

ASSESSMENT OF THE INTERNAL CONTROL SYSTEM

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***Abstract:** The auditor is interested to know the internal control system in an entity to assess the manager's attitude towards internal control and knowing the manner in which managers perceive the importance of internal control. Activity continuity is the overall objective of the internal control system.*

The manager's role is to create adequate internal control mechanisms to manage risks as they arise both from internal and external sources, due to economic, legal and operational changes.

Internal control mechanisms reduce errors and malfunctions, giving a reasonable assurance to the entity's management that the set objectives will be achieved, but they cannot provide an absolute assurance that they will not occur.

In order to obtain sufficient and thorough evidence after developing the audit procedure, the auditor should understand and know well enough internal control.

***Key words:** assessment, internal control, audit*

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The public entity must develop an assessment and verification program/ plan of the operation of its own internal control. The assessment of the effectiveness and efficiency of internal control will either refer to all the objectives of the public entity, or only to some of them. Each compartment leader must perform, at least once a year, verification and a self-assessment of the internal/ managerial control subsystem established at this level.

Assessment consists of:

- critical analysis of specific internal control instruments already implemented, in order to ascertain to what extent they are effective in mastering those risks and to make the necessary corrections;
- design and precise definition of the specific internal control instruments that need to be implemented.

Assessment is the managerial function that involves comparing results with objectives, finding the cause of major deviations (positive and negative) and taking corrective or preventive measures.

The ensemble of actions, policies and procedures that ensure the achievement of an entity's objectives and necessary measures to cope with risk represents the Internal Control System.

All forms of control exercised in a public entity, including internal audit, which are established by management in accordance with its objectives and legal regulations in order to ensure the administration of funds economically, efficiently and effectively, represent internal control.

Regarding internal control we can conclude the following:

- internal control is given by the policies and procedures which ensure that the given objectives are fulfilled;
- internal control is an ensemble of devices implemented in an entity by the official at all levels to have control over the operation of the business;
- internal control is a means to accomplish a goal and not a goal itself;

- internal control includes both procedures and policies, as well as the people at every level of the entity, aiming to obtain a reasonable assurance regarding the achievement of proposed objectives;
- internal control is not achieved by a certain specialized control structure of an entity, but it is a dynamic progress achieved by all the entity's personnel.

Considering these aspects, internal control is influenced by the motivation and behavior of persons within the entity.

The persons responsible for achieving the objectives of an entity are also responsible for the effectiveness of internal control that contributes to the achievement of those objectives. To achieve these objectives is performed an assessment of the effectiveness of internal control and the results of the assessment are communicated to the persons that have to report them.

The entity where an internal control is carried out is in a constant process of interaction and adaption to the changes from the internal environment, as well as from the external one. If we talk about the external environment we refer to business partners, normative acts, public, and others; if we talk about the internal environment we refer to persons, objectives and so on.

Internal control is effective when its elements correspond with the objectives of the entity, which must be consistent and evolving. Therefore, when the modification of an objective is intended, the effects over the internal control should be considered.

Internal control will not provide absolute assurance, only a reasonable one.

An effective internal control system reduces the probability of not achieving the objectives; however there is always the risk of malfunctioning of the internal control system as it depends of the human factor. Its design faces constraints regarding resources, organizational change and management attitude that can have a profound impact on the effectiveness of internal control. Assessing the effectiveness of internal control requires proper documentation, direct and relevant questions, observation of the process and techniques underlying the control and evaluation of the self-assessment results.

Internal control cannot provide absolute assurance because there are inherent limitations of internal control related to the possible emergence of: some errors of judgment in making decisions; dysfunctions due to the human factor; secret agreements between the entity's employees and so on.

These inherent limitations of internal control lead to failure of internal control activities. Internal control reduces errors, malfunctions, but it cannot provide absolute assurance that they will not occur.

An internal control is effective when it involves maintaining a balance between: autonomy and unity, aiming the transition from centralization to decentralization, from constraint to granting freedom of actions; conservatism and flexibility, aiming at increasing efficiency in terms of coherence and adaptability to changes.

An effective internal control contributes to the success of an entity in different ways, namely:

- orients people that manage risk of inappropriate actions;
- ensures persons to use their own creativity, expressing their opinions;
- people knowing the risks have the necessary flexibility to adapt to change;
- allow people to have reliable and timely information;
- through increased efficiency and efficacy, the entity increases the confidence of third parties in it.

The purpose of control is to increase the efficiency and effectiveness of the activity carried out within an entity.

The internal control's assessment varies depending on the domain and their frequency depends on the significance of controlled risks and importance of controls in reducing risks.

The best time for the assessment of internal control is when everything goes "smoothly". The worst time is during or after a crisis. A crisis tends to distort the normal perspective and therefore the results will be ineffective.

The manager must ensure continuously the verification and assessment of the operation of the internal control system and its elements. The malfunctions or other problems identified regarding the operation of the internal control system must be solved operatively by corrective measures.

As a result, continuous verification and assessment are incorporated into normal activities determined by the entity's operation. Verification and assessment include regular management and supervisory activities and other measures taken by the personnel in the fulfillment of tasks. They are carried out continuously and in real time, dynamically adapt to changing conditions and are integrated in the activities of the institution. Also, verification and assessment cover each component of internal control and involve measures to correct unsystematic, unethical, uneconomical and inefficient internal control systems.

Assessing the effectiveness of control may relate to specific and/ or circumstantial requirements, either to all the objectives of a public entity, or to some of them, the manager makes this decision. Internal control cannot ensure the achievement of general goals.

Control risk is a component of the audit risk. That is why financial auditors should assess control risk, because an effective internal control reduces the amount of planned audit evidence.

For the assessment of the internal control system present interest the entity, managers, as well as auditors. The general objective of the internal control system is business continuity. From the general objective derive specific objectives, which can be grouped in the following categories:

- operational objectives meant to ensure: efficient use of assets, resources, and protection of assets against losses;
- informational objectives that allow timely preparation of reports required in taking decisions by the Board of Directors, management, personnel;
- compliance objectives, by which is pursued the assurance that the activity is conducted in accordance with: normative acts; internal regulations; supervisory requirements; policies and internal procedures.

The internal control system must be designed and organized as to provide: rules governing the entity, to have a better control over it; the proper way of organization of each employee for better administration of the activities assigned.

Internal control is not an ensemble of statistic elements, but a dynamic process that involves all levels of management, aiming to obtain a reasonable assurance that the entity's activities will be achieved. Organizing an internal control system that ensures a perfect operation is very expensive and therefore unpractical, that is why the objectives of the internal control are relative and non-absolute, aiming to obtain reasonable assurance.

The objectives of internal control are to ensure that things are done properly, on the one hand, and on the other hand identifies malfunctions within an entity, respectively the things that are not done properly.

Internal control includes all activities that are conducted in an entity, namely those related to the accounting system, as well as other activities with impact on the entity's operation.

For the existence of an effective internal control system, the following aspects should be considered:

- clear definition of responsibilities for each job;
- an employee's responsibilities not to overlap with the responsibilities of another employee, the work of an employee should be a continuation of another's work;
- employees who handle material goods should not be responsible with their supply and reception;
- no employee should have direct control over all important aspects related to an important operation.

The assessment of internal control should be applied and understood in each activity and each component of the approached internal control system. In some cases, evaluations take the form of self-assessments and independent verifications. Self-assessment helps management detect problems early and minimize costs.

Self-assessment of internal control is a powerful management instrument, a method to ensure that the internal control system is solid and that the management analyses objectives and processes, identifies risks in achieving those objectives and assesses the operation of controls to diminish the identified risks.

Self-evaluation can determine the necessary changes in the internal control culture of the public sector. The use of this instrument implies that managers and personnel with management attributions evaluate their own activities and procedures and determine their effectiveness in relation to the adopted objectives of internal control.

By self-assessment each public entity must establish the degree of compliance of internal control, have an action plan that identifies the areas that need improvement and prepare a report regarding the internal control activity.

The development and harmonization of the internal control system is based on a framework methodology for self-assessment that needs to be adapted to each public entity.

The premises of self-assessment are¹:

- Transmission of the questionnaire regarding self-assessment of the stage of implementation of internal/ managerial control, to the heads of all departments/ organizational structures of the public entity.
- Elaboration of responses to the questionnaire, in which the questions address both assessing the effectiveness of existing controls and gathering information to improve their efficiency.

The questionnaire is addressed to all levels of management. The questions included in the questionnaire aim the extent to which, first, the general requirements specified in the standards, and other specific requirements, taking into account the area of the standard, are implemented in the entity.

- Formulation of fundamental answers to the formulated questions. Answers should be based on current practices and not on what the compartment believes should answer nor what it intends to implement in the future.
- Consolidation and analysis of results, based on responses formulated by managers.

¹ ORDIN nr. 946/2005 pentru aprobarea Codului controlului intern/manAGERIAL, cuprinzand standardele de control intern/manAGERIAL la entitatile publice si pentru dezvoltarea sistemelor de control intern/manAGERIAL – REPUBLICAT, ACTUALIZAT 2012, cu modificările și completările ulterioare (ORDER no. 946/2005 for the approval of the Code of internal/ managerial control, including internal/ managerial control standards in public entities and for the development of internal/ managerial control systems – REPUBLISHED, UPDATED 2012, with subsequent amendments and completions)

- Organize a discussion with management personnel to present the results and draft the conclusions.
- Develop a report on the internal/ managerial control system as a basis for an action plan for areas identified as needing improvement.

Self-assessment represents the main form of implementation of management rules defined by Standard 24 "Verification and assessment of control" of the Code of internal/ managerial control, whereby a public entity must establish a function to assess its own internal/ managerial control system, whose exercise is the responsibility of each person occupying a management position in the public entity.

Self-assessment of the internal control system, performed regularly, at least once a year, prevents the malfunction of internal control by detecting weaknesses and correcting them. However, self-assessment represents, for managers, a useful and effective means to collaborate in assessing internal control procedures. The entire self-assessment process of the intern/ managerial control system/ subsystem must be well organized, pragmatic and it should add value, not to be regarded as a "bureaucratic burden" and it is mandatory that senior management supports it. The manner in which senior management of an entity gives importance to assessment/ self-assessment of intern/ managerial control has a direct impact on its effectiveness. The tone of upper management influences how lower management and employees perform and react to assessment/ self-assessment.

The self-assessment of the intern/ managerial control system in a public entity involves the following steps:

1. disposition by the public entity's manager, through an internal decision, regarding programming and performance by each subordinated compartment from the organization chart, of self-assessment of the intern/ managerial control system/ subsystem.
2. convocation of a work meeting of structures responsible for monitoring, coordination and methodological guidance of the intern/ managerial control system, hereinafter referred to as Structure, in order to establish measures for the organization and operation of the self-assessment operation.
3. completion by each compartment of the public entity's organization chart of a Self-assessment questionnaire on the stage of implementation of intern/ managerial control standards. The questionnaire is a general one, applicable to all public entities, and includes a set of minimal criteria according to which is assessed/ self-assessed the quality of internal/ managerial control systems of public entities, are identified the risk areas and the necessary directions of change.

CONCLUSIONS

A public entity in which self-assessment is practiced has a formalized and documented process by which management that is directly involved, participates in a structured way to a series of actions, such as: identification of the existing risks; assessment of internal control processes that allow mitigation and management of these risks; development of an action plans to bring the risks to acceptable levels; estimation of the probability that the entity's objectives will be achieved.

Self-assessment process presents a number of advantages:

- head of departments acquire training and experience thanks to which they can assess risks, associate control processes and manage those risks and increase the chances of achieving the objectives of the entity;
- informal controls, called "soft" are more easily identified and assessed;

- staff members are motivated to "assimilate" control processes existing in their compartments, and the corrective measures taken by the Structure are sometimes more effective and faster;
- the entire chain objectives – risks –controls within the entity is the objective of better monitoring and continuous improvements;
- internal auditors are involved in the self-assessment process and get to know it very well, either as entertainers or to conduct training on the concepts underlying the self-assessment program;
- internal audit is much better informed about the processes of internal/ managerial control. Therefore it can exploit this information and allocate resources, which are usually reduced, examine functions that show weaknesses or significant residual risks;
- management, having increased responsibility regarding management and control processes within the entity, will be less inclined to delegate these responsibilities to specialists;
- thorough knowledge and deepening the concepts of internal/ managerial control and their use to communicate;
- has the effect of extending the scope of the internal/ managerial control processes within the entity and improving corrective measures taken by those responsible for the process;
- can validate a number of conclusions resulting from the self-assessment process, information can be synthesized and can be formulated based on these overall opinions on the effectiveness of internal/ managerial control within the entity.

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