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# The main aspects of implementing the system of public internal financial control in Ukraine system

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## Abstract

This article summarizes the arguments and counter-arguments within the scientific discussion on the study of the effectiveness of public internal financial control. The main purpose of the study is to highlight the main aspects of the implementation of the system of public internal financial control for further study of the effectiveness of the use of state resources by heads of institutions. The need for the head of the institution to report in the manner prescribed by the legislation of Ukraine on the effectiveness and efficiency of the institution, achieving certain purposes (missions), strategic and other goals, including internal control requires appropriate knowledge of public resources management. Analysis of the formation of state internal control allows us to trace trends in its development, to draw parallels with the best international practices in this area. Systematization of literature sources and approaches to solving problems of improving the system of public internal financial control has shown the need for continuous improvement, taking into account the rapid changes in economic mechanisms of the state and public administration. The object of research is the system of state internal financial control of Ukraine. The article presents the results of the historical analysis of the functioning of the system of state internal financial control. The results of the study can be useful to internal auditors, academics and managers who carry out their activities in the field of internal control, risk management, internal audit.

**Key words:** state financial control, internal control system, internal audit.

## Introduction

The introduction of a modern model of public internal financial control is aimed at strengthening the responsibility of managers for the management and development of institutions in general (managerial responsibility and accountability). The purpose of internal control – quality implementation of budgetary institutions to plan and organize activities, form an adequate internal control structure, oversee internal control and risk management to achieve the goal, and create a decision-making system, including financial, on the principles of legality, economy, efficiency, efficiency and transparency.

The introduction and operation of the internal control system is aimed at efficient, economical and efficient use of resources provided by taxpayers for the development and livelihood of Ukraine.

The head of the institution organizes and ensures the implementation of internal control in accordance:

- 1) with legislation governing the planning of the institution, budget process, management of budget funds, state property and other resources, organization and maintenance of accounting;
- 2) preparation and submission of reports, administrative services, implementation of control and supervisory functions, procurement of goods, works and services, legal work, work with staff, activities to prevent and detect corruption, ensuring secrecy and information security;
- 3) protection of information in information, telecommunications and information and

telecommunications systems;

4) organizations document management, including electronic document management and information flow management, interaction with the media and the public, addressing other issues related to the functioning of the institution.

Therefore, disclosing current issues related to the organization of the state internal financial control system for staff to understand its role in effective management is an important element of public policy in resource management.

**The purpose of the article is** to highlight the main aspects of the implementation of the system of public internal financial control in Ukraine for further study of the effectiveness of the use of state resources by heads of institutions.

### **Material and methods**

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

- 1) Prerequisites for the formation of public internal financial control in Ukraine;
- 2) The main results of the practical implementation of public internal financial control in Ukraine on the example of the central executive body;

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

### **Results and discussion**

**1.** According to Article 26 of the Budget Code of Ukraine internal control is a set of measures applied by the head to ensure compliance with the law and efficiency of budget funds, achieving results in accordance with the objectives, plans and requirements for the budget institution and its subordinate institutions.

The Budget Code of Ukraine stipulates that the Cabinet of Ministers of Ukraine determine the procedure for internal control.

To implement Article 26 of the Budget Code of Ukraine, the Cabinet of Ministers of Ukraine issued a Resolution of December 13, 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).

This Resolution interprets the concept of “internal control” in accordance with the Budget Code of Ukraine.

The resolution defines the concept of “internal control system”, it is: implemented by the head of the institution policies, rules and measures that ensure the functioning, relationship and support of all elements of internal control and aimed at achieving certain goals (missions), strategic and other goals, objectives, plans and requirements for the activities of the institution”.

It should be noted that the Resolution considered the organization and functioning of internal control in late 2018, while the current Resolution took into account and takes into account the requirements set out in the Methodological Organizations for the organization of internal control by budget managers in their institutions and subordinate budget institutions. It is approved by the order of the Ministry of Finance of Ukraine dated 14.02.2012 № 995 “On approval of Methodical recommendations on the organization of internal control by managers of budget funds in their institutions and subordinate budget institutions” (hereinafter – Methodical recommendations).

The Guidelines state that “internal control covers issues of institution planning, budget management, accounting and financial and budget reporting, protection of assets from losses, targeted and efficient use of budget funds and other issues not limited to financial aspects of the institution's activities”.

To understand the place of internal control in the general system of state control, it should be

noted that internal control is an element of the Public Internal Financial Control (hereinafter – PIFC).

The Ministry of Finance of Ukraine under its responsibility ensures the formation and implementation control, determines the basic organizational and methodological principles and assesses the functioning of internal control and internal audit systems. It is determined in the article 111 of the Budget Code of Ukraine and the Regulation on the Ministry of Finance of Ukraine, approved by the Cabinet of Ministers of Ukraine on June 24, 2016 № 394).

The PIFC system is being reformed in accordance with the European PIFC model, namely in accordance with the Concept of Public Internal Financial Control “Orang book”.

Modern PIFC is a set of three interrelated elements:

Internal control (managerial accountability – financial management and control);

Functionally independent internal audit;

Central harmonization unit.

Financial management and control (hereinafter – FMC) are one of the three pillars of the PIFC European Concept.

The FMC is understood as a system that provides for the planning, use and control of financial resources in order to effectively and efficiently achieve the goals set for the institution.

The FMC process is continuous and affects managers at all levels and employees of the institution and the FMC's activities in the institution must first provide the head with sufficient guarantees that the institution will achieve its goals; its activities will be effective and efficient in the relevant legal field. Reports (financial and non-financial, internal and external) will contain reliable information.

The FMC in public institutions should be organized and implemented in such a way that management (senior, middle, operational levels) is responsible for achieving certain goals in accordance with the allocated budget and available resources. At the same time, management should be accountable for the results achieved, the budget, and other resources used. Thus, managerial responsibility for the economical, efficient, effective and lawful use of resources is a key principle of the FMC. Without managerial responsibility, it is impossible to achieve the results of improving the FMC system, and vice versa, without a proper FMC system it is not possible to ensure a system of managerial accountability to achieve goals in economical, efficient, effective and legal ways.

The manager is responsible for the FMC system in the organization, and this is his direct responsibility. Heads of financial and accounting departments are not directly responsible for the implementation of the FMC. Their role is to assist the head of the institution in developing standards, providing information, providing recommendations and, if necessary, providing analytical support. It is the head of the budget institution, which is responsible for the use of budget funds, commitments made in accordance with certain goals and objectives, activities in accordance with certain standards in economic, efficient and effective ways.

Accountability is a complex phenomenon and concerns various stakeholders. First, if the budget institution is a ministry, the minister is directly accountable to the Prime Minister and the Cabinet of Ministers for implementing the strategy, objectives set by the Government, and for which the ministry receives an annual budget. Second, the Minister is accountable to the Ministry of Finance for the efficient and effective use of these funds in accordance with the FMC standards set by the Ministry of Finance in the Budget Code, the State Budget Law and other relevant legal and regulatory acts. Third, the head of the budgetary institution is accountable to Parliament for the policy pursued by his ministry and the general management of the institution. If the head of the budget institution is not the Minister (head of the relevant agency, service, inspection, administration), then he is first accountable to the relevant line ministry, and then through the relevant minister – the Cabinet, the Ministry of Finance and Parliament. Such accountability applies to all resources received from the Ministry of Finance (and other public sources), even if these funds

are transferred to the tier two administrator.

Thus, the FMC and management accountability are interrelated.

This means that the appointment of the head should determine his clear responsibility and managerial accountability for the activities of the institution. Without managerial accountability, it is impossible to carry out FMC. In the absence of managerial accountability, the FMC is narrowed down to traditional budgetary control, i.e. verification of spending according to the budget and legal field. Such limited control can be exercised through the Treasury system and does not require managerial accountability. The result of the traditional control system is only compliance with the principle of compliance, regardless of the efficiency and effectiveness of spending these funds, and managerial responsibility for decisions is absent. The result is inefficient spending of public funds, lack of correlation with the goals that the Government is trying to achieve.

The task of the modern FMC system is to replace the old practice of control and focus on the goals set for the organization, allocated resources and their effective and efficient use. It is the head of the budgetary institution which makes the decision who knows best how to make optimal use of resources (not the auditor, external or internal, not the inspector, not the Ministry of Finance or any other government agency). Therefore, the role of the manager is crucial, respectively, managerial accountability for the use of public resources is important (of course, to ensure effective management accountability, the manager needs relevant information presented in a convenient format).

The introduction of the FMC system and managerial accountability in public institutions should be result-oriented and systematic.

The system approach, first, involves the development of a broad organizational strategy (policy) for the implementation of the FCC and management accountability (responsibility) in a public institution. Without a proper organizational strategy, individual pilots in the assessment and implementation of the FMC will be fragmented. At the same time, for government agencies, pilot activities are a tool to teach the implementation of new FMC practices.

In addition, it is important to remember that the implementation of the FMC system in public institutions is an endless process, but it requires less time after a series of consistent and successful (annual) evaluations and improvements, because the results of each stage of evaluations and improvements become the basis of regular operational processes and control measures in government agencies.

In 2017, the authority to perform the PIFC harmonization function was transferred from the State Audit Office to the Ministry of Finance of Ukraine.

The Department of Harmonization of Public Internal Financial Control has been established within the structure of the Ministry of Finance of Ukraine.

The Central Harmonization Unit is an integral part of public internal financial control, and at the same time, combining internal control and internal audit, serves as a tool to achieve harmonization of internal control and internal audit in accordance with recognized international standards.

Elements of PIFC, as well as directly related elements of internal control, apply to all activities and financial and non-financial processes in the institution.

PIFC in Ukraine is built taking into account the main international standards of state internal control, namely:

INTOSAI Guidelines for Internal Control in the Public Sector and the EU (International Organization of Supreme Audit Institutions);

Memorandum IIA (Institute of Internal Auditors);

Analyzing the norms set out in the Budget Code of Ukraine, we can determine that:

The subject of internal control is compliance with the law, efficiency and cost-effectiveness of the use of budget funds and other resources, achieving results in accordance with the established goal in the process of tasks, plans and requirements of administrative, financial, economic,

technological and other processes.

The object of internal control is the activities of the budgetary institution and its subordinate institutions.

According to the Resolution of the Cabinet of Ministers of Ukraine dated 13.12.2018 № 1062 the system of internal control in the institution consists of the following elements:

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, conduct their assessment, 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 management and employees of the institution to influence risks in order to achieve certain goals (missions), 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, transmission of information and its use by 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.

We emphasize that all elements of the internal control system are interconnected and apply to all activities and financial and non-financial processes in the institution.

The elements of internal control together constitute a risk-oriented system of internal control, the main component of which is risk management, as a key factor in the earliest detection and response to events that may affect the goals of the budget organization (institution).

Every economic entity has its own objective function, which is realized and achieved through effective management.

One of the functions of individual entity management is internal control, the subjects of which compare the planned and actual values of parameters, draw an analogy with the external economic and legal environment, identify deviations in parameters, assess the danger of deviations for the entity, identify factors that caused deviations, as well as determine the degree of their influence, prepare the information base for management decisions.

**2.** Among the central executive bodies is the work of the Ministry of Defense of Ukraine, where a number of measures were taken to form a new ideology of departmental internal control based on the principles of risk management. Pilot projects to improve internal control were conducted, departmental Standards of Internal Control and the Procedure for the Organization of Internal Control in the Armed Forces of Ukraine were developed.

Thus, the Ministry of Defense of Ukraine regulates in accordance with the order of the Ministry of Defense of Ukraine dated April 4, 2019 № 145 “On approval of the organization in the system of the Ministry of Defense of Ukraine internal control and risk management”, which came into force on July 1, 2019. The order was issued to replace the Temporary Procedure for the Organization of Internal Control and Risk Management in the Ministry of Defense of Ukraine and the Armed Forces of Ukraine, and the Instruction on the Organization of Internal Control in the Armed Forces of Ukraine. This Procedure was developed to meet the requirements of Resolution № 1062. The Procedure defines the key terminology of internal control and risk management.

In addition, the National University of Defense of Ukraine conducted research to improve the internal control system in the Ministry of Defense of Ukraine. The results of research work were used

during the study of the implementation of the internal control system in the Ministry of Defense of Ukraine and developed draft Internal Control Standards in the Ministry of Defense of Ukraine.

In order to gradually improve the process of improving internal control, certain stages are envisaged and the transition to the functioning of an improved system of internal control at all levels of government is ensured. Measures to harmonize information exchange on internal control and internal audit have been fully implemented; a comprehensive system of internal control response in the Armed Forces of Ukraine to audit conclusions and recommendations has been built.

The new impetus to the work on the development of internal control was given by the decisions of the Defense Ministry on the application of departmental Internal Control Standards in the Ministry of Defense of Ukraine and the Armed Forces of Ukraine from January 1, 2017, as well as on delimitation of internal audit and Department of Internal Audit and the Chief Inspectorate of the Ministry of Defense of Ukraine.

The Unified List of Capabilities of the Ministry of Defense of Ukraine and the Armed Forces of Ukraine includes requirements for the acquisition of internal control capabilities at all levels of government by structural units of the Ministry of Defense, the General Staff, military authorities, military units and institutions of the Armed Forces of Ukraine.

Recommendations for the implementation of national standards of quality management and risk management of the ISO, COSO series were sent to the heads of concerns and state-owned enterprises that are within the scope of defense ministry management.

At the initiative of the General Staff of the Armed Forces of Ukraine, positions of auditors were held in the services of operational (air) commands to strengthen the capacity of military authorities to carry out internal control and operational risk management.

Monitoring of the implementation of internal control at all levels of government during inspections and management control measures carried out by military authorities is provided.

It should be noted that the organization of the internal control system, including the construction and effectiveness of the risk management system involves appropriate analysis and provision of objective, sound and independent recommendations aimed at improving and enhancing the effectiveness of such activities. To systematically assess the state of risk management, the Internal Audit Department of the Ministry of Defense of Ukraine has developed a Temporary Guideline on Risk Management Audit and initiated such audits. The Ministry of Defense of Ukraine is the first among the ministries to introduce such a form of control.

To practically clarify the level of internal control and build a risk management system in the Ministry of Defense and the Armed Forces of Ukraine, the Main Inspectorate of the Ministry of Defense of Ukraine has developed a Methodology for assessing the economic effect and key performance indicators of the risk management system. The effectiveness of the risk management system of the subject of internal control. By the method of appropriate calculations, the methodology makes it possible to obtain appropriate values that can characterize and give an independent assessment of the organization of the risk management system of the subject of assessment.

The method of assessing the economic effect and key performance indicators of the risk management system is based on the method of expert assessments in determining possible risks and states the real state of affairs of the assessed object.

Foreign advisers from NATO countries, including the United States and the United Kingdom, are actively involved in the implementation of the Western model of internal control in the Defense Ministry and the Armed Forces of Ukraine. Legislative settlement of problematic issues of implementation of internal control at the Government level.

In order to implement the NATO-Ukraine Annual National Programs, the Ivan Chernyakhovskiy National University of Defense of Ukraine conducts introductory courses on internal control and risk management for the command staff of the Ministry of Defense of Ukraine

and the Armed Forces of Ukraine.

The Defense Ministry is taking measures to provide information on the development of internal control, within which a thematic section on the information resources of the Ministry of Defense of Ukraine has been created.

According to the results of the assessment of the state of internal control in the initiated issues on revision of certain structural units of the Ministry of Defense of Ukraine, as well as a number of regulations of the Ministry of Defense of Ukraine to strengthen internal control in the riskiest areas of financial and material resources.

## **Conclusions**

Risk management is becoming an integral part of the capability-based defense planning and capability assessment organization.

In general, taking into account the first steps in the implementation of departmental Internal Control Standards, the level of maturity of internal control and risk management in the Ministry of Defense of Ukraine and the Armed Forces of Ukraine is assessed as initial. Procedures and regulations of internal control require further development and increased attention of heads of military authorities, commanders and chiefs.

These steps to improve internal control and implement a risk management system in the Ministry of Defense and the Armed Forces of Ukraine fully meet modern requirements.

Prospects for further research are seen in the analysis of practical performance indicators of internal control and risk management.

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