

THE INTERNAL CONTROL UNDER CONDITIONS OF PUBLIC FINANCIAL CONTROL SYSTEM REFORMATION: THE STATE OF IMPLEMENTATION AND THE PERSPECTIVES OF DEVELOPMENT

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Introduction. Nowadays in Ukraine in current conditions of market economy development, accompanied by the processes of distribution of forms, values and consequences of fraud in the sphere of budget funds and public property, the most important need is to provide the efficient public financial control (hereinafter- the PFC), which will contribute to the legal and effective expenditure of public funds and property. At the same time, according to the results of public financial control practice during last years it has lost it's effectiveness. Most of all it's due to the fact that the public financial control wasn't in time to adjust itself to the variable market environment. Besides, it's performance was effective only in the command-administrative economy and already had lost it's topicality. For improving of current public financial control system the specialists have taken a series of normative documents and have implemented the new concept of "internal control" into their practice. The aim of this concept is to become a priority form of public financial control and to combine the most important achievements of international community in this area. Despite the fact that there are lot of scientific articles and researches devoted to this problem the analysis of them doesn't give a complete knowledge about the essence of the public financial control system and it's components. Besides the applied aspect of internal control implementation as a part of public financial control is barely represented. Thus, according to the current research we have attempted to represent the complete idea about the system of PFC, carry out its critical analysis and ground the place of internal control with the theoretical and practical recommendations for it's implementation.

Analysis of the research and publications. The analysis of recent publications on the specified problem and the analysis of current developments in the field of the research has allowed us to divide the existing works into three groups:

the first group should include the developments that explore the issues of internal control, but in terms of business, excluding the specific activity of public institutions. In this aspect it should be emphasized such scholars as Butynets T.A. [2], Vyhovska N.V. [3], Dovbnya V.D. [7], Kovalchuk S.T. [13], Kulakovska L.P. [15], Marchenko D.M. [16], Neskorodyev Y.V. [17] and others;

the second group — scientific papers devoted to the public financial control and the research of international experience in this field, but do not cover the place of internal control in the system of PFC, and therefore do not cover the Concept of public internal financial control [14] and partly differ from the direction of current research. In this sense we can define the following authors: Vuytsiv M.M. [5], Gulko V.V. [6], Pozhar T.O. [18] etc.;

and the third group — the fragmentary experience in the current research area, authored by such scholars as Bugaenko V.G. [1], Vynnychenko N.V. [4], Shevchenko N.V. [4, 23], Slobodyanyk Y. B. [19], Futoranska Y. M. [20], Chugunov I. Y.[21] Fedosov V.M. [21], Chumakov I. Y [22] and other researchers.

The object of this research is the process of public financial control.

The aim of research. Therefore the current research, based on the existing works of various scholars, is essentially a rather new study. The aims of it are

to carry out a critical analysis of the current system of public financial control in Ukraine and justify the place of internal control in it;

to offer the ways of the public internal financial control system development in Ukraine.

The methods of research are systematic and comparative analysis of scientific literature and statistical information.

The statement of the main results of research and their justification. The key elements of the current public financial control system are shown in Figure 1.

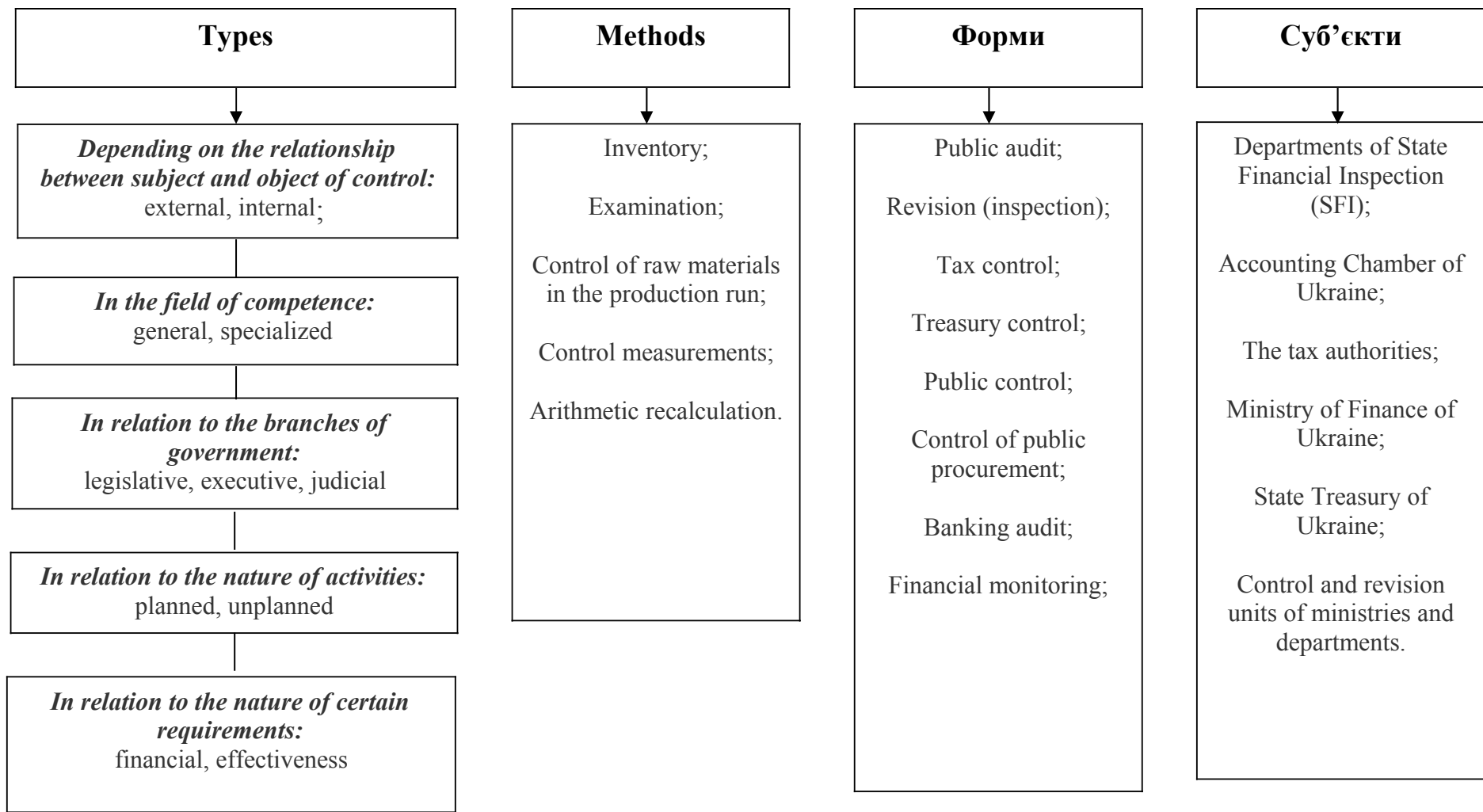


Figure. 1. The key elements of the current system of public financial control in Ukraine (types, methods, forms and subjects)

Thus, according to the Figure 1, the current system of public financial control consists of the basic key elements, which finally determine the activity effect of such a system. Next it should be considered the key elements of public financial control in Ukraine, shown in Figure 1. and given their characteristics (Table 1).

Table 1

The characteristic of the elements of current public financial control system in Ukraine (summarized by the authors)

Element	Characteristic
1	2
Subjects of PFC	The subjects of PFC include a lot of regulatory authorities. It should be noted that there is a significant intersection of their functions. The indicated problem has been realized by a majority of lawmakers, but yet not completely eliminated. Even all attempts of SFI and the Accounting Chamber of Ukraine to delineate the powers of the subjects of PFC in the newest version of the Budget Code of Ukraine, which entered into force on 01.01.2011 didn't solve the problem. At present all subjects of PFC have almost identical powers which are purely external
Objects of PFC	Public and municipal services
Methods of PFC	Nowadays PFC methods used in the practice of regulatory authorities are totally agreed with the key purpose of control measures — identifying violations and punishment of persons committed them. The main drawback of current PFC methods is their inability to find reserves of their activity and make provisions for preventing offenses. Therefore it is necessary to review the existing methods and improve them according to the current requirements

1	2
The forms of PFC	<p>The PFC forms reflect the expression of a particular subject of PFC.</p> <p>Nowadays the main form is revision. The basis of public internal financial control, performed by SFI, along with different types of control is inspection. Such type of control over the activities of public and municipal sector is aimed primarily to detect violations and punish responsible for the commission persons but not to assess the results, achieved in the management of public finances. The current need to perform the inspection at is due to an extremely low level of financial discipline in the public sector of economy, the lack of system of internal control and decentralized internal audit in the public sector.</p> <p>However, the carrying out of inspection after a considerable period of time (sometimes two or three years) after making some managerial decisions and operations with public finances is rather difficult, and in many cases it is impossible to eliminate financial irregularities and their consequences.</p>
Types of PFC	<p>The classification of PFC is sufficiently completed but also has many disadvantages. This is especially true for follow-up control over the previous and the current one, which is rather ineffective according to the opinion of the international community.</p>

Thus, each element of public financial control has its own drawbacks and is far from being perfect. The existing list of shortcomings should be supplemented by common drawbacks that can not be attributed to a specific element:

1. PFC system exists as a combination of separated units and does not operate as a united system
2. PFC system does not meet the European requirements for a number of circumstances, such as the prevalence of follow-up over the previous and current;
3. PFC system is not based on thorough theoretical foundation. Most of the key concepts even enshrined in law that hinders the development of PFC and create difficulties in the way of reform.

The current direction of development of Ukraine is aimed to strengthen the state's role in the management of public finances and reducing overuse in the public sector. The system of public financial control, of course, has a very strong structure, but the leading role is held by the State Financial Inspection of Ukraine, which control the legitimacy, effectiveness and proper use of public resources, and accuracy of accounting records and the reliability of financial reporting spending units. Analysis of the SFI activities as the main subject of PFC led to the conclusion that there is an annual increase in the number and extent of violations, the most common of which are:

- violation of the Budget Code requirements about misuse of budget funds, paying liabilities of taking over approved appropriations;
- over expenditure of budget funds because of spending due to payment of excessive volume and value of work etc;
- budget spending for the purchase of property in over limit standards;
- illegal transfer of state and municipal property non-state subjects;
- non mandatory procurement procedures;
- undervaluation of assets as a result of not using of indexations and as a result of not posting the purchased assets and surplus inventory.

These violations are mainly found during the control of public institutions. The analysis of SFI activity during the last five years shows that considerable part

of total quantity of enterprises, institutions and organizations with financial irregularities detected during 2007-2012 years are public institutions (Figure 2).

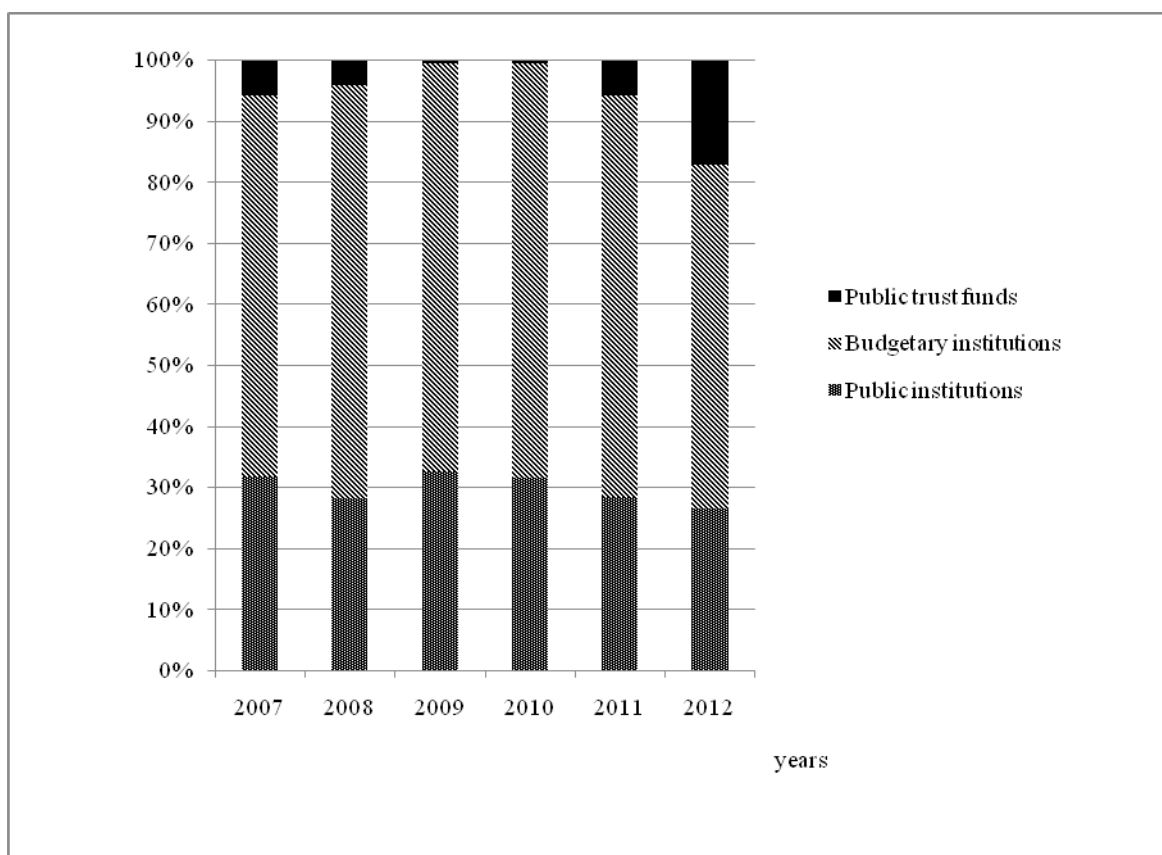


Figure 2. The dynamic structure of business entities and organizations with identified by the SFI financial irregularities of Ukraine during 2007-2012 years

Thus, based on the data shown on the Figure 2, we can conclude that the financial and economic activities of public institutions in Ukraine mainly need a reliable previous and current control. In confirmation of this thesis we should present SFI statistics on identified financial breaches that led to the loss of financial and material resources during January-May 2008, 2009, 2010, 2011 and 2012 [8-12] (Figure 3). By this time it was checked accordingly 3,8 thousand, 3,9 thousand, 4,1 thousand, 3,7 thousand and 4,6 thousand of public institutions and organizations.

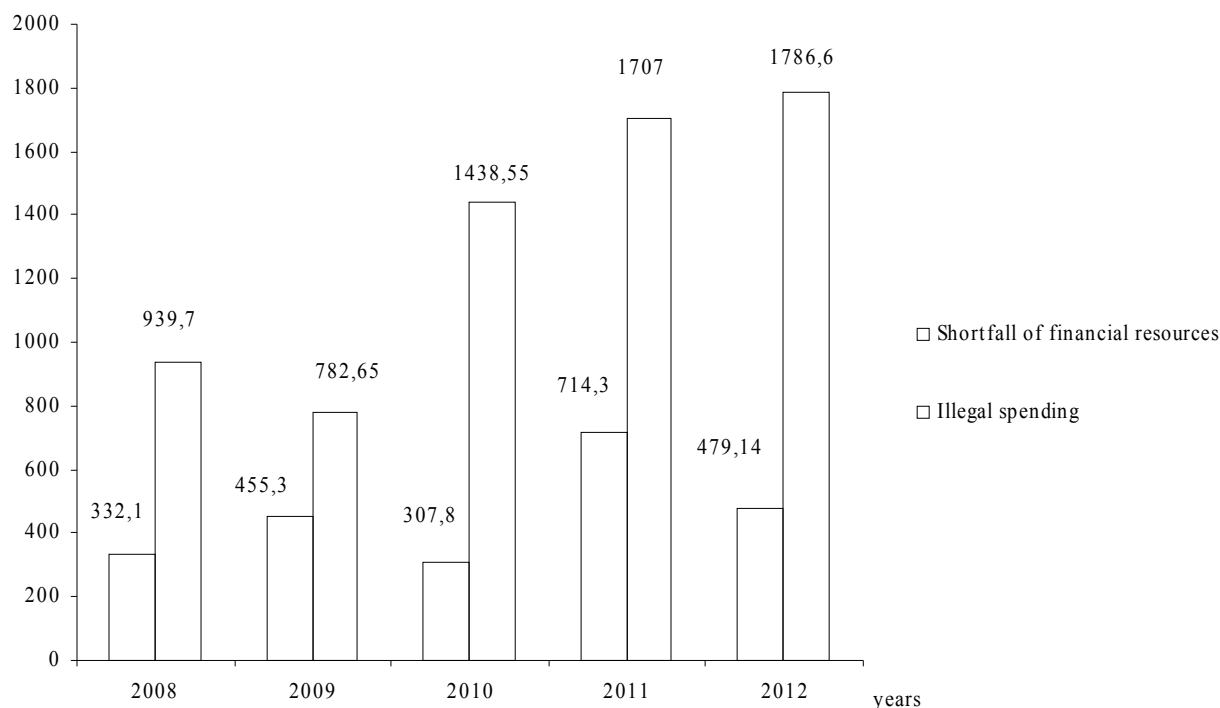


Figure 3. Dynamics of identified financial irregularities detected by SFI that led to the loss of financial and material resources in January-May of 2008-2012 years

So, the data on the Figure 3 shows that the number of detected violations in the financial period tends to increase. Thus, only in January-May 2012 it was detected a lot of violations that led to the loss of financial and material resources at 2,27 billion hryvnas. Within the rights and powers granted by the State Financial Inspection of Ukraine it was taken appropriate measures to eliminate violations that led to the loss of financial and material resources, in the amount of 810,6 million hryvnas. Consequently, a significant amount of violations is still not reimbursed. This conclusion reaffirms the need for the development and large-scale application of previous and current control, but not the following one

The awareness of outlined drawbacks and existing dynamics had led to the beginning of a radical reform of PFC according to European experience. The basis of this reform was the Concept of PIFC — a concept model of public internal financial control.

PIFC Concept was developed by the European Commission in the late 1990s for countries — candidates for EU membership. This concept is used by countries trying to develop their own system of public internal financial control and build a proper system of national government and financial control and audit. PIFC is a model based on the responsibility of the head of department and includes an internal control, internal audit and harmonization of these two components at the central level. France has proposed to add to this model one component — financial security. Great attention is paid to the model of PIFC procedures of previous and current control, which aims to determine the causes of violations, and follow-up by the supreme control authority (Accounting Chamber) and government bodies in the form of audit procedures to assess the quality of internal control. In Ukraine, it is presumed the follow-up, which is a clear disadvantage because it is aimed to identify the committed economic crimes, rather than to prevent and anticipate them. According to official statistics in Ukraine following control is dominating one, accounts for more than 70% and takes the form of the revision (inspection). It is also fiscal in nature and approaches for the EU is not a PIFC, because it does not fit into the basic concept of responsibility of the manager . The next control is aimed primarily at detecting crime and bringing the perpetrators to justice, and not to assess the results of the management of public finances. Therefore, inspection, conducted a few years after the administrative decision or event is unable to eliminate financial irregularities and their effects through the state and society. This fact becomes the reason of losing a lot of resources. Realizing the need for a radical transformation of the national system of public control, the government of Ukraine has developed a Concept for the development of public internal financial control and approval of a plan for its implementation until 2017.

The main objective of this Concept is to adapt national legislation to European standards, and to improve the efficiency of public and municipal sector by moving away from administrative to management culture, in which the heads of these bodies carry out financial management to achieve the appropriate level of economy, efficiency and effectiveness by defined goals and objectives. One of the

major steps towards a European system of public financial control is the development and entry into force of the new Budget Code of Ukraine and especially the new wording of Article 26 according to which: compulsory introduction should take place the basic components of the European model of PIFC — internal control and internal audit (Figure 4).

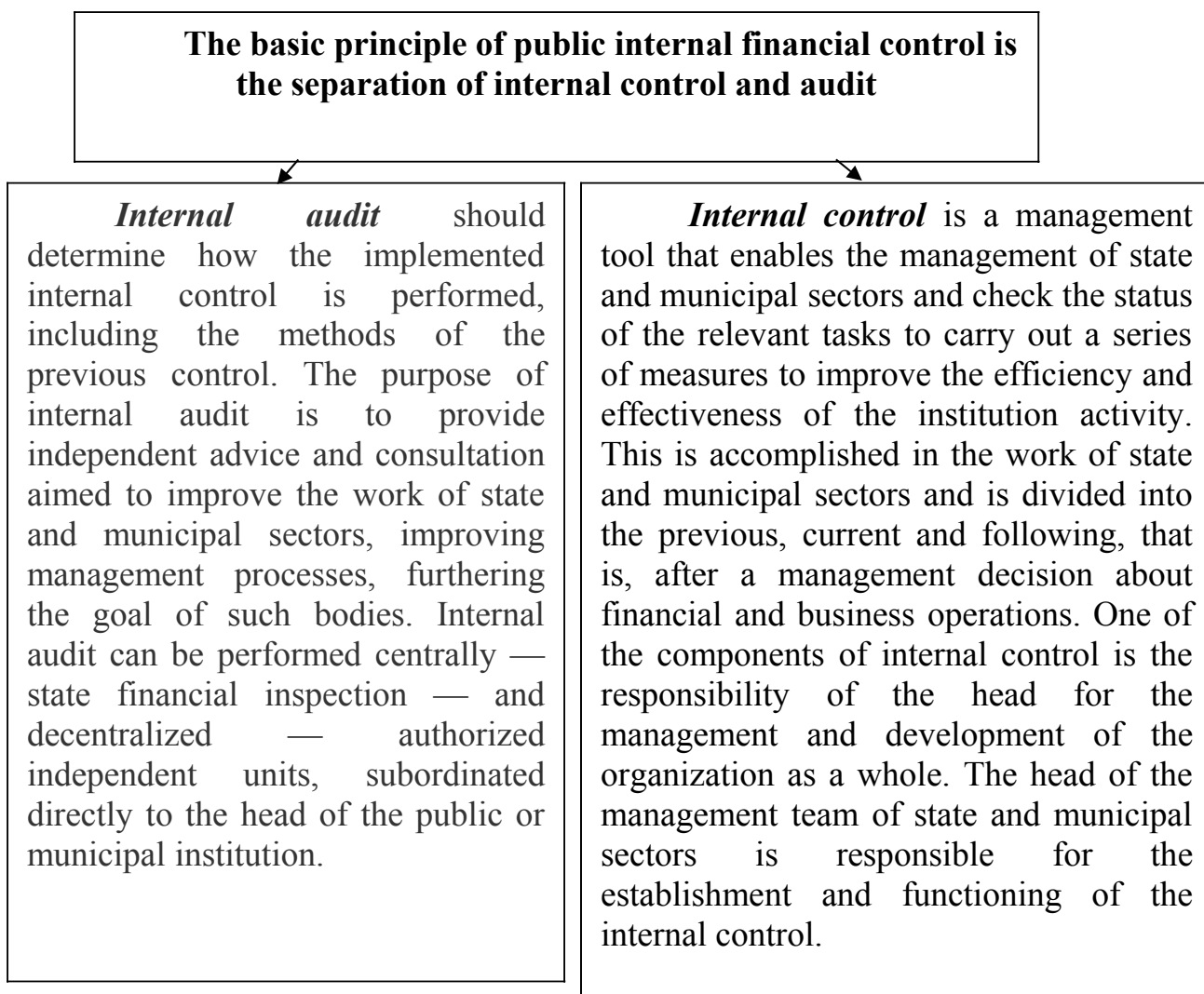


Figure 4. The separation of internal control and internal audit as a fundamental principle of public internal financial control

So personal responsibility for the implementation and effective functioning of these components is assigned to managers at all levels — from the chief to lower level managers and even individual departments of institution.

Thus, it is possible to provide a graphic representation of the main elements of public financial control based on the place of internal control in it. This scheme is totally agreed with the implementation of the Concept of Development of Public Internal Financial Control in Ukraine. This system of public financial control will exist after the implementation of all measures depicted above in terms of its basic elements and is shown in Figure 5.

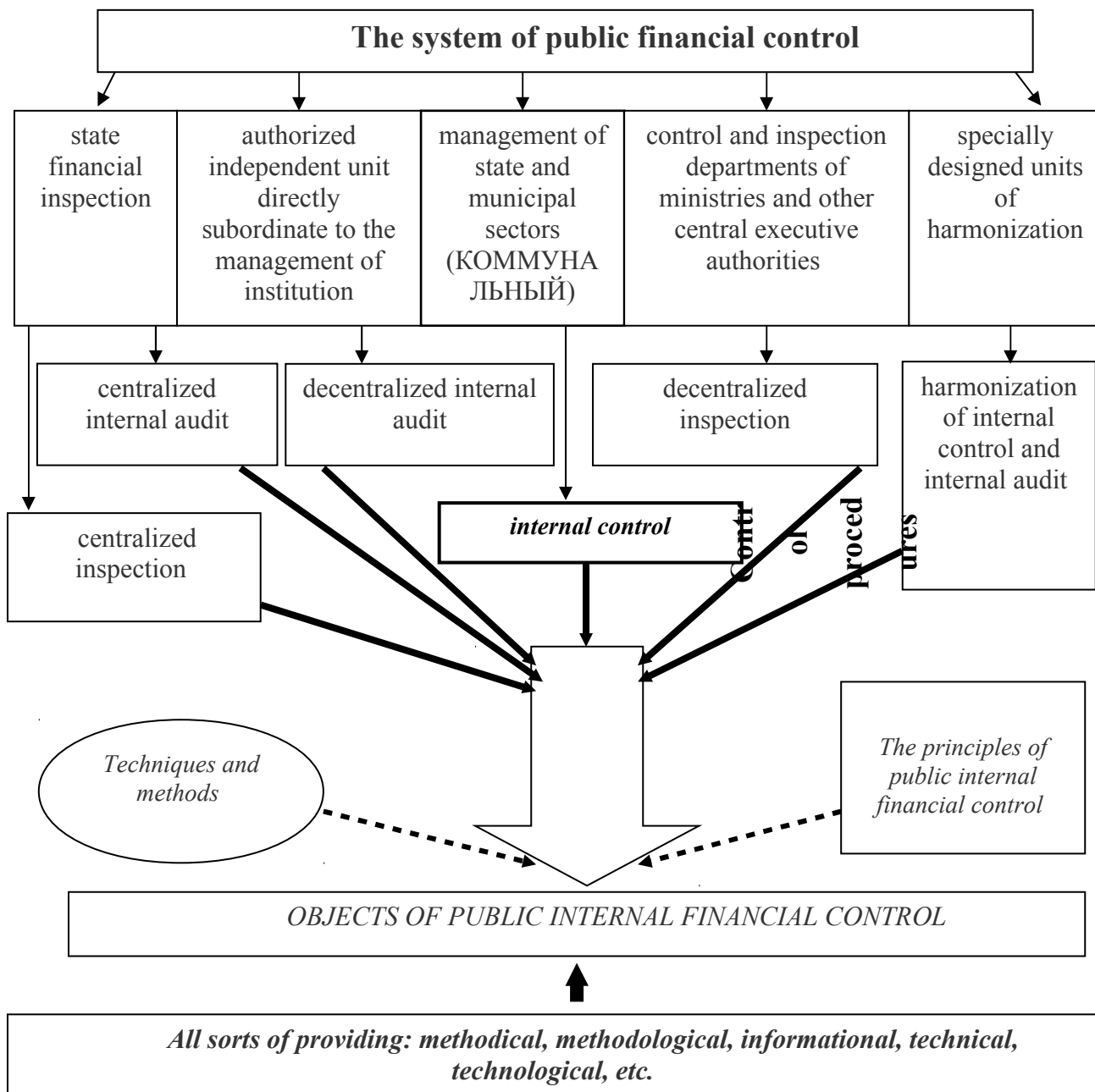


Figure 5. The system of public financial control (summarized by the authors)

Thus, given the changes that are taking place in recent years, the system of financial control takes more newer features and there is a sharp change in its overall construction. In this key position in such a system is an internal control as an integral element.

Internal control – is an activity of the leader who controls the object aimed at risk assessment and monitoring, which is within the control environment through the implementation of specific control procedures and sharing of information to ensure sustainable and lawful operation of the business.

According to the authors opinion ensuring of the internal financial control system development should shortly implement the following measures:

1. Development of a model of internal control for individual departments in the management structure, institution or organization (hereinafter — the object of control). This provision reflects the hierarchical structure of the object of control.

2. Development of organizational chart of internal control, which should include the implementation of control functions at all levels — from administration to individual employees. Each higher level of control system has new features not found in any of its components.

3. Development of specific forms of control, taking into consideration the particular structure of the object. As forms of organization, we should distinguish centralized and decentralized form of internal control. In the centralized form of internal control internal controllers are in the department of accounting and are subordinated to it's chief administratively and methodologically. The best option is the monitoring of decentralized form. When the Head of Internal Control department administratively is subordinated directly to the head of the enterprise, because it is responsible according to the Concept of public internal financial control.

4. Development of direct control procedures aimed at specific tasks faced by the internal control.

5. Development and support of specific stages of the implementation of internal control in budget-funded agency.

Conclusions and prospects of subsequent researches. Thus, introduction of internal control in a public sphere is an unchanging process, taking into account the necessity of realization of Conception of development of public internal financial control. But such process is multilevel and requires consciousness from all participants. Thus as a subject of subsequent researches in this sphere it is necessary to specify the expedience of construction and ground of universal model of organization of internal control in public institutions.

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