INTERNAL AUDIT REFORM AS ONE MAIN COMPONENT OF THE PUBLIC INTERNAL FINANCIAL CONTROL SYSTEM IN GEORGIA

Nino Chovelidze
GTU PhD Student,
The Faculty of Business Technology

RESUME

The Public Internal Financial Control System ensures the formation of independent, objective, public, transparent and professional public internal financial control, including formation of internal audit system. The internal control represents an instrument providing the transparency of the principles of financial management and control (FMC) for the purpose of the State's financial stability maintenance and enhancement.

This paper discusses the public internal financial control system's integral part - an internal audit unit reform. The system which I mentioned and the implementation of internal audit is an important issue for our country integration with the EU. This research paper reviews the compliance of the PIFC law in Georgia with international standards for the professional practice of internal auditing.

Key words: internal financial control, transparent, integration, internal audit, recommendation, governance, independence, standard, board, knowledge.

INTRODUCTION

"The conventional wisdom is that Government cannot be effective in the absence of public trust. Government auditors play a central role in fostering such trust, and have even been referred to as the guardians of public trust. Without them, citizens would lack credible insight into the soundness of the many inner workings of government."

Richard Chambers IIA President and CEO 2011

According to the Institute of Internal Auditors, "internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes." Another world we can explain that internal audit is responsible for monitoring the effectiveness of the internal control processes that have been established by management. The effective of the internal control system contributes to the whole implementation of a common system of public finances management and control (The IIA, 2011).

The importance of internal auditing in the public sector should be discussed below:

1. Government auditing is a cornerstone of good public sector governance as it provides unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve the intended results and also by promoting the appropriate ethics and values within the organization. Internal auditors help government organizations achieve accountability and integrity, improve organizational performance management and instill confidence among citizens and stakeholders.

2. The government auditor's role supports the governance responsibilities of oversight, insight and foresight. Oversight addresses whether government entities are doing what they are supposed to do and serves to detect and deter public corruption. Insight assists decision-makers by providing an independent assessment of government programs, policies, operations and results. Foresight identifies trends and emerging challenges.

3. Internal audit activity has become an essential internal assurance mechanism in public financial controls and a tool for monitoring and evaluating managerial activities prior to external evaluation by external auditors.

4. Internal auditors further enhance transparency, fairness, re-

duce corruption and ensure value for money in public procurement. An internal audit function is an essential part of any public expenditure management system and should ensure that public spending is within budgetary provisions; disbursements comply with specified procedures, provides for the timely reconciliation of accounts and effective systems for managing and accounting for physical and financial assets.

5. They also work with management to improve service delivery and ensure compliance with applicable laws, provide independent and objective assurance to an organization's management that its risks are being mitigated to an acceptable level, and reports where they are not.

6. Internal auditors are an integral part of government financial management and an instrument for improving performance and performance management in the public sector. Internal auditors could also play an instrumental role in performing value-for money (VFM) audits otherwise called "Performance Audits."Performance audits are concerned with the audit of economy, efficiency and effectiveness of government expenditures or spending plans. In practice, performance auditing is focused on assessing whether organizations are doing the right things, in the smartest way.

If organization wants to have an effective public sector audit, public sector audit activities needs: organization independence, which allows the audit activity to conduct work without interference by the entity under audit; The audit activity's powers and duties should be established by the public sector's constitution, charter, or other basic legal documents; Audits should be conducted with complete and unrestricted access to employees, property, and records as appropriate for the performance of audit activities. The audit activity needs a professional staff that collectively has the necessary qualifications and competence to conduct the full range of audits required by its mandate.

Based on the above, the aim of the work paper is to asset internal audit reform, as a part of the public internal financial control system, in Georgia.

LITERATURE REVIEW

The public internal financial control legislation should detail responsibility of IAU-s and the organization's other organizational units to identify risks and related controls, and detail IAU-s' responsibility to assess the risks and controls. Internal audit methodology should detail procedures and directions required for the purpose. It should give definition of efficiency, one of the three 'e'-s of performance audit that is in accord with the term as used in the best international practice, i.e., making the most of the fewest possible rather than available resources. The main question is whether the fewest possible resources have been put to optimal or satisfactory use. Apart from the definition, we believe internal audit standards should give examples of making the most of the fewest possible rather than available resources[1].

Public Internal Financial Control (PIFC) is the framework used across the European Union member states from the former Eastern Bloc as a means to implement the basic control systems to safeguard public resources. PIFC is comprised of two primary components: (i) financial management and control systems and (ii) internal auditing. With regard to internal auditing, the PIFC framework is based on IIA Standards for the Professional Practice of Internal Auditing[2].

Boards and audit committees should satisfy themselves that audit committee members have an appropriate level of expertise and specifically experience relevant to the sector in which the company operates. It is reasonable to expect that such considerations become an important part of both the annual audit committee assessment exercise and board succession planning. When making appointments to the audit committee the board should consider the overall knowledge and experience of the committee in order to achieve sec-

1 NGO - Transparency international Georgia, "challenges of public internal financial control in Georgia", Article 7.4, P.42, July 2014 http://www.transparency.ge/sites/default/files/post_attachments/Challenges%20of%20public%20internal%20financial%20control%20in%20Georgia.pdf

2 "BELARUS: NOTE on the REFORM of INTERNAL AUDIT", p.3

toral competence[1].

The audit committee should, at least annually, assess the independence and objectivity of the auditor, taking into consideration relevant UK law, regulation, the Ethical Standard and other professional requirements. The audit committee should consider the annual disclosure from the statutory auditor and discuss with the auditor the threats to their independence and the safeguards applied to mitigate those threats[2].

INTERNAL AUDIT REFORM IN GEORGIA

Following the declaration of independence from the Soviet rule in 1991, Georgia undertook a series of structural reforms to move toward a new state model. These included measures aimed at trade liberalization and legal and regulatory reform. However, weak fiscal management and lack of public sector capacity reduction the effects of these reforms. The 'rose revolution' of 2003 gave a new impulse to the reform process. The Government recognized the urgent need for a better functioning public sector to perpetuate economic gains and meet growing social inequities. In 2004, the Ministry of Finance prepared the Strategic Vision for Public Financial Management (PFM). In 2007, Government of Georgia and the European Commission concluded agreement about "Supporting Georgian Financial Management Reform".

Georgia's PIFC reform, effectively, started in 2010. However, it was an EU-Georgia agreement that laid the foundation of the PIFC system in 2007. Although the Law on Public Internal Financial Control adopted in December 2011 was a step forward compared to its predecessor, the law does not ensure effective functioning of the PIFC system. The law was the regulator of internal audit and inspection activities, but not in compliance with internation-

1 KPMG, "the impact on the role and responsibilities of audit committees", p.4

2 KPMG, "the impact on the role and responsibilities of audit committees", p.13

al standards, in particular there were no separate internal audit and inspection roles. In 2015, changes the law “public internal financial control” and the status of the harmonization center has changed as The Department of State Internal Control in the Ministry of Finance, which is Implementing the functions of the Harmonization Center (to compliance EU model). Also new law functionally separated internal audit and inspection and some term have been updated (for example: term “discovery” changed as term “findings”).

This main goal of this research paper is to answer the question:

Is the PIFC new law in compliance with international standards for the professional practice of internal auditing?

In my topic I have discussed only 5 standards from International standards for the professional practice of internal auditing**.** They are:

- 1000 **-** Purpose, Authority, and Responsibility;
- 1100 – Independence and Objectivity;
- 1130 – Impairment to Independence or Objectivity;
- 1200 – Proficiency and Due Professional Care;
- 1300 – Quality Assurance and Improvement Program.

1000 – **purpose, authority and responsibility -** “The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Definition of Internal Auditing, the Code of Ethics and the Standards. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval”.

1000. C1 – The nature of consulting services must be defined in the internal audit charter.

1010 – Recognition of the Definition of Internal Auditing, the Code of Ethics, and the Standards in the Internal Audit Charter The mandatory nature of the Definition of Internal Auditing, the Code of Ethics, and the Standards must be recognized in the internal audit charter. The chief audit executive should discuss the Definition of Internal Auditing, the Code of Ethics, and the Standards with senior management and the board.

In Georgia the PIFC law consists of the projects of internal audit charter should be developed as a result of consultation with the Harmonization Center, but not talking about the minimum requirements for Regulation of Internal Audit charter, who, when review it and to whom present for approval.

1100 – Independence and Objectivity The internal audit activity must be independent, and internal auditors must be objective in performing their work.

Interpretation: Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the chief audit executive has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship. Threats to independence must be managed at the individual auditor, engagement, functional, and organizational levels. International Standards for the Professional Practice of Internal Auditing (Standards) Issued: The Institute of Internal Auditors Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others. Threats to objectivity must be managed at the individual auditor, engagement, functional, and organizational levels.

1120 – Individual Objectivity Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest.

Interpretation: Conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. Such competing interests can make it difficult to fulfill his or her duties impartially. The conflict of interest exists even if no unethical or improper act results. It can create an appearance of impropriety that can undermine confidence in the internal auditor, the internal audit activity, and the profession. The conflict of interest could impair an individual's ability to perform his or her duties and responsibilities objectively

The PIFC law does not define what each principle means. But article 17 – basic principles of activities of internal audit units - talking about: internal audit units shall perform their activities in compliance with this law, other legislative and subordinate acts of Georgia, internal audit standards, the code for internal auditors, the statutes of internal audit units and the following basic principles: a) independence; b) integrity; c) objectivity; d) professionalism; e) confidentiality; f) legality; g) transparency.

1110 – Organizational Independence. The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity.

Interpretation:

Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:

1. ·NGO- Transparency international Georgia, "challenges of public internal financial control in Georgia"

2. BELARUS: NOTE on the REFORM of INTERNAL AUDIT;

3. KPMG, "The Impact on the role and responsibilities of audit committees";

4. The law "Public Internal Financial Control";

5. Institute of Internal Auditors (IIA)– IPPF International Professional Practices Framework, 2013;

6. What is difference between internal audit and internal control? https://enablon.com/blog/whats-the-difference-between-internal-audit-internal-control/

7. https://www.mof.ge/4178

საქართველოში შიდა აუდიტის რეფორმა - სახელმწიფო შიდა ფინანსური კონტროლის სისტემის კომპონენტი

ნინო ჭოველიძე
სტუ ბიზნეს ტექნოლოგიების
ფაკულტეტის დოქტორანტი

რეზიუმე

სახელმწიფო შიდა ფინანსური კონტროლის სისტემა უზრუნველყოფს დამოუკიდებელ, ობიექტურ, საჯარო, გამჭვირვალე და პროფესიონალურ შიდა ფინანსური კონტროლის ფორმირებას, რომელიც მოიცავს შიდა აუდიტს. შიდა კონტროლი წარმოადგენს ფინანსური მართვისა და კონტროლის პრინციპების გამჭვირვალე ინტრუმენტს, რომლის მთავარი მიზანია ქვეყნის ფინანსური სტაბილურობის შენარჩუნება.

აღნიშნულ ნაშრომში განხილულია შიდა ფინანსური კონტროლის რეფორმის ერთ-ერთი კომპონენტი - შიდა აუდიტი. ეს რეფორმა და რეფორმის ფარგლებში შიდა აუდიტის დანერგვა, საქართველოს ევროკავშირში ინტეგრაციის მნიშვნელოვანი კომპონენტია. აღნიშნული კვლევა ეხება „სახელმწიფო შიდა ფინანსური კონტროლის შესახებ“ საქართველოს კანონის შესაბამისობას შიდა აუდიტის საერთაშორისო სტანდარტებთან.

საკვანძო სიტყვები: შიდა ფინანსური კონტროლი, გამჭვირვალობა, ინტეგრაცია, შიდა აუდიტი, რეკომენდაცია, მმართველობა, დამოუკიდებლობა, სტანდარტი, საბჭო, ცოდნა.