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## THE ROLE OF INSPECTION IN EUROPEAN MODEL OF STATE FINANCIAL CONTROL

*The entry of Ukraine into the European Community requires also the development of public financial management system, in particular public internal financial control and external independent financial control as its major elements. The analysis of the problems hindering the sustainable systems functioning has been provided. The role of inspection in the European model of state financial control and the key directions of its modernization have been determined.*

*Keywords: public internal financial control; State Financial Inspection of Ukraine; inspection; independent external financial control; Accounting Chamber of Ukraine; risk-oriented approach.*

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## МІСЦЕ ІНСПЕКТУВАННЯ В ЄВРОПЕЙСЬКІЙ МОДЕЛІ ДЕРЖАВНОГО ФІНАНСОВОГО КОНТРОЛЮ

*У статті доведено, що входження України в європейське співтовариство вимагає в тому числі розвитку системи управління державними фінансами, складовими якої є державний внутрішній фінансовий контроль та незалежний зовнішній фінансовий контроль. Проаналізовано проблеми на шляху до побудови надійних систем таких складових. Визначено місце інспектування в європейській моделі державного фінансового контролю та основні напрямки його модернізації.*

*Ключові слова: державний внутрішній фінансовий контроль; Державна фінансова інспекція України; інспектування; незалежний зовнішній фінансовий контроль; Рахункова палата України; ризикоорієнтований підхід.*

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## МЕСТО ИНСПЕКТИРОВАНИЯ В ЕВРОПЕЙСКОЙ МОДЕЛИ ГОСУДАРСТВЕННОГО ФИНАНСОВОГО КОНТРОЛЯ

*В статье обосновано, что вхождение Украины в европейское сообщество требует в том числе развития системы управления государственными финансами, составляющими которой являются государственный внутренний финансовый контроль и независимый внешний финансовый контроль. Проанализированы проблемы построения надежных систем таких составляющих. Определено место инспектирования в европейской модели государственного финансового контроля и основные направления его модернизации.*

*Ключевые слова: государственный внутренний финансовый контроль; Государственная финансовая инспекция Украины; инспектирование; независимый внешний финансовый контроль; Счетная палата Украины; рискоориентированный подход.*

**Problem statement.** Ukraine's signing an Association Agreement with the EU caused the necessity to accelerate the process of reforming the components of public financial management system. These components include public internal financial control and independent (external) financial control. In order to implement the provisions of this Agreement as a whole and determine a specific action plan to build reliable systems of internal control and external audit in particular, the Cabinet of Ministers of Ukraine as of 17.09.2014 #847-r approved the Action Plan for the implementation of the Association Agreement between Ukraine, on the one hand, and the

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European Union, the European Atomic Energy Community and their Member States, on the other hand, in 2014–2017 (hereinafter – Action Plan).

By taking in consideration the provisions of Association Agreement with the EU and Action Plan, the question arises: what is the place of inspection in the system of public financial control?

**The review of the recent problem-related publications.** In recent years, the research on the development of public internal and external financial control in Ukraine has involved such Ukrainian scientists as P. Andreev (2013), E. Chechulina (2011), S. Chornutskyi (2012), I. Chumakova (2013), I. Stefanyuk (2012). However, problems of inspection analysis are still not fully considered. Therefore, an important practical task is to determine the role of inspection and the vectors of inspection development in the framework of European integration.

**Research objectives** in this article is defining the role of inspection and prospects of its modernization in the process of building the European model of state financial control.

**Key research findings.** Chapter 3 "Management of public finances: budgeting, internal control and external audit" of the Association Agreement between Ukraine and the EU (Article 347) specifies that the urgent need is the implementation of the standards and procedures of the International Organization of Supreme Audit Institutions (INTOSAI), and the exchange of best practices in the field of the EU external control and audit of public finances, with the special emphasis on the independence of the relevant authorities and further development of the system of public internal financial control through the harmonization with internationally recognized standards and methodologies as well as with the best EU practice on internal control and internal audit in public bodies (The Association Agreement between Ukraine..., 2014). As for inspection, there are no guidelines concerning its further development. Therefore, the question arises: what should we do with this kind of control?

According to the EU officials' opinion (the members of the project SIGMA) the answer is simple: inspection as a form of control, must be reformed. SIGMA is the program supporting efforts to improve governance and management which is a joint initiative of the Organization for Economic Cooperation and Development (OECD) and the EU.

The background information of the SIGMA project which concerns the sections of the Action Plan for the realization of the Strategy of development public financial management system (May 2014) (Strategy of the development..., 2013) states that in the context of the development of internal audit it is necessary to modernize the approaches to financial inspection by the creation of a new Agency on financial investigations. However, in the current difficult economic and political situation in Ukraine the presence of both functions is crucial.

According to the experience of the USA, UK, Italy, France, Sweden, Austria, Belarus, Georgia, Kyrgyzstan, Kazakhstan, the formation of the Agency for financial investigations is possible in case of the availability of reliable systems of internal and external financial controls. However, in some CIS countries, such as Moldova, Uzbekistan and Russia there are such bodies as the State Financial Inspection. In Ukraine it still exists, which can be explained by the implementation of reforms in external and internal public financial control systems.

Since in Ukraine, similarly to on Moldova, Uzbekistan and Russia the reforming of these systems is in process, so the question of formation of the Agency for financial investigations loses its relevance. After all, the system of internal financial control as well as independent (external) audit has many problems and does not function properly. Such problems can be defined as follows:

1) in the field of public internal financial control:

- the imperfection of methodology for internal control and internal audit in the public sector;

- the functioning of the Central Harmonization Unit against the best practices of the EU member states, in the structure of the State financial inspection of Ukraine;

- the lack of interaction between the heads of ministries and other central bodies of executive power with internal audit units which operate in the institutions headed by them;

- insufficient staffing of internal audit units due to the lack of qualified specialists.

2) in the field of independent (external) audit:

- the narrow range of powers of the Accounting Chamber, in particular, the lack of power to control the revenue side of the state budget;

- the imperfect standards of the Accounting Chamber to audit the public finances;

- the imperfect mechanism for the analysis of the implementation results of the Accounting Chamber's audit.

In addition to the abovementioned areas in the development of public financial control in Ukraine, in the Association Agreement of Ukraine and the EU (Article 347) it is also stipulated that the improvement of the methods is aimed at eliminating fraud. Under the imperfect systems of internal and independent (external) financial control inspection plays an important role in reducing the disturbances in the budget sector. After all, the main objective of inspection is to ensure the detection of law violations and identifying officers and materially responsible persons guilty of such violations.

Unlike the internal financial control, financial inspection activities are not regulated by international standards and are not included into the model of public internal financial control of the EU. However, one of the main advantages of financial inspection is the accountability of budgetary institutions on the use of available budgetary funds.

Therefore, in order to strengthen the accountability in the public sector until the time when the reliable system of internal financial control in budgetary institutions starts to function the modified function of inspection should exist there.

Under the conditions of cut spending on the maintenance of the central executive power bodies activity of and the critical state of the state budget, a modified version of this function should focus on the use of minimum labor and material resources.

That is why planning of control and revision work of the State Financial Inspection of Ukraine should be carried out by using the risk-oriented approach. The first steps in this direction have been done in 2012 by the adoption by the protocol meeting of the Methodological Council of State financial inspection of Ukraine as of

23 April 2012 #7 concerning the Concept of the risk-based selection of control objects to the Plan Control and Auditing work of the State financial inspection of Ukraine and its territorial bodies. In addition, as a part of the World Bank project there was drafted a plan and methodology for storage and use of information for risk assessment and planning of work of the State Financial Inspection bodies in Ukraine.

An electronic database was later formed which collects information on the activity of control objects obtained from various sources. However, in practice the use of this database is facing obstacles such as the collection of necessary information to assess the risks of budgetary institutions – in fact, the collection of information is carried out manually! As a result, a significant amount of time and human resources is lost.

Therefore, the urgent need is to improve the process of information collection by connecting to the existing database all major spending units and modernization of the procedures on risk assessment of financial irregularities by the controlled institutions.

Nevertheless, modification of inspection function requires the revision of its methodology. This is due to the need to reduce spending of human resources, to conduct the inspections and reduce the time conducting of such inspections.

One of the areas in the methodology improvement is the need to do inspection based on risk assessment. As the basis for developing a formula for determining the risk inspection can be taken the formula for determining the audit risk as proposed by the American Institute of Certified Public Accountants (AICPA) in its Statements on Auditing Standards – SAS 47 "Audit Risk and Materiality in Conducting an Audit" (Statements on Auditing Standards...).

**Conclusions.** The process of building reliable systems of internal and external control, based on international standards and complying with the fundamental principles of accountability, transparency, economy, efficiency and effectiveness, requires further implementation of inspection function by the State financial inspection of Ukraine, but in a modified form. The latter implies the use of an approach based on risk assessment for selection of controlled objects and directly during the inspection in order to determine the most risky areas of activity of controlled object and conducting a more detailed inspection of these areas. Only after ensuring the effectiveness of the public internal financial control system, transferring a part of functions to the Accounting Chamber of Ukraine and also transferring the Central Harmonization Unit to the Ministry of Finance of Ukraine, it will be possible to consider the establishment of the Agency of financial investigations.

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