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INTERNAL/MANAGERIAL CONTROL – SUBJECT OF THE PUBLIC INTERNAL AUDIT

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Abstract: *The current article is intended to be a synthetic presentation of a comparison between the internal/managerial control and public internal audit, in an attempt to comprise similarities and differences, based on the premise that both functions used by the manager have the same general objective, namely the attainment of the entity's goals under conditions of economization, efficiency and effectiveness.*

Keywords: *audit, internal control, public institutions, risk management*

1. INTRODUCTION

We began our approach from the finding that, unfortunately, in current practice, the confusion between the concepts of internal control and internal audit still persists among military organizations. This confusion has been fueled by the frequent use of the term internal control instead of audit, and vice-versa, which introduced the idea that the two concepts are similar. Dealing with the persistence of such contradictory realities, Jacques Renard, in his book entitled "*The Theory and Practice of Internal Audit*" (p. 15), formulated the following explanations which we share in full, namely: *on the one hand, the audit is suffering from an excess of media coverage of the term "audit", and, on the other hand, internal audit is not always and everywhere called internal audit, being confused with terms like "inspection", "financial control", "internal verification", and "internal control".*

Therefore, even though both activities include elements that make them similar, there

are more features that differentiate them from the point of view of the concepts, the legal framework, the organization, the methodology, the use of findings and the way of reporting within the public entities.

2 DEFINING INTERNAL / MANAGERIAL CONTROL

The Romanian expression "control intern" derives from the English term "internal control", which received the most inappropriate translation, as it was not taken into account that, for the Anglo-Saxons, "to control" mainly means, "to own the control / to keep under control", and only secondarily "to check". In Latin countries it is exactly the opposite way. Consequently, the meaning of the expression "internal control" being much wider, it cannot be assimilated to a form of traditional inspection, verification or control, but it does not exclude it either. Therefore, in its widest acceptance, internal control is the

answer to the question “what can there be done to keep the best control of the activities?”

After the transition to the market economy, the control activities were fundamentally reorganized, and, step by step, there was a switch to a new system of control having a new basis and new tasks, a system which was flexible and efficient, focused on the risks for the institution and in support of the management. Thus, “since 1999, the following have been introduced in the Romanian control system by law: the concept of internal control and the concept of internal audit only for public institutions, which has imposed the need for the clarification of the concepts and practices in the field. Through this law, internal control is proposed in a European manner, meaning that only its general and specific functions are provided, the way of organization and exercise being settled by the general management of the public institution “[4].

The organization of the system of internal control is the task of the management of the institution which updates it continuously according to the evolving risks and the emergence of new situations within the institution. It has been gradually understood that internal control is a process and not a function and each activity must have its control component, which helps it be effective. Lately, the “control has evolved, and is still evolving, through continuous improvement of the organization and the management systems, as well as of the environment in which they work and which, in turn, is in continuous motion”[4].

The general objectives of the internal control are the following: to achieve, at an appropriate level of quality, the goals of the public institutions in accordance with their own mission, under conditions of regularity, efficiency, economization and efficacy; to safeguard public funds against losses due to error, waste, abuse or fraud; to respect the law, the regulations and the management decisions; to develop and to maintain some systems for the collection, storage, processing, updating and dissemination of financial and management data and information, as well as some systems and procedures for information.

The internal control, regarded as a manager’s activity, is a dynamic process, permanently adapting its tools and techniques to the cultural changes of the institution which are determined by the level of the competence of managers. It is not an end in itself, but a means created to support management processes through the use of specific procedures, techniques, and tools.

In accordance with the normative acts in force, internal control should be organized for each activity and must be made clear in formal written procedures, in the job descriptions, as well as in the regulations for the organization and functioning of the institution.

The activities through which the objectives (general, individual, and derived) are attained are transformed into tasks (basic components), responsibilities and functions (aggregate components) and are assigned to be carried out by the structural components of the public entity (positions and departments). This leads to the definition of an organizational structure which is appropriate to the objectives. The managerial control cannot operate in the absence of a plan and an organizational structure.[19]

The activities that are carried out in an institution can be divided into two categories from a procedural point of view: the procedure of execution and the procedure of management.

The execution procedure focuses on fulfilling the functional duties of the institution according to its established mission, while the management procedure focuses on managing the execution procedure well and on reaching the main aim of the institution. At the same time, the management procedure ensures the functioning of the institution and its success in the external environment, by using most of the management functions for: predicting, organizing, commanding, coordinating and controlling. Life has shown that managers do not think the same way, which also causes different attitudes in tackling and solving problems. There may be so big behavioral differences in management that the consequences of the attitudes can lead to totally different views on management.



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Along with governance and risk management, internal control is the third component of the governance of institutions. Good governance depends on risk management to understand the problems faced by the institution and by internal control in order to achieve its objectives.

The general requirements of internal control relate to: ensuring the fulfillment of the general objectives through systematic evaluation and maintenance at a level acceptable to the risks associated with structures, programmes, projects and operations; ensuring a cooperative attitude of the management and execution staff, the staff having the obligation to resolve requests of the management at any time and to entirely support the internal control; ensuring the integrity and competence of the management staff, their knowledge and understanding of the importance and role of the internal control; establishing the specific objectives of the internal control, so that they can be appropriate, comprehensive, reasonable and integrated to the mission of the institution and within its overall objectives; continuous supervision of activities by the management staff and the materialization of the obligation of the staff to act correctively, promptly and responsibly whenever there are infringements of the legality and regularity which apply to carrying out operations or activities at high costs, ineffectively or inefficiently.

The requirements specific to internal control relate to: the mentioning, in written documents, of the organization of the internal control, of all the operations of the institution and of all significant events, as well as the recording and preservation of the documents in an appropriate manner so that they are available at any time to be examined by those in power; immediate and correct registering of all significant operations and events; ensuring

approval and conduct of operations only by individuals with special training for these purposes; sharing the responsibilities for the conduct of operations by the same people, so that the approval, the control and the registration are appropriately assigned to different individuals; ensuring competent leadership at all levels; the use of resources and documents only by responsible and authorized individuals; the safety of resources and documents. The literature in the field reveals five functions of management, which is also regarded as the art of leadership. They are the following: predicting, programming-organizing, coordination, command-training and control.

The essential elements of the control in any institution are the following: purpose, engagement, monitoring, and learning. The control is made up of the elements of an institution, i.e. the resources, the systems, the procedures, the culture, the structure and the tasks, all of these collectively helping the people and fulfilling its objectives. The following concepts are important in understanding the nature of the control:

- the control is achieved by people from across the entire institution, including the board of directors, the management staff and other personnel (the individuals are responsible for the design, implementation, monitoring and protection of the control, which depend on many organizational factors that influence their behavior and motivation);

- the people who are responsible, individually or in a team, for the reaching of the objectives must also be responsible for the effectiveness of the control contributing to the attainment of these objectives (those people, managers or not, have a duty to assess the effectiveness of the control in terms of the tasks, the team or the unit for which they are responsible, as well as to communicate the

results of these assessments of individuals whom they must report to);

- the institutions are in a constant process of interaction and adaptation. To achieve effectiveness of the control, its elements within an institution must correspond to the objective; they must be consistent and systematically updated. This means that, if we want to change a particular aspect of the institution, we must also take into account what the consequences on the control would be;

- the control needs to provide reasonable assurance, not absolute assurance. Even when evidence of prudence and understanding is given, absolute assurance is not possible for two reasons, namely:

- ✓ firstly, there are inherent limits of the control which refer to the possibility of the appearance of errors of judgment in decision making, the malfunctioning due to human errors, secret agreements between personnel which may lead to failure of the control activities or can make the management staff to pass over the control. Control may reduce the number of errors and failures, but can provide absolute assurance that there will be none of them;

- ✓ secondly, we can and must take into account the cost-benefit balance when creating the control within the institution. The cost of the control must be judged in relation to the benefits, including the decrease of the risks involved. The decisions made when creating the control require the acceptance of certain levels of risks. Not even results or actions can be predicted for sure.

The assessment of the control necessarily involves an analysis, even if partial, of the administration of an institution. However, the control is not the only element of the administration of an institution and that is why it does not recommend the objectives to be settled but it favors the reliability in reaching them as it follows: it ensures the individuals responsible for monitoring and decision-making that they have accurate and reliable information which allows them to track the results of the actions or of the decisions and to report them; it does not interfere with making strategic and

operational decisions which will later turn out to be wrong because the decisions related to the course of action and to the way of taking action are administrative aspects, which are not part of the control.

3. DEFINING INTERNAL AUDIT

In 1941, *J. B. Thurston*, the first president of the International Institute of Internal Auditors, amazingly foresaw that the most brilliant prospect of internal audit would be "*the management assistance*". In 1991, *Joseph j. Mossis* – the president of the Institute of Internal Auditors of the United Kingdom - made the same remark, but in more precise words: "*it is clear to those who work as Internal Auditors that Internal Audit has a vital role to play, as it helps the management to take the reins of the internal control.*" [8]

Before the concept of internal audit gained stability, several definitions of it had succeeded each other throughout time.

The official definition of internal audit was adopted by I.I.A. in June 1999 and is as follows:

"The internal audit is an independent and objective activity which ensures the level of control an organization holds over operations, which guides it in improving operations and that contributes to adding extra value.

The internal audit helps the organization to attain the objectives by assessing, through a systematic and methodical approach, its processes of risk management, control and management of the enterprise, at the same time making proposals to enhance effectiveness" [8].

Additionally, the professional norms developed by IFACI (the International Federation of Automatic Control), define the internal audit as "*an independent and objective activity which ensures the level of control an organization holds over operations, which guides it in improving operations and that contributes to adding a plus of value*" [6].

In our country, at a first stage, the internal audit was defined by Law 672 of 2002 as "*a functionally independent and objective activity which offers assurance and counseling to the*



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management staff for the proper management of public revenue and expenditure while perfecting the activities of the public entity; it helps the public entity to carry out its objectives through a systematic and methodical approach which assesses and improves the efficiency and effectiveness of the management system based on risk management, control and administration procedures".

Later on, through the amendments by Law 191 of 2011, public internal audit is redefined for achieving coordination with international standards as follows: *"functionally independent and objective activity with the purpose of assurance and counseling and designed to add value and improve the activities of the public entity; it helps the public entity to fulfill its objectives, through a systematic and methodical approach, it assesses and improves the efficiency and the effectiveness of the risk management, of the control and of the governance procedures".*

Within the new approach, one can identify the basic direction of action of the internal public audit:

- assurance and counseling;
- adding value and improving the entity's activities;
- helps the entity to fulfill its objectives;
- improves the effectiveness and the efficiency of the risk management, of the control and of the governance procedures

This new approach expands the competence of the audit function on all the activities of the audited entity, but, at the same time, raises issues of competence and credibility of the auditors in carrying out the tasks.

This way, the function of audit is at the highest level of the entity - in *the area of management and governance*. This positioning creates special expectations from the audited

entity in terms of support for achieving the objectives. The function of *"error hunter"* of the audit can no longer be accepted as it must make its own contribution to attaining the objectives of the entity.

At the same time, the former action limitations induced by Law 672 of 2002 have disappeared. Law 672 of 2002 regards *"the proper administration of public revenue and expenditures, which perfects the activities of the public entity."*

The internal auditors and the manager must be considered partners and not adversaries, as they have the same objectives, including the effectiveness of management and to reaching the proposed targets. The managers must understand the recommendations of the auditors and welcome the aid they receive for the mastery of the continuously occurring and evolving risks. [5]

The way of organizing and functioning of the public internal audit includes both regularity (compliance) and quality, aiming at the functioning of the systems of management and of internal control as well as their performance (system audit and performance audit).

Additionally, according to the standards of the internal control, the internal audit involves three main activities for the proper understanding of its own function:

- the internal audit provides independent and objective assessment of the internal control system of the public entity;

- the internal auditor completes his actions through audit reports, which list the weaknesses identified in the system and make recommendations for overcoming them;

- the director/the manager has the necessary measures, in the light of the recommendations of the internal audit reports, to eliminate the weaknesses detected through the auditing missions.

4. THE RELATIONSHIP BETWEEN THE PUBLIC INTERNAL AUDIT AND THE INTERNAL/MANAGERIAL CONTROL

The internal control and the internal audit activities are two activities which approach totally different procedures and which include elements that make them similar but also differentiate them. The standards of good practice in the field highlight that each employee with internal control duties is responsible for his own internal control within the institution. The responsibility is to the management staff that has organized and implemented the control. To this respect, "internal control is found in the internal structure of each management function, of each activity and is the responsibility of each employee. Therefore, the organization of a distinct department within the institution is not recommended.

Besides own internal control, the management has other control responsibilities which can evolve, decrease or develop according to the risks existing in the department that coordinates it. [5]

The internal audit is intended "to assess and ensure the management regarding the level of functionality of the system of internal control, separately, on each form of its manifestation. [4] "If the original purpose of the audit was the detection of fraud, it has evolved in time so that it currently represents the functionally independent and objective activity of assurance and counseling of the manager of the public institution for proper risk management, internal control and management processes, but it does not assume managerial responsibility[7].

Internal audit and control activities within public entities are related to their management - the process of achieving organizational objectives through engaging and involving the four main functions: planning, organizing, training and motivating, and control. Both activities are organized and conducted in public entities, including public authorities, public institutions, national companies or

societies, autonomous public entities and commercial societies in which the state or an administrative-territorial unit is the major shareholder.

Unlike the internal control, the internal audit is an independent activity for objective assurance and counseling intended to add value and contribute to the improvement of the business of an entity, by supporting its objectives in a systematic and orderly approach to the assessment of the processes of risk management of control and governance.

The internal audit, unlike the internal control, is organized as a distinct structure subordinated to the general manager of the entity, being part of the functions of the enterprise.

A synthetic parallel between internal control and internal audit may be the following:

- *The internal control is integrated in the organization, while the internal audit is an independent structure;*

- *If the internal audit is organized at the highest level of the organization's management, the internal control is organized at each level of management;*

- *The internal control is a continuous process while the internal audit is a planned mission;*

- *The internal control states findings, settles responsibilities and watches over the improvement of findings, while the public internal audit states findings and issues recommendations and conclusions;*

- *The findings of the internal control are mandatory unlike the recommendations of the audit, which are optional ;*

- *If the results of the control are reported to the hierarchical superior and not to the highest level of management, the public internal audit has got its own way of reporting to the highest level of management.*

5. CONCLUSION

In conclusion we can say that the audit is not a type of control "disguised" in a different, more modern form. Its role is to be a



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correction factor for the adjustments required by the evolution of the entity, so as to ensure organizational efficiency.

The ultimate objective of the audit is to identify results and recommend solutions based on feedback from staff and managers. The audit also involves a systematic examination of the practices and policies implemented in an organization in order to highlight the gap between "**what is being done**" and "**what is necessary to be done**". This is achieved by identifying weak and strong points, as well as by identifying areas that you can improve.

It can also be concluded that the implementation of the control system within the institutions of the Ministry of Defense is the responsibility of the management of the institution, and that the monitoring of the functioning and the efficiency of the system is the task of the internal audit. Internal auditors and managers must be regarded as partners, not as opponents, because they have the same goals, including the effectiveness of management in order to achieve the proposed aims in terms of performance.

The internal audit will attain its objectives only if the system of internal control is well-organized, formalized and periodic, but also endowed with the most complete standards, procedures, guidelines and codes of professional conduct (not ethical codes). These are meant to support the audit morality, taking into account that the auditor must not be subject to any suspicion. The internal audit is considered to be the last level of the internal control system of the institution. It does not carry out activities or inspections, but it evaluates the internal control system and provides the general management with a perspective on its functionality within the institution.

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