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IMPLEMENTATION OF INTERNAL CONTROL SYSTEMS NECESSITY TO REDUCE THE RISK OF DENATURATION IN AUDIT

Florin BOGHEAN
"Ştefan cel Mare" University of Suceava, Romania
florin.boghean@usm.ro

Ioana Diana CHIHAI
"Ştefan cel Mare" University of Suceava, Romania
ioanach97@gmail.com

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Abstract:
Internal control is the process designed, implemented, and maintained by those charged with governance, management, and other personnel to provide reasonable assurance as to the achievement of an entity's objectives regarding the credibility of financial reporting, the efficiency and effectiveness of operations, and compliance with laws and regulations. The applicable regulations to identify and evaluate the risks of significant distortion by understanding the entity and its environment. In this research, we will highlight the elements of a risk-based internal control system that will bring benefits to an entity: efficiency and effectiveness of operations, the credibility of financial reporting, compliance with applicable legislation and regulations.

Key words: internal control, audit, risk management, corporate governance.

JEL classification: G38

1. INTRODUCTION

In practice, the concept of "corporate governance" should be seen as a process in which the organization is involved as a whole and refers to all component internal parts that work together and will ultimately be integrated into a single recognized governance structure 1992). Corporate governance is a concept with a broad connotation that includes the following elements (Shleifer, A., Vishny, R. W. 1997):

- the responsibility of managers for the accuracy of the information in the financial reports;
- the existence of deadlines for financial reporting;
- communication and total transparency on financial results;
- the transparency of internal audit, processes and external audit.

The word control comes from the Latin language, from the expression "contra roles" that means "checking a duplicate document after the original" (Ghiţă M., 2004). In the specialized literature we have other meanings, namely,:

- in the French-speaking sense "control is a verification, a careful inspection of the correctness of an act";
- In the Anglo-Saxon sense "control is the act of supervising someone, something, a thorough examination or the power to lead, as a tool to regulate a mechanism." (Marcel Ghiţă & al. 2009)

As a series of financial scandals occurred in the world in the 1990s, which highlighted the unethical and transparent behavior of those who ran large companies, the concept of corporate governance, which represents the mechanisms behind which a company is run and controlled. Many of the businesses of these organizations have had a global impact. Some of them have permanently destroyed confidence in bankers, the historic American financial center on Wall Street and the stock market.

In turn, the European Parliament refused to grant discharge to the European Commission for the 1996 Community budget and called for establishing a committee of independent experts to examine how this body detects and treats fraud, financial contracting practices, management defective and practicing nepotism. The report issued by the independent experts on March 15, 1999 led to the dismissal of the SANTER Commission the following day. It was time to acknowledge the crisis in the financial management of the Community budget and the lack of transparency and accountability of the Commissioners at the time. As a result, the new Prodi Commission, which followed the Santer Commission, initiated a series of reforms and published in March 2000 the "White Paper" on managerial reforms within the services of the European Commission, which is based on (European Commission, 2012):

- “service culture” within an organizational culture that presupposes the existence of responsible managers who fully assume their responsibilities and show total transparency;
- strategic planning and scheduling of activities by setting priorities, allocating and efficient use of resources;
- human resources development, through a new personnel policy;
- Financial management, audit and control are considered fundamental elements of the reform.

Internal control is increasingly seen as a solution to various potential problems due to its important goals, namely, (European Commission, 2014):

- keeps the company on track for profitability and mission achievement, minimizes surprises that arise during this objective and allows management to cope with rapid changes in the economy and the competitive environment;
- internal control ensures efficiency and effectiveness;
- reduces the risk of loss of assets;
- helps establish confidence in financial statements and
- Compliance with rules and regulations.

Internal control consists of all forms of control exercised at the level of the entity, including internal audit, established by management in accordance with its objectives and legal regulations, to manage resources economically, efficiently and effectively (Boghean F., 2019)

2. RESEARCH METHODOLOGY

The research performs an x-ray of good practices regarding the application of the internal managerial control system, for a healthy financial management, an integral part of good governance but also a basis of performance and management of integrity and compliance, with impact on reducing the risk of distortion in audit. The paper addresses qualitative research, descriptive and experimental studies on effective internal control systems as a premise for reducing the risk of distortion. The research starts from the premise that the realization of some syntheses regarding the internal control systems implemented in organizations can contribute to the improvement of governance and risk management processes.

3. THE BENEFITS OF THE INTERNAL MANAGERIAL CONTROL SYSTEM

In 1985, the American senator Treadway initiated a significant research on the issue of internal control, thus constituting the "Treadway Commission." Subsequently, a committee known worldwide as the "Organizational Sponsorship Committee" - COSO was created. (Committee of Sponsoring Organizations of the Treadway Commission). This committee was made up of several members of the Internal Audit Institute, professionals in the field, external audit firms and large American companies. The results of the research of this committee were published in a paper known as "The Internal Control Framework." This paper defines the concept of internal control, a problem that has aroused and still arouses controversy, given the differences in the translation of the

English term "internal control," which for Anglo-Saxons means first "control" and then "Check," while for French-speaking countries it is the first "check" and then "inspect."

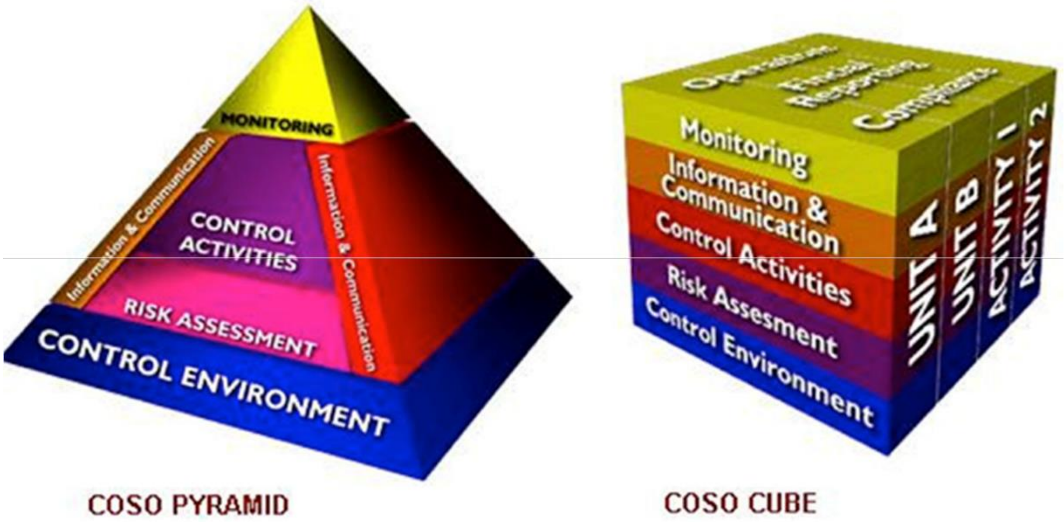

Chart no. 1. COSO internal control model
Source: www.coso.org

These components act to establish a foundation for sound internal control within the entity through well-oriented leaders, shared values, and a culture that emphasizes responsibility for control. The various risks faced by the entity are identified and assessed as routine activity at all levels and in all functions of the entity. Control activities and other mechanisms are proactively designed to address and reduce significant risks. The essential information for identifying the risks and for fulfilling the business objectives is communicated through established channels from the bottom up, from the top down and throughout the entity. The entire internal control system is constantly monitored and issues are addressed timely.

The fact that the resources available to a public entity are always limited, obliges the entity to make a comparison between the additional costs generated by the new internal control system and the benefits brought before it is implemented and developed. The construction and proper functioning of this process, which is a long requires collective and individual efforts, so that it can be adapted and possible to the specifics and dimensions of the public entity, but respecting the legal provisions and general principles of internal managerial control.

Internal managerial control is not just a general notion, a doctrine or many reports and tables to be completed but a set of effective tools through which an entity can be managed. Internal managerial control must be efficient, does not generate additional costs, lead to saving material, financial and human resources.

Internal control, no matter how it is designed and operated, can only provide reasonable and not absolute assurance that the entity's objectives are met. The probability of achieving them is affected by the inherent limits of internal control. This is due to internal and external factors that were not and could not be taken into account when designing (designing) internal control, such as (Mirela Paunescu, 2019):

- human errors: negligence, inattention, misinterpretations, errors of reasoning, etc.;
- abuse of authority manifested by some persons with leadership, coordination or supervision responsibilities;
- limiting independence in the exercise of official duties;
- frequent changes in the internal and external environment of the entity;
- inadequate control procedures;
- unadapted or adapted and unapplied control procedures;
- Internal control costs.

Among these inherent limitations of internal control we mention

- cost/benefit ratio: starting from the consideration that the cost of an internal control should not exceed the advantages that would result from its exercise.
- directing internal controls mainly to routine transactions and less to unusual ones.
- the probability of human errors due to negligence, inattention, misunderstanding or misinterpretation of legal norms and instructions received;
- the probability of evading internal controls because of secret agreements between a member of management and an employee, with persons outside or inside the organization;
- the probability of an abuse by a person responsible for the application of internal control.
- the probability that some procedures, due to the change of certain conditions, become inappropriate.

In practice, it has been proven that managers at all levels, especially those without formalized procedures or if they are not updated, usually do internal control without realizing it. Thus, each person in charge, wherever he is, organizes himself to lead his activity through

- defining the tasks of each,
- establishing work tools and techniques,
- professional training,
- endowment with electronic equipment and systems,
- Supervising the activity of the staff, etc.

Practical experience has shown that the entity changes gradually over time, so it is necessary for management to constantly supervise and monitor the evolution of internal control mechanisms.

4. REQUIREMENTS FOR THE DESIGN AND IMPLEMENTATION OF A VIABLE INTERNAL CONTROL SYSTEM

All companies, regardless of size, must face risks at all levels. Management must determine how prudent it is to accept and strive to maintain risks at those levels. Setting goals are to prerequisite risk assessment. Although not a component of internal control, it is a requirement to allow internal control. Financial reporting objectives are based on the term of credibility, which implies that they provide a true and fair view in accordance with the general financial reporting framework adopted - this is the basic object of financial reporting (Court of Accounts, 2011).

For example, controls that prevent asset fraud - such as maintaining a fence around assets and a person in charge of verifying authorization to move goods - fall into the operational category. These controls are not normally relevant to the financial reporting objective because any losses would be detected during inventories and reflected in the financial statements. However, if for financial reporting reasons management relies solely on permanent inventory, such as for interim reporting, physical asset security controls will also fall into the financial reporting category because these controls, along with inventory records, will be permanently needed to ensure the credibility of financial reporting.

Risk identification is an iterative process and is often integral to the planning process. It is also useful to consider the risks starting from a "white sheet of paper" and not only starting from the review of known risks. The risk management process involves (Dănescu Liliana, Prozan Mihaela, 2020):

1. identifying the risks related to the objectives of the institution, including those due to internal and external factors, at the level of the institution and at the level of activity.

2. risk assessment:

- estimating the significance of risks;
- Assessing the probability of occurrence of risks.

3. evaluation of the inclination/disposition (degree / level) of acceptance of some risks by the management of the institution;

4.creation of responses/determination of actions to be taken:

- four types of risk responses must be considered: transfer, tolerance, treatment or termination. Of these, risk management are the most relevant, as effective internal controls are the main risk management mechanism;
- appropriate controls that can be introduced to avoid risks can be screening or prevention

The use of automated information processing systems introduces several risks that must be considered by the institution. These risks arise, among other things, from

- uniform processing of transactions;
- computer systems that automatically initiate transactions;
- increased potential for undetected errors;
- the hardware components and software used;
- Recording of economic operations that are unusual or not frequent (routine).

For example, a risk inherent in the uniform processing of operations is that the error resulting from computer programming problems will occur systematically in similar operations. Effective information technology controls can provide management with reasonable assurance that the information processed by its information systems meets the intended control objectives, such as ensuring the completeness, timeliness and validity of the data and maintaining its integrity. Information systems involve special types of control activities. The information system includes, in a broad sense, information both from the entity and from outside it, and these can be processed either manually or automatically.

Information quality - affects the ability of management to make the right decisions. The reports must contain sufficient and adequate data to support the control effectively. The quality of information includes assertions whether (KPMG, 2009):

Is the content adequate - Is the information needed there?
Information is on time - Is it when needed?
Information is current - Is it the latest available?
Is the information correct - Are the data correct?
The information is accessible - Can it be easily obtained from the appropriate parties?

Managerial responsibility implies responsibility for good financial management and performance at all levels of an entity, respectively, for all five components of internal control. This also means that managers must report on the actions taken and decisions taken to meet the objectives of the entity they lead.

5. CONCLUSIONS AND PROPOSALS

Internal control is a process performed by the board of directors, management and all staff of the entity, designed to provide reasonable assurance about the achievement of the organization's objectives, given the efficiency and effectiveness of operations, credibility of financial reporting and compliance with applicable laws and regulations.

Internal control should not be a separate component of the entity, but a process integrated into its activities and culture, in which all its employees are involved (from management to employees), a dynamic process that continuously adapts to the changes it undergoes. The organization. An effective internal control system reduces the likelihood of failure to achieve objectives, providing management with only reasonable assurance, not absolute assurance.

The components of internal control are the control environment, risk assessment, control activities, information and communication and monitoring. The control environment can be considered an umbrella that houses all other components, including personal, professional integrity, general attitude and ethical values of management and the measures taken by it, as well as by those in charge of governance regarding the internal control system and its importance within the entity.

Risk assessment plays a key role in selecting the appropriate control activities that will be implemented at the entity level. In short, the risks are associated with objectives defined and assumed by management, to be subsequently identified and evaluated, so that for the most significant of them to choose the most effective controls.

Control activities are the policies and procedures implemented by management, at all its levels, to address risks to achieve the entity's objectives. Depending on when it is applied, internal control activities can be preventive or detection. Depending on their nature, they can take many forms, such as authorization, performance review, task separation, verification, reconciliation.

Information systems are responsible for processing and reporting internally generated and externally generated data and play a significant role in the management of the company, as the quality of management decisions depends on them.

Management monitoring of controls involves assessing the extent to which they operate intentionally and may consist of ongoing checks or evaluations (internal or external) at some point. Although all employees and all persons in the management of the company must be part of the internal control, each of them can play, depending on the specific position and responsibilities, a specific role. For example, the responsibilities are different for those on the audit committee, the CFO or the person in charge of the internal audit.

The objective evaluation of the stage of the internal managerial control system, both at the level of the department and at the level of the public entity (including those subordinated, under coordination or under authority) is critical as it involves taking concrete measures, transposed in the Development Program. The internal managerial control system; the identification, following the evaluation, of possible non-conformities, may lead to the assumption of new specific objectives at the level of the compartments.

A permanent problem identified at the level of public entities is the lack of qualified human resources, but also the staff turnover, which sometimes creates deficiencies during the implementation process and development of the internal managerial control system.

The main limitation of our study is the lack of completeness, namely, the focus on a small number of cases and organizational situations. However, we believe that writing can be considered a solid basis for future research.

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