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**INTERNAL CONTROL UNDER PUBLIC FINANCIAL CONTROL  
SYSTEM REFORMATION: THE STATE OF IMPLEMENTATION  
AND DEVELOPMENT PROSPECTS**

*The article presents the key elements of the current system of public financial control, its critical analysis is given. The role of internal control within this system is grounded, and by means of official statistics their necessity is demonstrated. Propositions on the internal control development within the system of state financial control in Ukraine are presented.*

*Keywords: internal control; public financial control (PFC); public internal financial control (PIFC); State Financial Inspection (SFI).*

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**ВНУТРІШНІЙ КОНТРОЛЬ В УМОВАХ РЕФОРМУВАННЯ  
СИСТЕМИ ДЕРЖАВНОГО ФІНАНСОВОГО КОНТРОЛЮ:  
СТАН ВПРОВАДЖЕННЯ ТА ПЕРСПЕКТИВИ РОЗВИТКУ**

*У статті наведено основні елементи діючої сьогодні системи державного фінансового контролю та зроблено її критичний аналіз. Обґрунтовано місце внутрішнього контролю в такій системі та за допомогою офіційних статистичних даних доведено його необхідність. Розроблено пропозиції, спрямовані на розвиток внутрішнього контролю в системі державного фінансового контролю в Україні.*

*Ключові слова: внутрішній контроль; державний фінансовий контроль; державний внутрішній фінансовий контроль; державна фінансова інспекція.*

*Табл. 1. Рис. 5. Літ. 23.*

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СИСТЕМЫ ГОСУДАРСТВЕННОГО ФИНАНСОВОГО КОНТРОЛЯ:  
СТАТУС ВНЕДРЕНИЯ И ПЕРСПЕКТИВЫ РАЗВИТИЯ**

*В статье приведены основные элементы действующей сегодня системы государственного финансового контроля и проведен ее критический анализ. Обосновано место внутреннего контроля в такой системе и с помощью официальных статистических данных доказана его необходимость. Разработаны предложения по развитию внутреннего контроля в системе государственного финансового контроля в Украине.*

*Ключевые слова: внутренний контроль; государственный финансовый контроль; государственный внутренний финансовый контроль; государственная финансовая инспекция.*

**Introduction.** Nowadays in Ukraine under the 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 crucial need is to provide efficient public financial control (hereinafter – the PFC), which will contribute to legal and effective expenditures of public funds and proper-

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ty. At the same time, according to the results of public financial control practice during last years it has lost its effectiveness. Most of all this happened due to the fact that public financial control wasn't in time to adjust itself to the changing market environment. Besides, its performance was effective only within the command and administrative economy and had later lost its topicality. For improving the 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 practice in this area. Despite the numerous scientific articles and research on this issue the analysis of them doesn't give sufficient knowledge about the essence of public financial control system and its components. Besides, the applied aspect of internal control implementation as a part of public financial control, is hardly represented. Thus, according to the current research we have attempted to offer a complex concept of the PFC system, carry out its critical analysis and ground the place of internal control with theoretical and practical recommendations on its implementation.

**Latest research and publications analysis.** The analysis of recent publications on the specified problem and the analysis of current developments in this field has allowed us divide the existing works into 3 groups:

- the first group includes the developments that explore the issues of internal control, but in terms of business, excluding the specific activity of public institutions. Here we can mention such scholars as T.A. Butynets (2008), N.V. Vyhovska (2011), V.D. Dovbnya (2011), S.T. Kovalchuk (2012), L.P. Kulakovska (2011), D.M. Marchenko (2010), Y.V. Neskorodyev (2012) and others;

- the second group covers scientific papers devoted to public financial control and the research of international experience in this field, but doesn't identify the place of internal control in the PFC system, and therefore doesn't cover the concept of public internal financial control (Concept for the development of public internal financial control, 2005) and partly differ from the direction of current research. In this field we can mention the following authors: M.M. Vuytsiv (2012), V.V. Gulko (2011), T.O. Pozhar (2011) etc.;

- and the third group represents the fragmentary experience in the current research area, by such scholars as V.G. Bugaenko (2010), N.V. Vynnychenko (2010), N.V. Shevchenko (2010), Y.B. Slobodyanyk (2011), Y.M. Futoranska (2009), I.Y. Chugunov and V.M. Fedosov (2009), I.Y. Chumakov (2011) and others.

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

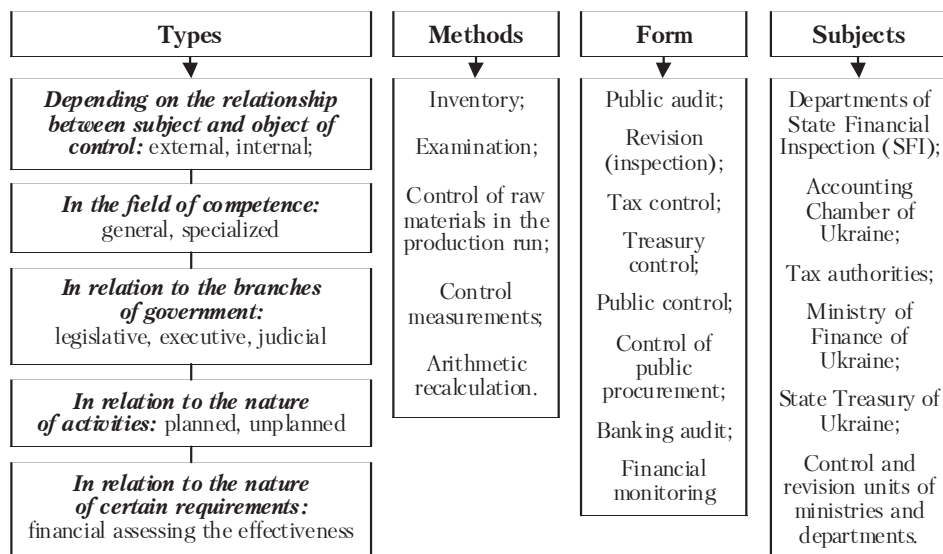
**The aim of research.** The current research, based on the existing works of various scholars, is essentially a rather new study. Its aims are:

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

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

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

**Key research findings.** 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), developed by the authors**

Thus, according to Figure 1, the current system of public financial control consists of the basic key elements, which determine the activity effect of such a system. Next we should consider the key elements of public financial control in Ukraine, as shown in Figure 1 and to give their characteristics (Table 1).

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 European requirements for a number of reasons, such as the prevalence of follow-up control over the previous and current.
3. PFC system is not based on thorough theoretical foundation. Most of the key concepts are even enshrined in law that hinders the development of PFC and create difficulties for furthers reforms.

The current direction of Ukraine's development is aimed at strengthening the state's role in public finance management and reducing the overuse in the public sector. The system of public financial control, obviously, has a very strong structure, but the leading role is held by the State Financial Inspection of Ukraine, which controls the legitimacy, effectiveness and proper use of public resources, and accuracy of accounting records and the reliability of financial reporting spending units. Analysis of 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:

- the violation of the Budget Code requirements about the misuse of budget funds, paying liabilities of taking over approved appropriations;
- overexpenditure of budget funds because of excessive payments and overpaid of work etc.;

- budget spending for the purchase of property in over limit standards;
- illegal transfer of state and municipal property to non-state subjects;
- non-mandatory procurement procedures;
- undervaluation of assets as a result of not using indexations and as a result of not posting the purchased assets and surplus inventory.

*Table 1. The elements of current public financial control system in Ukraine, summarized by the authors*

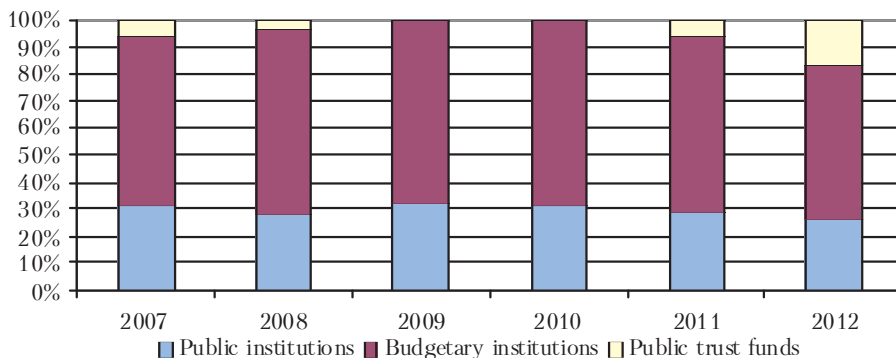
Element	Description
Subjects of PFC	The subjects of PFC include a lot of regulatory authorities. It should be noted that there is a significant intersection of their functions. The indicated problem has been realized by a majority of lawmakers, but yet not completely eliminated. Even all attempts of 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 came into force on 01.01.2011 but 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 current requirements
Forms of PFC	The PFC forms reflect the expression of a particular subject of PFC. Nowadays the main form is revision. The basis for 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 sectors is aimed primarily at detecting violations and punish responsible persons but not to assess the results, achieved in public finance management. The current need to perform the inspection is due to an extremely low level of financial discipline in the public sector, the lack of internal control system and decentralized internal audit in the public sector. However, carrying out inspection after a considerable period of time (sometimes 2 or 3 years) after some managerial decisions and operations with public finance is rather difficult, and in many cases it is already impossible to eliminate financial irregularities and their consequences.
Types of PFC	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 international community.

These violations are often found under the control of public institutions. The analysis of SFI activities during the last 5 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).

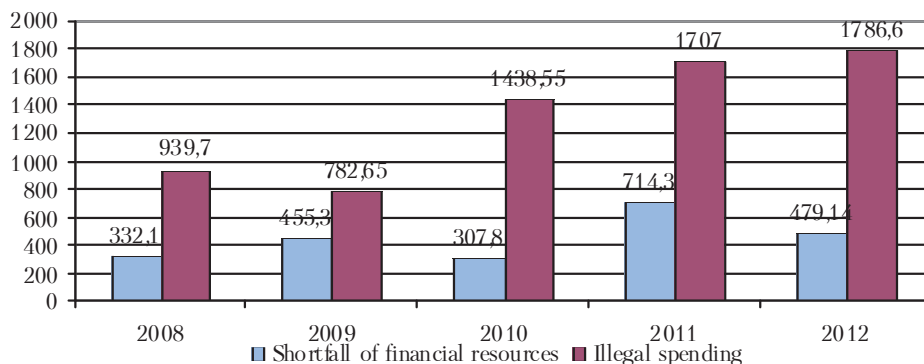
Thus, based on the data shown in Figure 2, we can conclude that financial and economic activities of public institutions in Ukraine need a reliable previous and current control. In confirmation of this thesis we should present the SFI statistics on the identified financial breaches that led to the loss of financial and material resources during January-May 2008, 2009, 2010, 2011 and 2012 (Reports of SFI, 2008–2012) (Figure 3). By this time it checked accordingly 3.8 ths, 3.9 ths, 4.1 ths, 3.7 ths and 4.6 ths of public institutions and organizations.

So, the data in Figure 3 show that the number of detected violations in the financial period tends to increase. Thus, only in January-May 2012 it detected a lot of violations that led to the loss of financial and material resources at 2,27 bln UAH. 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 mln UAH. 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.



**Figure 2. The dynamic structure of business entities and organizations with identified by the SFI financial irregularities in Ukraine during 2007–2012, based on the data of SFI**



**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, based on the data of SFI**

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 for 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 the candidates for the EU membership. This concept is used by the 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 a department head and includes internal control, inter-

nal audit and the 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 presumes the follow-up, which is a clear disadvantage because it is aimed to identify the already committed economic crimes, rather than to prevent them. According to the official statistics in Ukraine following control is dominating, accounting for more than 70% and it takes the form of revision (inspection). It is also fiscal in nature and is not a really PIFC, because it does not fit into the basic concept of manager responsibility. The following control is aimed primarily at detecting crime and bringing perpetrators to justice, and not to assess the results of public finance management. Therefore, inspection, conducted a few years after the administrative decision or event is unable to eliminate financial irregularities and their effects through state and society. This fact becomes the reason for 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 the 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 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 for the basic components of the European model of PIFC – internal control and internal audit (Figure 4).

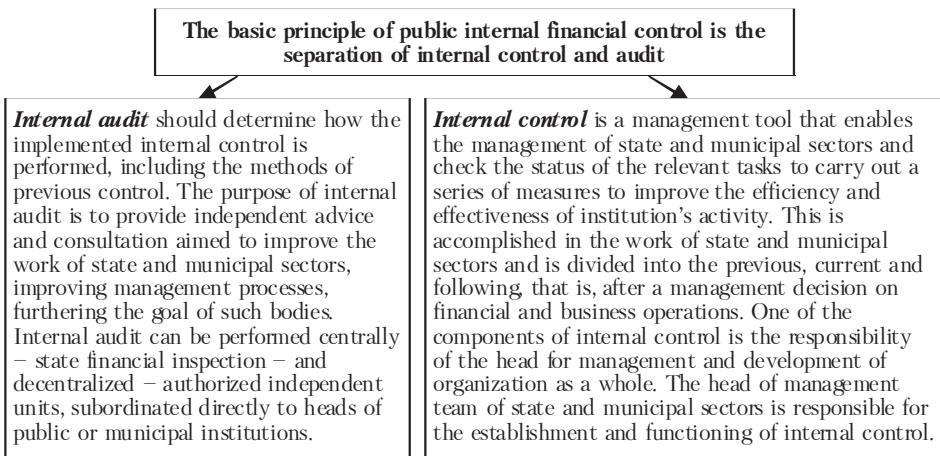


Figure 4. The separation of internal control and internal audit as a fundamental principle of public internal financial control, developed by the authors

So personal responsibility for the implementation and effective functioning of these components is assigned to managers at all levels – from 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.

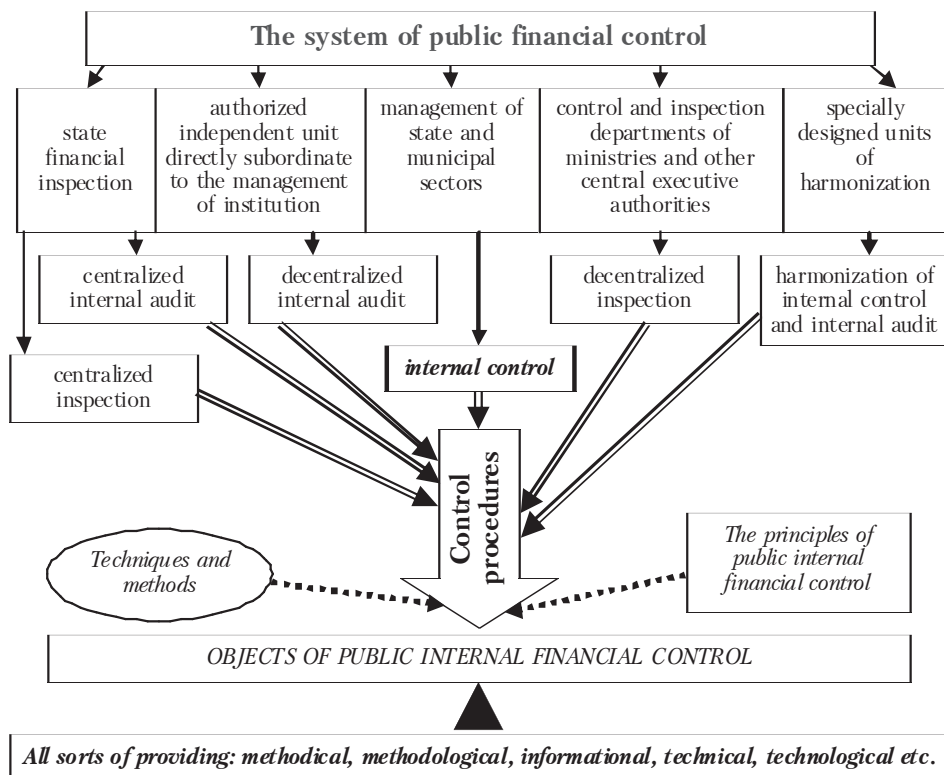


Figure 5. The system of public financial control, developed by the authors

Thus, given the changes that are taking place in recent years, the system of financial control acquires new features and there is a sharp change in its overall construction. In such a system the key position belongs to internal control as its integral element.

Internal control is an activity of a 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 information to ensure sustainable and legal operations of business.

Ensuring internal financial control system development should include the following measures:

1. Development of a model of internal control for individual departments in 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 an object. According to the arrangement form, we should distinguish centralized and decentralized forms of internal control. In the centralized form of internal control internal controllers are in the accounting department and are subordinated to their chief administratively and methodologically. The best option is monitoring the decentralized forms. The head of the internal control department administratively should be subordinated directly to the head of the enterprise, because he/she is responsible according to the Concept of public internal financial control.

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

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

**Conclusions and prospects for further research.** Introduction of internal control in the public sector is a permanent process, taking into account the necessity for the realization of the concept of development of public internal financial control. But such process is multilevel and requires consciousness from all participants. Thus, as a subject of the following research in this field it is necessary to specify the expedience of constructing a universal model of internal control organization in public institutions.

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