

## Internal audit as the basis of management system

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**Abstract:** A public law company is a relatively new form of legal entity that combines features of public entities (subjects of public law), unitary non-profit and corporate commercial organizations (subjects of private law). Such conflation of public and private law has led to the integration of certain elements of the management system from each of the above listed legal forms within the framework of a public law company: in public law companies it is required to establish supervisory board, management board (or the sole executive body - general director), audit committee, internal audit service and internal control service. In the article the authors analyze the specifics of organization and operation of the governing bodies of public law companies. The authors refer to the control bodies of public law company as audit committees, internal control services and internal audit services as the elements of management of a public law company. The authors make conclusions on the presence of the gaps and conflicts in the legislation regulating the activities of public law companies. Such gaps and conflicts reduce management efficiency in public law companies. The authors have developed recommendations aimed at improving the management system of public law companies in terms of improving the performance of various control bodies, eliminating the existing legislative deficiencies and increasing the efficiency of the implementation of control powers in order to improve the efficiency of the management system.

**Keywords:** supervisory board, management board, audit committee, internal audit service, internal control service, revision commission.

### 1. Introduction.

A public law company is a relatively new form of legal entity that is established as a non-profit organization (Federal Law of the Russian Federation. (2016)) (hereinafter referred to as “FL. (2016)”), but may be vested with the powers of government authorities to perform certain state functions and public services. As of 01.04.2022, there are five public law companies operating in the Russian Federation: "Russian Environmental Operator", "Unified State Development Company" (hereinafter referred to as “USDC”), "Territorial Development Fund", " Unified Gambling Regulator ", "Military Construction Company".

The structure of governing bodies and their competence are defined in the (FL. (2016)), as well as in other federal legal acts by which public law companies (hereinafter referred to as “PLC”) were established, as well as in the decrees of the Russian Government approving the PLC Charters (See: Decree of the Russian Government. (2020)).

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According to the authors, there are some shortcomings in the law that need to be amended. However, the fact that the PLCs operate as public law entities creates a special responsibility for such companies towards the public. The aim of this study is to establish the interaction framework for the governing bodies of PLCs to ensure their efficient performance and transparency. The objectives of the study are to define the duties of the PLC bodies charged with control and audit in order to optimize governance and avoid overlapping.

## 2. Methodology.

Over the past period, there have been quite a number of publications by researchers that address different aspects of the PLCs' activities:

the goals of PLC with regard to their functions and public law powers (A.R. Bayrakov (2020), A.D. Vnutskikh (2019), N.S. Gnezdilov (2019), O.V. Zaitsev (2017), I.A. Fedorova & A.V. Eremeyev (2018));

the management system of PLC, role and procedure of founder's participation in PLC activities (Zaitseva Y.A. (2019));

the property complex and participation of PLC in civil and financial legal relations (Zaitseva Y.A. (2019), Zaitseva Y.A. (2019 (2)), Zaitseva Y.A. (2020), Zemlyanskaya N.I. (2020));

the issues of control activities over PLC have been considered by researchers only partially (Volchenko I.A. & Kirina O.A. (2016)).

Much of the material on the practical activities of PLCs is available on the websites of these organizations (Official website of PLC "Russian Environmental Operator". (2022), Official website of PLC "Unified State Development Company". (2022), Official website of PLC "Territorial Development Fund". (2022), Official website of PLC "Unified Gambling Regulator". (2022), Official website of PLC "Military Construction Company". (2022)).

The authors point out that there are no known published studies on the organization of internal control (hereinafter referred to as "IC") and internal audit (hereinafter referred to as "IA") in PLCs. All the documents related to studies on the establishment and operation of audit committees (hereinafter referred to as "AC") refer to the activities of joint-stock companies. Two normative documents regulating the performance of audit committees have been issued in relation to joint-stock companies (Information Letter of the Central Bank of the Russian Federation (2020), Order of the Federal Agency for State Property Management (2014)). It should be noted that these documents refer to recommendations by the Central Bank to public joint stock companies and to recommendations by the Federal Agency for State Property Management to joint stock companies with state ownership shares. The authors are also aware of the works of researchers on this issue (Emelyanova V.D. (2019)).

The authors used fact-finding, monitoring, analysis and synthesis to ensure a systematic and comprehensive approach to developing recommendations and conclusions.

## 3. Results.

The legislator has defined the highest governing body of PLC as Supervisory Board (FL. (2016)) (hereinafter referred to as "SB"), a collegial management body, the majority of which is composed of persons holding public offices, municipal offices, or who are civil or municipal servants. No remuneration system is provided for such persons for their participation in the work of SB. The decision on the composition of SB and the regulations on SB is made by the Government of the Russian Federation. At the same time, SB competence suggests that regular monitoring of both the mechanisms for preparing draft decisions and the timing of their adoption, as well as the timely and full implementation of decisions, is necessary in order to ensure the proper operation of the system.

In addition to SB, PLC has an executive body(s) (hereinafter referred to as "Management"). The sole executive body is general director (hereinafter referred to as "GD"), and a collegial body may be established - the Management Board.

**Table 1.** Audit and control within the competence of Supervisory Board

[compiled by the authors]

<b>Powers of SB</b>
Control over the activities of PLC
Adoption of the provisions on IC system of PLC
Approval of the provisions on IA service of PLC, the annual action plan of IA service and the annual report of IA service
Appointment and dismissal of the head of IA service of PLC and determining their employment contract conditions
Approval procedure for the recruitment of the external auditor of PLC, approval of the selected external auditor through a competitive examination
Appointment and termination of the chairperson and members of the AC of PLC, stipulation of their remuneration, bonuses, and disciplinary measures

Due to the fact that the work of SB is carried out on a 'voluntary' basis, it can be a challenge for the work of SB to be efficient. SB must be provided with complete and reliable information on the financial and organizational situation of PLC. Appropriate internal audit bodies shall be established for this purpose.

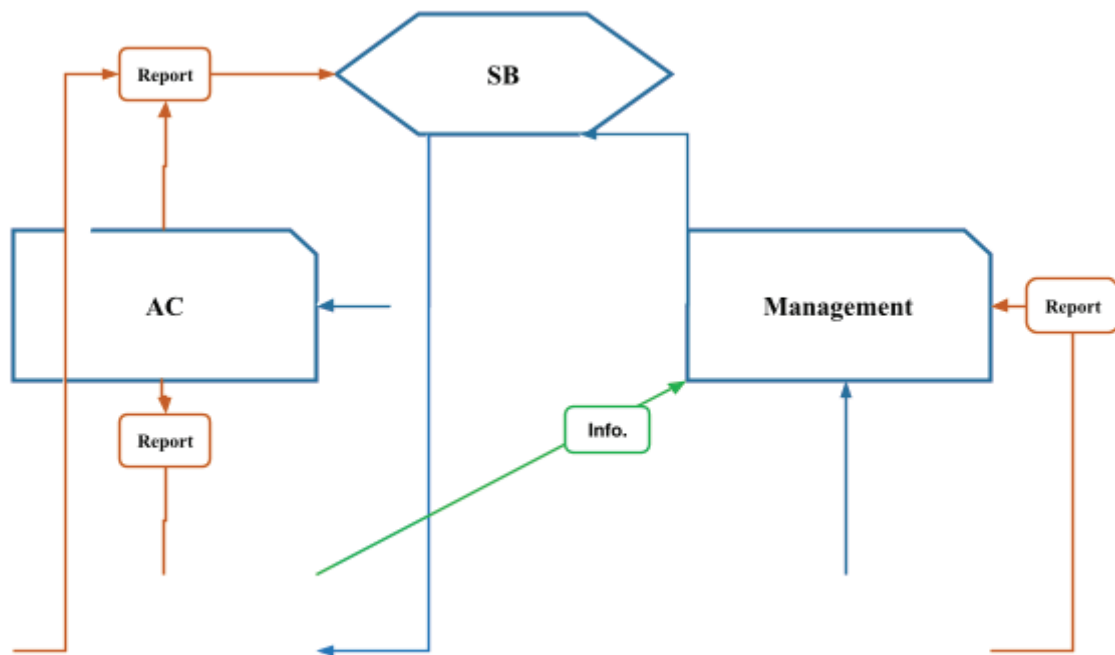
In corporate organizations, which include joint stock companies, the whole control system is subordinated to the needs of 3 categories of users, each of which receives information from different sources (see Table 2):

**Table 2.** Relationship between control bodies and categories of users in the corporate sector [compiled by the authors]

User category	Information resource	Information provider
Owners and their representatives	Inspection reports	Revision Commission and (or) Audit Committee (IA body)
External users, owners and their representatives	Auditor's conclusion	Audit company (external independent audit body)
Management	Auditor's report	
	Inspection reports	IC service (IC body)

Based on the principles of formation of the bodies of PLC (FL. (2016)), the authors drew the following conclusions:

- 1) The representative of the owner in PLC is SB. The AC is formed under SB, is subordinate to SB and some or all members of the AC may receive remuneration (payment) from PLC for their duties. The amount and procedure of payment for the members of the AC shall be determined by SB. Information on the results of the control and analytical activities of the AC shall be submitted to SB.



**IC service  
IC service  
(the head of service)**

**Figure 1:** PLC management, audit and control bodies: chain of command and information flows [compiled by the authors]

2) The IA shall be accountable to SB. The manner in which the IA shall be carried out shall be determined by SB. However, SB shall only appoint the Head of IA. The amount and procedure for remuneration of the Head of IA shall be determined by SB. The authority to determine the size, composition and remuneration of IA service is not laid down in the law for a particular management body of PLC. Information on the results of the audit activities of IA service shall be submitted to SB as well as to Management.

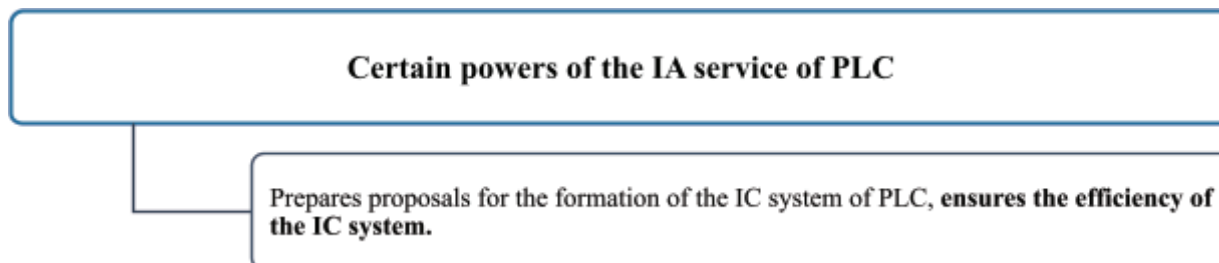


Figure 2: Certain powers of the IA service of PLC [compiled by the authors]

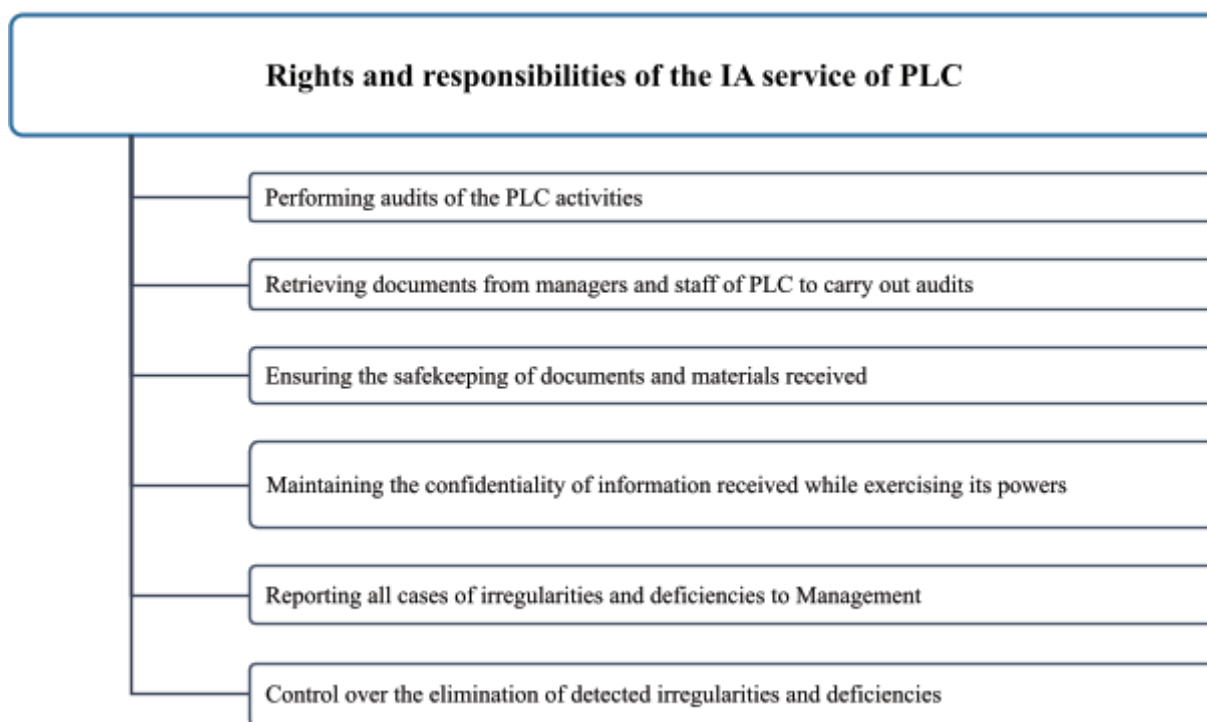
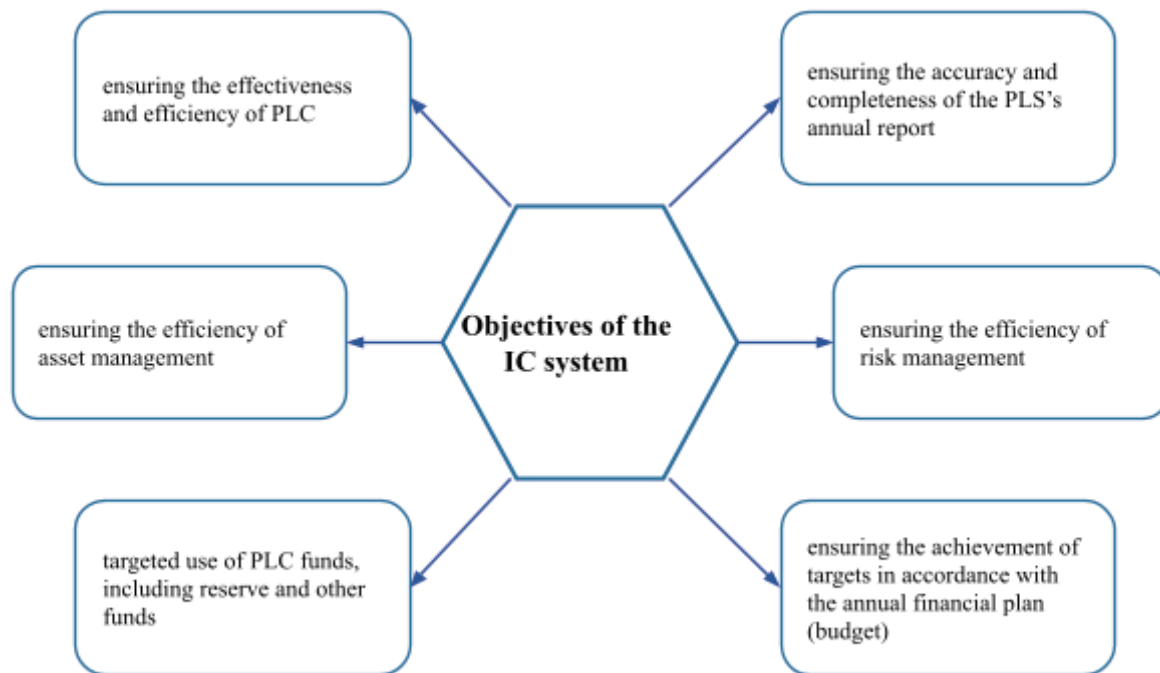


Figure 3: Rights and responsibilities of the IA service of the PLC [compiled by the authors]

3) The IC service is a structural subdivision of PLC and reports to the management of PLCs. The control procedure shall be determined by SB. The size, composition and remuneration of IC service shall be determined by Management. Information on the IC results shall be submitted to Management.



**Figure 4:** Objectives of the IC system of PLC [compiled by the authors]

The external audit of PLC's financial statements is mandatory. With regard to external audit, PLC follows a similar approach to that of the corporate sector:

- the final auditor's report with a conclusion on the truthfulness of the accounts is submitted to SB;
- the auditor's report with a list of detected deficiencies, irregularities and proposals for their correction shall be submitted to Management.

**Discussion.** By analyzing the current legislation, the authors believe that the powers of SB in relation to the AC are insufficiently enshrined in the legislation.

The powers of the SB should include, but are not currently laid down in law:

- drafting of the AC regulation;
- approval of the AC budget;
- approval of the AC activity plan for the year;
- consideration of the annual report of the AC.

All these issues are defined in the normative documents regulating the operation of the AC (Information Letter of the Central Bank of the Russian Federation. (2020), Order of the Federal Agency for State Property Management. (2014)), in the internal legal acts of corporate organizations (Official website of the JSC "Far East and Arctic Development Corporation". (2022)) and it is advisable to introduce them as the powers of SB in the legislation on PLC (FL. (2016)).

In the opinion of the authors, the powers of the IA service in FL. (2016) to ensure the efficiency of the IC system is excessively peremptory. In the absence of a chain of command, it is practically impossible to implement the power to **ensure** that decisions are taken. The authors believe that this wording should take the form of a recommendation: the IA service develops recommendations to improve the efficiency of the IC service. A similar approach is enshrined in Article 160.2-1 of the Budget Code of the Russian Federation (Code of the Russian Federation. (1998)).

The legislator made no provision for competence regarding the appointment (hiring) of the IA employees. The authors take the position that it is advisable to enshrine this competence in the law (FL. (2016)) for SB.

In their analysis of the websites of the existing PLCs, the authors identified a situation where, according to the PLC charter, bodies with overlapping functions have been created. The USDC has established both the IA service, the AC and revision commission (see: "Unified State Development Company". (2022)). All three bodies are subordinated to SB. There is no expediency in this functional duplication, in the authors' view.

#### 4. Conclusion.

The IC and IA system of PLC, established by the legislator, ensures that PLC governing bodies (SB, GD, the Management board) are provided with timely and sufficient information to make management decisions. At the same time, the authors have identified some problems that reduce the efficiency and developed recommendations for changes both in terms of clarifying the powers of SB and the powers of the IA service (FL. (2016)).

The authors also believe that it is necessary to develop recommendations on the AC of PLC in the form of normative document, taking into account the specifics of PLC which is a non-profit organization with some powers to perform public functions and to provide public services.

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