Annals of the „Constantin Brâncuşi" University of Târgu Jiu, Economy Series,
Special Issue/2015 - Information society and sustainable development

THE INTERNAL CONTROL MODELS IN ROMANIA

TEODORESCU CRISTIAN DRAGOȘ
PHD LECTURER, FACULTY OF ECONOMIC STUDIES,PETROLEUM-GAS UNIVERSITY, PLOIESTI, ROMANIA
teodorescucristian@teron.ro

Abstract
Internal control is indissolubly linked to business and accounting. Throughout history, domestic and international trade has grown exponentially, which has led to an increasing complexity of internal control, to new methods and techniques to control the business. The literature has presented the first models of internal control in the Sumerian period (3600 - 3200 BC), and the emergence and development of internal control in Egypt, Persia, Greek and Roman Empire, in the Middle Ages till modern times.

The purpose of this article is to present the models of internal control in Romania, starting from the principles of the classical model of internal control (COSO model). For a better understanding of the implication of internal control in terms of public and private sector, I have structured the article in the following parts: (a) the definition of internal control in the literature; (b) the presentation of the COSO model; (c) internal control and internal audit in public institutions; (d) internal control issues in accounting regulations on the individual and consolidated annual financial statements; (e) internal / managerial control; (f) conclusions.

Keywords: *internal control,COSO model,internal audit,managerial control*

JEL Classification : *H83, M10, M42*

1. The definition of internal control in economic literature.

The definition of internal control according to COSO (Committee of Sponsoring Organizations) in 1992 was the first major attempt to define the internal control. In accordance with the " Internal Control – integrated framework " document, issued by COSO, the internal control is " a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives of the following categories:

1. Effectiveness and efficiency of operations;
2. Reliability of financial reporting; and,
3. Compliance with applicable laws and regulations.

Richard Brown and Willard E. Stone described in their works the internal control‘s evolution in different historical era.

The term control was used in accounting books in the early 20' (Kester, 1922, pag.4), designing in fact administrative internal controls. In 1939, an accounting work describes the internal checking like a method to perform a mutual control between employees (Kester, 1922, pag.241).

In Romania, after1989, a first definition of internal control is given by Government Ordinance 119/1999 on internal audit and financial control, which defines at art.2 (i) the internal control as "all measures taken at the level of public institutions on organizational structures, methods, procedures and systems for monitoring and evaluation, set up to: achieve tasks at a appropriate quality level and meet regularly, economically, efficiently and effectively adopted policies ; compliance with the law and the management decisions; safeguarding of assets and resources, conduct and maintain accurate and complete accounting records, the timely delivery of accurate and complete information for management decision making. "

The Law No. 672/2002 on public internal audit (Official Gazette no. 953/2002) presents a more concise definition of internal control in comparison with the definition given by the Ordinance119/1999. The internal control is "all forms of control exercised at public entity, including internal audit, established by management in accordance with its objectives and legal regulations in order to provide fund administration in an economically, efficiently and effectively manner; also includes organizational structures, methods and procedures ".

2. The presentation of COSO model.

The internal control is "a process, affected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance"

The COSO model has 5 essential pillars: control environment, risk assessment, control activities, information and communication, monitoring activities.

The control environment is defined by COSO as "the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization" . It is well known that the control environment is influenced by the integrity, ethical values and behavior of employees, the management style, the assignment of authority and responsibility, the organizational structure. In a small company, the impact of management actions is significantly more powerful than in the big ones, because it is assumed that the owner has a direct contact with employees more often than the management of a large company.

The risk assessment is defined by COSO as " a dynamic and iterative process for identifying and assessing risks to the achievement of objectives " . Every company is subject to risks, whether they are internal risks (regarding the organizational activities) or external.

The control activities are defined as the actions established through policies and procedures that help ensure that management's directives to mitigate risks to the achievement of objectives are carried out.

There is a high diversity of control activities, depending on the entity, organizational culture, organizational structure, the number of activities, and the production structure. The most common activities are authorization, verification, reconciliations, segregation of duties and IT controls.

The fourth element of COSO model is information and communication. COSO defines communication and information as policies to carry out internal control responsabilities to support the achievement of its objectives. The communication must go in both directions:from the management to employees, and from employees to the management. Management should send a clear message to employees in supporting effective internal control, in communication of responsibilities of each employee on internal control, in participation in specific trainings.

Monitoring is defined as "ongoing evaluations, separate evaluations, or some combinations of the two used to ascertain whether each of the five components of internal control is present and functioning ".

The major change to the business environment, the globalization of economies, new technologies and legislative changes over the last 20 years have led to an update of the 1992 COSO model. Appeared in 2013, the updated document of the integrated internal control framework preserves the internal control's definition and maintain its 5 elements. .

The updated framework includes improvements and clarifications designed to help users in applying it. The revisions refer to: 1) broad based changes; 2) changes of the framework overall; 3) changes of internal control's elements.

The framework contains 17 principles who explain more detailed the 5 components. These principles can be applied to all organizations, private or state owned. In the same time the financial reporting was extended to nonfinancial entities, and new types of reporting occurred (sustainability reports).

3. The internal control and the internal audit in public institutions in Romania.

Law no. 672/2002 on internal audit and Government Ordinance no. 37/2004 (amending and supplementing regulations on internal audit) regulated the internal audit at public entities regarding the formation and use of public funds , the public property management, as an independent and objective functional activity.

In our country the legal requirements provide the following types of audits: 1. the system audit - provides an assessment of depth of management and internal control systems in order to determine whether they operate cost effective and efficient for identifying weaknesses and making recommendations for their correction; 2. The performance audit - examines whether the criteria for implementation of the objectives and tasks of the public entity is correct in evaluating the results and assess whether results are consistent with the objectives; 3. the regularity audit - examining the financial effects of actions on public funds or public property, in terms of overall compliance with the principles, procedural and methodological rules that apply to them. The overall objective of internal audit in public entities is to improve their management and can be achieved mainly by insurance activities and counseling activities designed to add value and improve the governance processes of public entities.

In terms of structural internal audit is organized into four hierarchical levels: a) the Committee for Public Internal Audit (CPIA) b) The Central Harmonization Unit for Public Internal Audit (CHUPIA); c) audit committees; d) internal audit departments of public entities.

The legal regulations establish a clear methodology for conducting internal audit mission. Starting with the 3 years plan, there is an assessment of the annual plan, the internal audit mission is established and the preliminary steps are leading - drawing the information frame addressed to the management of the public entity and the notification of triggering the public audit mission that is transmitted to the audited entity. The audit mission had four stages:1)

Preparing the internal audit mission;2) the intervention stage;3) the internal audit report;4) follow up the recommendations. All these stages have specific procedures and specific documents prepared by the auditor.

The concept of internal control was introduced in Romania by the Romanian Government Ordinance no. 119/1999, which took over the internal control models (COSO, CoCO) and adapted the generally applicable principles to the specific conditions of Romania. Since then, the concept of internal control performed in accordance with the socio-economic realities and the definition identified new approaches and improvements.

Following the occurrence of internal audit, the definition includes the internal audit as a form of control available to the public entity. The definition covers all aspects of a public institution, noting that the internal control is now managerial, leading to the idea that it is a public institution management tool available for carrying out its functions in accordance with its mission, in terms of regularity, efficiency and compliance with legal regulations. Both laws mentioned the preventive financial control (PFC) as an important form of control available to the management of the public institution. The preventive financial control is exercised over all operations that affect public funds and / or public assets. The person exercising the PFC receives the documents, records them in the special register, then proceed to formal verification by completing the checklist specific to the operation received the visa on: completing documents according to their content, the existence of authorized signatures from the specialized compartments and the existence of supporting documents according to the operation. If these operations satisfy the requirements of legality, regularity and framing into the approved budget the PFC visa shall be granted by the person authorized to do so, after which the operations are approved by the management of the public institution.

4. Internal control issues in accounting regulations on the individual and consolidated annual financial statements

The internal control is present in the work of companies and national companies, autonomous administrations, NGOs. The legal framework is the MPFO 1802/2014 approving the accounting regulations on the annual individual and consolidated financial statements, which replaced MPFO 3055/2009.

The order presented in chapter 11 called "internal control the internal control objectives, its purpose, requirements and the methods. the regulations sets out the general objectives of the internal control , such as compliance with legislation, application of management decisions, reliability of accounting information, the effectiveness of the entity's operations, efficient use of resources - which are found in one form or another in the laws and orders described above. A new objective shown in art.566 (1) is to prevent and control the risks of failing to meet targets. In this respect there must be a system to identify the main risks of the entity and to analyze them in order to minimize them. These actions are based on a set of procedures for identifying and managing risks. In this respect I believe that to achieve the desired results in the risk management an entity requires to seek internal audit, which has among its objectives the risk assessment.

5. The internal managerial control

The internal control is a form of control and a managerial function of the management of the public institution. The implementation and improvement of control systems has been a major concern of the Romanian public administration before the accession of Romania to the European Union. Internal control was regulated in the public institutions by MPFO 946/2005 approving the Internal Control Code, including 25 management standards / internal control to public entities and for the development of managerial control systems.

Standards are minimum management rules implemented by each public institution, being the reference system with respect to assessing the internal control system of the public institution.

Based on the essential elements of the COSO model, the Ministry of Finance defining the key elements of our internal managerial control: control environment, performance and risk management, information and communication, control activities, audit and evaluation.

The managerial control systems, together with internal audit and centralized coordination and harmonization of these components are the pillars of public internal financial control system.

The management of the public institution has the main responsibility in implementing internal managerial control strategies, while internal audit evaluates the optimal functioning of the internal managerial control system. MPFO 946/2005 provides the creation, by internal decision, of a structure for monitoring, coordination, methodological guidance of implementation / development of internal managerial control system.

This structure should not be organized as an independent one (division / office / department) within the institution, including employees and can't be outsourced to third parties. These two situations can lead, according to the Court of Accounts in assessing internal managerial control as nonconforming, given the express provision of Chapter VI, art.457, paragraph 3 of the Regulation on organization and functioning of the Court of Auditors - "Operation of internal control function is not assigned only to a specialized department within the entity or to a person outside the entity".

6. Conclusions

Analyzing the concepts presented above, I noticed that definitions shown are not contradictory, but converge to similar objectives and components, which in their implementation by persons from all organizational levels lead to the achievement of the objectives and to an adequate and effective control of organizatio's activities.On the other hand,for internal auditors and financial auditors, evaluating internal control is an important step in the engagement with major influences on the development of the audit plan and tests to be carried out. For managers a formalized internal control system, integrated to the general management, based on legal procedures and regulations leads in achieving the organization's objectives in an economic, effective and efficient way.

7.Bibliography

[1]. Richard Brown, A History of Accounting and Accountants (Edinburgh: Jack,1905), pag. 21; pag.29-40
[2]. D’ Aquila Jill– COSO’s Internal Controls - integrated framework, The CPA Journal, Octomber 2013, pag.23
[3]. Grady Paul, "The Broader Concept of Internal Control," The Journal of Accountancy (May, 1957), pag.41.
[4]. Kester, Roy B, Accounting Theory and Practice, 2nd Edition. (New York, New York: The Ronald Press Company), 1922. Pag. 4, 5.
[5]. Kester, Roy B,Principles of Accounting, 4th Edition. (New York, New York: The Ronald Press Company), 1939, Pag. 241.
[6]. Most Kenneth S., "Accounting by the Ancients," The Accountant (May, 1959), pag. 563.
[7]. Stone Williard E., "Antecedents of the Accounting Profession," The Accounting Review (April, 1969), pag. 284 - 286
[8]. Wilkins Anne M. & Haun Amie L, Reframing the Discussion on Internal Control, CPA Journal, Octomber 2014
[9]. Compedium of the public internal controls systems in the EU Member States, 2012, pag. 224- http://ec.europa.eu/budget/library/biblio/publications/2011/compendium_27_countries_en.pdf
[10]. ***http://www.curteadeconturi.ro/Regulamente/Hotarare_nr_155_2014_Curtea_de_Conturi.pdf
[11]. ***http://www.coso.org/documents/coso%202013%20icfr%20executive_summary.pdf
[12].***http://friedmanllp.com/insights/maintaining-effective-internal-control-over-financial-reporting--its-the-law
[13].Institute of Internal Auditors - https://na.theiia.org/about-us/about-ia/Academic Relations Documents/Life as an Internal Auditor.pptx
[14].***http://www.intosai.org/fileadmin/downloads/downloads/3_committees/4_goal4/FAC_TFSP_OECD_Partners_Good_Governance_Mapping_Role_SAI.pdf
[15]. OGR 119/1999, MO nr.430/1999
[16]. OGR 119/1999 , modificată și republicată în MO nr.799/2003
[17]. LEGEA 672/2002, republicată in MO nr. 780/2011
[18]. OMFP 1802/2014 privind reglementările contabile privind situațiile financiare anuale individuale și consolidate
[19]. OMFP 946/2005 pentru aprobarea Codului controlului intern, cuprinzând standardele de management/control intern la entităţile publice şi pentru dezvoltarea sistemelor de control managerial