

## **INTERNAL CONTROL - MANAGEMENT RESPONSIBILITY**

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### **Abstract:**

*Internal control is a process designed, implemented and maintained by the management of the organization in order to provide reasonable assurance concerning the fulfilment of tasks that refer to the credibility of financial reporting, also to the effectiveness and efficiency of operations according with laws and regulations.*

*Internal control has the following general objectives: achieving at an appropriate level of quality the functions of the organization, established in accordance with its mission in terms of regularity, efficiency, economy and efficiency; protection of public funds, compliance with laws, regulations and management decisions; development and maintenance of systems for collecting, storing, processing, updating and dissemination of data and information, and also development and maintenance of information systems and procedures and periodic reporting.*

*Internal control system consists of policies and procedures designed to provide officers that are responsible for corporate governance and executive leadership, with reasonable assurance that the entity achieves its objectives through the strategies adopted.*

**Keywords:** reasonable assurance, internal control, efficiency, effectiveness, risk assessment, risk management, liability management, control instruments, objectives, internal control system.

**JEL Classification:** G34

### ***The role of internal control***

In our view, internal control is considered as a dynamic process that has specific responsibility for protecting the heritage assets of the entity and preventing and detecting errors, fraud, waste, abuse and poor management.

To ensure the functionality, internal control must be continuously adapted to changes inside the entity. A functional internal control provides assurance that the assets of the organization are safeguarded, that reports are reliable and accurately reflect the economic and financial situation of the organization.

In literature, internal control is defined as the process designed, implemented and maintained by the management and staff at all levels, in order to provide

reasonable assurance regarding the achievement of organizational objectives, relating to the application of instructions, heritage protection, and improving the quality of information activities.

In practice, internal control is held in the functional structure of an organization, including resources, systems, processes, structure, tasks and organizational culture and contribute to the objectives set, grouped as follows:

- effectiveness and efficiency of operations includes the organization's mission and objectives relating to the use, in terms of economy, efficiency and effectiveness of resources and resource protection objectives of the organization concerning misuse or loss.

- reliability of the information, includes the objectives concerning proper accounting and reliability of the information used in the organization and also the objectives of protecting documents against fraud.

- compliance with laws, regulations and policies includes the objectives that give assurance that the organization's activities are conducted in accordance with the obligations imposed by laws and regulations and those regarding compliance with internal policies.

For these reasons, internal control is a set of devices established by the management and implemented by managers at any level for performance evaluation activities. The devices must be implemented to provide assurance regarding the achievement of organizational objectives.

The design and practical implementation of an internal control system aims at decentralization of control activities towards the leaders of functional structures of the organization. This means that each leader, at his level, is responsible for establishing and implementing internal control that are necessary and appropriate for the functioning and achievement of activities they coordinate. In this way the management gains autonomy to achieve objectives, also transparency and accountability in revenue collection and efficiency and effectiveness in managed funds.

Developing a system of internal control regarding the organization own culture, meets international standards and best practice in the field. A system of internal control is characterized by the following:

- *full process*, internal control involves a series of instruments of control which are integrated into activities of the entity;

- *designed by management*, setting goals and responsibility regarding the establishment and operation of internal control monitoring. Management tools to plan and implement internal control, monitor and evaluate their functionality;

- *implemented by all staff*, operability of internal control is provided by the staff of the entity, what they do, each at his post. To be able to achieve internal control, personnel must know their duties, responsibilities and authority limits of the job;

- *in pursuit of the mission*, the organization was established to achieve a purpose and should be concerned, in particular, to fulfill its mission.

- *risk identification*, to carry out the mission of the organization, risks are encountered, that is why management is required to identify and manage the risks, to limit the probability of occurrence and keep them within acceptable limits.

- *provide reasonable assurance*, the design and implementation of a system of internal control does not give to the management of the organization an absolute assurance regarding the achievement of objectives, no matter how well is designed and implemented, but a reasonable assurance. This level of insurance is one of trust, being determined by the management, based on the inherent risks evaluations, and associated to the activities in a quantitative and qualitative manner.

- *objectives*, internal control contributes to the overall objectives of the organization, to the specific objectives established at the level of functional structures and also to the individual objectives, set per each job in the organization. The achievement of objectives is limited by the inherent limits that specific to any system of internal control.

The aim is to ensure consistency of internal control objectives, to identify key factors of success and to communicate to the organization leaders, in real time, the information about performance and prospects. Whatever the nature or size of the organization, the efforts to implement a satisfying internal control are related to applying the rules and procedures related to internal control at all levels.

### ***Internal control and risk management***

Risk is defined as the threat that an event or action will adversely affect the organization's objectives and also the successful implementation of strategies. This definition emphasizes that risk is a threat that has an impact on the achievement of objectives.

In these circumstances, an adequate internal control policy should provide reasonable assurance to the manager that objectives are met. For this reason, the organization should in advance conduct activities relating to: defining the objectives, process mapping, analysis and assessment of risks inherent to the process or the risks that could threaten the achievement of the objectives of the entity.

Risk management is the most important part of any internal control activity, as it identifies adequate internal control instruments based on risk analysis, and the implementation activities for the control devices are answers to risk management.

Recognizing the essential nature of risk management in internal control analysis resulted in the emergence of risk management concept, which requires the modification of leadership style and provide the basic conditions of effective internal controls that contribute to achieving the objectives in terms of effectiveness.

Risk management is a process conducted by management and all staff and aims to identify events that could affect the achievement of activities and objectives, a process that involves the identification, evaluation, risk control and reporting.

**Risk identification** is a systematic and ongoing process which identifies potential hazards within the entity. This process is necessary to know the risks that have not been seen previously, to know the circumstances of the identified risks and risk assessment which occurred in the past, but currently has no importance for the organization.

Risks must be identified at any level where there is danger on the achievement of the objectives and measures are required to implement the arrangement of control devices to reduce risk to acceptable levels and maintain them identifying the risks has the purpose to detect any possible risk factors and create the conditions for handling the risks and analyze them.

Risk management is the responsibility of general management, who must organize the internal control system and to empower the staff of the organization.

**Risk assessment involves evaluating** the probability of materialization of risks and their impact on the objectives. This can be done by evaluating the policies and processes for managing risk related to their adequacy by determining the limitations which generate risk, determining internal control deficiencies and creating devices to improve internal control and their implementation so as to ensure the expected results by implementing the objectives.

The purpose of risk assessment is to establish a hierarchy of risks inside the organization and function of risk tolerance, to determine the most appropriate ways to deal with them. Risk assessment involves the following steps:

- assessment of the likelihood of identified risk materialization;
- impact assessment objectives if the risk materializes;
- evaluating assessment as a combination of probability and impact

The ones responsible for risk should take into account that risk cannot be avoided and under these circumstances the only concern should be to keep risks within acceptable limits, tolerated by the organization and not to seek the total elimination of risk, because the action can lead to other unexpected risks.

**Risk control** has the aim to transform uncertainty into an asset for the organization, limiting the threat. Risk control activity involves:

- *tolerance of risk* is the level of risk that the organization is prepared to accept or to whom the organization is willing to expose itself at a certain point, namely the acceptable limits in which the risk manifests. All risks that have a level of exposure situated above the tolerance limit should be managed by control measures;

- *treatment of risk assumed*, means that, during the development of the activity that generat the risk, the control tools are established in order to decrease

the level of risk and keep it within acceptable limits. Control tools are designed to limit the probability that an undesirable result materializes and to correct the results if the risk has materialized.

- *risk transfer* is done in those cases in which implementation of control instruments do not lead to the limitation or decreasing the level of risk in such a way that the entity can manage it. In these cases the best solution is to transfer them to another organization.

- *stopping the activity implies* that some risks can be eliminated or kept within reasonable limits by reducing or eliminating the activities.

Risk management aims to identify and assess risks in terms of impact and likelihood of materializing and to determine appropriate ways of managing significant risks. Viable risk management solution is to find a balance between the risk we already tolerate and the risk we are prepared to tolerate.

Please note that the treatment risk can be achieved by applying the following control tools:

- *preventive control tools* that limit the possibility that an event occurs, such as segregation of duties;

- *corrective control tools* with which we correct undesirable outcomes of the materialized risks;

- *directive control tools* that aim to ensure achievement of results, and it is used to prevent an unwanted to take place;

- *detection control instruments* with which we identify hazardous situations that have occurred.

*Risk reporting*, means that risk management process is subject to periodic review with the help of which the warning mechanisms of management can warn future or already existing risks are established and also of the internal control functioning. Risk supervision is required to monitor the progress of the risk profile and ensure that the activity of risk management is appropriate.

**Risk Review** process ensures that all risk management activities are reviewed at least once a year and that mechanism for informing the management on the new risks or an changes to the assumed risks, are established. Review processes are implemented to examine whether: risks persist, new risks have emerged, the impact and likelihood of risks have changed, internal control instruments are effectively put into work, or if certain risks must be treated or transferred.

To ensure effective management of risk is important to examine how specific individual responsibilities fall within the general framework of the organization and if every employee properly understands, their role on risk management. If this is not achieved, risk management cannot be properly and homogeneously integrated into the organization.

Risk management does not mean eliminating or minimizing the negative results that risks could cause to the organization's activities but to limit the

occurrence of risks. The objective is to identify the size of the organization which is subject to risks, understanding the phenomena that maintain high levels of risks and identifying the causes that give rise to risks.

Analysis and evaluation of risk management activities allow the identification, the hierarchy and risk assessment in such a manner that the organization can control them. This hierarchy will support decisions on risk treatment options, as well as ensuring the continuous improvement of organizational performance.

***The requirements and the object of internal control implementation***

Implementation of an adequate internal control system is an opportunity to ensure the entity's performance, because it identifies failure and creates the best control devices. This implies a profound and collective thinking on the strengths, but also on vulnerabilities of the implemented processes.

Malfunctions or errors are due to failure in carrying out internal control tools or improper implementation. Officials in charge of building the internal control system create and develop tools for internal control to allow possession of a good control over the functioning of the organization and the completion of each activity or operation.

Internal control instruments vary from one organization to another, depending on the size, complexity and nature of the activities and the applicable legal rules. They can be grouped as follows: objectives, resources, information system, organization, procedures and control.

*The objectives* are customized according to the business and functions of the general objectives of the organization, precise and clearly formulated, contained in a policy and strategy document, approved and notified to all staff. Based on these general goals each person responsible for the management sets specific objectives in carrying out the department he leads, ensuring that they are realistic and fully consistent with the mission and duties department, distributed inside the compartment, measurable, ie expressed in quantitative or qualitative indicators, monitored through the existing information available to management and are provided with realistic deadlines for achieving calendar.

*The means* are all human, financial and material, taken in conjunction with the achievement. They must enable the objectives set.

*Information system* means all the processes, methods and tools used within the entity, leading to an organic whole of the operations of collecting, processing, systematization, transmission, recovery and storage of data and information. This system should be integrated within the organization, in the form of journals, whose construction should be based on ranking, correlation and sequential centralization of information and indicators used by management to their business managers.

*The organization* is a set of measures, methods, techniques, tools and operations that management established in accordance with certain principles, rules, standards and criteria, procedural and structural components of the organization to achieve objectives. Without proper organization there can be no control over activities within the organization.

*The procedure* describes the steps to be followed, established working methods and rules applied in the execution of activities, duties or tasks. They can be grouped into: operational procedures relating to legal procedures, decision-making procedure that relates to the exercise of judicial competence and procedure liability covering.

*Control* consists of measuring results with the indicators set goals, finding the underlying causes of deviations and take corrective or preventive measures of need. Depending on the type of cases, corrective or preventive measures may be forward looking in nature, organizational, coordination, training, evaluation or control. Exercise-control evaluation function implies that the organization would develop its own control strategy for limiting the risks that may cause unwanted deviations from the policies and objectives.

Internal control activities in general, policies, methodologies and procedures relating to the organization:

- separation of responsibilities in order to prevent fraud and error, that the responsibility for asset management, the approval process, operational activities of accounting tasks and functions of key information technology, functions related to users;
- approval of the operations and activities of the entity, namely the establishment of clear rules of general approvals for the specific;
- preparation and use of accounting documents in accordance with legal requirements;
- protection of storage assets through entities, managing and securing appropriate and adequate physical controls.

Internal control aims to reduce irregularities, fraud and ensuring sound management. This is achieved by ensuring an adequate level of quality consistent with the mission of the organization's tasks under conditions of regularity, efficiency, economy and efficiency and the development and maintenance of systems for collecting, storing, processing, updating and dissemination of data and information systems and appropriate procedures. In this context, the internal control requirements are:

- objectives, mastery and steering of business;
- ensuring financial transparency and efficiency of financial flows;
- strengthening internal control systems and financial management;
- providing management an effective tool to assist in observation of activities and to facilitate the achievement of objectives.

Organization of internal control conducted at the functional structure is the task of the manager, who has established responsibilities regarding the design, implementation, operation and its improvement. Internal control should concern any operation or transaction within the entity and perform the following functions: financial, compliance and performance.

The head of the organization report on the design, implementation, operation and performance level of internal control. Reporting is done on a statement that shows that have been implemented adequate systems of control that ensure the legality and regularity of operations and ensure policies and procedures developed at all levels of the organization: approvals, authorizations, verifications, reconciliations, performance review, security of assets and segregation of duties.

***Internal control- the responsibility of management and all- staff***

Overall and at all level management is responsible for internal control steering of the whole device, each in their sphere of competence, ensuring it is consistent and efficient as a whole and it covers the main risks.

Management shall be responsible for the implementation of internal control within the organization, meaning that it is required to establish adequate internal control policies and to regularly monitor its effective functioning of insurance. Must also ensure the effectiveness of internal control in risk management.

Line management is responsible for developing internal control policies in the organization of functional structures and to implement control activities arranged by the leadership of the organization, taking into account the following:

- determination of the control, activities that require the implementation of internal controls;
- internal control design tools suitable and appropriate manner of their implementation;
- implement proper internal control;
- verification of the adequacy and functionality of control and ensure that the control mechanisms are applied in full, according to necessity;
- maintaining and updating the controls, which is a continuous task and it must occupy first place in the management concerns.

A good implementation of internal control does not guarantee success, however, short-term approach and even less in the long term. The role of managers is to get all the personnel of the organization's adherence to internal control system development, through communication and training. Therefore, staff involvement is through direct participation in the design of internal control device, particularly in the diagnostic phase.

Control activities taking place within the organization ensures the achievement of the objectives and ensures compliance with predetermined operating procedures. Constraints and restrictions on control activities are designed

to ensure that the staff of the organization to fulfill its duties properly and are not aware of activities that exceed the limit of responsibility.

Managers have the responsibility to define the nature, degree of aggregation and data-collection period according to the objectives and level of responsibility. This requires increased attention to the number and relevance of indicators of activity and results.

Management involves the exercise of managerial responsibility of an organization, within the limits of internal and external constraints in order to achieve effective, efficient and in accordance with the law objectives, communication in a transparent way and responsibility for management failure.

Internal control device established by management should be constantly adapted to the strategy and objectives of the entity, to the working environment, to the activities and organization of the entity. Device must ensure permanence and durability of internal control and internal control device efficiency.

Internal controls should not, in time, become the exclusive concern of specialists. Management sets the controller to implement, but may delegate operational pilotage charge of internal control department. The remaining staff implements activities of control designed by management. However, managers must remain, at their level, key actors in the adaptation to the realities of a public entity and to diagnose regularly the processes which are responsible for regularly.

Preparing and making managerial decisions on improving organizational performance requires knowledge of the progress of implementation of previous decisions, but also functional status affected by the decision process. The relevance and applicability in real-time decisions, and monitoring their implementation, in a competitive environment requires a set of methods and techniques appropriate to offer the manager the possibility of complete information on economic and financial organization. Thus, internal control should be viewed in this context, managerial assistance as a tool to derive a picture of the reality of the organization as a whole.

General Manager and other persons occupying management positions in public entities are responsible for the creation and the operation of an effective internal control system to give reasonable assurance that objectives will be achieved. In this regard, it notes that implementation of internal control within the organization and adequacy of policies is the responsibility of overall management objectives, and providing management with regard to functionality and efficiency of the internal audit duties.

Internal audit is responsible and concerned with the organization of the system of internal control within the organization and assists staff in maintaining effective controls by evaluating their functionality and their continuous improvement.

At the same time, supervision and monitoring process involves ongoing assessment and regular reporting by the responsible of the correct application of internal control mechanisms in order to determine the strength and consistency and to implement new control devices where this is necessary. This process requires that each responsible to organize and run their own business, to establish specific tasks, supervise the work of subordinate staff to devise appropriate working methods and procedures and consistent information system on coordinated activities.

***Contribution to improving internal control performance in organizations***

Internal controls are all seen as contributing to security measures that contributes to having control over the organization and aims on the one hand, to ensuring protection of information quality, and on the other hand, promoting the application of guidelines to improve performance management.

In organizing the system of internal control based on the concept of managerial accountability there are the following prerequisites:

- The head of the organization is responsible for the organization and operation, under optimal conditions, the internal control system;
- the organization's internal control system based on checks and corrective measures, as well as internal evaluation and external evaluation;
- head of the organization is responsible for achieving the objectives of the entity;
- head of the organization may delegate his power, but is not relieved of overall responsibility;
- the employment of managerial accountability is achieved by ensuring adequate competence;
- accountability requires transparency and accountability.

Internal control covers all structures, methods, techniques and procedures by which management assures that the administration of property and funds are properly and effectively administrated. This implies a control environment and an appropriate culture within the organization, characterized by integrity, ethics, management style, management philosophy, organizational structure, ensuring accountability and authority, human resources policies and practices, personnel competence.

Efforts to develop and modernize the internal control system in accordance with industry standards are channeled to:

- harmonization of existing legislation with EU law and control of European and international standards in the field;
- ensuring effective implementation of the regulatory framework and the procedural;

- strengthening of internal controls to ensure prevention of irregularities and recovery of losses due to irregularities or negligence;

- developing and strengthening institutional capacity;

For these reasons, leaders of organizations take the necessary steps to prepare and develop internal control systems within their organizations. These measures mainly consist of: internal control system development, building structure responsible for monitoring, coordination and methodological guidance of the internal control system, development of operational procedures for activities, analysis and development of information on the operation and performance of the system of internal control, internal control system development.

Internal control standards approved by the inspiration COSO, define a minimum of rules of management and control, and aims at developing a uniform and consistent control system. They act as a benchmark against which internal control systems are evaluated, risk areas are identified and directions for improvement are taken.

Internal control is a set of device, that management has established and it is implemented by managers at all levels to control normal activities.

These devices are designed to provide reasonable assurance regarding the achievement goals of the institution.

Functional characteristics of internal control are as follows:

- shift from ex post concept, pro-active techniques, which ensures continuity of quality assessment of financial management and control systems;

- the organization to attain its objectives through systematic evaluation and maintenance at an acceptable level of risk associated structures, programs, projects and operations;

- ensuring the integrity and competence of management and executive staff, along with a knowledge and understanding of the importance and role of internal control;

- monitoring continuously, all activities and working properly, promptly and responsibly whenever breaches of the legality and regularity in conducting operations or carrying out activities;

- providing clear command relationships, execution, reporting and accountability;

- the system of preventing of internal control must meet the requirements of efficiency and effectiveness.

Internal control activities are even more effective as they are integrated into separate procedures, rather than overlap with current tasks, because they are not limited to verification operations made by managers on operations carried out by subordinates, but the checks and controls done at each position within the competences assigned.

The internal control system, existing in every public entity needs to be developed, refined to the level that allows management to having a better control over the functioning of the organization as a whole and over each activity in order to achieve objectives.

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