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AUDIT OF PUBLIC FINANCES: METHODOLOGICAL ISSUES AND THE CASE OF UKRAINE

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ABSTRACT

The paper aims to analyze the methodological issues that exist in the field of public finance audit, and find ways to solve them on the example of Ukraine. The methodological basis of the study is the analysis of scientific publications, regulations, standards; best practices analysis; retrospective analysis of ACU's performance indicators; content analysis of reports on the results of audits; method of logical generalization and systematization in formulating conclusions and recommendations. The study found that an important role in maintaining the functions of the SAI in society is played not only by the fact of auditing public finances, but also its methodology, including compliance with INTOSAI standards and building confidence in its results. The recommendations concern the need to: conduct financial audits of all major administrators of budget funds in accordance with the requirements of INTOSAI standards; ensure the timeliness of financial audits, the results of which should be published together with the financial statements; assessment of the skills of the ACU's specialists performing financial audits to plan staff training; revise approaches to the interaction of the ACU's auditors with

internal audit departments to support the development of the internal audit function in the public sector; establish a quality control system according to the requirements of ISSAI 140; revise the approaches to the implementation of public finance reform on the transition to the application of the principle of accrual in accounting. Implementation of the recommendations will strengthen the role of the Accounting Chamber in society by increasing the credibility of its audits and their importance for improving the efficiency of public administration.

Keywords: *Audit; Public Finance; Accounting Chamber; Trust; Financial Reporting*

1. INTRODUCTION

The modern system of public audit is able to meet society's demand for a complete, reliable and unbiased assessment of the public administration. The requirements of information transparency and publicity of the processes of collection and use of taxes, budget formation and adoption are put forward by many international institutions. Therefore, the prospects for further economic integration and deepening of Ukraine's political association with the European Union are closely connected with supporting the development of an external independent audit institution in the country.

Stability of the legal field, observance of the principles of transparency and accountability in the field of economy and finance, public administration are important factors in ensuring the country's development and adherence to its national interests in the long term. Simultaneously, the crisis of recent years and its consequences have exacerbated the problems of the inefficiency of the control system, which should be the key to the effectiveness of the ongoing reforms and the fight against economic crime and corruption.

2. LITERATURE REVIEW

According to Hay and Cordery (2018), auditing in the field of public finance has existed for a long time, more than a century, but continues to evolve, responding to the needs and expectations of society. And although there are many explanations for the similarity of audit in the private and public spheres, at the same time the audit of public finances is a special area affected by the peculiarities of the control system in the state, the level of economic and social development, the effectiveness of the public administration system, etc.

The system of control of public finances plays an important role in creating a transparent and effective system of public management of financial resources, which should ensure the sustainable development of modern society.

Thereby, Bonollo (2019) emphasizes the importance of the Supreme Audit Institutions (SAIs) for the functioning of the public administration system, as they oversee the use of public resources and ensure the accountability of public authorities to society.

Therefore, the reform of the public finance control system should be based on the need to ensure its function of maintaining the legal, fair and efficient formation, distribution and use of public financial resources (Meiss et al., 2017).

In their successive studies, Hay and Cordery (Cordery & Hay, 2019; Hay & Cordery, 2021) emphasize that Supreme Audit Institutions play an important role in ensuring public sector accountability. Researchers provide substantial evidence that public sector auditing is extremely valuable to a wide range of users. By auditing the financial statements of public sector entities, assessing their integrity, compliance with regulatory requirements, conducting performance audits, as well as advising parliamentary committees, SAIs make a significant contribution to the development of society.

Examining empirical data from New Zealand, the authors provide recommendations to the SAIs and politicians on the need to maintain public attention to the results of SAIs, which will generally ensure transparency in society and public confidence in the actions of the authorities (Hay & Cordery, 2021). At the same time, researchers draw attention to the importance of complying with the requirements of international standards in the field of public finance audit INTOSAI, which are aimed at increasing the value of the SAIs for society.

Current research in different countries confirm the relationship between the performance of the SAIs and the maintenance of good governance (Meiss et al., 2017; Milojević et al., 2018; Nevidomyi & Kanonishena-Kovalenko, 2019; Lentner et al., 2020; Bardash & Osadcha, 2020; Çeku, 2021; Bostan et al., 2021).

An external audit is able to ensure the legitimacy and transparency of the collection and spending of public finances, which is a prerequisite for democratic governance (Çeku, 2021).

Khorunzhak with her co-authors (2020) conducted a study of the current audit quality control system in Ukraine to develop proposals according to the main areas of its development and improvement based on the positive foreign experience and criteria determined by users of audit services. The authors have substantiated the necessity of introducing social (public) supervision, developing internal audit quality control, increasing the responsibility of audit

entities and hope that the recommendations provided will help overcome the identified shortcomings associated with the quality parameters of the audit services provided in Ukraine.

According to Bardash and Osadcha (2020), the public finance control system also plays an important role in maintaining the state's competitive position in foreign markets, since the rational use of financial resources, the formation of prudent public policy on public property management and public resources affects the overall state of the economy.

Iryna Drozd with the group of scholars (2021) analyzed the methods, indicators and the extent to which the study of public procurement effectiveness via bibliographic and case studies is performed. The authors believe that the methodology of auditing the procurement effectiveness, taking into account the quantitative and qualitative parameters of procurement risks, will be a useful audit tool to determine the effectiveness of the use of public funds under individual procurements and identify areas of cost-effectiveness for the state budget funds.

Olena Antoniuk with scientists' group (2021) analyzed the development of the institutional framework for the provision of audit services. The authors correlated the classification of audit services in normative documents, including documents of the professional organization of auditors. The issue of institutionalization was considered in the context of the interaction of accounting problems at the national level in Ukraine and the practice of auditors. It has been proven that the provision of accounting services is a priority in the activities of auditors. The conclusion of this paper helps to identify vectors in the development of a regulatory framework of audit services national level (Rodrigues, Semenyshena, 2021).

In addition, as noted by Bostan et al. (2021), in recent years, against the background of the aggravation of the economic and financial crisis in many countries, the quality of public finances has come to the fore, which involves not only changing the way public resources are allocated, but also their efficient use.

Under these circumstances, the Supreme Audit Institutions have a strong capacity to help governments stabilize the economy, respond quickly to economic shocks, and ensure the proper functioning of markets for goods, services, and labor.

The majority of researchers note that in Ukraine there is still no common methodological basis for building an effective system of public finance audit. As a result, there is a lack of audit information, reduced quality of audit activities and credibility of state

institutions and management decisions made on the basis of audit information (Pikhotskyi, 2019).

3. RESEARCH PROBLEM

The transformation of the public finance control system that has been taking place in Ukraine in recent years is due to the need to support the implementation of public administration reforms in the context of European integration. Signed in 2009, the “EU-Ukraine Association Agenda to prepare and facilitate the implementation of the Association Agreement” defines the structure of the public finance control system that meets the requirements of international standards and should be made in Ukraine.

In order to fulfill its commitments, Ukraine has launched appropriate reforms aimed at developing external public audit and public internal financial control. These components are elements of the overall system of public finance control and should harmoniously combine the parliamentary and governmental branches of control (Figure 1).

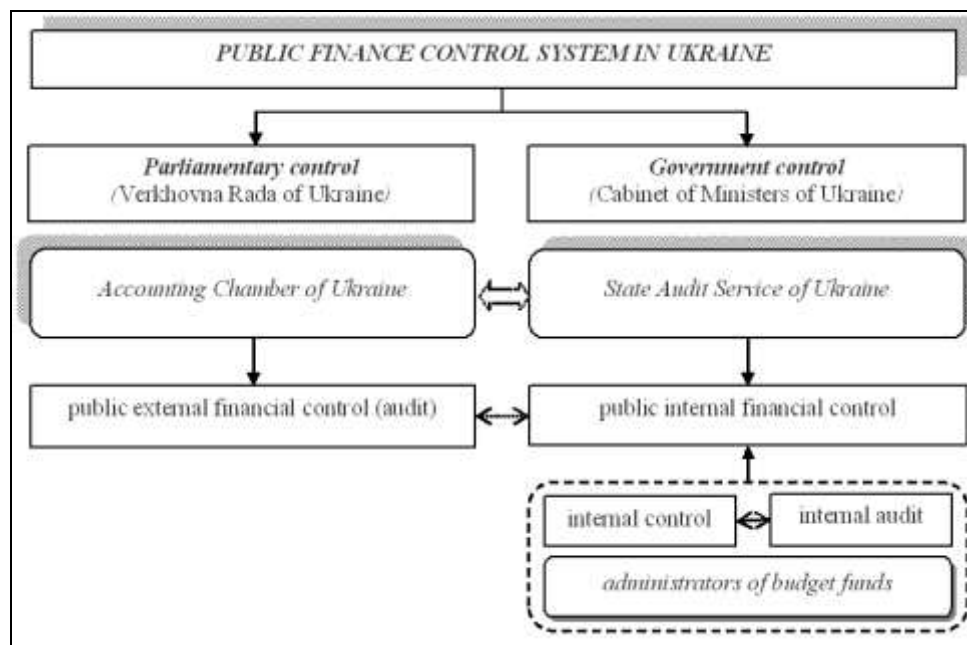


Figure 1: Public finance control system in Ukraine
 Source: compiled by the authors

Ukraine started the process of harmonization of national and international standards in the field of accounting and financial reporting in 1998, since 2004 International Auditing Standards have been fully applied. According to research (Antoniuk et al., 2019, 2021), in recent years, the Ukrainian legislation on audit has been adapting to the legislation of the European Union. However, the transition to the use of international accounting and auditing

standards in the public sector, which began in 2007, has been significantly delayed. The main reason is the need for fundamental changes in the applied approaches (first of all, the transition to the application of the accrual method), which also requires a revision of many regulations and appropriate training of specialists.

The adoption in 2015 of the new Law of Ukraine "On the Accounting Chamber" was due to the need to revise the approaches to the functioning of the supreme audit institution, which should be the Accounting Chamber (ACU). The advantages of the law include the norms that became the beginning of the implementation of the state audit in Ukraine in accordance with the requirements of international standards INTOSAI.

The list of measures of the state external financial control (audit) includes financial audits, performance audits, examinations, analysis, etc. Norms that establish the organizational, functional and financial independence of the ACU can also be positively assessed; introduction of a procedure for competitive selection of candidates for the positions of members of the ACU; the declared application by the ACU in its activities of the International Standards of Supreme Audit Institutions (ISSAI); a more clearly defined procedure for responding to the ACU's reports; the requirement to conduct an external audit of the ACU and external evaluation of its activities.

It should be noted that the Accounting Chamber of Ukraine has been a full member of INTOSAI since 1998. At the same time, the Law of Ukraine "On the Accounting Chamber" updated in 2015 only partially takes into account the requirements of INTOSAI standards. Thus, for the first time since the existence of the Accounting Chamber, the term "audit" has been introduced into the law (previously, the ACU carried out only control measures). In addition, the law stipulates that the Accounting Chamber applies INTOSAI standards in its activities insofar as it does not contradict the Constitution and laws of Ukraine.

Simultaneously, we must state that the Accounting Chamber has only just begun to implement real steps towards the implementation of INTOSAI standards in its practice.

With the renewal of the members of the Accounting Chamber in 2018, there have been positive changes in the financial support of the Chamber, the development of its staff, the establishment of communication with Parliament and the media. However, the results of the functional evaluation of its activities conducted at the end of 2018 by international experts with the support of the German Government and the Delegation of the European Union to Ukraine

indicate a low level of maturity in international standards and imperfect governance. The main range of issues outlined by the experts concerns the following:

With the renewal of the members of the Accounting Chamber in 2018, there have been positive changes in the financial support of the ACU, the development of its staff, the establishment of communication with Parliament (Verkhovna Rada of Ukraine) and the media. However, the results of the functional assessment of its activities, conducted at the end of 2018 by international experts with the support of the German Government and the Delegation of the European Union to Ukraine, indicate a low level of maturity in international standards and the imperfection of the management system. The main range of problematic issues outlined by the experts concerns the following:

- there is no appropriate quality control system;
- public audits conducted in the form of financial and performance audits do not meet the requirements of ISSAI standards;
- needs to resolve the issue of planning the activities of the ACU and monitoring the implementation of recommendations based on audit results;
- it is necessary to strengthen the independence of the ACU and its officials by making appropriate amendments to the legislation.

Numerous studies in the field of public finance audit in Ukraine focus on the regulatory and organizational issues of the country's control system (Antoniuk et al., 2019, 2020, 2021; Dubovik, et al. 2019; Drozd et al., 2021; Pikhotskyi et al., 2019; Bardash & Osadcha, 2020; Kaletnik & Zdyrko, 2021, Khorunzhak et al., 2020), the development the Accounting chamber's strategy (Nevidomyi & Kanonishena-Kovalenko, 2019). Simultaneously, in our opinion, the issues of the methodology of audit tasks performed by the SAI and the impact of audit results on maintaining the development of good governance need more in-depth analysis.

Therefore, the **aim of the study** was to analyze the methodological problems that exist in the field of public finance audit, and to find ways to solve them on the example of Ukraine.

4. DATA AND METHODOLOGY

The methodological basis of the study is the analysis of scientific publications, regulations, standards; best practices analysis; retrospective analysis of ACU's performance

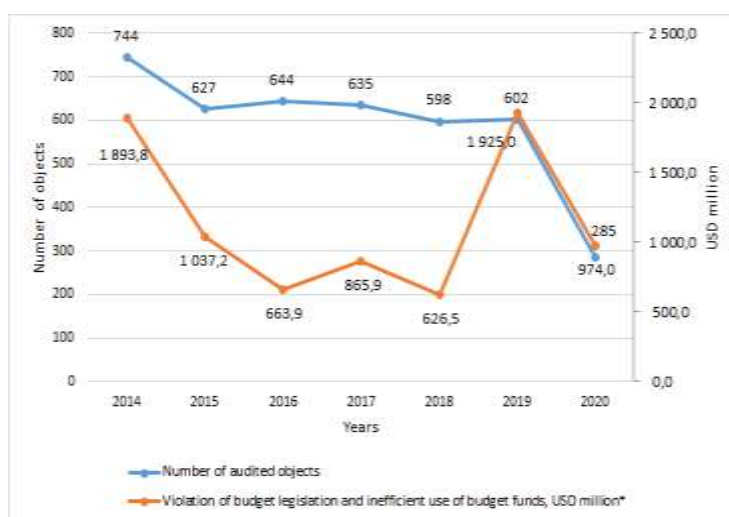
indicators; content analysis of reports on the results of audits; method of logical generalization and systematization in formulating conclusions and recommendations.

The study is based on the hypothesis that not only the fact of conducting an audit of public finances, but also its methodology, in particular, its compliance with the requirements of INTOSAI standards, plays an important role in maintaining the functions of the SAI in society and building confidence in its results.

Data, including reports on the results of audits of public finances conducted by the Accounting Chamber of Ukraine for 2014-2021, information on the publication of financial reports of ministries obtained from official sources. In addition, the authors took into account the results of processing empirical data collected by Slobodyanik et al. (2019) during a survey of experts in the field of independent audit and state control.

5. RESULTS AND DISCUSSIONS

An analysis of the performance indicators of the Accounting Chamber for the period from 2014 to 2020 displays a gradual decrease in the number of audited objects from 744 in 2014 to 285 in 2020 (Figure 2). At the same time, fluctuations in the identified violations in monetary terms do not yet make it possible to assert stable trends.



* at the average annual exchange rate of the USD against UAH

Figure 2: Violations uncovered by the Accounting Chamber of Ukraine in 2014–2020

Source: calculated by the authors based on ACU’s reports

A comparison of the number of detected violations with the amount of funds covered by control measures carried out by the Accounting Chamber also does not indicate a stable trend (Table 1).

Thus, the largest volume of violations was detected in 2019 (6.5% of the amount of audited funds), the lowest – in 2020 (2.2% of the amount of audited funds).

Table 1: Number of control measures carried out by the ACU from 2014 to 2020

Indicator	Years						
	2014	2015	2016	2017	2018	2019	2020
Amount of funds checked during the control measures, USD million*	50 462.6	16 941.4	12 289.6	18 947.4	11 202.2	29 524.2	43 954.0
Violation of budget legislation and inefficient use of budget funds, USD million*	1 893.8	1 037.2	663.9	865.9	626.5	1 925.0	974.0

* at the average annual exchange rate of the USD against UAH

Source: calculated by the authors based on ACU's reports

As noted above, the Accounts Chamber has only started to conduct financial and performance audits since 2015.

An analysis of the published reports reveals the ratio of audits to the total number of control activities carried out by the Accounting Chamber (Table 2).

Table 2: Number of control measures carried out by the ACU from 2015 to 2021

Year	Number of published reports of the ACU on control measures			% of financial audits to the total number of control measures
	Total	Including:		
		Performance audits	Financial audits	
2015	39	16	2	5.1
2016	61	48	2	3.3
2017	72	50	4	5.6
2018	83	63	3	3.6
2019	70	50	6	8.6
2020	48	32	2	4.2
2021	52	35	4	7.7

Source: summarized by authors using ACU's database (The Accounting Chamber, 2021)

It should be noted that since the beginning of the introduction of audits in the practice of the Accounting Chamber, performance audits have prevailed. This approach reflects the general trends in the development of public finance audit. This is confirmed by the study Bonollo (2019), in which the author emphasizes that recent academic research focuses on performance audits, rather than financial audits.

At the same time, performance audits fulfill the task of assessing the economy, efficiency and effectiveness of the management of an institution (or system, operation, program or measures). Such assessments cannot be made without confirmation of the accuracy and

completeness of the input information. That is why performance audits cannot replace financial audits.

First of all, it is important to ensure that all information of the audited entity, its financial data presented in the financial (budgetary) statements are correct and reliable, which is determined when conducting financial audits. During a compliance audit, auditors are assured that activities or services in the public sector are provided in accordance with regulations, instructions and procedures, information is correct, and financial management and activities of public sector officials are carried out in accordance with rules and regulations.

At the same time, auditors can analyze and express an opinion on the causes and possible consequences of non-compliance. And only after gaining confidence in the compliance of information with certain criteria can public auditors assess the economy, efficiency and effectiveness in the framework of a performance audit. Simultaneously, the performance audit provides in-depth analysis, sometimes of already known facts from a different point of view, providing innovative conclusions. In some cases, performance audits may be performed as a follow-up to compliance audits, during which auditors have identified non-compliance with best practice in general.

Accordingly, financial audits perform their important function by providing a basis for performance audits. In Ukraine, on the other hand, there was no practice of conducting financial audits in the public sphere until 2015. And after the adoption of the relevant amendments to the legislation, financial audits did not become widespread and did not receive the important role in the activities of the Accounting Chamber.

Content analysis of the reports of the Accounting Chamber based on the results of financial audits proves their incomplete compliance with the requirements of INTOSAI standards. It should be noted that according to the requirements of ISSAI 2000 the International Standards on Auditing (ISSAI) for financial audit include International Standards on Auditing (ISA) developed by the International Auditing and Assurance Standards Board (IAASB), under a formal agreement between the INTOSAI Professional Standards Committee (PSC) and the International Federation of Accountants (IFAC) and its independent standard-setting body the IAASB.

In Ukraine, the International Standards on Auditing in the private sector have been applied since 2004, so the Accounting Chamber can implement them.

The methodological problems are as follows:

- According to the requirements of ISSAI 2200.20 (ISA 220.20) “The auditor shall not represent compliance with ISAs in the auditor’s report unless the auditor has complied with the requirements of this ISA and all other ISAs relevant to the audit.” Consequently, when conducting financial audits of public finances, the generally accepted audit methodology must be fully complied with. Instead, the Audit Chamber adopted in 2015 Methodological Recommendations for Conducting Financial Audits that do not comply with ISA. The latest reports on the results of the financial audit contain a reference to the Methodological Manual on Financial Auditing, approved by the Accounting Chamber on 17.12.2019 № 37-9, but this act and the manual have not been made public, which makes it impossible to assess its compliance with standards.
- The period of financial audits should be consistent with the issuance of financial statements, which should be confirmed when made public. The timeliness of a financial audit is crucial for users of financial statements, as it allows them to obtain verified information on the basis of which economic decisions are made. This is also emphasized by Milojević et al. (2018), pointing out that in this case, users are not interested in studying budget procedures that have taken place a long time ago, and there is no effect from public condemnation of officials who left leadership positions some years ago. Instead, the Accounting Chamber conducts financial audits for different periods of time and much later than the official dates of publication of financial statements.
- Content analysis of reports on the results of financial audits proves the presence of problems with identifying risks, materiality and audit sampling, due to lack of practical experience in conducting financial audits by specialists of the Accounting Chamber. Reports differ significantly in size, structure and form of presentation of information, which also does not contribute to their perception by users.
- Lack of interaction between the auditors of the Accounting Chamber and the internal audit departments, which were established in 2012 and are mandatory for all budget organizations. The lack of such communication increases the work of external auditors and does not contribute to the development of the internal audit function, the effectiveness of which can be increased as a result of such interaction. At the same time,

the influence of an effectively functioning internal audit department on improving the efficiency of public expenditures and the performance of public service tasks by public institutions has been empirically confirmed (Postula et al. 2020).

- The lack of a quality control system that meets the requirements of ISSAI 140 also does not allow to perform audits in full compliance with the standards. Adopted in 2015, the Recommendations on the management and quality control of control activities carried out by the Accounts Chamber do not provide for the establishment of a quality control system that is mandatory for SAIs. In addition, the quality control system for audit activities, introduced in Ukraine in recent years, is aimed at maintaining high standards (Khorunzhak et al., 2020). This also applies to public finance.

It should be noted that in order to benefit from the introduction of financial audits in the field of public finance, it is necessary to build an appropriate reporting process by public sector entities. In Ukraine, all public sector entities are required by law to publish financial statements on their official websites. Accounting is conducted in accordance with the requirements of the National Accounting Regulations (Standards) For The Public Sector, in accordance with which the financial statements are also prepared.

During the period analyzed from 2015 to 2021, the Accounting Chamber conducted 23 financial audits, only 3 of which were conducted at the ministry level. However, an analysis of the official websites of the ministries revealed that only 6 of the 19 ministries publish their financial statements in accordance with the law, another 2 – a year late. All others do not publish financial statements at all.

Such inattention to financial reporting, in our opinion, is due to the fact that for many years in domestic practice the cash method of accounting has been used in the public sector. According to this approach, budget reporting is important, which reflects the movement of accounts during the financial year. The attention of the main users is focused on it – the Treasury and other state regulatory authorities. Under such circumstances, the weight of the information contained in the financial statements is lost.

As noted by Lentner et al. (2020), the most significant disadvantage of the cash approach is that it is impossible to accurately determine the financial position of the particular budgetary organization, as well as to adequately establish the total amount of actual expenses. Instead, accrual accounting gives a complete picture of the assets and liabilities of the

budgetary organization and provides an analytical approach to accounting entries, as well as allows users to compare financial statements over several years. Research shows that the shift to accrual-based accounting contributes to better planning and financial control in the public sector, in addition to the efficient and successful management of public finances.

The problem of transition to the accrual method in the field of public finance in Ukraine has been discussed for a long time. Reforms in this area, which have been going on for decades, have included the transition to the application of new standards in the public sphere since 2013. However, the transition was significantly delayed. From 2018, public sector entities are required to report on generally accepted financial statements, consisting of a balance sheet, income statement, cash flow statement, equity statement, notes to the annual financial statements, and the appendix to the annual financial statements "Information for segments".

The issue of consolidation of financial statements remains unresolved in terms of determining the structure and procedure for the formation of general consolidated financial statements of public sector entities. At the same time, accountants of budgetary organizations still pay more attention to the preparation of budget reports. In our opinion, it is at this point in time that it is important to ensure the right approaches to the preparation of financial statements, in particular by auditing them.

The result of financial audits should be reliable financial statements prepared in accordance with the requirements. In addition, the process of financial audits will identify problems of asset valuation and completeness of their reflection in the financial statements of budgetary organizations, which is a key issue in the consolidated financial statements of the country.

It should be noted that from 2021 in Ukraine, in support of EU reforms, the EU4ACU project is being implemented, which is part of the program "Development of external audit and control of public finances in Ukraine." The implementation of this project should strengthen the management of public finances in accordance with the general requirements of the EU, in particular by expanding the possibilities of external audit of budget funds by the supreme audit institution of Ukraine – the Accounting Chamber. Within the framework of this project, the audit methodology should be improved: introduction of risk-oriented audit planning, bring financial audits, compliance and performance audits in line with ISSAI standards, introduction of a modern control system and audit quality assurance. Achieving the expected results set for

the project will allow for better budgetary control, help overcome budget inefficiencies, abuses, and prevent corruption in areas where public finances are involved.

Therefore, the Accounting Chamber should revise its approach to the number of financial audits it conducts. The best practices of countries that have made the transition to the use of INTOSAI standards show the importance of starting with the introduction of financial audits, gradually moving to compliance audits and performance audits, which require more resources and training, but can fundamentally change the role of SAI in society.

6. CONCLUSIONS AND RECOMMENDATIONS

Summarizing the above, we propose the following:

- a) The Accounting Chamber should decide on the full application of ISA in its activities in performing financial audits. Developed guidelines for conducting financial audits should comply with ISSAI / ISA and not violate them.
- b) The Accounting Chamber should draw public attention to the importance of the information contained in the financial statements of administrators of budget funds. To do this, it is advisable to conduct a financial audit in accordance with the standards of all major administrators of budget funds, including ministries. Based on the results of such audits, conclusions should be drawn on methodological issues that arise during the preparation of financial statements.
- c) To ensure the timeliness of financial audits, the results of which should be published together with the financial statements, it is advisable to revise the approaches to the annual planning of the Accounting Chamber.
- d) It is necessary to assess the availability of relevant skills of the Accounting Chamber's specialists performing financial audits, in particular, knowledge of accounting, audit methodology, sampling skills, risk assessment, etc. Based on the results of the assessment, it is advisable to plan appropriate training for staff.
- e) Approaches to the interaction of the Audit Chamber's auditors with internal audit departments need to be revised to support the development of the internal audit function in the public sector.
- f) The formation of the quality control system in the Accounting Chamber in accordance with the requirements of ISSAI 140 requires a review of the organizational structure

and powers of individual departments, which will provide a basis for further implementation of INTOSAI standards and improve the quality of the Chamber as a whole.

- g) Approaches to the implementation of public finance reform need to be reconsidered in order to move to the application of the principle of accrual in accounting and ensure full maintenance of various state registers, which contain information on assets of public sector entities (in particular, the Unified Register of State Property, the Land Cadastre, the State Register of Real Property Rights, etc.).

Implementation of the recommendations, in our opinion, will strengthen the role of the Accounting Chamber in society by increasing the credibility of its audits and their importance for improving the efficiency of public administration.

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