Monitoring and Audit of the State Financial Resources: The Problem of Effective System Arrangement (the case of the Republic of Kazakhstan)

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Abstract

The research goal is the problem identification of the current state financial control in the Republic of Kazakhstan and the estimation of the progressivity of developed project on implementation of state audit of financial resources of the country against this background. The practical research organization for all elements of the state financial control (subjects, objects, and communications) enabled to obtain reliable source data to identify these problems and their causes. The author has held the economic effectiveness analysis of the Supreme Audit Institution of the country and the local audit committees for the last period. Identified problems allowed making a comprehensive analysis of the draft law on introduction of state audit system. The problems of the state audit system development in the course of reform in the Republic of Kazakhstan might be useful for developing countries with poor public financial control, as well as for the developed economies in order to improve and identify latent problems. The author’s conception about the need to separate the control and audit on the basis of managerial nature of the latter has a universal theoretical and methodological value.

Keywords: Financial Analysis, Financial Control, ISSAI, Management, State Audit, State Financial Resources

1. Introduction

The relatively low level of efficiency is observed in the Republic of Kazakhstan relating to the use of budget funds and the relatively low quality of state services. Financial operations of the government authorities, associated with budget funds movement, are not transparent, which creates conditions for corruption. The study, held by International Budget Partnership, showed that the Open Budget Index in 2012 for the Republic of Kazakhstan is 48 points out of 100 possible (the next research will be conducted in 2016)¹. This position is the average one. The Open Budget Index reflects an assessment of the key budget documents availability, objectivity and reliability of their content, the control degree of the state bodies of the government legislative branch and higher authorities, exercising the financial control and audit. At the same time in terms of the supreme organ effectiveness on financial control and audit the Republic of Kazakhstan got into a group of “weak” states. This indicator reflects the effectiveness of the supreme governing body, taking into account the degree of its independence and the presence of its objective possibility to carry out a qualitative audit.

This situation caused to develop a wide-ranging reform of the state financial control (hereinafter - SFC) and the state audit implementation. In this process foreign experience is systematized, different models of audit and control organization are compared, problems in the search for the best performance of the state financial control and audit are identified. According to the Concept of the state

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audit implementation in the Republic of Kazakhstan (dd. September 3, 2013), it is created as a full and effective institution of the public and the government. The state control system should detect financial irregularities and take actions to respond, and the state audit must evaluate the governance with a focus on improving the activities of the audited entity, the growth of its effectiveness. This evaluation also includes the quality of the activities of state bodies and organizations exercising the functions of financial resources management.

There is an administrative groundwork in the Republic of Kazakhstan (hereinafter - RoK) for the state audit implementation: the state planning, project evaluation, and the results of budget execution estimation, public policies and programs, the state bodies’ activities.

Accounts Committee for Control over Republican Budget Execution of the Republic of Kazakhstan (hereinafter - Accounts Committee), as the supreme body of SFC, has the membership in five (5) international organizations (Table 1).

Table 1. Participation of the Republic of Kazakhstan in the international organizations for the state financial audit and control

<table>
<thead>
<tr>
<th>Organization name</th>
<th>Year of establishment</th>
<th>Year of the Republic of Kazakhstan joining</th>
</tr>
</thead>
<tbody>
<tr>
<td>International Organization of Supreme Audit Institutions (INTOSAI)</td>
<td>1953</td>
<td>2000</td>
</tr>
<tr>
<td>Asian Organization of Supreme Audit Institutions (ASOSAI)</td>
<td>1979</td>
<td>2000</td>
</tr>
<tr>
<td>European Organization of Supreme Audit Institutions (EUROSAI)</td>
<td>1990</td>
<td>2003</td>
</tr>
<tr>
<td>Economic Cooperation Organization Supreme Audit Institutions (ECOSAI)</td>
<td>1994</td>
<td>2004</td>
</tr>
<tr>
<td>Council of supreme bodies managers for financial control of states-members of</td>
<td>2000</td>
<td>2000</td>
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<td>the CIS</td>
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Source: drawn up by the author of the Article.

Such participation is a valuable opportunity to share experiences on various aspects of operation and functioning of the state financial audit and control.

Modern trends in the state audit implementation in various countries, as well as improving of the current systems in the development of the national economics, pose a number of pressing and urgent issues in such a study.

2. Materials, Methods and Organization of Research

The study used Panoramic, logical, functional, economic and mathematical methods of scientific knowledge, as well as the method of content analysis of documents.

To obtain the primary source data the author has conducted the following studies:
- Materials review in Bulletin of the Accounts Committee;
- Economic analysis of the annual reports of the Accounts committee for the years of 2011-2013 (the last published period);
- Economic analysis of annual and quarterly reports of local Audit Commissions (of regions, cities of Almaty and Astana) for the years of 2012-2014;
- Content analysis of the SFC structure and the accounting documents;
- Functional analysis of SFC bodies of Kazakhstan;

The materials are available online at http://esep.kz/eng.

The study was organized so that the results were aimed at identifying the provisions of an effective system of state audit, enabling to solve the problems arising in the field of State Financial Control.

The study is based on a systematic approach. Working hypothesis was the assertion that the effectiveness of any instrument of state control is only possible in case of the systemorganization of this instrument, in which the integrity and coherence of its (of the system) actions is ensured by the rational interconnectedness of elements.

In theoretical and methodological terms the author differentiates the state control and auditing of financial resources of the country as follows.

Control (from French contrerôle– isa comparison of the two lists) is held as monitoring of the presence / absence of behavior abnormalities of the controlled system. It is of factual nature.

Audit (from Latin Audit - listening) always requires
excluding the conflict of interests in the subjects carrying it out and its ultimate goal is the identification and resolution of mismanagement problems. It is of managerial nature. The Declaration of Audit Guidelines indicates that the audit arrangement is a necessary function component for an effective financial management of public funds, as this kind of control is associated with the social responsibility.

The author of the article is based on the recognition of the unity and coherence of economic processes. On the criterion of the control object from a number of areas in the field of public relations there is a possibility of economic control separation, one aspect of which involves financial control. The latter implements the category of the control function of finances, which in turn determines the development. Thus, the British professor of finance R.W. Mills emphasized in the whole the leading role of state control as the final stage of the administrative process and, at the same time, the conditions of the subsequent cycle management, in the absence of which such cyclicality will be broken. By continuing the thought of R.W. Mills we note that the state audit will be the next cycle.

The author is proceeds from the fact that modern audit cannot but include an assessment of the effectiveness in relation to the audited entity. In the literature different countries use different terms. For example, in Norway and Sweden the term “performance audit” (“management audit” or “performance audit”) is used, in Canada and the UK –“value for money audits” (“audit of benefit received from the money use”), in the United States – “operational audit”, in Australia – “performance audit work”. In contrast to control, which can be a control on compliance or control of financial statements, audit is always a performance audit by virtue of its administrative nature. Thus performance indicators may be different according to the particular methodology. This approach allows:

- Eliminating the confusion of audit and control categories;
- Avoiding duplication of functions and powers of control and audit bodies;
- Ensuring the freedom and independence of the auditor.

3. Research Results

Bodies of State Financial Control in Kazakhstan are presented in Figure 1.

It should be noted that the control measures in relation to programs and projects where the financial resources of the country are invested are carried out by many government bodies (Presidential Administration, the Government, the Ministry of National Economy, local representative bodies, and others). There are no systemic linkages between them within these control functions. There is a duplication of functions and powers and repeated audits of some objects while others are uncontrolled.
But one cannot say that in Kazakhstan SFC has no impact on the financial resources of the country. In fact, financial irregularities are revealed during audits in 9 cases out of 10.

During 2011-2013, the Accounts Committee monitored and evaluated the implementation effectiveness of 7 state and 28 sectoral programs. The implementation of these programs has not disbursed USD 2.21 billion; violations of the budget and other legislation requirements are established for the total amount of USD 2.63 billion (Figure 2).

![Figure 2](image)

Figure 2. The efficiency of the national budget funds use. (On the left: violations, USD bln; On the right: budget disbursement failure, USD bln).
Source: compiled by the author according to the reports of the Accounts Committee for the appropriate period.

The Figure 2 shows that during the analyzed period, the peak of the inefficient use of budget funds was in 2012. Reduction of undisbursed budget amount in 2013 is not associated with the change in the amount of irregularities. The sharp increase in the amounts used inefficiently in comparison with 2011 is due to the expansion of government programs.

The analysis of the republican budget deficit over the recent years has shown that the significant deviation trend of its actual scope from the planned one is retained despite the clarification and correction (Figure 3).

![Figure 3](image)

Figure 3. Growth dynamics of the actual and the planned volume of the budget deficit.
Source: compiled by the author according to the reports of the Accounts Committee for the appropriate period.

In adequate assessment of internal reserves, as well as of the revenue base of the republican budget ultimately results in a considerable difference.

<table>
<thead>
<tr>
<th>Positive innovations</th>
<th>Mistakes and issues</th>
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<tr>
<td>Functions of Accounts committee are enlarged by the controls implementation, including: Preliminary, current and the next budget estimation; estimation of management and usage of national nature resources Standardization of the state audit and control system Establishment of the Council on audit and risks Estimate of efficiency of the Accounts committee activities by the members of international organizations of the supreme bodies of the state audit Certification of the state auditors</td>
<td>The estimation right of the local budgets drafts is unreasonably excluded from the functions of the Accounts committees (in the field) The word combination “state audit and financial control” is met more than 300 times without the semantic differentiation Limited list of audit parameters Classification of audit and control does not differ Efficiency is provided only as the effect estimation according to the planned results Audit parameters are not distributed by the audit kinds Parameter “significance” is provided only as the quantitative Risk estimation is not included into the state audit and financial control system</td>
</tr>
</tbody>
</table>

Source: this is compiled by the author based on the Draft Law analysis.
In 2014, the Accounts Committee conducted audits on 36.98% less than in the same period of 2013. Therefore, the funds volume covered by the control has also fallen by 54.94%. But, despite the less number of audited control objects the amount of the violations detected has increased by 61.6%. These facts of financial irregularities themselves have increased by 8.12% in terms of quantity, the amount of procedural violations significantly increased from USD 177,580 million in 2013 to USD 900.17 million in the same period of 2014, reflecting the ineffectiveness of prevention in the area of financial responsibility.

Reports on the audit results of the Accounts Committee are sent to the Government of the Republic of Kazakhstan, and instructions and recommendations are sent to the state bodies and objects of control. The schedule for execution of these instructions and recommendations over 2010-2014 is shown below in Figure 4.

![Figure 4. Schedule for execution of recommendations and instructions issued by the Accounts Committee for 2010-2014.](image)

Source: compiled by the author according to the reports of the Accounts Committee for the appropriate period.

152 orders and 33 recommendations are due for execution, including 136 orders and 30 recommendations that have been carried out, or 89.5% and 90.9%, respectively. It is worth to note that the recommendations adopted in 2010-2012 were fully executed, in 2013 they were 98.4% executed. In 2010-2012 execution of the orders was 99.7%, and in 2013 - 99.6%.

The analysis results of information on the audit committees’ activities are of the same nature.

The total amount of violations revealed by auditing committee for the years of 2012-2014 was $ 4.58 billion USD. The violations structure is shown in Figure 5.

![Figure 5. Structure of violations revealed by Auditing Commission for 2012-2014.](image)

Source: compiled by the author according to the annual and quarterly reports of the Audit Commission for the appropriate period.

It can be seen that for several years a significant proportion of the revealed violations is accounted for violations in the budget funds expenditure (55-78 %), second place in the violations structure is taken by the misuse of state assets - 16-38 %, and the least of all accounts for revenue violations (5-7 %). However, in 2014 the proportion of irregularities significantly increased in the use of state assets, and amounted to more than a third part - 37.55%.

As it has been shown by the analysis of the structure and content of the SFC accounting documents there is no unity in terms of controls, methods of representation and other methodological aspects, which complicates the analysis on statistical data. The lack of a unified methodology for planning, conducting and reporting on SFC is the cause of such a problem.

The main problem of SFC's reports is the lack of aim to identify cause-and-effect relationships in the assessment methodology. Just their establishment allows you to identify their causes and consequences of problems, to develop corrective and preventive measures. Content analysis of the Accounts Committee’s reports found that the lack of causal method in economic analysis leads to the “diffuseness” in the formulation and solutions of problems, as well as to optionally developed recommendations for a designated problem. Audit Committee Reports do not contain recommendations and are in the nature of statistics of violations and calling to account.

Results of the draft law analysis are as follows (Table 2).

4. Discussion

The analysis performed on the Accounts Committee reports concerning execution of the republican budget...
and regional audit commissions showed that the activities of the SCF is needed, it provides the necessary information for monitoring and general conclusions, but cannot solve the problems of efficiency on financial resources management of the country.

Many public events, significantly invested with financial resources, have been identified with the help of SFC as ineffective. This enables to:

- prevent further expenses on ineffective events;
- designate the installation to eliminate activities fruitless and even negative for the Kazakhstan society.

Overall, this suggests that the executors and the program coordinators did not perform operational control over the relevant activities, achievement of target indicators and the final outcome. As a result, policy documents are made not fully, with violation of the budget and other legislation.

It should also be noted that target indicators are not always set correctly. For example, the program 128 “Implementation of the measures under the employment program 2020” as a final result the number of citizens who would come to the employment program is shown as an indicator as well as efficiency of its services. As can be seen, instead of the target indicator to reduce unemployment by a certain percentage, an indicator was proposed as a means but not a purpose.

We cannot say that low fiscal discipline of the subjects on financial management is stipulated by non-fulfillment of the recommendations of the SFC supreme body. On the contrary, almost one hundred percent implementation of the recommendations and instructions (see Figure 4) does not lead to a decrease in financial irregularities and increase of the budget execution efficiency from year to year (Figure 2). This problem cannot be solved at the SFC level, as the improvement of the financial resources management of the country to increase the efficiency of their use is in the field of state audit, but not control.

A negative factor reducing the transparency of all the SFC bodies’ activities is the lack of close cooperation with the population through public organizations. The financial control bodies cannot systematically receive a constructive criticism from the active part of civil society and, therefore, to respond to it. The accounting information provided to the public resources is not complete, in irregular periods, updated with delay, the analytics does not appear to be accessible for people who do not have professional knowledge in the financial sector.

Status of the Chairman and members of the Accounts Committee does not comply fully with generally accepted principles of independence, as in the Register of civil servants they are assigned with political offices.

Functional analysis of the SFC bodies system showed that the systemacy itself is just not the case due to the absence of vertical links.

According to the draft law, the state audit system is designed in the form of internal and external audit (see Figure 6).

![Figure 6](image-url)  
**Figure 6.** The system of state audit bodies.  
Source: compiled by the author based on the analysis of the draft law “On the State Audit and Financial Control”.
Accounts Committee and the Commissions will become the entities for external state audit and financial control.

One of the problems of low efficiency of public financial management lies in the fact that Kazakhstan has not carried out a preliminary audit of the budget and public projects. This innovation is provided in the Draft Law and is progressive based on the following:

- State Audit formed as strategic, estimation performance of resources conformity to possibilities of goals achievement set by the state and the expected effects;
- it would prevent the budget shortages and surpluses;
- Increase in the efficiency of the budget investment and of the National Fund in the strategic programs for the long perspective;
- The state audit system would be more comprehensive, covering such an important stage of the budget process as the creation of the republican budget project.

However, a conflict of interests does not exist in a situation where an audit of the budget outcome may reveal incorrect planned (unreasonable or impossible to implement with these resources) parameters since the project has been approved by the auditors.

On the whole the content analysis of the draft law shows that conceptually a distinction audit and control has not been worked out, that's why many regulations and norms contain hypotheses and dispositions, mixing these concepts and their mechanisms. This led to indiscriminate use of financial terms in the draft law.

This approach is not correct from the standpoint of the economics methodology, as there is no need to fix in the body's title all the management functions and represent them intimately; otherwise it would be possible to continue this approach in the style of "authorized body on the state audit and financial control and risk management, etc."

But the problem is not only of theoretical and methodological character: in practice, it will cause excessive bureaucratization of processes, duplication of powers, unspecificity and lack of system accountability. We will explain by practical examples of General Electric Company, the cause of the financial crisis in the middle of the XX century was duplication of the control functions, risk management, economic security and auditing, and 68% of the company's human resources have been sucked into this haphazard activity.

Our opinion that the control and audit place in the current reform of the Kazakhstan SFC is not defined (the categories are neither united nor divided) is confirmed by the fact that the draft law adoption in its present form by the government assumes substitution of the word 'control' for 'audit' in parallel with amendments in other legislation acts.

The following economic mistakes with regard to audit are made in the draft law:

- A limited list of audit indicators (economy, productivity, effectiveness, significance and efficiency) that will affect the audit quality on account of the differences in the evaluated entities, and will also prevent the audit abilities of the entity in the system (in conjunction with other elements and objects of the financial system and other socially important systems);
- Efficiency is presented as a measure of financial control since efficiency in audit involves assessment of the effect not only on the scheduled results;
- Indicators of effectiveness, economy, productivity and efficiency are suggested to use depending on the type of state audit, and the type of “audit efficiency” is defined as the assessment and analysis of the audited entity’s activity for economy, productivity and efficiency. It is not clear what economic indicators should be identified by two other types proposed in the draft law “compliance audit” and “audit of financial statements”;
- Significance is presented as an indicator of financial control, but it should be not only quantitative but also qualitative, which is important when auditing socially important systems;
- The performance criteria of the state audit are not defined, while expanding the Accounts Committee's functions should result in the human resources involvement and, consequently, budget expenditures for these purposes.

In the State Financial Control all the sources are documents of public authorities, which exclude objectivity, versatility of assessment, as well as create opportunities for conflicts of interest. At the same time the accuracy of the information provided in such sources is not verified by a comparative method, but only assumed with reference to the responsibility to representing person. This problem
might be solved only with the help of the state audit, the management capacity of which enables and binds to use multi-vector sources for multicriteria reliable assessment.

At the same time the state audit should not be “scattered” in various subjects. It is impossible to achieve audit compliance with the international standard ISO 9001:2008 without inter-agency groups or other independent forms of organization at planning and organization of the audit course. For example, in the United States a complex ranking system PART is used, based on the ideas of the functional approach, which includes a set of tools, steps and elements of the budget programs effectiveness evaluation. One of the distinctive features of the system is an invitation of representatives of various federal government agencies, as well as external experts to evaluate.

To maximize the effect from strategic management in the state audit system implementation it is required to ensure the principle implementation of the strategic interests conjugation and actions synchronization at all the levels, including the local one, with the most complete account of the strategic interests of the key budget-forming corporations (Figure 7).

It is obvious that the central and local budgets should be developed in line with the strategies. If there is no such a system, the state audit of the strategic management programs at some level becomes meaningless, since the coordination of the actions and decisions of all the bodies involved in strategic planning is not achieved. It will be endless recommendations regarding the individual elements in the strategic management structure unrelated to the system. Their implementation will be complicated with the necessity to involve another system element and even in the implementation it will not give the final results for the country.

Figure 7. Systemic basis for the state strategic management.
Source: compiled by the author based on the study of Government extension to PMBOK and Strategic Management by Hitt et al.

5. Conclusion

Thus, SFC in Kazakhstan does not show the effectiveness in financial discipline reduction, recommendations executed by it lead to nothing and as a result the national budget management remains low. Basically, the Accounts Committee and the Audit Committees perform the function of statistical information collection and processing to identify deviations (financial irregularities “after the event”). There is no independent assessment of the effectiveness of government agencies’ activity covering all the aspects of their work within the framework of the current financial supervision system. The current system of SFC is insufficient for good governance, and therefore there is a need to implement the state audit.

The SFC reports mainly emphasize the information disclosure about budget violations committed, mismanagement and inefficient use of budgetary funds,
but there is no information on the nature of violations and the grounds for inefficient use of budgetary funds, and, the most important, on concrete proposals to eliminate them and opportunities (methods) to recover the budget damage caused by ineffective programs. The same problem is duplicated at places and even more pronounced.

According to the research results, SFC cannot substitute the audit and shall not perform audit functions. Since the audit is more resource-intensive, methodologically difficult, the causal method can and should be used within its framework. Control should remain control, the results of which may be a part of the initial data for the state audit procedure.

The key issue of the draft law is that there is no clear separation of audit and control, in order to avoid duplication of functions and inconsistent actions. The draft contains no elaborated concept of audit and control differentiation, due to which these concepts and their implementation mechanisms are mixed in a lot of provisions thereof. This is based on an initial incorrect vector to bring the management of the state budget implementation only to audit and control instead of integrated management with the functions and powers division.

As of today the Republic of Kazakhstan requires a qualitatively new system for state control and audit bodies. In this system, the state control will be in the detection of financial irregularities and response measures, and the state audit will involve the assessment of financial resources management in order to improve the functioning of the audited entity. The construction of such a system in any country should start with state strategic management streamlining.

6. References