



## Internal audit analysis in monitoring of public finances - the case of Kosovo

Ylber Prekazi<sup>a</sup>

<sup>a</sup> PhD candidate, Faculty of Business and Economics, South East European University, North Macedonia, Str. Ilindenska n.335, 1200 Tetovo, e-mail: ylberprekazi@gmail.com

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### **Abstract**

**Purpose:** Internal auditing has recently become a profession with great potential and each time is being developed and improved to extend its impact to a better management of public money. So, in recent years we see an evolution of function of internal audit as elsewhere in Kosovo, becoming an element of important public internal financial control.

**Methodology:** Data sources from the accounts of one were used to carry out the work significant samples of budget organizations in the Republic of Kosovo as well as a questionnaire dedicated to this topic. Secondary data are also used as laws, regulations, guidelines, standards, codes of ethics, and best professional practices for internal audit, as well as the way budgets are spent in certain organizations budgets also reflected in the external audits that have been done over the years.

**Findings:** This paper describes and analyzes the current state of internal audit in monitoring of public finances, looking at it from a normative point of view, implementing institutional capacity and to the concrete effects that this important function of the link gives to the view of public finance surveillance.

**Originality/Value:** Aware that the internal audit function is not the only instrument of public finance oversight, above all it has an important role to play within the public sector organization and aims at advisory activity independent and objective in providing reasonable assurance, aimed at adding value and improving the functioning of the public sector entity, namely the budget organization. It also assists the subject in meeting the objectives, providing a systematic approach to discipline, evaluate and improve the effectiveness of management processes risk, control and governance in general.

## **Introduction**

Reports from public institutions regarding the spending of public funds have withdrawn each time the attention of many interest groups. Any public institution (as at the central level, local or even independent institution) that uses public money to achieve goals and their activities must add here to the principles of accountability and transparency in spending public finances. For this there are oversight mechanisms related to the manner in which public money is spent by government institutions, such as the local level or even central level. According to competencies, commitment, organization, degree of autonomy and independence and other components, the state audit is distinguished depending on the nature of the state (unitary or federal), the political system (monarchy or parliamentarism) or by the level of development of democracy (Bexheti, 2017).

The monitoring of public finances in Kosovo is mainly done through three levels: first level Internal Audit, second level External Audit - which is usually the Office of The Auditor General or an Independent Auditor, as well as the third level is the Assembly of Kosovo through the Parliamentary Committee on Public Finance Oversight. Internal audit as a first link of monitoring of expenditure realization public funds has an important role and can affect a more effective management, more efficient as well as the realization in full compliance with the legal provisions of public expenditures of previously approved. The budget as one of the main instruments of a government, through which numerous economic, social, environmental policies, and other policies and priorities are implemented defined, at the same time care must be taken that it is properly distributed and managed in efficiently and transparently, inter alia. Effective oversight of public finances apart that increases transparency and assures citizens that public money is being properly managed, is important also for the country's aspirations in the integration processes, especially in the Union European.

The highest institution of economic and financial control in the Republic of Kosovo is the Office National Audit and is accountable for its work to the Assembly of the Republic of Kosovo.

The public administration must have the mission of efficient, effective and economical use of funds public, and an audit has a very important role in fulfilling this mission internal or external audit. Quality audits strengthen accountability and increase transparency of budget organizations directly affecting its accountability large in the spending of public funds and at the same time ensures the interest of taxpayers and increasing public accountability.

Almost, in all general auditor reports and various reports that have been done by other organizations highlighting the internal audit capacity building and financial control in budgetary organizations and independent public institutions.

Should we always wait for the external audit findings and annual pre-reporting the legislature to raise the question of where was the Internal Audit in this or that organization budget!

Internal audit has an important role within the public sector organization and has for the purpose of independent and objective advisory activity in providing reasonable assurance, which aims to increase the value and improve the functioning of the public sector entity. It assists the subject in meeting the objectives, providing a systematic, disciplined approach, to evaluate and improve the effectiveness of risk management processes, control and governance in general.

Internal audit differs from external audit, but their purpose must be the same that consists of supporting good governance in this context by contributing to greater accountability from public sector entities, increased transparency, and exploitation of public funds efficiently, effectively and economically.

For effective governance and public expenditure management in accordance with the rules relevant is the effective cooperation between management, units of internal

audit and audit committees. In recent years we have a range documents drafted in Kosovo in the field of internal audit that contain the principles general and refer to standards already known but which need to be improved continuously in step with other changes pertaining to this field.

Internal audit services need to be used efficiently for it improve the actions of budget organizations, as well as the activities of internal auditors must be in full compliance with International Standards for Professional Practice in Internal Audit (SNPPAB).

### **Literature review and current state of internal audit in Kosovo**

Everywhere, there is paid great attention to the public sector and especially public funds, and the government always requires the improvement of their management, as expectations are high in improving the lives of the population. This given that a government constitutes ethnicity greater employment, spending and thus can boost more activity economic high.

Public financial management can vary from country to country in many ways, but the purpose and objectives in all cases is almost the same that through the use of right of public funds to increase the welfare of citizens. Using public funds in expenditures on education, health and through other capital investments to achieve the goal of common for the good of all society.

Public finances in their management process should be overseen and controlled to ensure the effective use of public funds, and enabling achieving the objectives, but each time taking into account the legality and standards relevant in this area. An important role in this regard has internal audit as independent activity, to support the management in the realization of financial management in compliance with international rules, guidelines, standards and best practices.

Auditing as a function in the public sector has been continuously developed, and constitutes a supporting instrument in increasing accountability and in the best possible management of public resources. The Institute of Internal Auditors defines

“Internal Audit” as an independent activity to provide objective and advisory reassurance, designed to add value and improve the operations of the organization. Internal audit helps the organization in meeting its objectives by bringing a systematic, disciplined approach to evaluate and improve the efficiency of the risk management process, control and governance.

Public financial management (PFM) constitutes an important system and presents essential aspects of an effective state. So, from all the protagonists of this system professional engagement is expected, first of all and transparent in order to increase the effects from the use of public funds for the purposes of the whole public, respectively all society and its various strata. Continuous internal control system in Kosovo has evolved, especially in recent years, but has been followed by inappropriate practices time and in a way has ‘suffered’ the consequences of its historical past. As it also points out in her study the author Mjaku (2019), the system of public internal control in Kosovo, in the past was characterized by a high degree of centralization and complexity of internal due to the long history of sub-rule, traditions and decisions managers who were subject to what was known as ‘delegated’.

It is known that Kosovo uses the legal currency "Euro" unilaterally and therefore does not have standard monetary policy mechanisms available, so fiscal policy is the main and only instrument of macroeconomic policies. In this context, the greatest focus of the entire decision-making spectrum, public policy makers and many other diverse entities is in managing, changing, implementing these policies, often creating discussions and opening up inexhaustible debates about long time.

Baber (1983) in his study argues that political competition increases the demand for monitoring in the public sector, and especially for auditing. Therefore, an independent activity as is the audit, in this regard contributes immensely to the management system of public finance (PFM) for purposes of the general interest of society as a whole and needs now and in the future.

Messier, (1997) states that the performance of a firm depends heavily on a function of sound internal audit. So, the internal audit function helps the subjects different to perform better, and thus enable the achievement of more objectives easier and safer.

Public Internal Financial Control (PIFC) is a concept that refers to the totality of internal control systems both from the managerial and financial aspect, which has for the purpose of protecting the financial interest in all budget organizations as central, local and in independent institutions. To achieve this goal structures are involved various administrative, as well as methods and procedures are defined, bearing always take into account the internal audit, so that the whole activity of is carried out in principle transparency, legality, more economical use, more efficient and more effective. Operation of a solid and reliable PIFC system, as an important part of the overall public financial management system has always been a condition for obtaining EU funds (PIFC Strategy 2015-2020, 2015).

A check makes sense when the internal audit unit is independent and the internal audit reports help provide information for planning, evaluation and decision making in it future, especially when that information has characteristics such as: relevance, completeness, comprehensibility and comparability. But it has often been raised as an issue by scholars different than taking into account the opinions and information provided by the internal auditor which is aimed at the interest of the subject, and which offers a certain solution. But there are such cases that the internal auditor is in the service of the narrow interests of the employer (Brady and Lowe, 2003).

The activity performed by the internal audit serves the functioning of the entity in realization of planned objectives and observance of content according to legality, as well as growth and development, but also facilitates the work of external audit, when it comes to budget sector in the public sector functional, independent internal audit and effective then facilitates the work of the auditor general.

According to (Diamond, 2002), The audit function has involved many countries to receive a broader picture of the economic and social implications of government operations, which often referred to value for money or performance audit.

Laker (2006) identify the following characteristics of internal audit: structure and resources, independence, approach, internal audit plan, reporting. So, it's very necessary for an efficient oversight of public finances and in this context also a well-functioning internal audit as a link in the oversight chain should there are concrete plans, strategies in line with the objectives and goals of the entity, but first of all, there should be an advanced legal framework, then enforcement capacity institutionalized structures, and finally timely and transparent reporting.

Mjaku (2019) in her doctoral study conducted for Kosovo, where according to analyzes made by three econometric models, the results found consist of public financial control system as an instrument of macroeconomic policies in the period of Legal-administrative reform in the Republic of Kosovo has an impact on increasing the efficiency of public funds.

### **Legal framework and enforcement capacity**

In the normative aspect of the field of internal audit and supervision of public finances in Kosovo are currently in force Law no. 06 / L-021 "On the control of internal public finance" which regulates the internal financial control system public, including financial management and control, audit of as well as their harmonization, in accordance with international standards for control internal and internal audit. This is the last law that was adopted in 2018 in terms of legal regulation of this field, but also are the rest of the laws, guidelines of various documents related to this activity and regulating in many aspects the appropriate legal framework for the proper functioning of internal audit and oversight of public finances.

Competent institutions should be maximally engaged in building a cohesion among the three laws that affect the field of public finances, which are: Law on Financial

Management, Public Law, the Law on the Office of the Auditor General and the Law on Internal Audit in Kosovo, in order to have proper management of public finances. Internal audit has the role of important in strengthening the legality in the spending of public funds, but they should be independent in their work and have cooperation with relevant institutions.

Finally, in accordance with the law mentioned above, the NRC regulation has been drafted - Nr. 01/2019 on the establishment and implementation of the internal audit function in the entity of the public sector. This enables the strengthening of internal audit within the entities of public sector allowing through an agreement to provide audit service internal from one public sector entity to another entity with the prior approval of Minister of Finance. The other possibility is that through contracting a company professional for conducting internal audit, after the approval of the Ministry of Finance.

So, the legal framework has facilitated the performance of the internal audit service in several variants, given that implementation and institutional capacity building is still being strengthened and year after year there have been efforts to create professional staff and right structures for this service in each budget organization.

In terms of implementation and institutional capacity related to the area of oversight public finances in recent years there has been progress in building troops and structures specific, knowing that this is also one of the most important requirements in the process of EU integrations.

The Ministry of Finance is the main institution in terms of internal audit in public sector entities, and through relevant departments and divisions within conducts audits on entities that have not yet established an internal audit unit.

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The Ministry of Finance is the main institution in terms of internal audit in public sector entities, and through relevant departments and divisions within conducts audits on entities that have not yet established an internal audit unit. So, the supervision of public finances in Kosovo in public sector entities (budget organizations) is initially done by the internal auditor who is part of the institution relevant public, or according to the legislation in force the budget organization can contract internal audit services if a service has not yet been established within the institution such according to regulation QRK-No.01 / 2019 approved by the government of Kosovo, which also supports in the law on internal control of public finances, there are several possibilities of functioning of internal audit in public sector entities, such as: independent unit internal audit; joint internal audit unit; through an agreement for the provision of internal audit service by a sector entity public to another entity, or through contracting a professional company for conducting internal audit.

Also, in support of the law on internal control of public finances is also the audit committee, which is an independent advisory body for the head of the public sector entity, and support for internal auditors.

Central harmonization unit, established as a separate department in the Minister of Finance, is responsible, inter alia, for the development and implementation of policies and strategic documents for the development of financial management and control, and auditing internally, in accordance with internationally accepted standards and good practices of EU. Also, among its main tasks and responsibilities are: preparation of rules, policies, manuals, guidelines, internal audit charter, code of ethics and professional standards for conducting internal audits by internal auditors and Internal Audit Units; made external assessments, for the review of the security of quality and performance of internal audit in the public sector entity; Offers advice

Professional for Internal Audit Units and internal auditors in all audit aspects, work plans, good European internal audit practices, as well as and the quality and adequate functioning of the internal audit system (<https://mf.rks-gov.net>). Also within this department are divisions such as: Central Division for the Harmonization of Internal Audit; and the Central Harmonization Division for Financial Management and Control.

### **Independence of internal audit**

The internal audit activity should be independent and the internal auditors must be objectively impartial in carrying out their work.

If we refer to the purpose and general objectives of the audit, we have two types of Various audits: external audit and internal audit. External audit is an independent activity performed on private sector entities or public by a third party, and is primarily focused on the control of financial statements.

According to the law on internal audit, the independence of this activity is ensured, and the audit of internally reports to the highest level within the organization.

The concept of internal audit is about an independent and objective activity, whose purpose is to support the head of the unit in achieving goals and tasks, through systematic evaluation of internal control and advisory activities.

Internal audit is an independent activity, objective of assurance and consultation, prepared to add value and improve the actions of an organization. It helps an organization to meet its objectives, bringing a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control and processes of governance.

According to the Institute of Internal Auditors (2010) the profession of internal audit, is guided by the code of ethics for internal auditors, and adheres to the following principles:

**Integrity** - The integrity of internal auditors builds trust and provides the basis for them

based on their judgment.

**Objectivity** - Internal auditors show the highest level of professional objectivity in collecting, evaluating and communicating information about the activity or process that examined. Internal auditors perform a balanced assessment of all circumstances relevant and not much influenced by self-interest or by others, during the formation of trials.

**Credibility** - Internal auditors are supposed to respect the value and ownership of information received and do not disclose information without proper authorization, except if it is a legal or professional obligation.

**Competence** - Internal auditors apply the necessary knowledge, skills and experience, while performing internal audit services.

Internal audit in Kosovo has started to function in accordance with UNMIK regulation 1999/16, organized in a single department for internal audit in all institutions, as a complete form of its centralization. During the transition period of competencies from international to local internal audit is regulated by law 2003/2 on the management of public finances and responsibilities. Later this feature is further developed by creating relevant legal infrastructure and setting up internal audit capacities in all institutions, and this can be seen as a form of decentralization, as the creation of units within several budget organizations began. In 2007 the law on internal audit was adopted for the first time, which then is revised and supplemented in 2009, due to some shortcomings that have been identified over time this period, and as a result of the reforms undertaken in the field of public finances. AND finally in 2018 with the approval of law 06 / L-021 on internal control of public finance repeals the law on internal audit adopted in 2009, and

the aspect of internal audit is also regulated. According to this law, audit units have been established within public sector entities, and it has started certification of internal auditors for the public sector and licensing of these auditors. Institution responsible for certification and licensing of public sector internal auditors is the Central Harmonization Unit of Internal Audit (CHUIA) of the Ministry of Finance, which simultaneously organizes, regulates and institutionalizes the training system professional and ongoing internal audit. According to this law, the internal audit unit exercises its function in the manner of independently and reports directly to the head of the public sector entity and notifies the Audit Committee. As well as in relation to other organizational structures in the subject of public sector, the internal audit unit has functional independence in planning audit work, conducting audits and reporting.

### **Methodology**

The methodology used in this study will be focused on its use data from primary and secondary sources. Used for primary data purposes questionnaires to conduct surveys with relevant subjects related to the topic of research, while books, articles are used for the collection and use of secondary data and numerous journals, as well as other documents and reports published by the institutions of different.

For the realization of the questionnaire, the study population consists of 93 budget organizations, while the representative sample of this population will be 20 organizations. Distributed 45 questionnaire, and have included the organization manager, the head of the audit unit internal, and other employees from the internal audit unit. 38 of them responded officials who are part of the internal audit units or chief financial officer in budget organizations of three levels: central level (various ministries), local level (several by municipalities) and independent institutions.

In the use of secondary data, a large part of the research belongs to the analysis of documents, strategies, reports from internal and external audits which are made

mainly by the Auditor General of Kosovo which is also the institution highest economic and financial control in the Republic of Kosovo.

Also, information released during the audit process, including the audit opinion and the recommendations it has given are analyzed and compared with the relationships between the reports of to the Auditor General (ex. the recommendations given to budget organizations and their realization) and independent variables, such as: the size of the organization / institution (by number of staff and budget under management), type of organization / institution (Institutions central level, Local level Institutions, Independent Institutions), staff size in internal audit unit.

### **Data presentation and analysis**

According to the law on the budget of the Republic of Kosovo in 2019 there were 93 budget organizations (25 central level, 30 independent institutions, and 38 local level). Given the large number of budget organizations, we have focused on some of them, the which in a way will give the state of the whole system how it functions in terms of public finance oversight, and in this context the internal audit function.

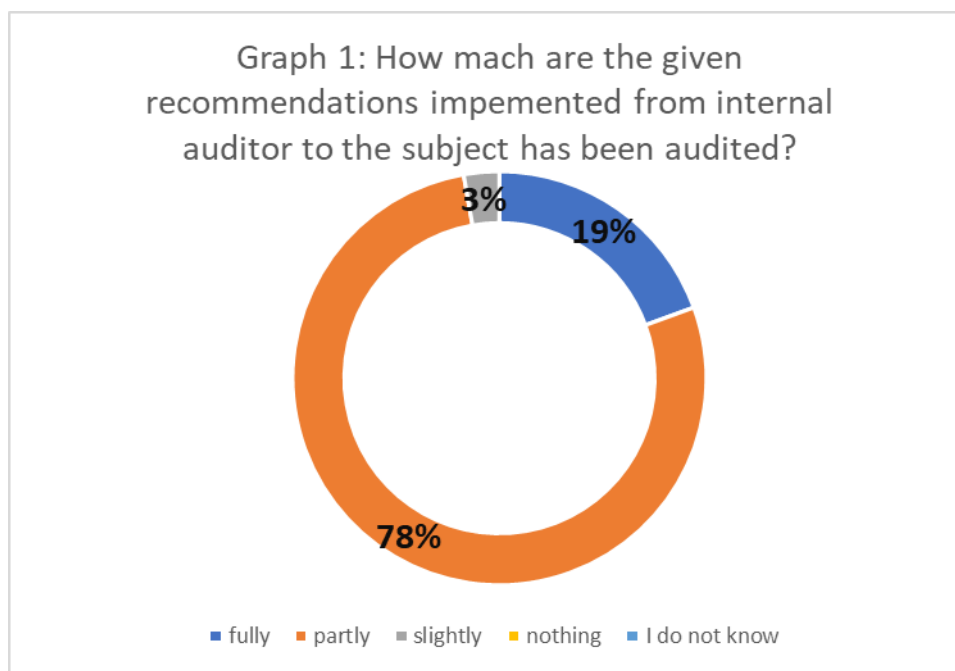
In the framework of this study, different budget organizations are selected and selected from each level, as each level has different roles and obligations. Budget organizations belonging to the central level such as ministries have a role in drafting relevant policies within the sector it represents, the role of a budget organization that is part of independent institutions mainly implements public policies, while those of the local level such as municipalities offer various local services.

In this study we have selected to analyze the internal audit function in overseeing public finances in six ministries (Ministry of Education, Science, Technology and Innovation; Ministry of Agriculture, Forestry and Rural Development; the Ministry of Finance and Transfers; Healthy ministry; Ministry of Economy and Environment; and Ministry of Foreign Affairs and Diaspora), four independent institutions (University of Prishtina; Air Navigation Services Agency; Independent Commission for Mines and

Minerals; and University Clinical Center of Kosovo), and ten municipalities (Drenas; Ferizaj; Fushë Kosovë; Lipjan; South Mitrovica; Obiliq; Prishtina; Rahovec; Shtime; Vushtrri).

According to the results obtained from the realization of the questionnaire it can be seen that the preparation and professional experience of staff employed in internal audit units in all levels where public money is used is satisfactory. Over 65 percent of staff have completed master studies, then over 57 percent have experience in auditing over ten years, about 53 percent have attended over ten trainings while 25 percent have attended 6-10 trainings from the field of audit. Number of employees in internal audit units within budget organizations is mostly 3-5 officials, or close to 53 percent of cases is this number of staff, while over 36 percent of organizations is 1-2 officials, and in 11 percent are more than 5 officials.

An important part of the internal audit analysis in overseeing public finances has also been the audit findings over the years and the improvements that have been made in future periods. From the results of the questionnaire, but also from the analysis of audit reports it was found that the largest number of recommendations given is from 6 to 10 recommendations, and what should be underlined here is that only some of them are implemented in the coming period. As presented in graph 1, the recommendations given by the audit of internally 78 percent are partially implemented, 3 percent are slightly implemented, while only 19 percent of them are fully implemented.

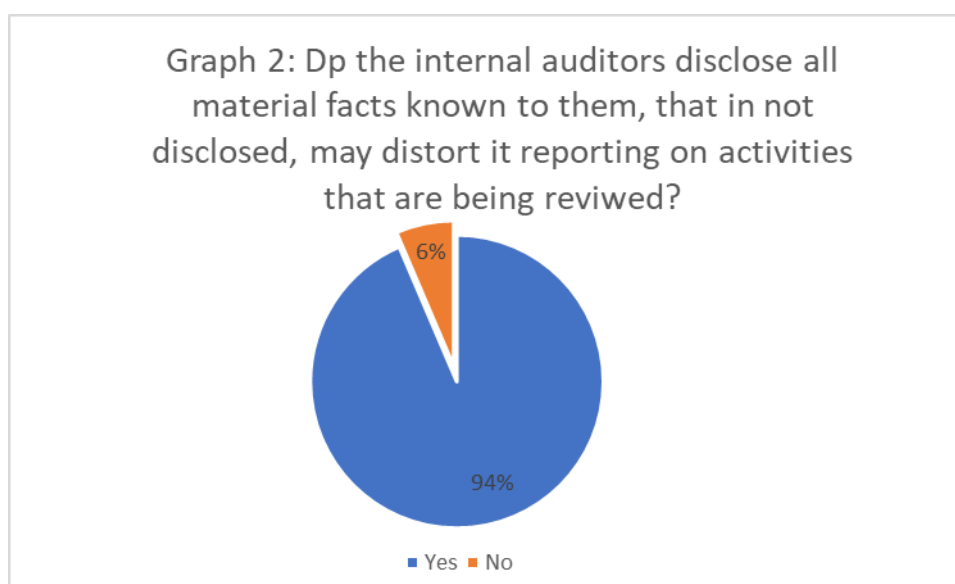


In carrying out its work, internal audit is one of the most important issues is his work without pressure and influence, as if we return to the audit concept of internally, it relates to an independent and objective activity, the purpose of which is to support management in achieving predetermined goals and tasks, doing systematic evaluation of internal control and various advisory activities.

Hence in this respect, the vast majority, or almost most of those who have responded question - Is the IA activity independent and are the internal auditors' objective for a long time performing their work? - have expressed that they are independent in carrying out activities and are objective in the performance of their duties.

Internal auditors across various budget organizations develop and document a plan that includes objectives, scope, timing, and resource allocation for each engagement, and all their activities are performed in accordance with the Standards International Internal Practice Professional Practice. Also, all activities are undertaken in accordance with the internal audit statute which document is signed by the head of the public sector entity (SSP) and the audit committee. Statute is available to all auditors and other staff. Internal Auditors in carrying out their activities in budget

organizations also set targets for each engagement, design and document a work program for each engagement to achieve relevant engagement objectives. Then they document the information sufficient, reliable, relevant and useful to support the results and the conclusions of the engagement, as well as the results of engaging the right parties.



Another positive aspect within budget organizations, besides the function of internal audit, most of them also have an audit board and / or committee which is independent of management, and have frequent and documented meetings between audit board / committee and finance managers, internal auditors and external. In these meetings the internal audit unit discloses all material facts of evidenced throughout their activities. This can also be seen in the answer they have given to 'yes' to the extent of 94 percent regarding the question (Graph 2): - Do the internal auditors disclose all material facts known to them that, if not disclosed, may distort it reporting on activities that are being reviewed?

So, in the analysis made through this research it was seen that the main effects it gives internal audit in a budget organization is in the function of controlling internally in the budget organization as well as in the efficient management of public



money, as in many cases, the external audit uses periodic and annual audit reports internal to the internal control function in the budget organization.

### **Conclusions and recommendations**

Based on the results from the analysis done, we can conclude that the condition of internal audit as the first but not the only link in the function of overseeing public finances in the Republic of Kosovo in many respects is consolidated over the years last, and continues to improve. In almost all budget organizations are established internal audit units, or at least there is an internal auditor.

Then, if we look at the level of budget organizations, at all three levels involved in this study, the central level (ministries), the local level (municipalities) and independent institutions the current state of internal audit in public finance oversight, seeing from the normative point of view, it is relatively satisfactory, and to a certain extent also from the aspect of implementation and institutional capacity that currently exists. Internal audit has its own concrete effects that it gives as an important function of the first link of public finance oversight.

Internal audit as a process increases the reliability of activities, projects various financial and other reporting submitted by each budget organization thereby also increasing public confidence in the management of public money.

And finally, it is important to deepen the cooperation within budget organizations, and findings and reflections made through auditor reports insiders to take seriously, and recommendations made by them are fully implemented, as seen from the research for now a large part of them apply only partially.

- Therefore, based on these conclusions of the internal audit analysis in oversight of public finances in various budget organizations in the Republic of Kosovo, in order to continuously improve the internal audit function as a very important link of public finance oversight, we recommend take the steps below:

- Increase the number of staff within the internal audit units, by enabling ongoing audits for most activities that are developed in the respective budget organization, thus empowering control of budget expenditures;
- Increased commitment by management but also other officials to it fully implement all recommendations coming from the internal auditor;
- Transparency and efficiency of each budget organization should be increased;
- Attending trainings by the staff in the framework of continuing professional education;
- Internal audit activity and services to focus on the evaluation of risk and not just in compliance audits.

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