer term:

- The CHU to analyse the extent to which the present FMC arrangements contribute, result in the delivery of the objectives of organisations as well in more efficient and effective public services within the financial parameters set by the budget;
- The CHU to establish whether control arrangements are compatible with the objective to establish a modern and efficient system for public financial management and place stronger emphasis on monitoring actual expenditure against the budget and actual outputs against targets than merely focus on the control of inputs.

4.3 Work in silos

There seems to be a need to stimulate initiatives for communication, co-operation and co-ordination between the services/entities in areas of FMC, external and internal controls and audits. The demands on such actions are not that clearly laid down in laws/regulations. However, the question is whether clarification of regulations should meet this need. There are many examples, not least in the literature on public bureaucracies and good communication, where one is warned that co-operation and communication based on formal requirements risks to become more a heavy work burden with few positive effects. Co-operation etc. needs, it is often said, to be based on common interests and supported at all management levels in order to be effective. The experts have also been told about recent positive examples of more active communication and co-operation between services based on initiatives taken by managers at different levels. For example the initiatives for better cooperation between the Anti-Corruption Prosecutor and FI (on delivering files) and NAC and CHU and CoA (on corruption risks). The experts' conclusion is that a first-hand alternative to use for better communication etc. should be to systematically stimulate and encourage such activities. And to use all opportunities to make good and interesting examples widely known among managers and staff.

We recommend as actions to take in the short term:

- underline the importance of effective communication etc. among all stake-holders on internal control or internal audit in policy papers and guidelines on FMC;
- highlight the importance of effective communication etc. in all seminars and training activities of managers on these subjects. And to the extent possible also stimulate participants to reflect on how their communication etc. ought to develop;

- highlight interesting initiatives for communication, co-operation or co-ordination on FMC or IA in the MoF PIFC Annual Report.

We add for the short term:

- All control entities and their staff is reminded that it is mandatory to report indications of potentially serious fraud and corruption. The CHU therefore, after consultations with the General Prosecutor's Office and the PIFC Council, issues a reminder and first guideline about the responsibility of all internal auditors, who in their work come across such indications of fraud or corruption, to report these to the General Prosecutor's Office.

4.4 Reforms demand specialists but supply of specialists is limited

The success of the on-going reform of the public administration is to a considerable extent dependent on an easy and affordable access to very varied specialist competencies for the entities under reform. Examples of such specialist areas are internal auditing, public sector accounting, financial management, micro and macro-economic analyses, asset recovery, public procurement and investigation of suspected financial crimes. Not all areas demand many staff but every area demands a high degree of specialisation. Today several of the public entities responsible for introducing and implementing parts of the PAR are struggling to find as well as to keep such specialists over time. Training is needed both in order to increase the level of specialisation of existing staff and to make sure specialists are updated over time. It is clear that the number of the available sought-after specialists needs to increase. It is equally clear that the concerned public entities struggle with finding, training and retaining the specialists they need.

Several actions to ease the current and forthcoming situation have been taken and more are already planned. The salary levels for internal auditors are proposed to be adjusted and the number of internal auditors in training is likely to increase already in 2017. The Government intends to revise the certification programmes for internal auditors and to draft new ones for Procurement Officers, Accounting Officers and eventual other experts in great demand. The IA units will be restructured and the intention is to make sure the re-structured ministries will have properly sized IA units (MoF plan, December 2017).

We recommend as actions to take in the short term (in order to reflect European practices):

- introduce in the certification programme for internal auditors a standardised examination of their knowledge in specified subjects relevant to the profession;
- carry out this examination by a carefully selected training institution supervised by the CHU on behalf of the PFIC Council (or a similar practice);
- require that a senior internal auditor has at least three years of proven practical experiences as internal or external auditor or closely related areas;
- require that a permanent Head of an IA unit meets the standards of a senior internal auditor and furthermore have some defined and relevant management experience.

We further recommend for the short term:

- that, as far as possible, similar levels of theoretical knowledge and practical experiences are considered to be applied for other specialists in the financial area;
- the Government complements its drafting of certification programmes with an analysis of how the demand for different types of specialists linked to the ongoing or planned reforms is likely to develop over time.

We recommend for the longer term:

- that the Government starts an analysis of the existing potential organisational alternatives on which one might build a longer term sustainable solution for the immediate as well as forthcoming major training needs of specialists as well as managers and generalists.

4.5 Lack of understanding in entities and among staff at all levels what FMC and IA is about

The overall objective of FMC is to contribute to delivering better quality services to the users and taxpayers in Moldova. The main purpose of FMC is to tighten up management and to clarify its responsibilities making every manager clearly accountable. The main implementation problem of FMC is that FMC is regarded as a purely technical exercise. However, it is to a great extent a reform of the “culture” and the habits of how management has been exercised. That is why such – and similar - reforms often take more time and efforts of all kind in order to achieve an effective implementation. FMC requires a different style of public management than what has been in place in many countries in the region. An example is that the nature of management according to FMC requires the managers to take some risks. Well-analysed, yes, but anyhow to take risks. Yet the penalty arrangements that apply in most transition countries and in Moldova when mistakes occur, discourage the willingness to take risk.

To help the managers fulfil his/her responsibilities advice and support is needed. That is the role firstly of a finance director or financial controller and, secondly, of the internal auditor. The role of the finance department ought to be much more enhanced than it is now in Moldova. The public finance legal framework also foresees such an enhanced role. The 2016 Law on Public Finance and Fiscal Responsibility and the 2010 PIFC law define management tasks in which finance departments could assist by analysing internal budget proposals, negotiating with MoF on budget proposals and monitor and report on budget execution. However, as have been mentioned above, finance departments are still mostly regarded as departments for bookkeeping.

The finance department staff needs appropriate training to understand what financial management actually means and what the role of a finance director within the organisation should be. There is also a need for training of top and middle managers in order to become ‘financially literate’. However, training will not be enough. Additional approaches for implementation of FMC will have to be considered. Submitting guidance material and awareness raising will not change the dominating management culture. Sanctioning might help but probably only in the short term. The implementation of FMC, especially the full implementation of managerial accountability, will undoubtedly take a long time before being fully established. It is therefore highly likely that a <u>step-wise “learn as you go” approach for implementing FMC will be needed.</u>

Although IA is better known than FMC, there are still managers and internal auditors that perceive the IA function as an extra control mechanism. Using IA for auditing the management of risks in operational processes is less common. The limited status and possibilities to continuous professional development including the high turnover of such staff will certainly risk to have negative effects on the quality of the IA activities. And, consequently, on the perception and appreciation by managers and other staff of the value added by IA to the organisation.

We recommend as actions to take in the short term:

- after restructuring ministries, to establish permanent training for staff of Finance Departments, including the Finance Directors;
- to organise mandatory trainings for top and middle management in FMC and IA;

- to analyse other approaches to implementing FMC, including a phased approach, taking into account legal framework, PFM objectives and institutions where tests of managerial accountability might lead to fruitful results (for example 'self-managing' institutions);
- to analyse if and to what extent and quality budget organisations have drawn up internal FMC procedures, if relaxing of these rules will conflict with the objectives of the 2010 PIFC law (Chapter II) and to which extent and level of quality these organisations are applying risk management.

We recommend for the longer term:
- introduce a step wise approach to implementing FMC in one ministry or 'self-managing' institution and, if possible, test delegated responsibility and authority in practice;
- train management and staff of the pilot ministry in new roles and responsibilities;
- evaluate the experiment with the new approach and amend it, where needed;
- roll-out the amended approach in more ministries;
- organise FMC trainings including risk-management for staff and senior officials of Local Level I working on FMC, in co-operation with the Moldovan Congress of Local Authorities.

4.6 Lack of sanctions

The lack of explicit sanctions in the legal framework for holding officials accountable has had, it is said, clearly negative consequences for not only the rate of the implementation but also for how the law in reality is applied. No sanctions give much room for managers to in fact not act at all. This lack of explicit sanctions must, it is said, be understood in a Moldovan legal context where a silent legal text in reality means no sanctions at all. On the other hand, legalising sanctions could be counter-productive. As indicated in point 4.5, it may help in the short term but it will eventually not change the mentality of managers.

We recommend as actions to take in the short time:
- to clarify the importance the Government, its ministers and officials attach to a successful implementation of effective internal control and internal audit systems in line with existing laws;
- from now on, to carefully monitor the continued implementation of these systems, and how successful they are;
- the MoF then to follow assessments by the CHU and discussions in the PIFC Council of how the need for sanctions is seen, come back on and recommend the actions eventually needed. The matter should also be highlighted in the forthcoming PIFC Annual Report.

4.7 Incomplete legal framework

IA units in the Moldovan Public Administration are very small. There are many IA units with only two or up to five 5 internal auditors (41%). Fifty-nine percent of the IA units have even only one auditor, mostly in Local level II organisations. According to 2010 PIFC law specialised central public administration authorities of Local level II are also obliged to create IA units, but the law does not contain clear criteria for when an IA function should be established or, where this function is established, it should include an IA unit. The effect is that the status of the small IA units is still low with the consequence that internal auditors are used for operational tasks (breach of independence), are not always given access to resources they need for their internal audit activity, and fear for repercussions if they reflect findings about poor management in their audit reports.

The 2010 PIFC law also lacks educational and/or professional requirements for being eligible to serve as an internal auditor. Such requirements are only mentioned in the Law on Classification of Public Functions. Both deficiencies in the PIFC law influence the quality of IA work done. The status of the position of an internal auditor within public institutions is low and not regarded as an attractive job on the labour market (salaries are low too). To improve this situation there is a need to amend the 2010 PIFC law[20]).

Defining how the IA function should be organised in an effective way that also facilitates an objective and independent function of the internal auditors, can be done by amending the 2010 PIFC law or be regulated by secondary legislation. A change of the 2010 PIFC law will be supported by the Committee of Economy, Budget and Finance of the Parliament. In December 2015 this committee passed a decision, based on the 2015 Annual report of the CoA, saying that the Government should initiate the amending and completion of the 2010 PIFC Law with the objective to enhance the status of the internal audit unit and improve the payroll for the internal auditors.

The MoF intends to analyse the internal audit universe in 2017 and to decide on establishing IA units of a minimum size in order to protect the quality and standing of the internal audit profession over time. There are several possibilities for enlarging the staff of IA units. One may be to merge small IA units, another to arrange access to use the IA function of larger entities based on a cost-sharing agreement with them. A further alternative may be outsourcing of the internal audit function. And there are several other ways. Such arrangements may be possible with no or limited additional costs. Carefully set up they will also need to meet all external demands for having an effective internal audit arrangement**.** This action will probably give a useful input for how to in a next step organise IA in Local level I (900 entities) and State and Municipal Enterprises.

It is clear that there is also a need to further close the gap that exists between theory and practice when it comes to IA methodology and understanding of the IA standards.

We recommend as actions to take in the short time: (in addition to 2017 MoF activities to amend the 2010 PIFC law and define IA universe and criteria for the establishment of IA function and IA units):

- improve the conciseness of the PIFC law by regulating the facultative establishment of Audit Committees, the role and responsibilities of the Finance Director, and the certification of staff of Finance Department and Heads of IA units and internal auditors;
- analyse how the larger entities to be created should operate in relation to the entities that will not have their own internal auditor(s) anymore and give recommendations for how a transition from the one or two person IA units to a larger unit could be best done;
- explore the extent of the gap between theory and practice when it comes to IA methodology and understanding of the IA standards by using a standardised survey which should be addressed to all or a statistically relevant number of internal auditors currently working in the public sector institutions and to arrange roundtables to find out what the causes of the mismatch are.
- examine how the larger entities, which are to be created, must operate in terms of entities that do not have their own auditor (s). Moreover, analyze and give recommendations for the way they could be best achieved by transition of an IA unit of one or two employees to a higher IA unit.

We recommend for the longer term:

- When a critical mass of larger units has been established, to train heads of IA units in their role as manager of a unit with professionals. This means training in all aspects of management:

[20] This activity is on the 2017 work plan of the MoF.

programming of audits and reporting on results, ensuring the quality of the audit products, creating a lasting value for the organisation, communication with top-management and balancing requests from several clients, human resource management (recruitment, professional development of staff, performance appraisal).

4.8 Too many reforms in parallel

Too many reforms, reforms started but not completed, ambitious time-schedules, lack of qualified staff to implement reforms, no or low co-ordination between donors about reform initiatives or on sequencing reforms - that is a fundamental part of the picture presented to the experts during their on-site visit. The PIFC reform is certainly not regarded as the most important reform. By some it is not seen as important at all. Government officials but also the donor community should be alert to avoiding overlaps or the risk of a reform fatigue among Government staff: “better fewer reforms with good results than many reforms with poor or even no results”. The slogan “Less is more” was introduced by the EU for support to ENI countries. It should be carefully considered when new reforms are in the entrance while related reforms are not yet completed or hopes for results are not in place.

We recommend as actions to take in the short term:

- the Government of Moldova to make an inventory of reforms and start a dialogue with donor community on prioritising and sequencing;
- the Government of Moldova to require donors to co-ordinate their support initiatives;
- the EU, as main counterpart of the Government in Moldova, to evaluate the realism of the implementation of reforms frequently (monitoring) and if needed to take corrective actions in order to avoid highly unclear results in the end;
- the MoF to compare its 2017 Action Plan with other reforms in terms of sequencing.

We recommend for the longer term:

- the Government to report on the results of the reform activities per ministry on annual basis to Parliament and society.

4.9 Operations of Financial Inspection function

The current remit of FI is broad and includes tasks which should be tasks of ministries (e.g. inspecting prices for social important goods) or of the CoA (auditing/inspecting Local level I budget organisations where CoA consider it has not enough resources for an annual audit). These and other programmed inspections in ministries and SOEs influence negatively the development of IA and of the CoA.

A reconsideration of the FI remit is recommendable, which should be in line with article 49 of the Association Agreement that stipulates that the EU and Moldova should co-operate in

“*b. the development of an adequate financial inspection system that will complement but not duplicate the internal audit function and will ensure adequate control coverage of government income and expenditure during a transitional period and thereafter”.*

Further, the use of the FI by Members of Parliament should be eliminated. From a principle but also practical point of view (CoA has a wider mandate as it is linked to Parliament) requests for inspections or audits should better be addressed to the CoA and not to a part of the Executive branch, a sub-ordinate body of the MoF.

We recommend as actions to take in the short term:

- to decide on re-structuring the FI into a sub-ordinate body of the MoF only acting on request;
- to analyse the position of the FI for further developing its professional expertise and services to foremost serve the prosecution and anti-corruption services and the consequences of the new position of the FI for IA, CoA and ministerial inspectorates (where existing) in the short and long term;
- after analysis, Government to approve the structure and competences of the new financial inspection body and date of entering into force;
- to train the staff of the new FI service in the newly defined competences.

We recommend for the longer term

- to introduce for the new FI service the utilisation of special financial investigative techniques, best standards and practices of EU countries;
- to train FI staff in understanding the requirements in relation to quality and quantity of evidence.

4.10 Structure of entities and companies linked to the public sector at all levels is complex

It is clear that there is a great and rather urgent need to start the time-consuming and probably complicated process forward of building up the internal control and internal and external audit arrangements of SOEs as well as other entities linked to the public sector at all levels. The planned territorial reform may be a good opportunity for drawing the line for which type of entities should be part of the public sector and how. As well as to strengthen the governance solutions by implementing more effective and efficient systems of internal controls and audit. The ongoing work by the MoF, with technical assistance from the World Bank, is an additional very good step.

We recommend as actions in the short term (taking into account the lessons learnt from the WB project):

- to clarify how many entities, their type of production of goods or services, clients, objectives, number of employees, current financial situation etc. exist at the local level owned or associated in one way or another to the local authorities. And to which extent these entities produce goods or services for the local authorities; a similar clarification may also be essential for entities at the central level;
- to analyse the level and quality of the internal control, internal and external audit and quality of the accounting arrangements for these entities;
- on the basis of such an analysis, to recommend the eventual actions needed in order to get well-functioning internal control and audit systems in place at all public sector levels within a reasonable time-frame.

We recommend for the longer term:

- A careful consideration, involving all stake-holders, of the possibilities and alternatives to make sure the local structures will be able to also meet future demands for public services.

5 Way Forward

The implementation in the public administration of systems for financial management, internal controls and internal audit are severely lagging behind the set objectives and the ambitions as expressed in the 2010 PIFC law and various policy documents. Implementation of these systems has not come far even if they are only seen as purely technical controls of the finances. However, they are even more fundamentally lagging behind as the implementation concerns key parts of a modern FMC system where managers are thought to have wide delegated responsibilities and where the managers also are hold accountable for actions taken, or not taken, based on how they manage the operations and risks of not achieving the objectives of their entities.

Each and every of the eight hurdles, put forward in the interviews and discussions the experts had with stakeholders, have had clear negative effects. Individually and together these hurdles provide the explanation to why the implementation of FMC and IA after six years is still in its infancy. There is now an urgent need for the political level of the government and the managers at all concerned levels of the public administration to take a clear lead and breathe new life into these reforms.

This much needed active lead should always be based on updated overall strategic perspectives. The FMC and IA reforms must fit well into the objectives of, and be carefully timed with, all other ongoing related PFM and PAR activities. Different activities within the reforms should to the extent possible not compete for the same limited personnel and other resources the Government has at its disposal. The implementation must be actively monitored. The CoA may contribute positively to the monitoring by annually reporting on the progress made on the FMC and IA reforms based on experiences from its audit activities. There should be readiness in all entities to quickly take actions in order to manage every potential (old or new) hurdle. The work must be based on an effective co-operation (including time planning) between all concerned parts of Government under the lead of the MoF. There must also be a close co-operation and communication between Government and donors in order to make sure the donor activities are clearly related over time to the work plan of the Government.

In this report the experts put forward many recommendations for the short and long term in order to better overcome identified hurdles and to speed up the implementation of FMC and IA for achieving sustainable results. Some of these recommendations may be demanding from both a political and resource point of view. However, there are also many recommendations which have a potential to give positive results quickly. The experts suggest that efforts should first be concentrated on the latter type of recommendations with the ambition to create good results that may be useful for many. And these results should then be widely disseminated to stake-holders. A step-wise approach will probably be preferable.

Against this background the experts suggest that upfront actions may be considered in the following areas:

- Better timing and sequencing of different parts of reforms (specifically PFM reform) are needed if PIFC should be implemented as foreseen in the 2010 PIFC law and agreed in Association Agreement;
- The monitoring and evaluation function of how the implementation of PIFC develops needs to be strengthened. Annual or bi-annual monitoring reports, prepared by the CHU of the MoF and endorsed by the PIFC Council, should reflect the achievement of clear targets for the

implementation. These reports should be discussed in Government meetings and repeated non-achievements should lead to sanctions;

- The PIFC Council should be revitalised. It should function more as a think tank on FMC and IA issues and as an advisor for the Minister of Finance on strategic issues than a discussion forum on PIFC technical issues. The CHU of the MoF should be more pro-active and their tasks should be reconsidered;
- More awareness raising is needed at all levels of the Government and public sector entities for making sure that the FMC concept is better understood and also implemented;
- There is an urgent need to set up professional training programmes and training facility. Ad-hoc solutions will not work; sustainable solutions are needed both in order to increase the level of specialisation of existing staff and to make sure specialists are updated over time;
- Certification programmes and tests of specialists should be standardised. The standards need to meet tomorrow's demands;
- Not only a quality of the staff resources needs attention but also the number of staff in public finance positions. There is apparently a need to strengthen the IA units with more staff positions. One way to do that is to merge existing IA units and to find effective ways to share these resources between different organisations. Or for example to restructure the existing FI and by that way to free up positions which may be transferred to IA units.

We conclude our analysis by underlining that the eight hurdles defined in this project, which all have negatively influenced the implementation and development of PIFC in Moldova, are all hurdles which can be overcome by taking relevant measures. These measures will require full attention of the Minister of Finance and sometimes even the support from the Government as a whole and also the donor community in order to achieve an efficient and effective implementation. The very positive feedback we received from most of the our counterparts when discussing the hurdles during our on-site visit gives us the assurance that most of the staff of the public sector organisations are not only willing but also motivated to contribute to the necessary steps to be taken in the PIFC reform. Commitment from the top, a clear steering process and a realistic prioritisation of measures to be taken is all that is needed.

Annex

List of interviews

NR	Name	Function
1	Mr. Octavian Armasu	Minister of Finance
2	Mr. Iuri Cicibaba	Deputy Minister of Finance and Chair of PIFC Council
3	Ms. Angela Voronin	Director of Treasury of Ministry of Finance
4	Ms. Nina Lupan	Deputy Director of Treasury of Ministry of Finance
5	Mr. Ion Sirbu	Head of CHU of Ministry of Finance
6	Mr.Petru Babuci	Head of CHU/FMC of Ministry of Finance
7	Ms. Viorica Pricop	Head of CHU/IA of Ministry of Finance
8	Ms. Ana Ducolia	Director Financial Supervision of Ministry of Finance
9	Ms. Natalia Levitchi	Deputy Director Financial Supervision of Ministry of Finance
10	Mr. Moran	Anti-Corruption Prosecutor
11	Mr. Secrieru	Director Financial Inspection
12	Mr. Ion Borta	Deputy Director Financial Inspection
13	Mr.Valeriu Babara	Deputy Director Financial Inspection
14	Mr. Alexandru Cius	Head Methodology Financial Inspection
15	Ms. Olga Tiju	Division Institutional Assessment at Integrity Department of National Anti-Corruption Agency
16	Ms. Carolina Viaraseu	Tax administration of Prosecutor's office
17	Mr. Tudor Copaci	Director of Public Property Agency of Ministry of Economy
18	Ms. Liliana Iasan	Deputy Minister of Health
19	Ms. Rodica Scutelnic	State Secretary of the Ministry of Health
20	Ms. Gabriela Frunze-Danail	State Secretary of the Ministry of Education
21	Mr. Andrei Stati	Head of Internal Audit of the Ministry of Education
22	Mr. Dorin Chirtoaca	Mayor of the Municipality of Chisinau
23	Ms. Raisa Cotorobai	Head of Internal Audit of the Municipality of Chisinau/Association of Internal Auditors
24	Mr. Stefan Creanga	Chairman of the Committee on Economy, Budget and Finance of the Moldovan Parliament
25	Ms. Tamara Andrusca	Member of the Court of Accounts
26	Ms. Tatiana Cunetchi	Member of the Court of Accounts
27	Mr.Oleg Balan	Rector of the Public Administration Academy
28	Mr.Andrei Grozan	Public Administration Academy
29	Mr. Aurel Simbateanu	Public Administration Academy
30	Ms. Aurelia Tepordei	Public Administration Academy
31	Mr. Veaceslav Ionita	Social Initiatives IDIS Viiorul
32	Ms.Diana Ranga -Enachi	Social Initiatives IDIS Viiorul
33	Mr. Sergiu Gaibu	Social Initiatives IDIS Viiorul
34.	Ms. Maya Gusarova	Senior Public Sector Specialist World bank
35	Mr. Andrei Busuioc	World bank
36	Mr. Constatin Rusu	World bank
37	Ms. Capoceanu - Kristic	Association of Internal Auditors
38	Ms. Livia Jandic	Association of Internal Auditors
39	Ms. Ekaterina Yakovleva	Project manager Public Finance Management EU delegation in Chisinau

NR	Name	Function
40	Mr Jordi Rodriguez	Project manager EU delegation in Chisinau
41	Mr. Lage Olofsson	EU Advisor PFM
42	Mr. Pawel Wojtunik	EU Advisor Anti-Corruption