

# Current approaches to evaluation of the effectiveness of the internal control system in the system of the Ministry of defense of Ukraine

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## Abstract

This article summarizes the arguments and counter-arguments within the scientific discussion on the study of the effectiveness of the internal control system. The main purpose of the study is to popularize the developed options for assessing the effectiveness of the internal control system. Systematization of literature sources and approaches to solving the problem of evaluating the effectiveness of the internal control system showed that as of now, in the system of state internal control approaches to evaluating the internal control system are not studied at a sufficient level. The urgency of solving this scientific problem is that the results of research work offers two practical approaches to subject assessment. The research of subject evaluation in the article is carried out in the following logical sequence: the main mechanisms of internal control are determined, the role of internal audit in the evaluation process is determined, the mechanism of evaluation of the internal control system is offered. Methods of analysis and synthesis became methodical tools of the conducted research. The object of the study is the system of internal control of the budgetary institution in the system of the Ministry of Defense of Ukraine. The article presents the results of an empirical analysis of the functioning of the internal control system, which showed that the developed methods for evaluating the effectiveness of the internal control system can be used by specialists of the internal audit service. The results of the study can be useful for internal auditors, academics and managers who carry out their activities in the field of internal control, risk management, internal audit.

**Key words:** evaluation of internal control efficiency, internal control system, internal audit.

## Introduction

Today, Ukraine is in the process of implementing public internal financial control in accordance with the commitments made under the Association Agreement between Ukraine, on the one hand, and the European Union, the European Atomic Energy Community and their Member States, on the other hand (ratified by the Law of 16.09.2014).

Pursuant to Part 3 of Article 347, Section V of this Agreement, the Parties shall exchange information, experience, best practices and take other measures to further develop the system of

public internal financial control by harmonizing with internationally recognized standards (developed by institutions such as INTOSAI (International Organization...), Institute of Internal Auditors (IIA), International Federation of Accountants (IFAC (International Federation...)) and methodologies, as well as EU best practice on internal control and internal audit in public bodies (Association Agreement between...).

Public internal financial control is based on: internal control and the functioning of the

central harmonization unit, which develops methodologies and standards for public internal financial control, and internal control is seen as a combination of financial management and control with the function of independent internal audit.

The introduction of state internal financial control has been introduced in all central executive bodies, including the Ministry of Defense of Ukraine.

In the system of the Ministry of Defense of Ukraine, the following basic documents regulating the issues of internal control and internal audit have been issued for the implementation of national measures in the field of development of state internal financial control:

1) order of the Ministry of Defense of Ukraine dated 02.04.2019 № 145, (as amended by the order of the Ministry of Defense of Ukraine dated 25.06.2020 № 227) “Procedure for organizing internal control and risk management in the system of the Ministry of Defense of Ukraine” (Order of the Ministry of Defense of Ukraine No. 145, 2019);

2) Order of the Ministry of Internal Affairs № 475 of 15.12.2020 “On the organization of internal audit activities in the system of the Ministry of Defense of Ukraine” (Order of the Ministry of Defense of Ukraine No. 475, 2020).

Managers at all levels should be accountable for their own activities in terms of budget expenditures – not only in terms of implementation policy, but also in terms of financial management and control policy. Each manager is responsible for the formation and implementation of appropriate financial management and control systems for: performance of tasks, goal setting, activity planning, budgeting, accounting, control, reporting, documentation and monitoring.

Thus, taking into account Article 26 of the Budget Code of Ukraine, the heads of budgetary

institutions must organize the functioning of the internal control system in subordinate institutions (Budget Code of Ukraine: Law of Ukraine of July 8, 2010), and the task of the independent internal audit service is to assess the effectiveness of this system and provide constructive recommendations for its improvement.

At the same time, as of now, both in the system of state internal financial control of Ukraine and in the system of the Ministry of Defense of Ukraine there is no method of assessing the effectiveness of internal control, which is a problematic issue in the implementation of internal audit activities.

At the same time, in the system of the Ministry the issue of developing approaches to assessing the effectiveness of the internal control system was carried out in 2017. Specialists of the Internal Audit Department of the Ministry of Defense of Ukraine developed an approach to assessing risk management (Order of the Internal Audit Department of the Ministry of Defense of Ukraine No. 33, 2017) and the Department of Economics and Financial Support of the National University of Defence of Ukraine named after Ivan Chernyakhovskiy in 2020, where a dissertation for the degree of Doctor of Philosophy was prepared on the topic: “Substantiation of recommendations for evaluating the effectiveness of internal control of the Ministry of Defense of Ukraine” (Loishyn, A., 2020).

Given the above, the developed approaches to performance evaluation can complement existing methodological approaches, taking into account previous research.

**The purpose of the article** is to highlight and promote the practical results of developing a methodology for assessing the effectiveness of the internal control system of the internal audit service in the system of the Ministry of Defense of Ukraine.

## Results and discussion

The development of the variants of the method of assessing the effectiveness of the internal control system proposed in the article was carried

out within the research work “Internal Audit” by specialists of the National Defence University of Ukraine named after Ivan Chernyakhovskiy and

the Internal Audit Department of the Ministry of Defense of Ukraine.

To achieve the goal of the study, it is proposed to decompose it and consider separately:

1) the method of assessing the effectiveness of the internal control system in the areas of functioning of the internal control system in terms of its elements;

2) methods for evaluating the effectiveness of the internal control system according to the criteria of regulation, implementation and effectiveness.

In the course of research methods were used: analysis, synthesis.

**2.1.** The methodology for assessing the effectiveness of the internal control system by the Internal Audit Service of the Ministry of Defense of Ukraine has been developed taking into account regulatory and administrative documents in the field of public internal financial control, as well as best international practices in the subject area.

It should be emphasized that the construction of the internal control system (hereinafter – ICS) in the system of the Ministry of Defence of Ukraine was carried out according to the principles of the COSO model (developed by the Committee of sponsoring organizations of Treadway Commissions) (COSO).

COSO is an internationally recognized integrated framework for internal control, containing 17 fundamental principles and 81 points for consideration. Key components: adequate control environment, well-functioning risk assessment process, sufficient and effective control measures, relevant / sufficient and timely information and communication and adequate monitoring.

The structure of the ICS model is regulated by the Resolution of the Cabinet of Ministers of Ukraine of December 12, 2018 № 1062 “On approval of the Basic Principles of Internal Control by Budget Managers and amendments to the Resolution of the Cabinet of Ministers of Ukraine of September 28, 2011 № 1001” (hereinafter – Resolution № 1062 ) and its elements are defined (Resolution of the Cabinet of Ministers of Ukraine No. 1062, 2018):

internal environment – processes, operations, regulations, structures and distribution of powers

for their implementation, rules and principles of human resource management, aimed at ensuring the implementation of the institution's tasks and functions and achieving goals (missions), strategic and other goals, plans and requirements institutions;

risk management – the activities of management and employees of the institution to identify risks, assess them, determine how to respond to identified and assessed risks, review identified and assessed risks to identify new and changed;

control measures – a set of management actions implemented in the institution, which are carried out by the management and employees of the institution to influence risks in order to achieve the institution's goals (objectives), strategic and other goals, objectives, plans and requirements for the institution;

information and communication (information and communication exchange) – creation of information, its collection, documentation, analysis, transfer of information and its use by the management and employees of the institution to perform and evaluate the results of tasks and functions;

monitoring – tracking the state of the organization and functioning of the internal control system as a whole and / or its individual elements.

At the level of the Ministry of Defense of Ukraine, the requirements of Resolution № 1062 were implemented by issuing the order of the Ministry of Defense of Ukraine dated 02.04.2019 № 145 “Procedure for organizing internal control and risk management in the system of the Ministry of Defense of Ukraine”.

The elements of internal control are interconnected, apply to all activities and financial and non-financial processes in the institution.

The methodology for evaluating the effectiveness of the ICS (hereinafter – the Methodology) by the Internal Audit Service (hereinafter – the Service) includes the study, analysis and evaluation of information about management philosophy, its style and principles, organizational structure and distribution of powers and responsibilities, information flow and

principles of formation and submission of reporting information.

The method is a set of interrelated methods and techniques of appropriate evaluation of the effectiveness of the ICS, which involves a number of tasks:

1) planning the evaluation of the effectiveness of the ICS, preliminary determination of the category and range of employees who may be involved in the interview;

2) formation of a bank of issues (statements) that may indicate the effectiveness of the ICS;

3) determination of the list of documents required for analysis and evaluation, establishment of appropriate communications with officials directly involved in the process of functioning of the ICS in the institution;

4) conducting a preliminary analysis of the submitted documents on IJ issues;

5) direct interviewing of certain personnel and direct work on the object of the audit task.

In order to achieve completeness and accuracy in the process of assessing the effectiveness of ICS, it is necessary to conduct an assessment in accordance with Resolution № 1062 and the order of the Ministry of Defense of Ukraine № 145 elements of ICS: internal environment, risk management, control measures, information and communication (information and communication); monitoring.

The proposed method involves an internal audit specialist to use a questionnaire (checklists) which, for convenience, provides answers only yes or no.

That is, there are two options for the evaluation approach:

1) to confirm or refute the proposed statement, which takes place in the functioning of the ICS. For easy further calculation, it is suggested to evaluate the answers: yes – 1, no – 0 points, respectively (Table 1).

**Table 1 – The structure of the checklist for evaluating the effectiveness of ICS**

№	Question / evaluation	Assertion (regulation)		Audit evidence
		Yes	No	
		1	0	
1	Content of the statement?			Contents of audit evidence

2) to confirm or refute the proposed statement, which takes place in the functioning of the ICS. For evaluation it is offered to estimate answers: yes – 1, no – 0 points accordingly. Also, in the presence of a positive statement, it is

necessary to assess the level of maturity of the statement. That is, the degree of its quality of work in accordance with the criteria: situational, initial, repetitive, manageable (Table 2).

**Table 2 – The structure of the checklist for evaluating the effectiveness of ICS (2)**

№	Question / evaluation	Assertion (regulation)		Maturity levels (quality)				Total points	Audit evidence
		Yes	No	Situational	Initial	Repetitive	Controlled		
		1	0	1	2	3	4		
1	Content of the statement?								Contents of audit evidence

As a result, it is necessary to calculate the amount of points obtained and divide the amount of points obtained by the maximum possible number of points in the context of each element of the ICS. This will allow you to determine the percentage efficiency for each of the evaluated elements.

Further, the overall efficiency of the ICS is calculated on the basis of determining the average value in the corresponding total percentage expressed for all elements of the ICS.

Based on the results of the evaluation of the effectiveness of the JIA, the internal audit specialists prepare proposals for the improvement of the JMS of the controlled object. Accordingly, the management of the object of the audit task organizes the development of an action plan to improve the ICS.

The head of the institution, internal control manager, internal control unit (if any) and other officials directly involved in the operation of the ICS are responsible for methodological support of those responsible for activities, heads of structural units of the institution in developing and documenting action plans for further improvement.

Information on the study of the effectiveness of the ICS is attached to the audit report, for which a relevant section is provided. In the case of a separate inspection of the effectiveness of the ICS, a separate audit report is compiled with relevant recommendations and suggestions.

It should be noted that in accordance with the Resolution of the Cabinet of Ministers of Ukraine of December 12, 2018 № 1062 internal control system should cover issues: planning the institution, budget process, management of budget funds, state property and other resources, organization and accounting accounting, preparation and submission of reports, provision of administrative services, control and supervision functions, procurement of goods, works and services, legal work, work with staff, activities to prevent and detect

corruption, ensuring secrecy and information security, information protection in information, telecommunication and information-telecommunication systems, organization of document circulation, including electronic document circulation and management of information flows, interaction with mass media and the public, the decision of other questions connected with functioning of establishment.

If the Resolution of the Cabinet of Ministers of Ukraine № 1001 the object of internal audit is the activities of the institution, and the system of internal control should cover the issues set out above, then the list of test questions should be appropriate to the application and operation of ICS in terms of its elements (Fig. 1).

Next, several separate questions are proposed as an option, which is proposed to be included in the relevant questionnaires during the study of the effectiveness of the ICS in the performance of the audit task in terms of the elements of the ICS. Questions in terms of elements are an example and in the actual assessment of their number and content should take into account the specifics of the institution.

Element № 1. Internal environment:

1) the manager and the risk assessment team are appointed. If there is an internal control unit – the unit is staffed, defined functional (job) responsibilities that correspond to the direction of the specifics of internal control;

...

5) internal documents of the institution regulate the issues of establishing the purpose (mission) and strategic goals of the institution.

Element № 2. Risk Management:

1) the internal documents of the institution regulate the issues of determining the officials responsible for the coordination of risk management;

...

68) Are the identified ways of responding to the identified risks adopted taking into account the defined acceptable level of risk?

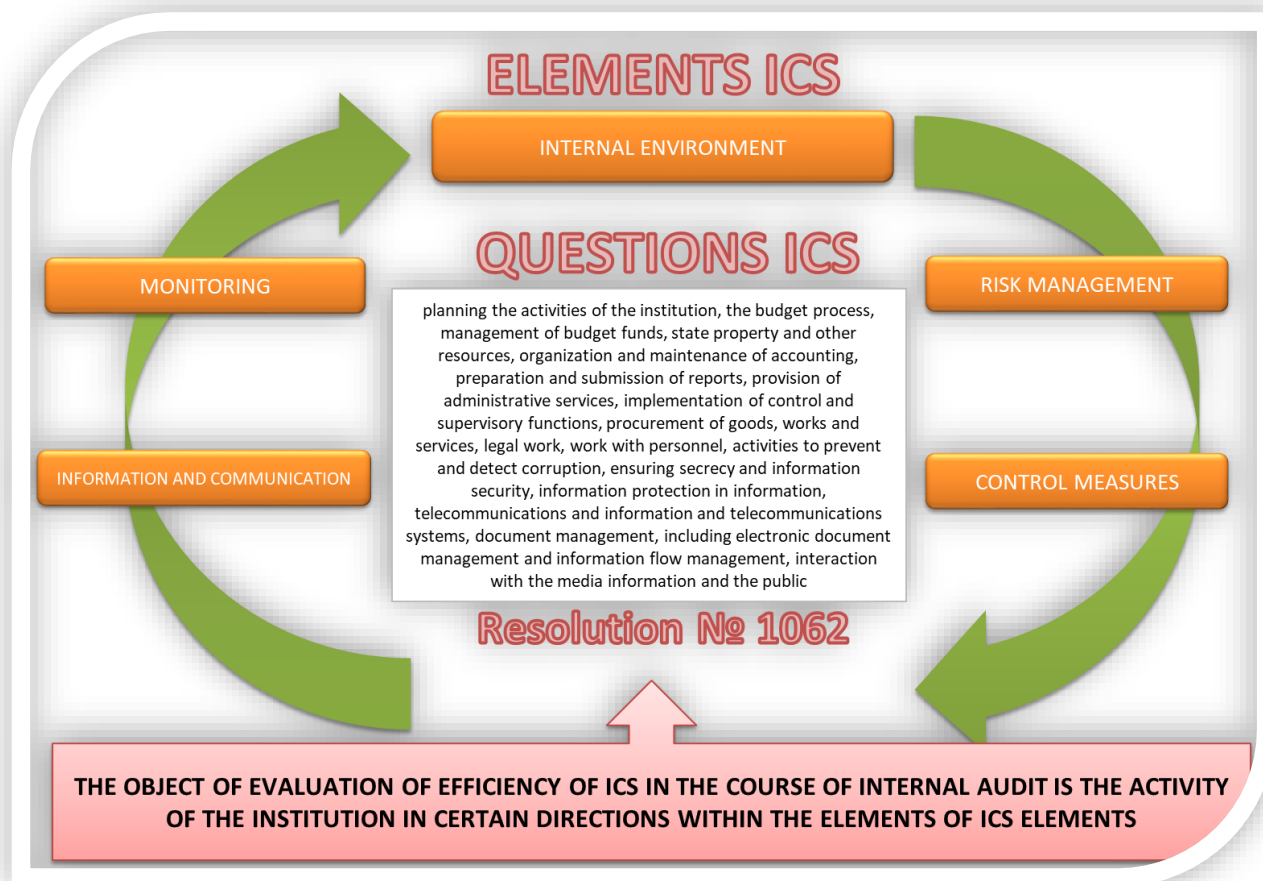


Figure 1 – The object of evaluation of the effectiveness of the ICS

Element № 3. Control measures:

1) internal documents of the institution regulate the establishment of authorization and confirmation procedures (in particular, obtaining permission from responsible officials to perform operations by endorsement, approval, approval of documents);

...

95) the institution provides for backup data in the direction of each independent structural unit of the institution.

Element № 4. Information and communication (information and communication exchange).

1) internal documents of the institution regulate the establishment of information exchange within the institution and with external users (procedures, forms, volumes, deadlines, list of providers and recipients of information, requirements for information of

financial and non-financial nature, storage of information);

...

10) the participation of personnel involved in operational activities in internal control and risk management measures is confirmed.

Element № 5. Monitoring:

1) internal documents of the institution regulate the issues of continuous monitoring during the current activities of the institution (management and supervisory activities of managers and employees of the institution during the performance of their duties to identify and correct deviations);

...

4) the institution confirms the timely response to the proposals and recommendations provided by the internal auditors.

It should be emphasized that the list of issues is not exhaustive and should be clarified at the



stage of drawing up the program of the audit task based on the specific activities of the institution and the areas of audit.

It is proposed to periodically review the bank of issues and make appropriate changes.

## **2.2. Methods for evaluating the effectiveness of ICS according to the criteria of regulation, implementation and effectiveness.**

The next version of the methodology for assessing the effectiveness of ICS is proposed to implement by assessing the degree of detail and completeness of measures in the system of internal control based on its three characteristics: the degree of regulation, the degree of implementation, the degree of effectiveness of control measures (procedures).

1. Regulation. Organization and regulation of the internal control system. Design Effectiveness – Designed to prevent and detect errors and fraud.

To assess the degree of regulation, it is necessary to check the availability and quality of the organization of the ICS in accordance with the method of checking the state of the organization and the quality of internal control in the system of the Ministry of Defense of Ukraine.

2. Implementation. Implementation of the principles of internal control. Operational efficiency – works as designed.

This principle (Latin Principium – the beginning, the basis) – is a statement that is

perceived as the main, important, essential, essential or at least desirable. In science, principles are general requirements for constructing a theory, formulated as the primary one that underlies a certain set of facts. When characterizing various systems, the principles reflect the essential characteristics that are responsible for the proper functioning of the system, without which it would not fulfill its purpose.

That is, in the case of confirmation of compliance with the substantive principles of internal control and risk management, the ICS functions correctly, where the correctness of the operation is confirmed by the corresponding efficiency. It should be reminded that the effectiveness of the ICS is not only the compliance of the content of efficiency as an economic category, it is primarily the effectiveness of internal control measures.

The implementation of the principles of internal control in the activities of the institution allows to assess the practical level and level of implementation of regulated measures for the organization of the internal control system of the object of internal audit. The principles of functioning of the ICS are set out in Resolution № 1062, Order of the Ministry of Defense of Ukraine № 145, COSO model. Evaluation of the implementation of the principles is set out in table 3.

**Table 3 – The Evaluation of the implementation of the principles**

Principle	Content	Yes /No	Audit evidence (link)
Principles in accordance with the requirements of Resolution № 1062			
Continuity	Policies, rules and measures aimed at achieving a defined goal (mission), strategic and other goals, objectives, plans and requirements for the activities of the institution, minimizing the impact of risks, are constantly used to respond to changes in the activities of the institution		
Objectivity	Making management decisions based on complete and reliable information based on documentary and factual data and excludes the influence of subjective factors		
Delegation of powers	Separation of powers and clear definition of responsibilities of management and employees		

Principle	Content	Yes /No	Audit evidence (link)
	of the institution, providing them with appropriate rights and resources necessary for the performance of official duties		
Responsibilities	The management and employees of the institution are responsible for their decisions, actions and tasks within the scope of their official duties.		
Prevention	Timely implementation of control measures to prevent deviations from the established norms		
Openness	Feedback mechanisms have been introduced and the necessary degree of transparency has been ensured during the evaluation of the internal control system		
COSO is an internationally recognized integrated framework for internal control			
PRINCIPLES FORMED TAKING INTO ACCOUNT THE FEATURES OF THE MINISTRY OF DEFENSE OF UKRAINE			
Implementation of the management function of the supervisory function of risk management	Management has a key responsibility for overseeing risk management		
	Oversight of risk management requires management to have a deep understanding of strategy, industry, and awareness of activities		
	Management evaluates the effectiveness of risk management in terms of its contribution to the value of the activities		
Creating operating structures	The organizational and staffing structure of the institution is determined based on its purpose, goals, strategy		
	Risk information is collected at all levels of the institution		
	Designated official in the field of risk management who provides methodological support (coordination)		
Defining the target culture	Integrity and ethical values, the environment of the institution affects the level of risk management (identification, management)		
	Management decisions are made taking into account the risk-oriented approach		
Demonstration of belonging to the key values of the institution	Management and staff understand the key values of the institution, which is a prerequisite for building an integrated risk management system		
Development and involvement of qualified personnel	The staff incentive system is provided and confirmed		
Evaluation of strategic alternatives	Management takes risks into account when planning to achieve a specific goal		
Defining goals and objectives	The goals of all structural units are within the strategy and purpose of the institution		



Principle	Content	Yes /No	Audit evidence (link)
Risk identification	The institution identifies the risks associated with the activity and the purpose of the activity at all levels		
	The institution forms a database of risks and periodically reviews them		
	Risks are appropriately structured and ranked		
Risk assessment	Risks are assessed by impact and probability of occurrence		
Risk response	The presence of cases of risk response has been confirmed		

3. Effectiveness of measures within the functioning of the ICS. The conditions for the effectiveness of the JCA can be confirmed by the following criteria (on the basis of the proposed criteria formulated the content of the necessary elements that may indicate the effectiveness of the ICS) (Pushkar M., Semanyuk V., 2016) (Table 4):

**Table 4 – The Evaluation of the effectiveness of measures within the functioning of the ICS**

Criterion	Content	Yes /No	Audit evidence (link)
controllability	The quality of performance of control functions of each subject of VK working in establishment is checked by other subject without any duplication		
distribution of powers between the subjects of control	There is a prevention of the situation when the primary control is concentrated in the hands of one subject of control. Otherwise, it leads to abuse and fraud		
the manager's interest in the control system	The interest and participation of senior management can be traced in the functioning of the ICS		
focus on the result	Means and measures of control are not more important than the actual goals of the organization		
competence and honesty of ICS entities	The competence of the ICS entities and management has been confirmed		
the effectiveness of methods and their conformity to the species activities	Control programs and its methods are appropriate and correspond to the type of activity that is controlled and provide for the provision of objective data on the measurement and evaluation of important parameters of the ICS		
rationality	SVC is organized rationally from the standpoint of saving labor, material and financial costs. Compliance with the principle of "cost-effect" implies that the total cost of the control system does not exceed the benefits created by it		
personal (single) responsibility and potential functionality substitution	Each control function is assigned to one area of responsibility to prevent irresponsibility and negligence		
priority	Absolute control over small transactions does not make sense, as it takes resources from more important business processes. The priority of strategic control is defined, even if in this case it is impossible to calculate the absolute economic effect of use control procedures		

Criterion	Content	Yes /No	Audit evidence (link)
strategic orientation	Non-strategic facts are not measured very often and no results are reported until the deviations from the standard become too large. Activities or impacts of strategic importance are monitored even when these activities (impacts/changes) are difficult or impossible to measure		
optimal centralization or adequacy organizational structure control	The optimal centralization or adequacy of the organizational structure of control corresponds to the scale and complexity of the controlled environment		
regulation, interaction, coordination	The effectiveness of the control system is related to its subordination to the regulations of control activities, the interaction of all subjects of control and coordination of their efforts		
introduction of new ones information technologies	There is an introduction of innovative IT technologies that strengthen control functions or prevent mechanical errors and other problems caused by human factors		
continuity of development and improvement	There is an improvement of the ICS, which is confirmed by the measures aimed at the development of the ICS		
warning unauthorized access to information and its safety in case unpredictable circumstances	Prevention of power outages, intentional damage, etc. is provided. Duplication of electronic media and their reliable storage and reproduction are provided		

This type of questionnaire involves confirmation or refutation of the proposed statement in the process of functioning of the ICS of the controlled object. In case of confirmation of the content of the proposed criterion, the auditor should indicate in the column "audit evidence" a relevant reference to the fact that confirms the audit opinion. This does not necessarily have to be just an appropriate guiding document, but first and foremost a reasonable confirmation of the auditor's opinion should be a logical inference formulated on the basis of a broad analysis of the activities of the object of study. Also, as a rule, it is proposed to evaluate the effectiveness of the ICS in parallel with the audit task, but subject to the sufficiency of an array of audit evidence and facts. Evaluating the effectiveness of the ICS is not an additional aspect of the audit task, but is primarily an independent evaluation of the relevant manager in the context of management responsibilities in terms of implementing a control system that provides adequate planning, programming, budgeting,

accounting, control, reporting, archiving and monitoring.

The auditor should obtain audit evidence by testing the internal control system to confirm any risk assessment of the internal control system that is determined to be less than high. The lower the internal control risk assessment, the more evidence the auditor needs to obtain that the structure and operation of the accounting and internal control systems are effective.

The overall degree of efficiency of the ICS is calculated as the average value of the evaluation results obtained by the three components of the methodology.

When completing the questionnaires, the effectiveness of the internal control system is considered effective until reversed.

Thus, the specialist of the audit service in the section of audit evidence enters information in case of confirmation by appropriate audit evidence of non-compliance with the statement, or the absence of a substantive element in the SEC of the institution.

To determine the target range of the level of efficiency of the ICS, you can use a scientifically

sound scale of general utility – the Harrington Scale, which is proposed in (Loishyn, A., 2020).

## Conclusions

The article considers two variants of the methodology for evaluating the effectiveness of the internal control system in the system of the Ministry of Defense of Ukraine. The methods are focused on the use of checklists, which are formed based on the specifics of the functioning of the audited entity and taking into account the current requirements for the organization of

internal control and risk management. Prospects for further research are seen in:

1) analysis of the results of practical application of the developed methods;

2) study of alternative criteria for evaluating the internal system, which can be used in the evaluation, in addition to general utility – the Harrington Scale.

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