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## DECISIONS OF PUBLIC ENTITY MANAGEMENT REGARDING APPROACHES IN THE INTERNAL CONTROL SYSTEM – INTERNAL AUDIT AND IT

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### Abstract

Romanian public entity can be seen as a service provider company that use/ manage public funds and/ or public patrimony. The manager of every public entity need to order the necessary measures for elaboration and/ or development of the internal/ managerial control system.

This study presents factors that can influence internal/ managerial control system and the situation regarding the implementation stage of the standards contained in the *Internal/ Managerial Control Code*.

Even if the self-evaluation questionnaire of the internal/ managerial control system is completed by every public entity, centralized and sent to General Secretariat of the Government, not all the standards related to the internal/ managerial control system were implemented.

The main factors which can lead to an improvement of the internal control system, as shown by the analysis of the study, are internal audit and information technology.

### Keywords

internal control, internal audit, annual report, decision-making process, audit tools, automation.

### JEL Classification

H83, M42, M15, O32

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### Introduction

The regulation of the internal control at the level of the public entities in Romania started with the publication of Government Emergency Ordinance no. 119/1999. Subsequently, in 2005, with the entry into force of the Order of the Minister of Public Finance no. 946/2005, the implementation of internal/ managerial control has become mandatory for public entities in Romania. The internal/ managerial control systems had to be developed taking into account the specifics of each public entity, after the *Internal/ Managerial Control Code*, including a number of 25 management standards. Subsequently, in 2015, the Order was repealed and replaced by the Order of the General Secretariat of the Government (OGSG) no. 400/2015 for the approval of the Code of Internal/ Managerial Control of Public Entities, which establishes 16 internal/ managerial control standards.

For the management, internal control and audit (Ciuhureanu, 2016) contribute to a more efficient organization, ensuring economic and financial discipline, resources' efficient

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management, compliance with rules, procedures, regulations, actions which are ultimately reflected in the reported accounting information and in the users' decisions.

According to Cobb-Douglas production function  $Y = Z * K^{\alpha} * L^{1-\alpha}$ , where:

Y = total production (the real value of all goods produced / services provided in a year)

L = labor input (the total number of person-hours worked in a year)

K = capital input (the real value of all machinery, equipment, and buildings)

Z = total factor productivity / technology

$\alpha$  and  $1-\alpha$  are the output elasticities of capital and labor, respectively. These values are constants determined by available technology.

there are quantitative, qualitative and technological factors that impact on the productivity of a company.

Even if Cobb-Douglas function demonstrates that every element of the equation transforms the final result (Y - total production), the purpose of this article is to prove that there is at least one qualitative, one quantitative and one technological factor that can modify the internal/ managerial control activity.

## **1. Method**

This paper aim is to demonstrate three hypotheses by analyzing the qualitative data. According to the law and professional standards and using the knowledge of informational technologies we will demonstrate that exists at least one element which confirms the assumed hypothesis.

### ***1.1. H1: Increasing the level of understanding the internal control notions and enforcement mechanisms it will raise the degree of implementation and development of the internal/ managerial control system in public entities.***

According to OSGG no. 400/2015, internal/ managerial control is defined as representing all the forms of control exercised at the level of the public entity, established by management in accordance with its objectives and legal regulations, in order to ensure the management of public funds in an economically, efficiently and effectively manner.

Within the public entities, annually, the self-assessment of the managerial internal control system is carried out in accordance with point 1.4 of Annex 4 - Instructions for drawing up, approving and presenting the Report on the system of internal managerial control in OSGG no. 400/2015, with subsequent modifications and additions (Calu e al., 2016).

The annual self-assessment of the managerial internal control system in public entities involves assessing how to implement the internal control standards by each compartment of the public entity structure and then generalizing the information from the self-assessment questionnaires developed by these compartments in accordance with the Annex 4.1 - Self-assessment questionnaire and Annex 4.2 - Synthetic summary of results of self-assessment of OSGG no. 400/2015, with subsequent modifications and additions.

Standards of internal/ managerial control are reviewed based on the general assessment criteria specific to each standard and can be implemented, partially implemented or not implemented.

The assessment of the compliance of the internal/ managerial control system with the internal/ managerial control standards is achieved in relation to the number of implemented standards, as follows:

- the system is compliant if all 16 standards are implemented;
- the system is partially compliant if 9 to 15 standards are implemented;
- the system is inconsistent if less than 9 standards are implemented.

According to The report of Internal/ managerial Control for 2016 published by Management internal control and interinstitutional relations department of the General Secretariat of the

Government, a number of 50 central public entities and 2.040 public entities under subordination or coordination had to implement the internal/ managerial control system.

The degree of implemented standards, as it results of the centralized reports on self-assessments within public entities, notes that 5 standards have a high implementation rate of over 95% (Standard 1 - Ethics and integrity – 96,21%), 5 standards have an implementation rate between 90% - 95%, 5 standards have an implementation rate between 80% - 90% and a single standard has an implementation rate under 80% (Standard 16 – Internal Audit – 69,01%).

According to Standard 16 from OGS no. 400/2015 for the approval of the Code of Internal/ Managerial Control of Public Entities, the public entity should establish or must have access to a competent audit team which is formed by professional auditors and whose activity is usually carried out according to programs based on risk assessment.

As Internal Audit law says, the internal audit department must be distinct in the direct subordination of the entity's manager and must have at least two employees. Internal auditors should perform their tasks objectively and independently, professionally and integrally, following the professional practice stands (rules and specific procedures) of the internal audit activity.

In this context, the internal audit department should be sized according to the size of the public entity and the risks associated with the activities carried out within the entity. Internal auditors should have the professional competencies required for internal audit work and they should pursue to upgrade their skills through a continuing professional development program.

Complying with these requirements can lead to a high degree of implementation for Standard 16 and for the previous standards too.

***1.2. H2: If the internal audit activity follows its purpose, it will contribute to the improvement of the internal/ managerial control activity.***

Internal auditors are responsible for complying with the International Standards for the Professional Practice of Internal Auditing (Standards) with regard to individual objectivity, professional competence and conscientiousness. In addition, internal auditors are responsible for complying with the Standards that are relevant to the fulfillment of responsibilities associated with their function, while Audit Executives are responsible for the full compliance of the Standards.

The International Standards for the Professional Practice of Internal Auditing developed by the Internal Audit Institution apply to all internal auditors and internal audit work carried out by them. In Standards, updated in 2016, *Performance Standard 2100 - The type of activity* describes the broad scope of internal audit activity:

*“Internal audit work should assess and contribute to improving governance processes, risk management and control, using a systematic and methodical approach.”*

In practice, internal audit team may assess the internal/ managerial control within an audit mission, sometimes define it as an objective or audit the entire internal control process. The achievement of this objective on impartiality led sometimes to a comparison between the documents related to the existing internal/ managerial control system and the answers given in the self-assessment questionnaire of the stage of implementation of the internal/ managerial control standards.

Taking into account that the number of internal control standards have been reduced from 25 to 16 standards and the legislation applicable to the internal/ managerial control system has been changed, internal audit team should be informed from the self-assessment questionnaire about the stage of implementation of internal/ managerial control standards.

Discussion or questionnaire addressed to the person in charge with the development of internal/ managerial control system is used during the internal audit mission. The purpose of

these discussions is to gather information, the accuracy of the answers to the questions formulated by the internal auditors being validated by the compliance with the documents existing in the files provided by the audited structure.

During the internal audit mission, the objectives, findings and recommendations main aim is to improve the activity of the audited structure. Usually, they also contain information about professional trainings of/ for the employees, to assure they are permanently updated.

As Petraşcu and Tamaş says, in order to rationalize the companies' activities for better asset management, cost reduction, profit maximization and achievement of medium and long-term objectives, any entity requires, besides control and internal audit, coaching.

In order to ensure that the entire staff of the audited structure is able to fulfill successfully their tasks and is aware of everything that the internal control system involves, the managers should continuously share new information on this subject, in order to make all employees accountable for this purpose.

***1.3. H3: If an integrated approach of internal processes is considered, improving internal/ managerial control involves the informational technologies (IT) implementation of the internal control management system.***

The Romanian public entities implemented applications for automatization of one or a part of their activities (especially in economics and human resources departments). The lack of dedicated software or having different features and databases may include extra cost and time for the entity and its employees.

Innovation implies the improvement of an existing concept or idea, as Nigel Slack (2016) says, using a process that tracks the stages of the idea's development, ending in a viable product/ service that can be marketed.

The process of innovation involves a succession of activities through which the designer tries to transform one or more ideas into products or services for the market. The models described in the imagination of a designer rarely define all the technical specifications. Innovation activity usually involves passing through key stages and deciding how to implement: open source software - using a community of development, crowdsourcing or idea management.

An integrated approach (Kim et. al., 2009) of internal control processes may be an improvement of the internal/ managerial control system. The IT solution can be developed as a web application, easy to model, accessed and personalized according to the specifics of the public entity, having a user-friendly interface.

The IT package should assure the risk management in the organization, correlated with the activity and evaluation of the employees, as well as the management of the documents and processes necessary for the implementation of a managerial control.

For example, the areas covered by the internal/ managerial control activity should include the following:

- the control environment - will include issues related to organization, human resources management, ethics, deontology and integrity;
- performance and risk management - target management issues related to goal setting, planning (multi-annual planning), scheduling (management plan) and performance (performance monitoring);
- control activities - focuses on documenting procedures, continuity of operations, recording exceptions (deviations from procedures), separation of duties, supervision;
- information and communication - the problems related to the creation of an adequate information system and a system of reports on the implementation of the management plan, the budget, the use of resources and the management of documents will be grouped;
- evaluation and audit - development of the assessment capacity of the internal / managerial control, in order to ensure the continuity of the process of improvement.

An integrated IT package can provide management with real-time access to the internal/managerial control system.

Nowadays, we are talking about robots and artificial intelligence and about the employees that should be prepared for the new job families that will be created by using IT in every activities sector. Artificial intelligence can improve the activities of the public sector. There are different kind of applications which can be used in public sector.

For example, Humanyze fuses the badge data with employee calendars and work emails. It is useful if office plans favor team work. Slack, a messaging application at work, helps managers to assess how quickly employees perform their tasks. Microsoft has a product that shows employees how they manage their time in the office, but gives managers information only in aggregate form.

The workforce strategy should take into account the automatization of activity, as well as traditional workforce and contract workers.

As Aral Sinan (2012) says, the combination of data on individual worker project completion, email messages, and work practices reveals a pattern of relationships among multitasking, technology use, and output. In this way, public entities will provide competitive services and will make effective use of their resources.

## 2. Results

Public entities should continuously monitor their internal control system and track it in dynamics. Related activities include defining/ updating their objectives and allocate the resources needed to meet them, manage their risks properly, constantly monitor the internal control environment, manage work procedures and documents in a centralized system, define performance indicators.

The internal control system can improve the public entities' activity by empowering the workforce with the right skill sets and using the appropriate technology.

The internal/ managerial control system can be improved by the internal audit activity and, if the internal audit functions properly, it can sustain the internal control in implementing standards and developing knowledge for employees.

On the other hand, the internal control can be improved by informational technologies in terms of efficiency and economy. To reflect tasks transformed by the informational technologies, we must focus on end-to-end process. The impact of informational technologies on the workforce must be analyzed continuously. Implementing and developing the suitable form of control for every public entity can also improve the process of decisional transparency.

## Conclusions

The aim of this paper is to demonstrate that Cobb-Douglas production function applied for public entities has the same impact as it was designed.

The Cobb-Douglas production function has a major role because, based on it, can be found qualitative, quantitative and technological factors which impact the internal/managerial control activity.

Starting with three hypostasis: *H1: Increasing the level of understanding the internal control notions and enforcement mechanisms it will raise the degree of implementation and development of the internal/ managerial control system in public entities, H2: If the internal audit activity follows its purpose, it will contribute to the improvement of the internal/ managerial control activity, H3: If an integrated approach of internal processes is considered, improving internal/ managerial control involves the informational technologies (IT) implementation of the internal control management system* which can be noticed in the study that exists at least one element to confirm their true value.

**The conclusions of each assumption** can be defined:

*H1: The involvement of employees in the internal/ managerial control activity and the degree of knowledge of the legislation in force can increase the level of implementation of the internal/ managerial control system.*

*H2: The internal audit activity may lead to an improvement of the internal / managerial control system if it has the necessary organizational and functional levers.*

*H3: Information technologies can bring several benefits to the internal / managerial control system (for example: reducing time spent on identifying data and registering in the system, eliminating human error, operational services at any time, cost reduction, eliminating the risk of personnel migration, speed and efficiency in the services provided and other).*

The results are meaningful because they highlight that internal/ managerial control system of a public entity can be improved if public entity management takes into account two important factors: internal audit and information technologies.

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