

Public Internal Financial Control as a Significant Segment in Reducing Corruption Elaboration of The System of The Republic of North Macedonia

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Abstract: The public sector is a significant segment of the country's economic system. For continuous monitoring and improvement of the quality of services provided by the public sector, it is necessary to have a functional system of internal financial controls.

The System of public internal financial control, through its action, directly plays a significant role in the fight against corruption. Bearing this in mind, the subject of processing in this paper will be the elaboration of the System of public internal financial control in the Republic of North Macedonia presented through the prism of activities that contribute to reducing the level of corruption. The aim of the paper is to contribute to strengthening the role of public internal financial control in the fight against corruption.

In the direction of comprehensive processing of the subject of this paper, a detailed analysis of the national legal, strategic and institutional framework was made, the activities of the national institutions for the implementation of public internal financial control in the direction of reducing or preventing corrupt activities are also analyzed. Also, the paper analyzes in detail the activities and reports related to public internal financial control in our country in relation to the requirements of the European Union through Chapter 32 - Financial control, the United Nations Convention against Corruption and the GRECO report. Based on these analyses, concluding observations and recommendations are given for improving the role of public internal financial control in the fight against corruption.

Keywords: financial control, anti-corruption, public sector

1. INTRODUCTION

Corruption is a dynamic phenomenon that has many forms and is associated with various economic, legal, political, sociological and other factors. The negative effects of corruption are great and they have a significant impact in the public, private and civil sectors. Corrupt behavior significantly undermines trust in the institutions of the system, the efficient use of public resources and represents a threat to democracy and the realization of human rights due to the erosion of social values.

The public sector, as a significant element of the economic system of the state, needs to have established strong mechanisms to prevent corruption. Institutions from the public sector, through the implementation of internal financial control, act preventively and correctively to reduce the level of corruption. The system of public internal financial control is a strong mechanism and aims to monitor whether public funds are spent in a responsible and appropriate manner. The Member States of the European Union and the states with candidate status for membership have started the procedure for establishing a system of public internal financial control.

The Republic of North Macedonia, as a country with candidate status since 2005 and gained a recommendation for starting negotiations with the European Commission in October 2009, in addition to the numerous obligations it has to fulfill for entry into the European Union, there are also the obligations arising from Chapter 32 - Financial control. In the process of bilateral screening with the European Union, in the past few years, according to the structure of the negotiation framework, the anti-corruption policy is a horizontal element that is included in all negotiation chapters. Taking into account the strong connection between public internal financial control and anti-corruption policy, the subject of processing in this paper will be the elaboration of the System of public internal financial control in the Republic of North Macedonia presented through the prism of activities that contribute to reducing the level of corruption. The goal is to contribute to strengthening the role of public internal financial control in the fight against corruption. In addition, the need for adequate implementation of public internal financial control by the institutions in the public sector is emphasized.

2. LEGISLATIVE, STRATEGIC AND INSTITUTIONAL FRAMEWORK

2.1. Anti-corruption policy – legislative, strategic and institutional setting

The legislative basis for the anti-corruption policy in the Republic of North Macedonia was laid more than two decades ago, that is, with the adoption of the Law on the Prevention of Corruption. More recently, measures and activities to prevent corruption in the exercise of power, public powers, official duties and politics, measures and activities to prevent conflicts of interest, measures and activities to prevent corruption in the performance of works of public interest by legal entities related to the exercise of public powers are carried out in accordance with the Law on Prevention of Corruption and Conflict of Interest (Official Gazette of the Republic of Macedonia [OG],2019).

The State Commission for the Prevention of Corruption (hereinafter referred to as: SCPC) is responsible for the application of measures and activities for the prevention of corruption. This commission should be autonomous and independent in performing the tasks determined by the law and has the capacity of a legal entity. The commission is composed of a President and six members, who are appointed by the Assembly of the Republic of North Macedonia. The competences of the SCPC are determined in detail by the Law (Law on Prevention of Corruption and Conflict of Interest, 2019, Article 17). The basic competence of the SCPC is to adopt a National Strategy for the Prevention of Corruption and Conflict of Interest, with an Action Plan for its implementation, which strategy needs to be adopted by the Parliament. The National Strategy for the Prevention of Corruption and Conflict of Interest is a basic document that should present in a systematized manner the measures and activists that will have to be implemented and contribute to reducing the level of corruption. In 2021, the Assembly of the Republic of North Macedonia adopted the "National Strategy for the Prevention of Corruption and Conflict of Interests 2021-2025", and in 2023 the SCPC adopted a Decision to amend and supplement the National Strategy and it is awaiting adoption by of the Assembly.

The Republic of North Macedonia is a signatory to all the most important international, European and regional documents in the field of the fight against corruption, which is why the principles and obligations of these documents are fully incorporated into the Strategy. Also, during its preparation, relevant national documents and reports from international organizations concerning

the Republic of North Macedonia were taken into account.

In this strategic document, the priority problems (areas) that generate a high risk of corruption have been detected and selected, and measures to overcome them have been identified. The problems and measures envisaged by this strategy are systematized in the following areas and sectors: Public procurement, Employment in the Public Sector, Political System, Judiciary, Law enforcement authorities, Health, Education, Labor and social policy, Urbanism and spatial planning, Environment, Agriculture, Sports, Economy and Business, Public Enterprises and Media and Civil Society. In the amendments and additions to this strategic document, two more new areas have been established, that is, they are: Supervision of the implementation of laws and Property in state ownership.

In the area of Law enforcement authorities, among other things, problems were also detected in the area of Public Internal Finance Control, more specifically for internal audit. It has been established that the Management of state institutions often do not implement the recommendations of the Internal Audit and the State Audit Office, which is why it is necessary to establish an efficient system of implementation of the recommendations, but also a system of responsibility. It is also indicated that objectivity and greater independence should be ensured in the work of the internal audit, through the application of an appropriate institutional model. The detection of the so-called problems and measures for the improvement of the internal audit in this strategic document, represents the basis for the interconnection of the public internal financial control and the national policies for the fight against corruption. This strategic document is of great importance because it contributes to the deepening and strengthening of inter-institutional cooperation and generally raises the level of awareness of active fight against corruption among all parties involved in its implementation.

2.2. Public internal financial control – legislative, strategic and institutional setting

As a result of the activities of harmonisation the Macedonian legislation and system of state administration with the laws and ways of functioning of the European Union, the internal audit in the public sector in the Republic of North Macedonia continues to develop as one of the components of the system of public internal financial control. In the context of these activities,

the Law on Public Internal Financial Control was adopted in 2009 (OG, 2009).

The Law regulates the system of public internal financial control, which includes financial management and control, internal audit and their harmonization, in accordance with international standards.

The coordination of the system of public internal financial control according to the Law implies:

- harmonization and supervision of financial management and control,
- harmonization and supervision of the internal audit and
- preparation and adoption of by-laws, manuals and guidelines. (Law on Public Internal Financial Control [PIFCL], 2009, Article 2).

The Central Harmonization Unit is a Department within the Ministry of Finance, with exactly defined competences in the Law on Public Internal Financial Control.

In the past period, the regulation on internal financial control was assessed by the European Commission as good, but due to the difficulties in its implementation, the need for its further clarification was imposed, that is, drafting a new Law on the system of internal financial control in the public sector, as well as its new by-laws.

The proposed Law on the system of internal financial control in the public sector is aligned with the new Organic Budget Law (OG,2022), and its further alignment with international standards for internal control and internal audit is also being carried out.

In the Parliamentary procedure for adoption is a proposal of a Law on the system of internal financial control in the public sector. The purpose of the this law is to define a framework of a modern, adequate and effective system of internal financial control in the public sector, which includes financial management and control, internal audit and central coordination and harmonization.

In the Republic of North Macedonia, the activities for the further improvement of the system of public internal financial control are determined by the "Public Finance Management Reform Program 2022-2025"(Ministry of Finance [MoF], 2022).

The Program is a strategic document for the development of the Public Finance Management system. The document is structured in eight pillars, which cover all areas of Public Finance Management.

In Pillar 6, which refers to Public Internal Financial Control, two priorities are determined: Financial Management and Control and Internal Audit. Within these priorities, the key measures and activities that should be undertaken to achieve the duly determined results are determined.

With the priority Financial Management and Control, the goal is to increase the effectiveness of internal controls in financial management, while ensuring the implementation of key financial processes in accordance with internal acts based on risk management.

In the part of the Internal Audit, the goal is to strengthen the effectiveness of the internal audit in the public sector, so that the internal audit units, through their engagements for assurance and consulting, will contribute to the achievement of the goals of the public sector institutions.

Undoubtedly, with the successful implementation of the planned activities, in addition to contributing to strengthening the effectiveness of the public internal financial control system as a whole, they will act preventively and have an impact in reducing the level of corruption.

3. SYSTEM OF PUBLIC INTERNAL FINANCIAL CONTROL ROLE IN THE FIGHT AGAINST CORRUPTION IN THE REPUBLIC OF NORTH MACEDONIA

3.1. Implementation of the System of public internal financial control

The system of public internal financial control aims to provide appropriate and transparent methods and organizational structures through which reasonable assurance will be provided that public funds are used for purposes determined by the competent state institutions (Government and Parliament). In addition, the system of internal controls is an effective tool in preventing fraud and corruption. In the public sector, overall supervision of this system is carried out by the Parliament and the Supreme Audit Institution. The Government is responsible to the Parliament for the management, implementation and control of its own policies and systems. These policies and systems need to be established, i.e. related to budgeting and accounting procedures, internal control measures and inspection services in order to prevent fraud and corruption.

The public sector operates using taxpayers' money. The way in which public funds are spent is in the center of attention of all citizens in the country. How the public sector and civil servants behave has a key influence on the formation of public opinion

and the trust of citizens. For this reason, taxpayers have the right to be assured that the public administration carefully and responsibly manages the funds.

An established and implemented system of public internal financial control can ensure that government funds are spent responsibly. Therefore, the system of public internal financial control is primarily based on well-established international standards that aim to make the management of public finances more transparent and accountable.

The system of public internal financial control is a structured model that helps management to establish the highest level of controls in the organization and consumer units. It aims to provide reasonable assurance that transactions comply with the principles of proper financial management, transparency, efficiency, effectiveness and economy, as well as with relevant laws and budget projections.

The system of public internal financial control is constituted by three main elements which are explicitly presented through the following formula (de Koning, 2007, p.51):

$PIFC = IC + CHU$, where $IC = FMC + IA$, from here

$PIFC = FMC + IA + CHU$

PIFC - Public Internal Financial Control;

IC - Internal Control;

FMC - Financial Management and Control;

IA - Internal Audit and

CHU - Central Harmonization Unit.

The three elements of Public Internal Financial Control have mutual points with anti-corruption policies. Namely, the Public Internal Financial Control represents a preventive mechanism for reducing the level of corruption.

Financial management and control in accordance with the Law on Public Internal Financial Control is implemented based on internationally accepted standards for internal control, through the application of the following interconnected components: control environment, risk management, controls, information and communications as well as monitoring.

In order to more clearly detect the mutual points of financial management and control and anti-corruption policies for the purposes of this paper, several elements from part of the components of the standards for internal financial control will be elaborated (Committee of Sponsoring

Organizations of the Treadway Commission [COSO],2013).

At the same time, in the Control Environment section, personal and professional integrity, as well as the organizational structure that ensures division of responsibilities, hierarchy and clear rules, rights, obligations and levels of reporting, have a key role in setting the base in an institution in the fight against corruption.

Institutions are expected to have sufficient activities related to ethics and integrity, a clear organizational structure, clear divided roles, responsibilities and powers, as well as monitoring activities.

Risk Management includes the determination, assessment and control of possible events or conditions that may have a negative impact on the achievement of the entity's goals in order to provide reasonable assurance that the goals will be achieved. In order to implement these activities, the manager of the public sector entity should adopt a Risk Management Strategy. The process of risk management should be carried out continuously in the institution, for the implementation of which it is necessary to have procedures for its implementation, clearly divided roles and responsibilities, the process to be fully documented and finally the whole activity to result in the preparation of plans/measures to reduce risks. In the assessment of the risks and the determination of measures to reduce them, it is inevitably necessary to determine the risks of corruption according to the nature of the operation of the institution. In this way, awareness is raised at all levels to undertake appropriate activities and measures to reduce the level of corruption.

Controls include:

- authorization and approval procedures;
- division of duties in a way that does not allow one official to be responsible for approval, execution, accounting and control at the same time;
- double signature system;
- rules for access to assets and information;
- ex - ante and ex post financial control;
- procedures for complete, accurate, precise and up-to-date accounting of all transactions;
- reporting and review of activities - assessment of efficiency and effectiveness of transactions,
- monitoring procedures;
- human resource management procedures and

- rules for documenting all transactions and activities related to the subject's activities. (PIFCL, 2009, Article 16).

All the above-mentioned control elements create the so-called a network of ex-ante and ex-post activities in the operation that has a direct effect on reducing the level of corruption. Controls include decentralization of power, as well as verification and monitoring of activities. The structure thus established is a strong shield in the fight against corruption.

Information and communications also play a key role in the fight against corruption. Institutions in the public sector are expected to ensure the organized management of information in the subject. In this direction, it is necessary to establish appropriate internal communication (exchange of information on a horizontal and vertical level). In doing so, it is necessary to define the policy of the information system, as well as to establish an appropriate system of communication with the citizens/users of the services.

Monitoring activities check the proper functioning of the financial management and control system. In doing so, the following two elements are significant, which have an impact in reducing the level of corruption: to have established an internal audit that adds value to the entity, to conduct audits in the most risky areas, and to implement internal audit recommendations in accordance with the deadlines, all recommendations from the external audit (State Audit Office, etc.) are implemented, and all organizational units are familiar with the findings of the State Audit Office and the determined weaknesses in the system indicated by the state audit.

The proposal of the Law on the system of internal financial control in the public sector establishes key reform activities in the area of financial management and control. Moreover, this Law after its adoption will be applied by all entities from the public sector, including all legal entities that are directly or indirectly established by the state or municipalities and public enterprises and trading companies that are majority owned by the central government or one or more local government units.

The implemented novelties in the draft law, in addition to improving financial management and control and expanding its application to all entities from the public sector, will immediately act to increase the level of accountability, thereby reducing the level of corruption.

In the Republic of North Macedonia according to the "Annual report on the functioning of the 2022

public internal financial control system" (MoF, 2023), it is evident that on average about 58% of the budget users adopted a risk management strategy, and about 50% of the budget users prepared a Risk Register. These data indicate that the number of institutions from the public sector that have identified risks of corruption in their operations is still small.

According to the identified weaknesses in the report, the Government adopted appropriate conclusions for the improvement of the system of public internal financial control, which the institutions are obliged to implement in the future.

The second element of the Public Internal Financial Control, the internal audit also has a significant role in reducing the level of corruption. The role of the internal audit is to provide support to the managers in the public sector entity for the achievement of the entity's goals, among other things, by assessing the appropriateness, the economy, effectiveness and efficiency of the financial management and control system for determining, assessing and managing the risks of the entity's management in relation to:

- compliance with laws, by-laws and internal acts and agreements;
- the reliability and comprehensiveness of financial and operational information;
- security of property and information and
- the performance of tasks and the achievement of goals.

These elements clearly position the preventive role of internal audit in preventing corruption within the institution.

In the Republic of North Macedonia, according to the indicators from the "Annual report on the functioning of the 2022 public internal financial control system" are obviously worrying the data on the average number of auditors per established internal audit unit, which has a value below one. Also, the level of implementation of the given recommendations of the internal audit is still low, which is around 64% on average. The low level of implementation of the recommendations of the internal audit is also detected in the "National Strategy for the Prevention of Corruption and Conflict of Interest 2021-2025".

The proposal of the Law on the system of internal financial control in the public sector prescribes which budget users from the central level must establish internal audit units, as well as new criteria for establishing internal audit in other entities,

taking into account: the average execution of the budget in the last three years and the number of employees. At the same time, the minimum number of employees in the internal audit units is defined, the method of conducting training and an exam for obtaining a certificate for an authorized internal auditor in the public sector, an obligation to prepare a Quality assurance and improvement program of internal audit, and conducting quality checks at the internal audit activities are introduced, as well as the criteria for establishing Audit Committees at public sector entities.

The mentioned reform activities are in direct correlation with the measures of the "National Strategy for the Prevention of Corruption and Conflict of Interest 2021-2025" in the part of the internal audit and practically with their implementation it represents the implementation of the anti-corruption policies determined in the National Strategy.

3.2. The system of public internal financial control and anti-corruption policies from the perspective of international organizations

In this part of the paper, it is of particular importance to elaborate the determined situations and the recommendations given in the reports of international organizations, for those elements where there is an interrelationship between public internal financial control and anti-corruption policies.

The subject of elaboration will be the Screening report of the European Commission for Cluster 1 – Fundamentals (European Commission, 2023), further, the Second Compliance Report of the Republic of North Macedonia - Fourth Round of Evaluation issued by GRECO (GRECO, 2023). Also, since the Republic of North Macedonia is a signatory to the United Nations Convention against Corruption, the Revised Action Plan under this Convention (United Nations Convention against Corruption, 2022) will also be reviewed.

By the European Commission in the screening report in the section of Chapter 32 - Financial control, it is explicitly stated that: "The Republic of North Macedonia should adopt and implement the Law on the system of internal financial control in the public sector" which will contribute to improving the framework of internal controls, improving managerial accountability and strengthening the internal audit function. Also, in this part of the report, the European Commission points out the need to "Strengthen the cooperation between the institutions that implement the public internal

financial control and the State Audit Office, with the anti-corruption institutions in order to ensure the full implementation of the laws.

With the Second Compliance Report of the Republic of North Macedonia - Fourth Round of Evaluation issued by GRECO, specifically related to the subject of elaboration in this paper is recommendation number 2, which is: „ GRECO recommended (i) to systematically conduct an integrity risk assessment at the central government that will cover all officials, advisers and external collaborators, as appropriate; (ii) to introduce appropriate corrective measures and provide adequate resources to the internal control units and to the bodies responsible for methodological advice in this area; and (iii) regularly evaluate the impact and effects of central government integrity measures (for example, declarations of interests and assets) and publish the results”.

With the Revised Action Plan on the United Nations Convention against Corruption, public internal financial control is generally covered in the part of the risk management process and the need to take concrete measures to establish an effective risk management system in all government institutions .

From all the elements elaborated in this part of the paper, it can be freely concluded that the System of public internal financial control is horizontally incorporated in all segments of the operation of public sector institutions. Because of this specificity of the public internal financial control system, its role in the fight against corruption is undoubtedly significant and crucial.

4. CONCLUSION

According to the subject of this paper and taking into account the purpose of the paper, i.e. to contribute to strengthening the role of public internal financial control in the fight against corruption the System of public internal financial control in the Republic of North Macedonia was elaborated in detail through the prism of activities that contribute to reducing the level of corruption.

The following are the concluding observations and recommendations:

- first and foremost, it is necessary to adopt a proposal for the Law on the system of internal financial control in the public sector as soon as possible, and in the next phase, it should be fully implemented by all public sector institutions;
- it is necessary to pay serious attention and implement the recommendations given by the international organizations, which refer to the

undertaking of activities and measures in the fight against corruption;

- it is crucial to continue and strengthen further cooperation between all institutions from the public sector that in any way have a role in the fight against corruption.

With the implementation of the conclusions given above, the system of public internal financial control in the Republic of North Macedonia will be placed on a reliable basis and its role in the fight against corruption will be strengthened, and consequently it will be acted upon directly i.e. it will result in a reduction the level of corruption in our country.

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