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Problems and Prospects for the Development of the Internal State Audit in Ukraine

Yuliia B. Slobodianyk[1*], Olha M. Halas[2]

[1]Kyiv National Economic University named after Vadym Hetman
03057, 54/1 Peremohy Ave., Kyiv, Ukraine

[2]Mukachevo State University
89600, 26 Uzhhorodska Str., Mukachevo, Ukraine

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[*]Corresponding author

Abstract. As a result of the reforms carried out in previous years, a two-tier system of public finance control was created in Ukraine, consisting of an external independent audit and state internal financial control. Recent changes in the current legislation and the announced plan for further transformations in the field of public finance control require analysis of the effectiveness of previous reforms and the appropriateness of changing the development vector of the relevant state institutions. The aim of the article is a retrospective analysis of the effectiveness of the implementation of the internal state audit function in Ukraine, the identification of problems and prospects for its development based on a systematic approach. The analysis of regulatory acts in the field of public finance control proves that the subsystem of state internal financial control is developing much more actively than the subsystem of external control. In the absence of a single concept for the development of these subsystems, a certain inconsistency of their functioning has been observed. The main achievements in the implementation of reforms in the government sector, carried out with the support of various international organisations, have been characterised. It has been determined that despite a long period of development of organisational and methodological support for the functioning of internal audit units in the public sector, as well as intensive training of employees, the State Audit Service of Ukraine continues to record financial irregularities, the list and amount of which remain unchanged from year to year. It has been substantiated that the described situation bears signs of the inconsistency of the efforts made with the actual results of the reform in the internal state audit sphere. The main reasons are the following: low salaries of employees of internal audit units that do not meet the necessary professional competencies and experience; widespread violation of the independence principle of internal state auditors, negatively affecting their ability to perform significant tasks; lack of accessible training and advanced training combining theoretical knowledge and practical cases. The practical significance of the study is to determine the prospects for the further development of the internal state audit function, to ensure the effectiveness of which a systematic approach should be applied

Keywords: internal state audit, external state audit, public finance control system, reforms, efficiency, Accounting Chamber, Office of Financial Control

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The Problem Statement

After the proclamation of independence, Ukraine began the process of transforming the system of public finance control, which did not meet the requirements of public administration in the new socio-economic environment. As a result of the reform, a two-tier system of public finance control has now been established, consisting of external independent audit and state internal financial control aimed at maintaining the legality of the use of budget funds and the efficiency of public bodies. The presence of these components fully complies with international standards in this area and is considered an integral attribute of modern civilised society. That is why the construction of a two-tier system of public finance control has become a requirement of Ukraine's international counterparties, and is also a part of the Ukraine – EU action plan, for the implementation of which several legal documents have been adopted. At the same time, the latest changes in the current legislation and the announced plan for further transformations in the field of public finance control require an analysis of the effectiveness of previous stages of reforms and the feasibility of changing the vector of development of relevant public institutions.

The purpose of the article is a retrospective analysis of the effectiveness of the internal public audit function in Ukraine, the identification of problems and prospects for its development based on the application of a systematic approach.

Analysis of Recent Research and Publications

The works of many Ukrainian scholars and practitioners are devoted to the problems of the effectiveness of the Ukrainian system of control of public finances, in particular the functioning of internal control and audit in public sector bodies. In publications of recent years, sufficient attention has been paid to the organisational, legal, and methodological support of the subsystem of internal public financial control. Thus, the authors M.V. Barinin and I.Yu. Chumakova [1] analyse the results of external and internal assessments of the functioning of the internal audit system in public and municipal sectors and identify problems in implementing best European practices in Ukraine. Accordingly, A.V. Khomutenko [2] suggests ways of improving the control over the execution of budgetary programs on the basis of the assessment of organisational, methodical, and legal bases of activity of existing subjects of financial control.

In the publication of M.I. Koshchynets [3] the components of the internal control system are examined, in particular, managerial accountability and responsibility of heads of budgetary institutions and their status in ministries, other central executive bodies, and regional state administrations in terms of elements of the COSO model.

The work of V.F. Pikhotsky et al. [4] presents the authors' methodological approach to the overall assessment of the effectiveness of public financial control and audit, based on the application of coefficients of control efficiency and public audit efficiency.

The analysis of modern publications proves the focus of research on the development of proposals for improving the methodology and organisation of internal control and audit in the public sphere, in particular on the basis of foreign best practices. Considering the problems of the effectiveness of the Ukrainian system of public finance control, most authors emphasise the effectiveness of the transformations. At the same time, recent legislative changes indicate the lack of a unified concept of development of existing branches of the public finance control system (Fig. 1) and determine the feasibility of analysing achievements and problems, especially in the development of internal public audit.

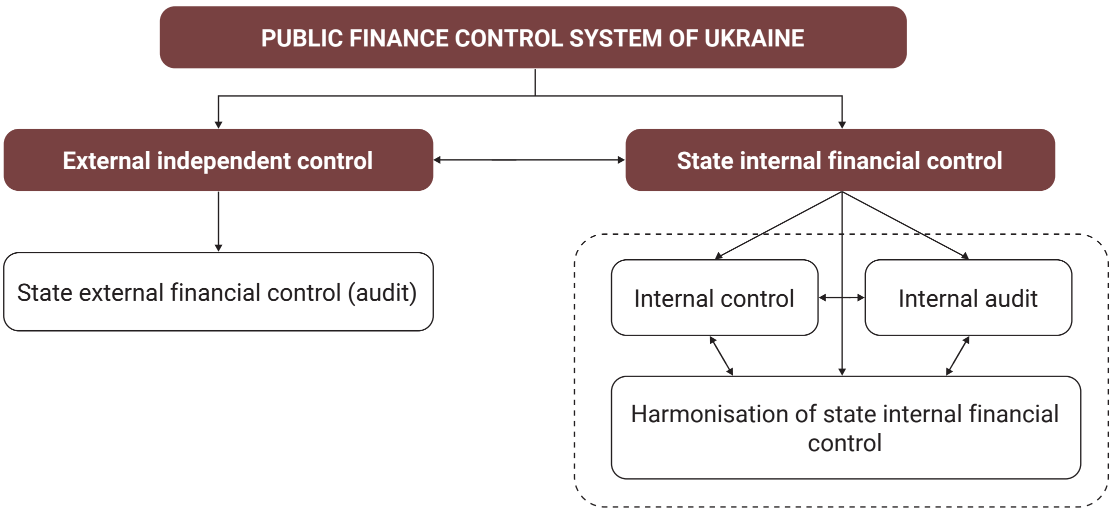

Figure 1. Modern structure of the public finance control system in Ukraine
Source: developed by the authors on the basis of [6; 7]

Research Results

The establishment of the system of independent external control of state finances is connected with the functioning of the Accounting Chamber of Ukraine, which is recognised by the world community as the supreme audit institution, is a member of international organisations INTOSAI and EUROSAI, and cooperates with them on various programs. At the same time, the reform of the functions of the Accounting Chamber in the direction of their compliance with the international Standards of State Audit ISSAI is still happening at a slow pace. The main shortcomings are certain limitations of the Chamber's powers to control local budgets, communal property, and other socially important resources. National performance standards and a system for assessing the quality of public audit also need to be developed.

With the adoption in 2015 of a new version of the Law of Ukraine "On the Accounting Chamber", the independence of the chamber was strengthened and its powers to audit the revenue side of the state budget were expanded [5]. In addition, the law contains a number of qualitative changes that should help reform the Accounting Chamber and create its positive image in society.

In addition, since 2005 there has been a purposeful reform of the subsystem of state internal financial control. Thus, the Concept of Development of State Internal Financial control was adopted [6]; provisions on the organisation and implementation of internal control and internal audit have been introduced into the Budget Code of Ukraine [8]; a number of regulations in the field of the internal audit were developed and approved, in particular, Internal Auditing Standards, Code of Ethics for employees of the internal audit department, etc. [9-11].

Analysis of regulations in the field of public finance control shows that the subsystem of state internal financial control is developing much more actively than the subsystem of external control. In the absence of a unified concept of development of these subsystems, there is some inconsistency in their functioning. Thus, since 2001 the following draft laws were registered: "On the System of State Financial Control in Ukraine", "On Financial Control", "On State Financial Control", "On State Control Over Observance of Budget Legislation and Responsibility for Budget Violations", "On Public Control Over the Use of Funds from the State and Local Budgets", etc. Some draft laws were submitted to the Verkhovna Rada of Ukraine several times or had different initiators, but none of them was adopted. The reasons were both the low quality of legal acts and the inconsistency of approaches to the organisation of the control system between the various subjects of the legislative initiative. Thus, a law that would lay the groundwork for the coordinated development of parliamentary and governmental branches of public finance control has not yet been adopted.

The Sustainable Development Strategy "Ukraine – 2020", approved in 2015, aims to implement European living standards and bring the country to a leading position in the world in four main vectors – development, security, responsibility, and pride. The group of reforms according to the vector of development includes the reform of public financial control and budget relations, civil service, and optimisation of the system of state bodies, management of state property. In addition, the document emphasises that the reform of public administration should create an efficient, transparent, open, and flexible structure of public administration, and the priority in public finance management is to increase transparency and efficiency of their distribution and spending [12].

A logical continuation of the reform process was the adoption in early 2017 of the Strategy for Reforming the Public Financial Management System for 2017-2020. The main objectives of the Strategy include improving the level of managerial accountability and the effectiveness of internal control and audit in government bodies at the central and local levels. At the same time, the developers of the Strategy identify the factors that complicate the development of state internal financial control in Ukraine, in particular:

– failure of the central unit to harmonise coordination functions in the field of financial management and control in the public sector;

– partial performance of internal audit functions in budgetary institutions due to the lack of their understanding by management, as well as due to inadequate professional competence of internal auditors;

– misunderstanding of the essence of internal control and internal audit by managers at different levels [7].

To increase the effectiveness of internal audits, the Strategy suggests that the Ministry of Finance of Ukraine should prepare proposals on priorities for development and increase the independence of internal audit units, and also introduce training programs for internal auditors [7].

At the same time, it should be noted that over the last decade, the state bodies of Ukraine have been cooperating on a regular basis with various international institutions that help carry out reforms in the general government sector. For example, back in 2005, Ukraine began cooperation with state institutions of the European Union in the framework of Twinning technical assistance, which provides support for institutional and structural reform in public administration through such cooperation mechanisms as:

– expert assessment in the relevant field of public administration;

– assistance to the state body in the development and preparation of amendments to existing legal documents;

– assistance to the state body in the development of internal regulations, procedures, instructions, etc;

– support of the state body in strengthening its institutional capacity through European experts conducting a functional survey and/or comparative analysis of the existing institutional structure of the state body;

– training of government officials by conducting relevant seminars, trainings, internships, study visits, conferences, round tables, discussions, etc. by foreign experts [13].

In early 2006, with the financial support of the United Kingdom's Department for International Development and the Swedish International Development Agency, Ukraine's Public Administration Assessment was conducted under the Support for Improvement in Governance and Management (SIGMA) program. The SIGMA program was initiated by the Organisation for Economic Co-operation and Development (OECD) and the European Union and is considered one of the European Union's most prestigious analytical centers to help Central and Eastern European countries modernise their governance systems.

Thus, the SIGMA program in 2010-2012 assessed public administration and civil service in Ukraine. As part of the program, experts prepared relevant recommendations for effective public finance management, in particular in the field of budget policy, financial management and control, internal and external audit, public procurement, and administrative services [13]. In addition to providing expert assessment and advice in the relevant field of public administration, staff were trained in effective methods and procedures, assisted in drafting legislation, and aligning it with European standards.

Currently, in the framework of bilateral cooperation between the Ministry of Finance of Ukraine and the Ministry of Finance of the Kingdom of the Netherlands, the following project is being implemented – the Program for the Development of Internal Auditors of the Public Sector of Ukraine. The purpose of the program is to systematise the training of internal state auditors and further implementation of their certification. The structure of training modules presented in table 1 is similar to those used by the Institute of Internal Auditors for the certification of specialists.

Table 1. The structure of training modules of the Program for the Development of Internal Auditors of the Public Sector of Ukraine

Learning unit	Structure of training modules	Terms and conditions of study
Unit A. Novice or junior auditors (without experience or with experience up to 2 years and without a certificate of unit A)	**A1)** Legal bases and Ukrainian standards of internal audit **A2)** Internal audit: basic principles **A3)** Fundamentals of accounting skills **A4)** Financial management and control	4-week training: 2 weeks – theory, 2 weeks – practice
Unit B. Mid-level auditors (2 to 3 years of experience and/or with Unit A Certificate)	**B1)** Internal audit: advanced level; **B2)** Interview skills; **B3)** Sampling techniques; **B4)** Reporting skills	4 modules 3-5 days each. Based on the results of obtaining the certificates of units A and B, the auditor obtains a diploma, after which 40 hours per year of continuous study are mandatory (seminars, specialised trainings, etc.)
Unit C. Auditors of higher/specialised level (with more than 3 years of experience and with certificates of units A and B)	**C1)** IT audit or **C2)** Performance audit or **C3)** Financial audit or **C4)** Audit of EU funds	The internal auditor must pass one of the optional modules (1 week)
Unit D. Heads of internal audit tasks and team leaders (perform a managerial function, have sufficient knowledge and experience and/or with certificates of units A and B)	**D1)** Risk-based audit planning **D2)** Project management **D3)** Communication skills at the strategic level **D4)** Management skills	4 modules 2-3 days each

Source: generalised by the authors on the basis of [14]

To facilitate the understanding of the essence of concepts and practical application of methods of various forms of internal audit, relevant methodological manuals were developed and published on the official website of the Ministry of Finance of Ukraine, namely: "State internal financial control: Ukraine and European experience", "Internal performance audit: methodical bases and practical aspects", "Internal financial audit", "Indicators of the state of internal control of public sector institutions of Ukraine", "Methodological guidelines for internal audit in the public sector of Ukraine", "Practical guidelines for implementing financial management and control and strengthening management accountability (responsibility) in public authorities of Ukraine", "Internal and external assessment of the quality of the internal audit function in public sector bodies of Ukraine", etc.

Thus, today in Ukraine, with the support of foreign donors and Ukrainian legislators, an internal state audit is being developed. Given the long time that has elapsed since the start of implementation, the internal public audit should provide the expected results. Therefore, let's analyse the current situation in this area.

The latest version of the Concept of Development of State Internal Financial Control for the period up to 2017 contains the definition of internal audit, which means "… activities to provide independent and objective guarantees (ensuring confidence within reasonable limits in achieving public and municipal sectors in a way that minimises the risk of fraud, waste, error, or unprofitability) and consultation" [6].

January 1, 2012, was to be the official start of the functioning of internal audit units in the central executive bodies. The implementation of this stage was based on the previous phase of intensive training of responsible personnel and the development of the above-mentioned methodological manuals. Therefore, during this period of time, the internal audit activity had to achieve the set goal and show the planned results. Instead, according to the official data of the State Audit Service of Ukraine, almost 10.7 thousand measures of state financial control were carried out in 2019 (including more than 1.5 thousand audits and inspections, almost 8.8 thousand monitoring of procurement, 449 state financial audits) at enterprises, institutions and organisations of various forms of ownership showed that the use of state resources continues in violation of the law [15, p. 11]. During 2019, more than 1.3 billion UAH of illegal and misappropriated expenditures and shortages of material and financial resources were found at almost 1.3 thousand entities, including more than 736.8 million UAH from operations with budget funds [15, p. 12].

The main financial violations were:

– illegal spendings due to overpayment for work performed and/or services provided, as well as overpayments due to overstatement of the quantity or value of purchased goods;

– making illegal (extra) payments from wages;

– non-accrual and non-transfer (incomplete transfer) of revenues to the general and special (except for the special fund of budget institutions) budget funds;

– lack of funds and material values;

– loss of income due to write-off of receivables;

– write-off of funds for expenses/expenses without receiving goods, works or services or in amounts exceeding their actual value;

– sale of goods, works or services (except for use, rent) by business entities free of charge or at reduced prices;

– illegal payments to individuals (compensations, financial aid, benefits and subsidies, pensions, scholarships), including those who were not entitled to receive them or in excess;

– non-target expenditures, etc [15].

The list is incomplete, but it is indicative that according to the State Audit Service of Ukraine, these violations are the most significant and widespread. In addition, according to the authors of the article, the list of violations has not changed for more than 10 years. It was concluded that this directly indicates the improper operation of internal audit departments. The assessment of the quality of their functioning conducted by the State Audit Service of Ukraine in 2016 only confirmed this conclusion. Thus, the 2016 report noted that the internal audit function remains incapable and is unable to influence the state of financial and budgetary discipline in the relevant field. Among the main shortcomings were the following:

– incomplete staffing of internal audit departments and insufficient number of internal auditors;

– entrusting internal state auditors with tasks incompatible with their powers that cause potential conflicts of interest;

– incorrect application of the requirements of the Internal Auditing Standards regarding documentation, inadequacy of audit procedures, collection of poor-quality audit evidence, incorrect interpretation of identified violations, etc;

– lack of analysis of the facts of financial violations in relation to the reasons for their commission and the presence of other shortcomings;

– assignment of insignificant issues to the tasks of internal audit, uncertainty for the study of global issues due to the non-application of risk-based selection and other criteria in planning;

– weak response to the results of internal audits, failure to take measures, failure to make relevant management decisions, even in the detection of significant violations and facts of fraud, etc.

This indicates a low level of professional training of relevant professionals and the lack of effective policies and procedures that would correct the situation. At the same time, this situation shows signs of the inconsistency of the efforts made with the actual results of reforms in the field of internal public audit. The analysis of the reasons gives grounds for the formulation of the corresponding conclusions.

First, the highly competent professionals needed by internal audit units must have the appropriate level of salary. However, the public sector is uncompetitive compared to the private sector. Thus, after a brief analysis, it can be noted that considering the knowledge and skills obtained by a certified internal state auditor in accordance with the Program for the Development of Internal Auditors of the Public Sector of Ukraine (Table 1) a specialist with such qualifications can quickly get a job in private companies that are interested in the development of the internal audit function and are able to properly assess the "market value" of such a specialist. At the same time, in the public sector, the specialists of internal audit departments belong to the lower level of managers, and, therefore, do not have the opportunity to receive a decent salary. In addition, with the adoption of the latest amendments to the legislation on pensions, the incentive to receive a higher pension was lost. It is no secret that many professionals have decided to move to the public sector in mature age –10-15 years before retirement. Motivation is the possibility of receiving a higher amount of pension. So far, this incentive has been lost, but no other has been created. However, this problem needs to be addressed immediately, otherwise the internal audit function will not work.

Second, the inclusion of minor issues in the tasks of internal auditors while ignoring acute operational problems, especially those with a high risk of non-compliance with current legislation, is not due to the ignorance of internal auditors. According to the authors, these facts are directly related to the violation of the fundamental principle of independence. In other words, internal auditors try to avoid complex issues because they are afraid of losing their jobs. That is, in solving this block of issues it is necessary not only to train specialists in risk-oriented approaches but also to work out a mechanism to ensure their real independence. This aspect is also related to the demotivation of internal auditors, as the results of internal audit rarely lead to effective management decisions. If no one is interested in the results of the work of internal auditors, it makes no sense to look for problems in the work of the organisation or institution, especially if it is associated with the risk of losing your job

Third, internal auditors need accessible training and retraining that combines theoretical knowledge and practical cases on how to assess risk, what constitutes the working documentation, how to conduct a survey, how to write a report so that it is accessible and understandable to users and clearly reflects the essence of the identified problems.

It should be noted that the assessment of the quality of functioning of internal audit units today is in accordance with the Procedure for the Ministry of Finance of Ukraine to assess the functioning of the internal audit system [16]. The following issues are investigated during the quality assessment:

– status and structure of the internal audit department, its organisational and functional independence, the number of employees of the internal audit department and the state of its staffing, compliance of staff with the qualification requirements;

– availability of internal documents on internal audit, their compliance with the Standards;

– planning of internal audit activities;

– organisation of internal audits, in particular the allocation of human resources, internal audit planning and preparation of internal audit programs based on its results;

– documenting the progress of internal audit and its results;

– monitoring the consideration of recommendations and the results of their implementation;

– results of internal assessments of the quality of internal audit;

– consideration of the recommendations based on the results of previous quality assessments;

– reliability, completeness and timeliness of reporting on the results of the internal audit department;

– the state of interaction of the internal audit department with the structural units of the institution;

– availability of a program to ensure and improve the quality of internal audit and the state of its implementation, etc. [16].

As a result of the quality assessment, an appropriate report is prepared, which outlines the general conclusions on the results of the quality assessment and recommendations for improving the internal audit system.

Note that this Regulation does not provide for specific measures to implement the results of such quality assessment. The developers emphasise the need to publish the results of the quality assessment on the official website of the Ministry of Finance of Ukraine. At the same time, the head of the institution should inform the Ministry of Finance about the status and method of consideration of the recommendations "within the period set by the Ministry of Finance" [16]. The normative act does not clarify the degree of responsibility of the management of the institution for non-compliance with the recommendations or partial consideration of them, for failure to provide relevant information or providing it in violation of deadlines. The authors believe that the norms of the provision should be stricter in this matter. Blurred responsibility will not improve the effectiveness of quality assessment.

In this context, it is advisable to pay attention to the requirements of International Standards on State Auditing, in particular ISSAI 1610 "Using the work of Internal Auditors", according to which the external public auditor in determining the use of internal auditors for audit purposes should assess the following parameters:

– the extent to which the organisational status and related policies and procedures of the internal auditors confirm the objectivity of the internal auditors;

– level of competence of internal auditors;

– application of a systematic and disciplined approach by internal auditors, including quality control.

If the external auditor's assessment of these parameters is negative, the work of internal auditors should not be used. Therefore, the significant shortcomings in the functioning of internal public audit at the same time complicate the conduct of external public audit, which in general affects the effectiveness and efficiency of the entire system of public finance control, and therefore requires immediate settlement.

The conclusions of are of particular interest. In 2018 the National Academy of Finance and Economics of the Ministry of Finance of the Kingdom of the Netherlands together with the Ministry of Finance of Ukraine conducted an assessment (review) of the functioning of internal control systems. The conclusions of this joint assessment are of particular interest. Based on the results, directions for further development of an effective internal control system were proposed [17]. Thus, the conclusions of experts on the problems of internal state audit are as follows:

– until 2018, more attention was paid to the development of internal audit than to financial management and control;

– internal audit is overloaded with tasks of compliance checks in subordinate institutions and state enterprises;

– internal audit should be refocused on performance audit;

– the role of internal audit in bodies with subordinate institutions and/or state-owned enterprises should be reconsidered [17].

In addition, today the first results of the quality assessment of the internal public financial control system can be seen. This assessment was conducted by the Department of Harmonisation of State Internal Financial Control of the Ministry of Finance of Ukraine. The "Information on certain issues of public internal financial control in 2019", published on the official website of the Ministry of Finance of Ukraine, identifies the main problems that were addressed during 2018 [18]. The main part of these tasks was to increase the number of employees and fill the relevant vacancies of internal audit units. Measures have also been taken to ensure the organisational and/or functional independence of structural units of internal audit, for example, delimit the performance of the internal audit and anti-corruption functions in individual Central Executive Bodies, as well as delineate control and verification work of individual structural units. Emphasis is placed on remarks on ensuring the direction of internal audit activities to improve the management system, internal control, prevention of illegal and inefficient use of resources, errors, or other shortcomings in the activities of the budget manager and enterprises, institutions, and organisations belonging to his sphere, etc. [18].

The reform of the State Audit Service of Ukraine announced at the end of 2019 by transforming it into the Office of Financial Control will also affect the further development of the internal state audit function [19]. At the same time, a full assessment of this impact can be provided only after the completion of organisational changes.

Conclusions

To sum up, it should be noted that currently in Ukraine the foundations for the large-scale introduction of the internal audit function in the public sector have been laid. Necessary normative legal acts have been adopted, methodological approaches have been developed, training and preparation for certification of internal state auditors are being carried out. At the same time, there is a need to further address the issues that hinder the development of internal audit based on best foreign practices. Ukraine's state budget funds and millions of dollars of international aid provided by donors for public sector reform in Ukraine may prove to be ineffective losses if the reform is not logically completed. However, the main thing is that Ukrainian society will lose trust in public authorities if the state fails to achieve strategic development goals.

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Проблеми та перспективи розвитку внутрішнього державного аудиту в Україні

Юлія Борисівна Слободяник[1], Ольга Мигалівна Галас[2]

[1]Київський національний економічний університет імені Вадима Гетьмана
03057, просп. Перемоги, 54/1, м. Київ, Україна

[2]Мукачівський державний університет
89600, вул. Ужгородська, 26, м. Мукачево, Україна

Анотація. У результаті проведених у попередні роки реформ в Україні створено дворівневу систему контролю державних фінансів, що складається з зовнішнього незалежного аудиту і державного внутрішнього фінансового контролю. Останні зміни чинного законодавства та оголошений план подальших трансформацій у сфері контролю державних фінансів потребує аналізу ефективності попередніх реформ і доцільності зміни вектору розвитку відповідних державних інституцій. Метою статті є ретроспективний аналіз результативності реалізації функції внутрішнього державного аудиту в Україні, визначення проблем і перспектив його розвитку на основі застосування системного підходу. Аналіз нормативно-правових актів у сфері контролю державних фінансів доводить, що підсистема державного внутрішнього фінансового контролю розвивається набагато активніше ніж підсистема зовнішнього контролю. За відсутності єдиної концепції розвитку означених підсистем спостерігається певна неузгодженість їх функціонування. Охарактеризовано основні досягнення у реалізації реформ в секторі загального державного управління, що проведені за підтримки різних міжнародних інституцій. Визначено, що незважаючи на тривалий період розробки організаційно-методичного забезпечення функціонування підрозділів внутрішнього аудиту в державному секторі, а також інтенсивного навчання їх співробітників, Державна аудиторська служба України продовжує фіксувати фінансові порушення, перелік і обсяг яких з року в рік залишаються незмінними. Обґрунтовано, що описана ситуація носить ознаки невідповідності докладених зусиль фактичним результатам реформування у сфері внутрішнього державного аудиту. Основними причинами визначено такі: низький розмір заробітних плат працівників підрозділів внутрішнього аудиту, що не відповідає необхідним професійним компетентностям та досвіду; повсюдне порушення принципу незалежності внутрішніх державних аудиторів, що негативно впливає на їх здатність виконувати значущі завдання; брак доступного навчання та підвищення кваліфікації, які б поєднували теоретичні знання та практичні кейси. Практична значущість проведеного дослідження полягає у визначенні перспектив подальшого розвитку функції внутрішнього державного аудиту, для забезпечення ефективності якої має застосовуватися системний підхід

Ключові слова: внутрішній державний аудит, зовнішній державний аудит, система контролю державних фінансів, реформи, ефективність, Рахункова палата, Офіс фінансового контролю