

The Role of the Internal Control Increasing Performance in the Public Institutions

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Abstract:

A well-functioning Internal Control System in the Public Institutions should be followed with a particular attention in increasing the performance of managing, executing and financial reporting in the public institutions. The Internal Control System should be correlated to transparency of accountability, segregation of duties in connection with development standards of democracy. The transparency and the managing are further required to be developed in Kosovo as a process in line with the Constitution and applicable laws.

To achieve the effectiveness and improve the quality of transparency of public money in Kosovo there is a continuous need for improvement of a fair and transparent reporting of public money and this is made possible in first place by an independent audit and by strengthening internal control system in the Public Institutions. The Internal Control System in the Public Institutions requires more than an effective monitoring takes. The process of compulsory implementation is essential and includes consequences and corrective procedures for inaction in line with rules and for not obeying rules, lack of proper caution, awareness, and misuse as well as interference in the processes.

Keywords: internal control; control and audit system; conflict of interest; corruption; fraud; competency; quality control.

JEL Classification: H0; H5; G28.

Introduction

The public sector represents that part of the economy in which is to be found the public property and includes the public companies in the form of autonomous administrations and the patrimony of the central, local and social security public administration (Lucan, Hlaciuc and Zaiceanu 2015).

The purpose of this paper is about handling accountability, effectiveness, transparency and performance over the functioning of Internal Control System in safeguarding public assets. The level of Internal Control functioning may be achieved following the below parameters:

- institution has written policies and procedures which make responsibilities;
- of an incumbent, limitation of authority, performance standards, control procedure and reporting relationships understandable;
- overall staff has available copy of manual, procedures and policies;
- functioning vertical and horizontal line of communication and responsibilities among incumbents;
- job description in place clearly stipulating duties and responsibilities for internal control and clear delineation of extensive knowledge, competencies and experiences required for each job position;
- employment practices to be applied according to knowledge, competencies and experiences applicable in line with the job position;

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- performance appraisal for incumbent to be carried out recurrently;
- undertaking appropriate disciplinary measures in cases when incumbent does not follow procedures and policies or standards of professional conduct (Financial Management and Control 2016).

1. Research methodology

Taking stock of research carried out through questionnaires with respondents employed mainly in Public, Educational and Independent Institutions and a part from Public Enterprises, most of questionnaires result to be corroborative.

The theory and practice of analytical procedures for evaluating the aggregate and certain misstatements detected during the audit and the mechanism of their impact on the auditor's opinion in the auditor's report is significant to study (Shvyreva and Petukh 2018).

For this to be accomplished, the company's management requires internal control (internal control) that powerful, simple, easy to operate, and safe for the enterprise. Thus the internal control will affect the formation of good corporate governance (Maya, Lubis, Maksum, Lumbanraja and Muda 2018).

This is highly relevant for research on and the practice of management and control in government and sets an agenda exploring the realities, opportunities and limits of audit overloads and deficits, exploring how to break out while holding on to the traditional core of the profession (Schillemans *et al.* 2018).

Table 1. The Items included in the final version of the questionnaire and the subscales they constitute

Employment	Number	Percentage
Management level	21	32%
Non – management level	44	68%
Total	65	100%

Source: Rexhepi (2016, 35-36)

Having the importance and the achievement of results as credible as possible, the questionnaire is focused more on level of employees which are not part of managing staff, that is 68% of respondents were not part of management positions versus 32% belonging to management positions (Rexhepi 2016, 22–29).

The major part of respondents was with superior education while few have had completed master study with extensive experience in their scope of field and with background in functioning of internal control and audit system with in the institution where they serve.

Table 2. The items included in the final version of the questionnaire and the subscales they constitute

Variable	Apprehension/Launch	Objective	Average	Standard deviation
Functioning of ICS (Y- dependant/categorical variable)	Respondents are asked at what level is Functioning of Internal Control in their working place	Measure level of Functioning of Internal Control	2.23	0.698
Conflict of Interest (X1- dependant/ categorical variable)	Respondents are asked at what scale can affect conflict of interest in functioning on internal control	Measure level of conflict of interest	1.66	0.695
Political instability (X2- dependant/ categorical variable)	Respondents are asked at what scale can affect political instability in functioning on internal control	Measuring judgement on political instability	2.03	0.755
Corruption (X2- dependant/ categorical variable)	Respondents are asked at what scale can affect corruption in functioning on internal control	Measuring judgement on corruption	1.53	0.706

Source: Rexhepi (2016, 45-48)

Statistical model is used to investigate whether there is an impact left by certain impediments such as conflict of interest (X1), political instability (X2) and corruption (X3) at the level of functioning internal control (Y), thus:

$$\text{Functioning of ICS (Y)} = \alpha + \beta_1 * \text{conflict of interest} + \beta_2 * \text{political instability} + \beta_3 * \text{corruption} + \varepsilon$$

Overall explanation of used variables in the statistical model is presented in the Table 2. The results presented show that the conflict of interest and political instability are two variables statistically significant, while corruption results not to be statistically significant, which means that there is no tendency to impact the functioning of internal control.

Thus, results show that the level of functioning of internal control has tendency to be impacted by the "conflict of interest", if the latter may increase, the likelihood to incur a higher impediment to non-functioning of internal

control is higher. Therefore, if employees at management and non-management level observe a conflict of interest in their work, they assess it as a tendency to reflect problems in functioning of internal control. The same result is applicable for the second variable used in the model, political instability. This variable also results statistically important based on the results of significance given to be 0.23. These results show that employees as respondents at management and non-management level reflect that political instability is assessed to be as an important impediment in functioning of internal control correctly.

That is, in a country which is prone to unsustainable political stability tend to reflect with non-functioning of internal control within the key state institutions. The corruption as well, according to the results, is assessed as an impeding element in non-function of internal control. The results show that as higher the corruption is the tendency of non-functioning of internal control is higher establishing this way one of the most discussed problems in the political area of developing countries (Rexhepi 2016). Public officials may be in position to extort a bribe for a legitimate public service otherwise they can deny to their clients or prolong it for an indefinite period (Rexhepi 2016, 75-79). As a conclusion we can highlight that with the increase of conflict of interest, political instability and corruption the probability of internal control system to be useless and non-functional in the interest of public institutions is higher.

Table 3. Composition of variables in the statistical model

Existence of corruption					
		No. of answers	%	% valid	Total percentage
		1	2	3	4
Who is responsible in preventing corruption and fraud Corruption (X2-dependant/ categorical variable)	Management of Institutions	26	40	40	40
	Non-management staff	1	1.5	1.5	41.5
	Government	21	32.3	32.3	73.8
	Taxpayer	1	1.5	1.5	75.4
	I don't know	4	6.2	6.2	81.5
	All	11	16.9	16.9	98.5
	Prosecution and Courts	1	1.5	1.5	1.5
	Total	65	100	100	100

Source: Rexhepi (2016, 86-87)

The test used by the program SPSS, and which measures the relation between variables, shows the correlation of the main responsible in preventing corruption and fraud. From the above table we can ascertain that the management of institution has 26 responses or 40% as responsible in preventing corruption and fraud followed by the Government as second with 32.3% and in the third category are reckoned the rest with 16.9%, which means that the main institutions still bear the main responsibility that may affect the efficiency in developing and preventing corruption. The ratio of distribution of bribery paid by businesses to public officials in Kosovo differs from 1.9% to customs officials to 0.8% for officials of public services (Kosovo Agency of Statistics 2006) and the plan (2002) claims that the perceived differences in economic views between economists and laypeople cannot be explained by economists' ideological bias, but is mostly a result of various biases in laypeople's perceptions and judgments about the economy.

From the information in the above table we can observe that 66.7% of corruption level is concentrated in the sectors of capital investments and cash flow which means that these two departments belong to other institutions with elevated budget and are not part of the OAG.

As a concern remains the institution of the Tax Administration where the sector of revenues results with 22,2%, which means that this sector is the main sector after the customs sector as the main collectors of revenues for the budget of Republic of Kosovo. As a concern is also the level of corruption and fraud in the sector of operating costs with 40% in the Ministry of Labour and Social Welfare and 50% in the sector of taxpayers according to Kosovo Agency of Statistics. At the regional level, in average 1.8% the bribe paid by businesses in the Western Balkans is reported to authorities and the same situation applies in Kosovo (Kosovo Agency of Statistics 2007).

Table 4. Level of corruption and fraud by entities based sectors

		Name of institutions							Total
		Office of the Auditor General	Agency of Statistics	Kosovo Tax Administration	University of Pristina	Ministry of Labor and Social Welfare	Municipality of Vushtri	Industry Commission for Mines and Minerals	
Level of corruption and fraud on these sectors	Sectors of revenues	3	0	2	1	1	2	0	9
		33%	0.0%	22.2%	1.1%	11.1%	22.2%	0.0%	
	Sector of operating costs	1	1	1	2	4	0	1	10
		10.0%	0%	10.0%	20.0%	40.0%	0.0%	10.0%	
	Sector of capital investments	6	1	0	0	0	0	2	9
		66.7%	11.1%	0.0%	0.0%	0.0%	0.0%	22.2%	
	Sector of taxpayers	1	3	0	2	0	0	0	6
		16.7%	50.0%	0.0%	33.3%	0.0%	0.0%	0.0%	
	Sector of cash flow	2	0	0	1	0	0	0	3
		66.7%	0.0%	0.0%	33.3%	0.0%	0.0%	0.0%	
Total		13	5	3	6	5	2	3	37

Source: Kosovo Agency of Statistics (2007)

2. Elements of Structure for Functioning of Internal Financial Control

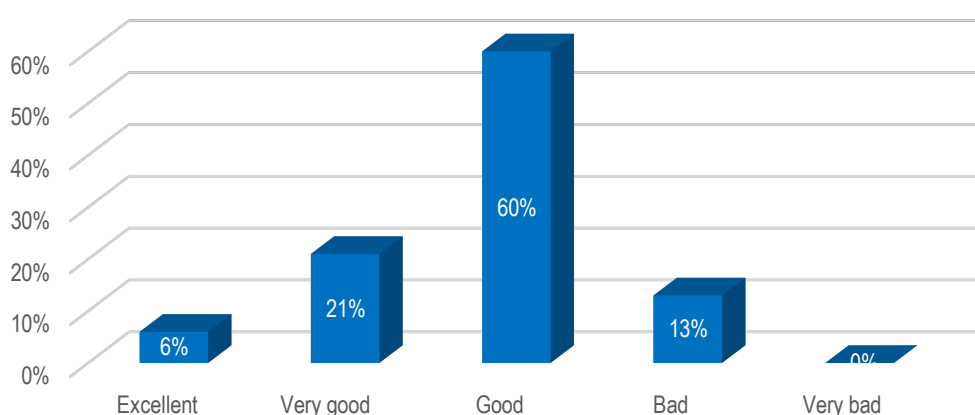
Internal controls are: organization, policies and procedures employed ensuring sufficiently that:

- programs achieve the intended results;
- resources are used consistently for the purposes of the budgetary organization;
- assets are safeguarded from misuse, fraud and mismanagement;
- laws and regulations are implemented;
- reliable information is used for decision-making process and in timely manner (Pearson, Roberts and Smith 2007).

The preparation of questionnaires is based on the references and models according to different literatures for the manner of functioning internal controls and audit and the application of the same in the Public Institutions. While among the main factors for the malfunction of the modality, that the Institutions have not yet been able to apply significantly to strengthen the internal control are:

- failure to create the proper division of tasks is estimated at 10%;
- failure to strengthen authorization and communication is estimated at 8%;
- lack of information and communication, estimated at 11%.

Figure 1. Communication level between managing and non-managing staff



Source: Rexhepi (2016, 115-117)

The graphic from Figure 1 shows the level of communication between management and non-management staff. This analysis of results is prepared having in mind five factors. Based on the available results from the respondents, we understand that the level of communication is good but not excellent, because 60% of respondents

have concluded and assessed that management and non-management staff have good communication, but only 6% conclude that their communication is excellent, that is the excellent flow of communication is weak and low, against 21% of respondents who assessed the communication as very good.

3. Monitoring Implementation of Laws

The implementation of laws remains challenging. According to duties stipulated in the working regulation, parliamentary committees are tasked with the oversight of law implementation. However, until August, let alone one committee (Committee for Economic Development, Infrastructure, Trade and Industry) none of the committees have succeeded to complete this process and to present the report before respective government committees with recommendations from the monitoring, although majority of committees have anticipated in their working plans monitoring of one or two laws in their scope of field. In comparison with six-month period of previous Legislation, planning seems to be progressive. However, it is obvious and far from reach that the Assembly will take significant role to oversee the implementation of laws by the competent institutions (Rexhepi 2016, 124-126).

3.1. Identification and Risk Assessment

The basis for development of this plan are the risks identified by the Internal Audit Units in the ministries and other institutions from public sector as well as assessment of General Directorate of Audit observed by the monitoring mission and oversight of audit structures. The collected and analyzed information determines also the audit coverage for the period 2010-2013. The drafted plan is focused concisely on the prioritization of identified risks, while the efforts are made to secure sufficient staff to carry out the audit activity throughout the public sector.

Although audit plans comprised the main risks of systems, the main fields that will be the audit subject shall include also the provision of objective audit assurance for wide range of risks which were not considered as key risks and were handled by the audit units of public entities. The following criteria were taken into account for risk assessment:

- key functions, organization and complexity of entities;
- financial reporting requirements;
- legal and regulatory framework;
- control environment.

In addition to criteria for risk prioritization the following factors were taken into account in the strategic plan:

- request for audits of strategic importance (according to stipulations in the Law for Internal Audit and Manual of Audit Procedures);
- specific requirements of the holders of public entities;
- specific areas with high risk identified by the Audit Committee which requires priority attention (mainly related to political factor);
- follow up recommendations issued by the State Supreme Audit (Kosovar Centre for Security Studies 2011).

By consolidating the data, it is estimated that audit coverage relied mainly on the priority of identified risks in the system of sectors in the organization placing this way focus on managing and complexity of audit entity.

3.2. Information System for Control and Audit

The audit requests, stages and analyses which include an overall and detailed understanding of identified zones that need to solve the problem, management requests shall have clear idea in regards with management of funds as a function for developing the system of key activities (National Audit Office 2010).

3.3. Risk Management in the Maturity Stage

The risks management is a form of system's awareness that needs to be in place to ensure a methodical approach related to the risk. The internal audit should be well placed to spread the message to leaders and throughout the activity of organization. Professional advises and advisory work should be addressed in the early stages that may help management to mitigate its risks: The risk assessment includes the use of professional judgment to determine the critical fields which requires audit attention based on the potential for adverse effect in the organization (Source: Ministry of Finance 2012).

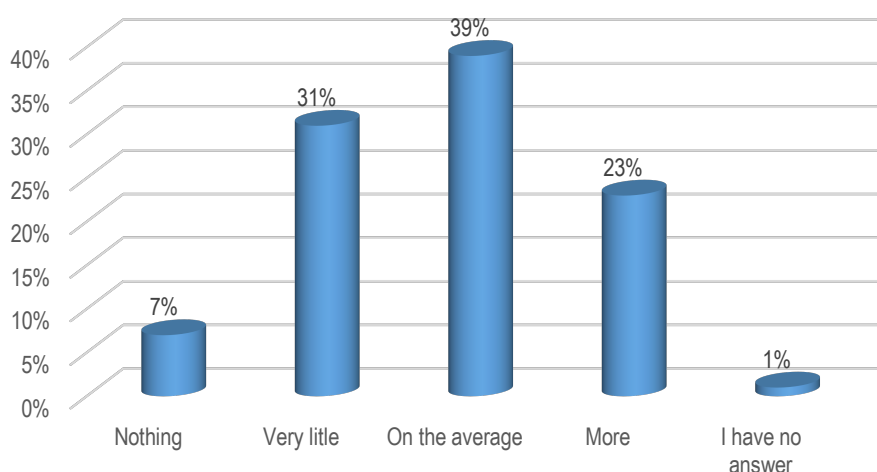
The Boards and Audit Committees have an oversight role to determine that the risks based on the management activities are at appropriate level and that these processes are adequate and effective (Source: Internal Audit Manual 2011). The Audit Committee examines, assesses, reports and recommends improvements for appropriateness and effectiveness of managing the risk process.

The management and the Board are responsible for their organization and process of control risk. However, internal auditor by acting with a consulting role may assist the institution in identifying, assessing and implementing the methodology in risk management and control and to address these risks to top management (Pickett Spencer 2013). Monitoring system helps management to determine whether the working objectives are met with available resources used. For this purpose, the systems are needed to ensure that the data whether for operational activity and finances are up to date and available in due time (Ministry of Finance 2010).

Having the responses on the question how much they are free to report ethical concerns within the frame of inappropriate functioning of internal control in the public institution, there is still a number of employees who hesitate to cooperate with the competent institutions.

According to analysis and presented results in the above graphic, most of respondents have expressed their assessment at average level, where working staff is not free to express its opinion over the non-functioning of internal control in the institution where the staff works and acts. This assessment collected 39% of respondents out of which 31% concluded the level of reporting over ethical concerns for non-functioning of internal control is at lowest level, against 23% who concluded that the level of reporting for ethical concerns is high and free to report. This percentage is not sufficient to increase the reliability of employees for reporting that they need to carry out towards respective institutions.

Figure 2. How to much the staff is free to report ethical concerns within the frame of inappropriate functioning of internal control in the institutions



Source: Rexhepi (2016, 135-136)

Another important activity is the measurement of the performance (achievements) of the institution. This activity includes the comparison of expected and realized results, the deviations from the plans are researched, the individual evaluation of the achievements is done, and the progress declared with the current one is examined.

Conclusion

As the main pillar of Internal Control System to advance Public Finances in Budgetary Organizations of Public Sector is considered to be independent work of internal and external audit which is a good action in improving and developing management activities in order for these departments to gain dominant, modern and determinant role by applying models of planning for the levels of risk that affect non-functioning of ICS in the institutions. Based on the observation results we reach the conclusion that proper functioning of Public Institutions should exist on the right principles with clear objectives of accountability on ethical basis. The accountability structure in the Public Institutions serves as a cornerstone for functionalizing mechanisms that impact risk management in the function of upgrading internal control system.

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