



DEVELOPMENT OF INTERNAL CONTROL AND AUDIT IN UKRAINE

Olena Antoniuk

National University of Water and Environmental Engineering, Ukraine
E-mail: o.r.antonyuk@nuwm.edu.ua

Natalia Koval

Vinnytsia National Agrarian University, Ukraine
E-mail: natkov@i.ua

Yaroslavna Mulyk

Vinnytsia National Agrarian University, Ukraine
E-mail: mulyk.yaroslavna@ukr.net

Svitlana Savitska

State Agrarian and Engineering University in Podilya, Ukraine
E-mail: ovcharss15@gmail.com

Natalya Kuzyk

National University of Life and Environmental Sciences of Ukraine,
Ukraine
E-mail: kuzyk.n.p@nubip.edu.ua

Marianna Koshchynets

National Academy of Internal Affairs, Ukraine
E-mail: marianna80@ukr.net

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ABSTRACT

Control plays an important role in ensuring the efficient use of funds, both public and business sectors of the economy. The purpose of the article is to consider the role of the State Audit Service of Ukraine in the implementation of financial state control. The study is based on the analysis of reports of the State Audit office of Ukraine on the results of state financial audits of health care institutions, which last took place in 2019. The analysis of the reports of the Ministry of Finance of Ukraine allowed to establish the effectiveness of the state financial audit at the national level during last three years. The article provides answers to the following questions: i) what tasks are performed by the State Audit office of Ukraine; ii) features of external and internal audit of public sector entities in Ukraine; iii) the effectiveness of internal audit at the national level on the basis of state financial



audits; iv) problematic issues of internal audit development on the example of health care institutions; v) the main directions of development of the state internal audit in Ukraine.

Keywords: State Financial Audit; State Financial Audit Report; Internal Control; Internal Audit; Risk; Accounting; Internal Control System

1. INTRODUCTION

In modern economic conditions in Ukraine, accompanied by an increase in the number and volume of violations of legislation on the use of material and financial resources in the public sector, there is an objective need to ensure effective state internal financial control over the activities of public sector entities, in particular internal control and internal audit. Control is the key to compliance with the legality and efficiency of managing and using financial resources and other assets, achieving results according to the established goals, objectives and requirements for the activities of public sector entities, and the reliability of their financial and budget statements. As a result, the quality of provided services to the population, their confidence in the state authorities increased.

State financial control is one of the most important functions of public administration, which contributes to the implementation of the financial policy of the state, ensures the process of formation and rational use of financial resources of the state to achieve the goals set.

The purpose of the research is to identify typical problems in internal and external control systems based on the results of the state financial audit.

The tasks are: to determine the role of internal control and internal audit in ensuring the effective use of budget funds, achieving planned performance results; based on the analysis of reports on the state financial audit of state institutions during the study period, to identify and summarize typical errors in internal control; to identify risks in the internal control system in state institutions in Ukraine.

2. LITERATURE REVIEW

Scientific publications testify to the relevance of the internal audit of public sector entities. Publications in recent years indicate a close relationship between internal control and the effectiveness of public administration. Researchers are exploring the ways in which public sector auditing can be valuable.



Research shows that the results of internal and external audits have different effects in the public sector than in the private sector. A review of the history of the development of the functions of internal and external audit of the public sector shows that there is a theory of agency and management control. Public sector auditing is an area where additional research is needed (Hay & Cordery, 2018). Other authors analyze the factors that contribute to increasing the efficiency of internal audit in the public sector which would help to set proper and more transparent governance of public financial resources. Their study investigated the relationship between effectiveness and contributing factors. The results proved that effectiveness has a positive relationship with internal audit quality, the competence of the internal audit team, the independence of internal audit, as well as with the support of internal audit from the management (Ruhani; Vokshi & Hashani, 2017).

Postula, Irodenko and Dube (2020) also discuss the efficiency of internal audit and its role in streamlining the operations and adding value to the functioning of public administration in Poland. The role of internal audit in public administration in Poland, as presented in the paper, confirms its essence and its core operational framework. However, the implementation of respective stages of the internal audit in the public sector needs improving, especially with respect to planning audit tasks based on risks identified in the organisation being audited.

The main research areas of 2019-2020 in matters of state financial audit are as follows:

- research on the role of risk management, internal control and compliance in public sector governance (Seed; Hamawandy & Omar, 2020);
- research on the contribution of the internal audit function to the implementation of external audit and the determination of audit fees (Saputra & Yusuf, 2019);
- study of the moderating effect of task complexity on external auditor's cooperation, top management empowerment and internal auditor's independence, which affect internal auditor's effectiveness (Algudah; Amran & Hassan, 2019);
- research on the influence of digitalization on audit as a governance mechanism (Manita et al., 2020).

Scientists consider various aspects of financial control, state financial audit, internal audit and other types of audit. In most cases (Drozd et al., 2021; Fabiianska et al., 2021; Khorunzhak et al., 2020; Semenyshena et al., 2021), a study of the implementation of financial control and its development in Ukraine is conducted; at the same time, its further implementation is not

considered, namely, the impact of financial control (state financial audit) on the establishment and determination of losses.

1. DATA AND METHODOLOGY

The methodological basis of this research is general scientific methods of cognition, special methodological techniques. To achieve the purpose of the research, the following methods are used: concretization, analysis, induction, deduction – when considering the components of the state financial audit, analyzing reports of state institutions in their interrelation and system integrity; retrospective analysis – for analyzing the performance indicators of state institutions for the audit period (3-4 years); comparison – when analyzing reports on the results of the state financial audits of various Ukrainian institutions, comparing identified deviations and violations; the method of logical generalization – when formulating conclusions.

The information base of the research is regulatory legal acts on internal control and audit, state financial control and audit, materials of the State Audit Service of Ukraine, reports on the results of the state financial audits of Ukrainian state institutions, scientific articles and reference literature on the research topic.

2. RESULTS AND DISCUSSIONS

The modern budget process requires compliance with financial and budgetary discipline by all participants in the budget process, which is provided by a system of effective and efficient control. At the same time, the main participants in the budget process are public sector entities, as the main managers of state funds.

Control over the activities of budgetary institutions is, first of all, the most important factor in strengthening public confidence in public authorities. Of course, such control will only enjoy the trust of citizens when it is objective and independent of those executive bodies that manage budget funds. Control is the main independent source of information to identify the causes of violations that occur in the management of public finances and public property.

In recent years, Ukraine has been actively conducting state audits in the State Audit Service of Ukraine, which is the central executive body whose activities are directed and coordinated by the Cabinet of Ministers.

In Ukraine, the state financial control system has three levels, namely: internal control, internal audit, which are elements of state internal financial control, and external control (state



external financial control). To ensure the implementation of external control at the second level, there are decentralized internal audit units that assess and contribute to the effective implementation of internal control, which is actually the foundation of the state. Implementation of state policy in the field of state financial control is provided by the State Audit Service of Ukraine, whose activities are directed and coordinated by the Cabinet of Ministers of Ukraine through the Ministry of Finance of Ukraine.

The State Audit Service of Ukraine among various tasks exercises control over budgetary institutions, economic entities of the public sector of the economy, as well as enterprises, institutions and organizations that receive (received in the period under review) funds from the budgets of all levels, implements state financial control through the implementation of state financial audit, procurement inspections, inspection (audit), procurement monitoring.

The State Audit Service of Ukraine in accordance with the tasks assigned to it exercises control over targeted, efficient use and preservation of public financial resources, achievement of budget savings and efficiency in the activities of budget managers, accounting, as well as preparation of financial and budgetary reports, condition and reliability of accounting and financial reporting, the state of internal control and internal audit of budget managers (The State Audit Service of Ukraine, 2016).

The main functions of the State Audit Service of Ukraine are shown in Figure 1.

The implementation of inappropriate expenditures of budget resources in the amount of UAH 312.7 million, illegal expenditures in the amount of about UAH 2.3 billion was established. The resource shortages in the amount of UAH 144.5 million were revealed. In general, in 2020, financial violations in the amount of UAH 154.4 billion, in 2019 – UAH 1.7 billion, in 2018 – UAH 2.2 billion, in 2017 – UAH 1.9 billion were detected (The report of the State Audit Service Of Ukraine,2020; The State Audit Service OF Ukraine, 2021, 2021).

Due to the need to transform the domestic state financial system, the government of Ukraine has developed a concept for the development of state internal financial control and approved an action plan for its implementation for the period up to 2017, and subsequently – until 2020. The main goal of this concept is to adapt domestic legislation to European legislation, ensure proper control over the management and use of state resources and the activities of relevant state authorities, local self-government bodies and other institutions



(Concept of Implementation of State police in the field of reforming the state financial control system, 2020).

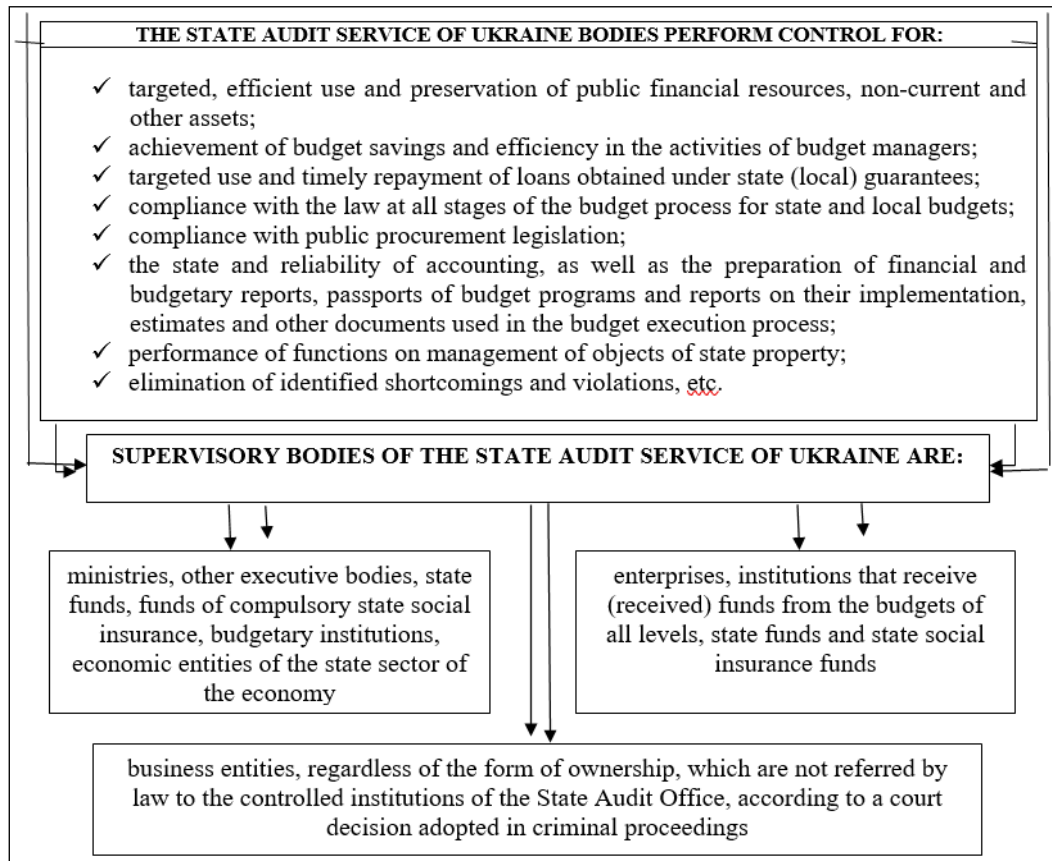


Figure 1: The functional activities of the State Audit Service of Ukraine

An important step towards the creation of the European SFC system was the development and implementation of the new Budget Code of Ukraine on 01.01.2011, in particular the new version of Article 26 «Control and audit in the budget process», according to which the mandatory introduction of internal control and audit in the activities of public sector entities was to take place (Budget Code of Ukraine, 2010).

According to the results of the analysis of the state of internal control and internal audit functioning in state bodies, conducted by the Ministry of Finance of Ukraine, the functioning of the internal environment is generally formalized in state bodies, control measures are implemented, internal administrative documents are approved, relevant action plans, working groups (commissions) on the organization and implementation of internal control are created, etc. As to the risk management, 64 % of the surveyed state bodies have implemented a regulation of risk management activities, 41 % made management decisions based on the results of risk assessment and risk areas of activity, 61% documented risk management activities. However, a number of shortcomings remain both in the introduction of a

comprehensive internal control system and in the implementation of risk assessment of the activities of a public sector entity (Ministry of Finance of Ukraine, 2019).

It is necessary to distinguish between the concepts of internal control and internal audit. Internal control provides compliance with the law and efficiency of budget funds, achieving results in accordance with the established purpose, objectives, plans, whereas internal audit is aimed at improving the management system, internal control, prevention of illegal, inefficient and ineffective use of budget funds, errors or other shortcomings in the activities of the institution, providing for independent conclusions and recommendations (Budget Code of Ukraine, 2010).

A similar situation has occurred regarding the understanding of the essence of internal audit, which is perceived as:

- an audit:

- conducted by internal auditors in budgetary institutions that has much in common with the activities carried out by the State Audit Service of Ukraine;
- that consists only in checking the targeted use of budget funds, compliance with the current legislation and the reliability of accounting and reporting;
- that identifies violations caused by minor errors in documents or processes;
- that solves problems that already exist in the entity's activities, rather than preventing them;
- internal control carried out by the relevant employee in relation to the financial and economic activities of an enterprise, organization, or institution (Internal Audit, 2020).

According to the results of surveys conducted within the framework of the LOGICA project, structural divisions for internal audit were created in only 0.5% of local authorities and 0.4% of budget managers, positions of internal audit specialists were introduced in only 42 budget managers out of 18,657 respondents. In addition, in 126 budget managers out of the total number of respondents, the responsibility for performing internal audit functions is assigned to officials who already perform other functions, which indicates a violation of the independence of the internal auditor (Internal Audit, 2020).



In accordance with the Budget Code of Ukraine and the Regulations of the Ministry of Finance of Ukraine, the Ministry of Finance of Ukraine ensures the formation and implementation of public policy in the field of public internal financial control, determines organizational and methodological principles and assesses the functioning of internal control and internal audit systems.

According to the Budget Code of Ukraine, budget managers, represented by their heads, organize internal control and internal audit and ensure their implementation in their institutions and enterprises, institutions and organizations belonging to the sphere of management of such managers of budget funds. The Ministry of Finance of Ukraine conducted an analysis of the functioning of internal control and internal audit in government agencies (ministries, other central executive authorities, regional and Kyiv city state administrations, other main managers of state budget funds) in 2020. The results of such an analysis showed further progress in reforming the system of public internal financial control in general and development of internal control and internal audit.

In particular, there are a number of positive developments in the organization and implementation of internal control, including through the formalization of elements of internal control, their components and ensuring practical application in the performance of functions and tasks. Thus, in 2020, budget managers took measures to improve the internal control system, in particular:

- separate working groups/commissions on the organization and improvement of internal control and risk management are created by separate managers;
- adopted internal administrative documents on issues of risk management activities;
- new control measures have been introduced or existing ones have been improved;
- approved action plans to improve the functioning and implementation of the system internal control, control of risk response;
- training events were held, etc.

At the same time, the activity of organizing internal control did not acquire signs of systematic, integral work. However, typical disadvantages are:

- providing the integrity of the internal control system (its elements are fragmentary, operate separately from each other);



- lack of unified approaches to business planning;
- consideration of internal control as a separate activity or measure (management control, supervision, control over the process of using budget funds, etc.);
- risk management and monitoring activities are not integrated into the management cycle and do not focus on key risks that may arise in the process of performing the main tasks.

The system of internal control is mainly built around compliance with relevant regulations. Control measures do not focus on the effectiveness of key processes, but on the use of budget funds, management of state property and other resources. In the reporting year, a number of government agencies took into account the recommendations of the Ministry of Finance and provided organization of internal audit activities in accordance with the established requirements, for example:

- measures have been taken to ensure the independence of internal audit units;
- the capacity of internal audit units has been increased and the positions of internal auditors have been filled;
- improved approaches to planning internal audit activities;
- measures have been taken to change priorities during internal audits (in particular, the share of internal audits in assessing effectiveness continues to grow);
- improved approaches to ensuring and improving the quality of internal audit, etc.

The results of the assessment of the functioning of the internal audit system of public sector entities are shown in table. 1.

The activities of the State Audit office of Ukraine in terms of assessing the internal control system can be traced at the sectoral level, for example, the results of the audit of health care facilities. Appropriate internal audit measures are recorded in the activities of the Ministry of Health of Ukraine. The Operational Action Plan for Internal Audit of the Ministry of Health of Ukraine for 2019 has been prepared taking into account the tasks and results of the Strategic Action Plan for Internal Audit of the Ministry of Health of Ukraine for 2019-2021. However, the practical results of the state audits conducted in 2019 indicate the presence of violations in the use of funds allocated for the maintenance of health care facilities, in accordance with the established estimates.



Table 1: The results of activity of internal audit in central executive bodies and regional state administrations *

Type of audit	The nature of the violations	Year			
		2017	2018	2019	2020
Financial audits/compliance audits	violations that led to the loss of resources (illegal, non-targeted costs, disadvantages, shortage of resources), UAH million				
	<i>central executive bodies</i>	1396,2	933,9	1,1 billion	13 billion
	<i>regional state administrations</i>	216,2	270,4	388,5	91,7
	Violations that did not lead to loss of resources (overstatement of liabilities, overstatement of the need for budget funds, understatement of assets, surpluses, diversion of funds into receivables, maintenance of excessive units, etc.), number, thousand				
	<i>central executive bodies</i>	6,4	4,9	57,8	44,9
	<i>regional state administrations</i>	0,5	1,0	3,8	1,7
	non-financial violations, number (violation of the order of accounting, inaccuracy of financial and budgetary reporting, non-compliance with legislation, plans, administrative documents, etc.)				
	<i>central executive bodies</i>	13,4	15,5	Reflected as part of violations that did not lead to loss of resources due to changes in the method of presenting information	
	<i>regional state administrations</i>	1,8	2,6		
		Losses reimbursed, amount, UAH million			
	<i>central executive bodies</i>	179,7	364,6	no data available	359,3
	<i>regional state administrations</i>	8,9	22,4	no data available	21
	level of loss compensation, %				
	<i>central executive bodies</i>	13	39	17,8	2,8
	<i>regional state administrations</i>	4	8	7	22,9

*Source: summarized by the authors using database of Ministry of Finance of Ukraine (2021)

It should be noted that some violations are similar in nature, as evidenced by the results of audits of other health care facilities, which are summarized on the basis of processing of reports on the results of public audits. It should be noted, that in table 2 included only violations that exceed the threshold of 200 thousand UAH, although there is a significant number of violations with less monetary expression.

As you can see, the lack of properly organized internal control system made it impossible to prevent violations and shortcomings in the financial and economic activities of the institution, which affected its completeness of income generation, the effectiveness of expenses incurred and the formation of financial results. Based on the results of the table 1 and table 2, typical violations in the organization and maintenance of accounting and internal control system of are summarized and the impact of inefficient organization of internal control system in the form of financial, social and economic effects is illustrated (fig. 2).



Figure 2: Impact of inefficient organization of internal control system for the activities of public institutions

*Source: summarized by the authors

A significant role has to be assigned to control measures, which are a set of introduced management actions carried out by the management and employees of the institution to influence risks in order to achieve certain goals and objectives of the institution. Typical control measures to ensure the reliability of accounting and reporting data are:

- obtaining permission from responsible officials to perform operations through approval procedure;
- delineation of responsibilities among employees to reduce the risk of making mistakes or committing illegal actions;
- control over access to tangible and intangible resources, accounts, etc.;
- establishing rules and requirements for performing operations and monitoring the legality of their implementation;
- reconciliation of credentials with actual data;
- assessment of the overall performance of the institution;
- monitoring the implementation of assigned tasks, etc.

3. CONCLUSIONS AND RECOMMENDATIONS

With the increasing scale of public sector entities of various forms of ownership and the creation of a competitive environment, comprehensive control over the processes taking place within the institution is possible only through the creation of an effective system of internal control and active implementation of internal audit. It is internal control as an important

tool of the enterprise management system with the help of special procedures and a set of control actions helps to ensure the effective implementation of tasks.

The latest challenges of state financial control in Ukraine indicate the urgent need to develop internal control and internal audit of public sector entities as tools of the management system, which through special procedures and a set of control actions help to ensure the effective implementation of the assigned goals and objectives. Now, there are a number of factors that slow down their full functioning, in particular, insufficient awareness of their progressive role by the management of the budget manager, erroneous identification with other types of control, lack of recording the results of their implementation, management reporting, etc.

Analysis of the results of state financial audits in Ukraine revealed typical violations in accounting and internal control, among which the most common are shortfall in income, inefficient use of financial resources, overestimation of the salary fund; lack of provisions on structural divisions, non-compliance of certain provisions of the order on accounting policy with the current requirements of the legislation, etc. The presence of similar violations in different state institutions indicates their uniformity and inhibition of decision-making to solve problems at the industry level.

The identified amounts of financial violations significantly affect the financial stability of the industry and the state. It is proposed to consider such an impact in the form of financial, social and economic effects, such as diversion of funds from state or local budgets, inefficient implementation of state financial policy tasks.

The results of the study are important for identifying and assessing risks in the activities of public institutions and developing measures to prevent them. Generalized and defined typical violations in accounting and internal control system of public institutions allow us to take them into account in the process of developing proposals and recommendations for: elimination of violations and shortcomings identified during the audit and prevention of them in the future in the industry's activities;

- elimination of the causes and conditions that have led or may lead to violations and shortcomings in the activities of public institutions;
- improving the efficiency and effectiveness of activities of public institutions;



- increasing the responsibility of managers over the effectiveness of their management decisions and performance of activities.

Table 2: Analytical summary of the results of the state financial audit in 2019 on the example of health care facilities*

Audit entity	The period covered by the audit	The nature of the violation	The amount of financial losses	The total amount of financial losses
Department of Health and Civil Protection of Zalishchyk District State Administration	2019	Additional non-targeted spending	3,4 UAH million	7,613 UAH million
		Payment of fines and penalties	513 thousand UAH.	
		Loss of assets due to incorrect accounting	3,7 UAH million	
Municipal non-profit enterprise "Vinnitsa City Clinical Hospital №1"	during 01.03.2016 - 31.07.2019	Financial violations	5,2 UAH million	5,2 UAH million.
Borznianska Central District Hospital	during 01.01.2015 - 31.07.2019	Loss of financial and material resources	453,1 thousand UAH	453,1 thousand UAH
Municipal institution "Maternity hospital №7" (Odessa)	01.06.2013 - 31.12.2018	Violation of financial discipline	321,39 thousand UAH	1,0 UAH million
Municipal institution "Maternity hospital №1" (Odessa)	during 2017-2019	Reimbursement of the special fund at the expense of the general fund	471,8 thousand UAH	
Municipal institution "Maternity hospital №2" (Odessa)	2018	Over-fulfillment of balances allocated from the local budget to pay for medicines and medical supplies	216,5 thousand UAH	
Volyn Regional State Administration Health Department (Budget program "Creation of blood banks and its components")	during 01.01.2016-30.09.2018.	Inefficient use of funds for wages	115,8 thousand UAH	1137,9 thousand UAH
		Excessive accrual and payment of wages	802,0 thousand UAH.	
		The single social contribution is overpaid	220,1 thousand UAH.	
State enterprise «Ukrvaktsina»	01.01.2018	Availability of expired drugs in the warehouse, inefficient procurement management	10949,6 thousand UAH	10949,6 thousand UAH

*Source: summarized by the authors using database of the State Audit Service of Ukraine (2021).

The areas of further research are: development of draft documents to improve the system of accounting and internal control for public sector entities; development of methods for identifying risks of activities in accounting and internal control (audit); development of proposals at the industry level to prevent violations in the accounting and internal control system, which are systemic.

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