



Taking Action Against Irregularities and Fraud - Are We Still at the Beginning?

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Abstract

The aim of this paper is to approximate the current state of risk management in irregularities and fraud in public sector organizations. Current regulations in the field of financial management and control in the public sector in the Federation of Bosnia and Herzegovina define the concepts of irregularities and fraud within the system of internal controls in public sector organizations, the responsibility of management and employees for reports and actions. The paper will present data from official consolidated reports on the functioning of the financial management and control system, which indicate that the management of risks of irregularities and fraud and the implementation of actions to prevent and eliminate irregularities and fraud by users are still insufficiently developed. The possible causes of such a situation will be analyzed, and possible solutions will be considered: elaboration of legal enactments and concretization of individual roles in taking actions against irregularities and fraud.

Keywords: Financial Management and Control, Internal Control System, Irregularity, Fraud

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1. Introduction

By signing the Stabilization and Association Agreement between the European Communities and their Member States, of the one part, and Bosnia and Herzegovina of the other part, Bosnia and Herzegovina (and its entities and the Brčko District of Bosnia and Herzegovina) committed in Article 90 to, inter alia, develop “internal financial control in the public sector, **including financial management and control**, functionally independent internal audit, and independent external audit systems in Bosnia and Herzegovina, in accordance with internationally accepted standards of control and audit and methodologies and the best practices of the European Union“ (Stabilization and Association Agreement between the European Communities and their Member States, of the one part, and Bosnia and Herzegovina, of the other part, June 30, 2015, p. 43).

Within the development of the regulatory framework for financial management and control in the public sector in the Federation of BiH, special emphasis was placed on the issue of risk management of users, especially risk management of irregularities and fraud and implementation of actions to prevent and eliminate irregularities and fraud. Users were introduced with the obligation of annual self-assessment of financial and control system and submission of reports to the Central Harmonization Unit of the Federal Ministry of Finance-Finance which, based on the submitted data, each year constitute the annual consolidated report of functioning system of financial management and control in the public sector in the Federation of Bosnia and Herzegovina and submit it to the Federal Government for adoption. Annual reports indicate a low level of development of risk management for irregularities and fraud, which requires additional efforts to improve the regulatory and methodological framework, and an active approach to the issue of providing individual support to users.

2. Irregularities and frauds in the system of financial management and control

For the work and business of any organization, including public sector organizations, it is necessary to have a system of internal controls, which, simply put, represents all those management activities aimed at avoiding or reducing risks that have a negative impact on achieving the organization's goals.

Acting in accordance with the obligations of the signed Stabilization and Association Agreement, the Law on Financial Management and Control in the Public Sector in the Federation of Bosnia and Herzegovina (hereinafter: the Law on FMC) was adopted in the Federation of Bosnia and Herzegovina, as a *lex specialis*, which deals specifically with issues.

internal controls, ie financial management and control (hereinafter: FMC) based on the COSO model¹. Regarding the purpose, goal and subject of financial management and control, the Law on FMC prescribes: “(1) FMC is based on risk management and is introduced to improve financial management and decision-making in the realization of the organization's goals, especially general goals such as:

- a) compliance of operations with regulations, plans, contracts, policies and procedures;
- b) performing activities in a proper, ethical, economical, efficient and effective manner;
- c) protection of assets, liabilities and other resources from losses that may arise from mismanagement, unjustified spending and use, and protection from irregularities, abuse and fraud;
- d) reliable, complete and timely financial reporting and monitoring of business results.“
(Zakon o finansijskom upravljanju i kontroli u javnom sektoru u FBiH, Sl. novine FBiH 38/16, p. 2).

Although irregularities and frauds are defined by other applicable regulations, the Law on FMC offered definitions of these terms, and defined the **irregularity** as "non-compliance or misapplication of laws and other regulations arising from actions or omissions of users of public funds, which has or could have adverse impact on budget funds and funds from other sources“ (Zakon o finansijskom upravljanju i kontroli u javnom sektoru u FBiH, Sl. novine FBiH 38/16, p. 1), and **fraud** as “intentional act or omission relating to false, inaccurate or incomplete presentation of facts, and abuse resulting in a negative effect on budget funds and funds from other sources“ (Zakon o finansijskom upravljanju i kontroli u javnom sektoru u FBiH, Sl. novine FBiH 38/16, p. 1).

The Law on FMC paid special attention to taking action against irregularities and fraud, devoting a special chapter to them (V "Taking action against irregularities and fraud"):

- (1) The head of the user of public funds is responsible for managing the risks of irregularities and fraud and carrying out actions to prevent and eliminate irregularities and fraud in his organization.
- (2) All employees in the organizations referred to in Article 2 of this Law are obliged to report any significant irregularities and possible suspicion of fraud to the head of the user of public

¹ The COSO model is a generally accepted international model for establishing, managing and evaluating an internal control system that consists of five interrelated components: control environment, risk assessment, control activities, information and communication, monitoring and evaluation. The abbreviation COSO refers to the Committee of Sponsoring Organisations of the Treadway Commission

funds, ie the competent body for dealing with irregularities and frauds in accordance with regulations governing this area.

(3) Submission of a report on irregularity and possible suspicion of fraud by employees of organizations in the Federation shall in no way affect their employment status and acquired employment rights, and an employee who submits information on irregularity and suspicion of fraud is guaranteed protection of integrity.“ (Zakon o finansijskom upravljanju i kontroli u javnom sektoru u FBiH, Sl. novine FBiH 38/16, p. 4),

Therefore, the head of the organization is responsible for managing the risks of irregularities and fraud, including a preventive and reactive approach, but all employees in the organization are also responsible for reporting suspected fraud. Regarding the body to which the report is submitted, the Law on FMC refers to the "competent authorities" bearing in mind the wide range of irregularities and fraud, and consequently the wide range of bodies to which the report can be submitted (different types of inspection bodies, prosecutors, corruption, etc.).

In addition to the Law on FMC, the Federal Ministry of Finance and Finance has published Standards for Internal Control in the Public Sector in the Federation of Bosnia and Herzegovina, which have brought public sector organizations, in the context of European integration, even closer to the requirements required by the COSO model. One of the requirements of the Standard is that "risk identification at the level of significant objectives and activities of users of public funds is performed in terms of internal and external risk factors, including the risk of fraud and corruption“ (Standardi interne kontrole u javnom sektoru u Federaciji Bosne i Hercegovine, Sl. novine FBiH 75/16, p. 59).

It can be seen from the above that the current regulatory framework in the field of financial management and control recognizes the risk of fraud as a ubiquitous and priority problem that needs to be constantly pointed out. However, the results of the annual self-assessment of the functioning of the FMC system indicate that the application of the above provisions is often only "on paper".

Sources of information on irregularities and fraud are very important for the detection of irregularities and fraud, regardless of whether the sources are external or internal. External sources of information are, for example, the Audit Office of the institutions in the Federation of BiH, commercial (external) external audits, budget inspection, citizens (through applications), NGOs, etc. On the other hand, internal sources of information are those based on employee reports, findings of internal audit, etc. where it is very important to have a transparent

system of action in case of suspicion of irregularities and fraud. In internal audit, this procedure is specified by applicable regulations in the field of internal audit.

The Law on Internal Audit in the Public Sector in the Federation of Bosnia and Herzegovina stipulates that one of the competencies of the head of the internal audit unit is to “inform the head of the organization if there are suspicions of irregularities and / or fraud that may result in criminal activities or violations for further action“ (Zakon o internoj reviziji u javnom sektoru u FBiH, Sl. novine FBiH 47/08, p. 6) and one of the internal auditor's obligations is to “inform the head of the internal audit unit if irregularities and / or fraud are suspected during the audit.“ (Zakon o internoj reviziji u javnom sektoru u FBiH, Sl. novine FBiH 47/08, p. 7)

The Methodology of internal audit in the public sector in the Federation of Bosnia and Herzegovina (Sl. Novine FBiH 13/12, 93/13, 93/15) also prescribes the following: „If the internal auditor suspects fraud during the audit, he terminates the audit process and notifies the head of the internal audit unit, who is obliged to immediately notify in writing the head of the organization who is obliged to take the necessary action and notify the competent authorities.“

Unlike the area of internal audit, as mentioned earlier, in the area of financial management and control, the obligation of employees to report suspicions of irregularities and fraud is prescribed, but this provision is not elaborated in detail, which obviously creates difficulties in its practical application.

Namely, in the event that an employee in a public sector organization during the performance of his work suspects a certain irregularity or fraud, it is necessary to have two key information at the very beginning:

- TO WHOM to report an irregularity or fraud and
- HOW to report an irregularity or fraud.

3. What do the data from the consolidated annual reports on the functioning of the system of financial management and control in the public sector in the Federation of BiH say?

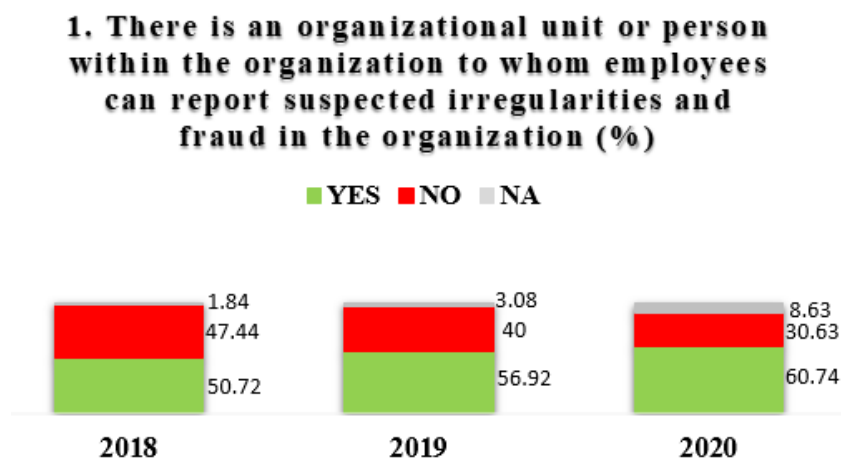
In 2017, the Federal Ministry of Finance-Finance published the Rulebook on the implementation of financial management and control in the public sector in the Federation of Bosnia and Herzegovina, specifying the method of reporting on the FMC system. (Pravilnik o provođenju finansijskog upravljanja i kontrole u FBiH, Sl. novine FBiH 6/17, 3/19). The

mentioned ordinance prescribes obligatory forms for annual reporting on the FMC system, through self-assessment and which consists of five parts according to the requirements of the five mentioned COSO elements. Within the segment "Risk Management", a part "Assessment of the risk of irregularities and fraud" is envisaged, in which public sector organizations are asked two questions:

1. Is there an organizational unit or person within the organization to whom employees can report suspected irregularities and/ or fraud?
2. Are there procedures in place to prevent and detect irregularities and fraud in the organization?

Below (Chart 1 and Chart 2) is an overview of the responses of public sector organizations based on data from the adopted Annual Consolidated Report on the Functioning of the FMC System for 2018, 2019 and 2020.²

Chart 1. Results in the field of risk assessment of irregularities and fraud, question 1

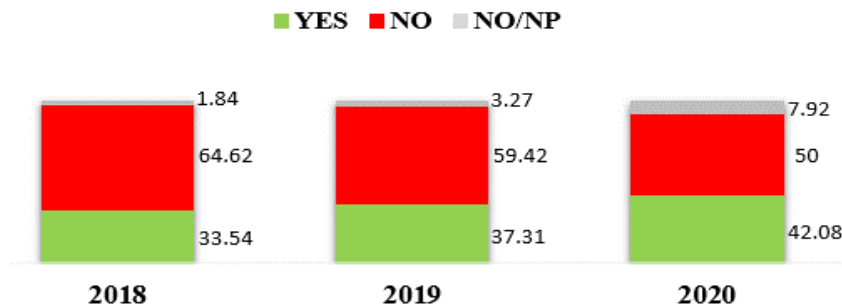


Source: Federal Ministry of Finance, CHJ Coordination Board (nd)

² Annual Report for 2018 was made on the basis of a total of 489 user reports, for 2019 on the basis of 520 user reports, and for 2020 on the basis of 568 reports

Chart 2. Results in the Risk assessment of irregularities and fraud, question 2

2. Procedures to prevent and detect irregularities and fraud are established in the organization (%)



Source: Federal Ministry of Finance, CHJ Coordination Board (nd)

These data show a rather devastating situation in public sector organizations, which in most cases are financed in whole or in part from the budget of the Federation of BiH, which is why they are expected to focus more on protecting public funds from irregularities and fraud.

However, the answers they gave in their self-assessments show that approximately half of the beneficiaries have an addressed organizational unit or person to whom employees can report suspected irregularities and fraud, and this percentage is even lower when it comes to the existence of specific procedures to prevent and detect irregularities and fraud. in organization.

Based on the data they provided, it is evident that a large number of organizations do not provide their employees with information on WHO or HOW to report suspicions of irregularities and fraud, which, without any doubt, makes it difficult to detect fraud in the organization. If an employee suspects fraud, it will be easier for him to decide to report it when it is clear to whom he should report and when there is a transparent and clear reporting procedure in the organization. Such a system in the organization encourages employees to act and work properly. Otherwise, if the employee does not know who to turn to, what will happen to his report and when it will end, it is more likely that he will decide to remain silent in order to protect himself. Such a work environment sends a message to its employees telling them to report irregularities and fraud are not welcome and can only harm them.

Therefore, it is very important that all public sector organizations establish a system of reporting suspected irregularities and fraud and develop procedures for action. They should focus on raising awareness of the risks of irregularities and fraud with a special focus on prevention and detection.

4. Steps to improve risk management of irregularities and fraud

Given the feedback from the practice we have, it is obvious that concrete steps must be taken to better address the risks of irregularities and fraud.

One such measure is the establishment of appropriate channels for reporting irregularities and fraud. Special telephone lines, anonymous surveys of employees, appointment of persons in charge of handling reports, etc. are possible measures available to public sector organizations.

Then, it is very important that the organization has procedures for dealing with reports of suspected irregularities and fraud. The purpose of such procedures is to provide detailed information on how applications are handled, to whom they are delivered and to whom they are forwarded, and what stages such a procedure takes. This type of procedure should be transparent and accessible to everyone (eg via the organization's intranet, bulletin board, etc.). The goal is to send a clear message to all employees that the organization has a system in place to report irregularities and fraud and encourages employees to use that system.

Cooperation of public sector organizations with the competent authorities for dealing with reports of irregularities and fraud is very useful, because it enables the exchange of relevant information with those authorized to conduct investigations, handle evidence, initiate and conduct certain procedures and even impose certain sanctions.

Separation of duties is a principle that requires mandatory application in the organization because it is an essential element of the system of internal controls for the prevention and detection of irregularities and fraud. The processes in the organization should be set up in such a way that the individual employee is not allowed to perform tasks without checking and supervision, because such a way of working provides room for mistakes and fraud.

We always return to the COSO model and its application is visible here: the organization should have a strong control environment, (eg clear and accessible codes of ethics, tone "from the top" to raise awareness of fraud and), manage the risks of irregularities and fraud and develop risk response plans based on them, strengthen control activities through the development of procedures for dealing with reports of irregularities and fraud, have an efficient system of information and communication from top to bottom of the structure and vice versa, horizontally and vertically, exchanging information and reports on irregularities and fraud in the organization and ultimately through assessment and monitoring through self-assessment and internal audit, re-examine and strengthen internal controls in the fight against irregularities and fraud.

5. Conclusion

One of the goals of financial management and control is to protect the organization from irregularities, abuse and fraud, especially when it comes to an organization that belongs to the public sector and uses taxpayers' money. The system of internal controls enables the prevention and detection of irregularities and fraud, if it is developed in the right way. The public sector organization in the fight against fraud should always develop two answers: TO WHOM to submit a report and HOW to submit a report, emphasizing the issue of responsibility: on the one hand the responsibility of management in terms of building an efficient system and sending a clear message to all forces, and on the other hand the responsibility of employees for reporting irregularities and fraud.

Given that there are a large number of public sector organizations in the Federation of BiH (estimated at over 2000), the optimal solution would be to further develop existing regulations and offer users concrete examples of good practice and examples of procedures for dealing with irregularities and fraud, with basic mandatory elements and space for individual customization to each user. In this way, it would directly affect the improvement of the system of internal controls in public sector organizations and enable more intensive action in case of suspicion of irregularities and fraud, all in order to protect public funds.

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Sažetak

Cilj rada je da približi postojeće stanje upravljanja rizicima kod nepravilnosti i prevara kod organizacija javnog sektora. Važeći propisi iz oblasti finansijskog upravljanja i kontrole u javnom sektoru u Federaciji Bosne i Hercegovine definišu pojmove nepravilnosti i prevara u okviru sistema internih kontrola u organizacijama javnog sektora, odgovornost rukovodstva i zaposlenih za prijave i postupanja po prijavama. U radu će biti prikazani podaci iz zvaničnih konsolidovanih izvještaja o funkcionisanju sistema finansijskog upravljanja i kontrole koji ukazuju na to da je upravljanje rizicima od nepravilnosti i prevara i provođenje radnji za sprečavanje i otklanjanje nepravilnosti i prevara kod korisnika još uvijek nedovoljno razvijeno. Biće analizirani mogući uzroci takvog stanja, te razmatrana moguća rješenja: razrade zakonskih odredbi i konkretiziranja pojedinačnih uloga u poduzimanju radnji protiv nepravilnosti i prevara.

Ključne riječi: finansijsko upravljanje i kontrola, sistem interne kontrole, nepravilnost, prevara