
REFLECTIONS ON QUALITY AND INTERNAL CONTROL IN PUBLIC ENTITIES

Munteanu Florea Ionela¹ and Condrea Elena²

¹⁾ Bucharest University of Economics Studies, Romania,

²⁾ "Ovidius" University of Constanta, Romania

E-mail: consultant.munteanu@gmail.com; E-mail: elenacondrea2003@yahoo.com

Abstract

Financial globalization opened the gates for competition and set the rules for a new. By gaining access to information, the public becomes enthusiastic with the concept of added value. At the same time, people ascertain the growing possibility of claiming quality and transparency. Media channels and open-markets encourage the attempt to identify new opportunities and also highlight the benefits of transparency and responsible communication. In this context, the importance of control matures. An important step towards institutional development is made as managers implement planning based on a preliminary analysis of risks. Our study analyzes the attitude towards the internal control manifested by the Romanian public entities such as it is revealed in evolution by the state auditors. The analysis of noncompliance indicators represents a starting point capable to develop new theories on ways to improve the role and purpose of internal control. Our goal is to introduce a model of assessment of the public entities management that can synthesize the key issues able to raise the awareness on the importance of internal control. At the same time, our model may become a starting point to expanding the studies on the results reported following the controls performed in the public sector.

Keywords

internal control; public entities; development

JEL Classification

M40, M42

Introduction

Public entities are catalysts for public funds and public heritage. The utility of these institutions may become evident provided that the activity is channeled towards sound financial management and quality public services. The evidence of that derives from the face that public entities bring a valuable input to economy and have the ability to generate employment and budget revenues.

In Europe, special attention is paid to these structures. Studies demonstrate that public entities and in particular state-owned enterprises (SOEs), have an important contribution to the national budget of the Member States where they are organized (Arahoni, 2010). According to European statistics, an important share of the employed population activates in SOEs' in most developing European countries. At the same time, the analysis of competitiveness in the public sector compared to private entities has demonstrated the need

for reforming and implementing “good governance practices” (Kaufmann, et.al., 2002), where managerial responsibility, sustainability and transparency are primary requirements. Starting from the fundamental need for evolution, the regulatory framework has developed in Europe, and thus, set the premises for development of significant levers of control over corporate governance (Cavaliere, et.al, 2008). Managerial accountability is a conceptual challenge and a requirement of public sector regulations to fight fraud, corruption and waste of public money. (OECD, 2016)

In this context, a new mechanism emerged: control of public entities and of the use of funds and public patrimony (Chang, 2007). The opportunity of control has been analyzed, both from the perspective of an external institution with auditing abilities and from that of internal control. In concept, an efficient missions that being carried out by independent professionals, capable of issuing fair-minded opinions.

In Romania, the regulations regarding internal control in public entities went a long way towards harmonizing with European requirements. Because the need to set up an independent, professional institution arose, the Romanian Court of Accounts has been set up, with the precise mission to strengthen financial management, to promote and raise awareness of the importance of accountability, fairness and good practices in public management. Additionally, at the level of the public entities, the obligation to implement an internal control system has been established with the purpose to assess corporate governance and to prevent the waste of public resources, fraud or corruption.

In order to differentiate public-sector specific regulations from the requirements of the implementation of internal control in the private sector, there is a special expression in Romania that is used in public entities: "internal managerial control". In practice, the term "managerial" used in the public sector is perceived by managers as a synonym to responsibility.

Brief introduction of the terms analyzed in this study

In Romania, the first directives on internal control were implemented starting with the adoption of Ordinance 119/1999 on internal control and preventive financial control. Subsequently, the legislative framework was extended with the definition of the internal audit concept (Law 672/2002), the definition of the managerial internal control standards (Order 946/2005), the requirements of corporate governance in public enterprises (Emergency Ordinance 109/2011), the clarification of the obligations regarding the preventive financial control (Order 923/2014) and the implementation of the financial management control (Government Decision 1151/2012).

Public entities include all the public sector authorities and institutions, autonomous public institutions and state-owned companies.

State-owned enterprises are companies in which the state exercises control through various means, regardless of the size of the ownership. The current definition was given by ESA2010 and was implemented in the Romanian legislation according to the Ordinance no. 119/1999.

Internal control has been given multiple definitions, but in general terms, it represents all the forms of control in a public entity, the methods, techniques, procedures set by management according to its strategies and policy for efficient and economical public resource management.

The role and requirements of internal managerial control in Romania

According to literature, the foundation of an effective legal framework converges towards the definition of the internal control requirements, which are imperative to be implemented at the level of the public entities. The efficiency of the internal control system depends on the institutional credibility, the efficiency of the public service and the prevention of fraud.

The general requirements mainly relate to understanding and design of an effective risk management system that allows management to set reasonable and integrated objectives for the enterprise's mission. Both the management and the executive staff must work together in order to accomplish the entity's activities, demonstrate professionalism, integrity and responsibility.

Specific requirements describe the need to issue written documents for all operations, ensuring an integrated system of approval, control and registration. Also, management must determine how to access resources and information, as well as procedures and individuals entitled to use and preserve them.

Research methods

Our study aims to develop a model for the evaluation of managers in public enterprises, starting from the study of the development directions of the managerial internal control.

Our research has been conducted in three stages:

- we identified the directions for the development of the internal control in Romania in the light of the findings made by the Romanian Court of Accounts as a result of the carrying out the audits of the public entities
- we determined the key factors of appreciation of the management of public entities by state control bodies
- finally, we introduced a model for assessing the management of the public enterprises, by correlating in an intuitive way the requirements and the results of the internal control.

The main sources of our research come from the Annual Reports of the Court of Accounts of Romania in the period 2009-2016.

The indicators analyzed at this stage of our research refer to the number of deviations found by the state auditors of the Court of Auditors during their missions. The indicators for quantification of deviations were also taken into account. The quantification of nonconformities was structured in the audit reports as: amounts representing additional income (determined as a result of incorrect calculation of tax liabilities), damages (breach of the legislation on income and expenditure public, illegal trading of assets) and unlawful payments.

The processing of the indicators was based on a comparative and structural analysis of the data, which allowed us to explain the evolution over time of the understanding and implementation of the internal control mechanism in Romanian public entities.

Results and comments

The trend of internal control in Romania received positive appraisals during the analyzed period by the external auditors of the Court of Accounts. State auditors appreciated that the degree of compliance with the implementation of the internal control mechanism within public entities has improved over time, but there is still room for improvement in this respect. The progress of managerial compliance regarding internal control is calculated by public auditors in terms of decreasing the number of deviations found over time. Figure no.1 shows graphically the evolution of deviations (nonconformities) regarding the internal control implemented at the level of the public institutions.

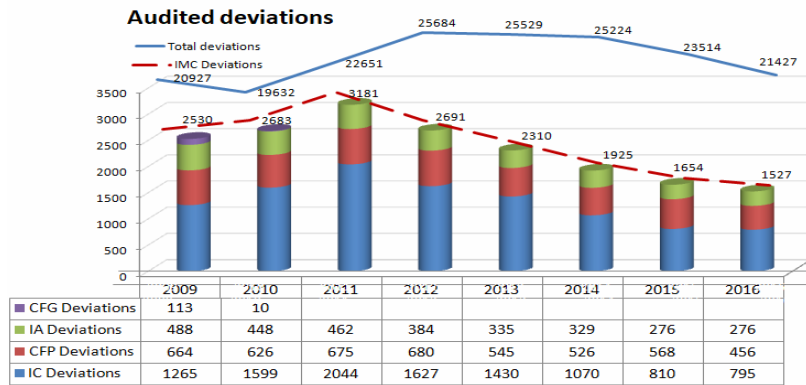


Fig. no. 1. The main deviations related to internal control observed by state auditors in public entities

Source: The Romanian Court of Accounts, 2009-2016

The above figure demonstrates that the number of deviations regarding the internal control mechanism implemented (IMC deviations) in public entities has decreased over time. Structurally, internal control deviations mainly included inconsistencies such as insufficient implementation of procedural measures, misunderstanding of the risk management mechanism and deficiencies in setting up risk registers, as well as insufficient dimensioning of control structures.

Also, there were problems regarding the implementation of preventive financial control (CFP deviations). In Romania, the CFP indicator relates to the supervision of the liquidity operations through a preliminary check of the documentation underlying each operation involving cash flows. Preventive financial control is considered to be an important tool to fight against fraud and liquidity leakage and the Court of Auditors' findings demonstrate that there have been a significant number of deviations in this respect during the investigated period of time.

Another important tool in running the internal control mechanism is internal audit (IA deviations). The specialized literature has long debated the role of internal audit for good corporate governance. According to the Court of Audit's analysis, in practice, there are numerous non-conformities in relation to the implementation of internal audit, such as the insufficient dimensioning of the department, due to the lack of a prior analysis of the risks of the activity. It was also found that the internal audit activity was carried out on a formal basis, because the persons nominated as internal auditors actually performed other duties or were reporting to the financial-accounting compartments or did not carry out the activities stipulated in the audit plans or in vocational training programs.

Financial control (CFG deviations), another internal control tool, was not scrutinized enough so we cannot assess the evolution of the indicator over time.

According to the Court of Auditors, the key factors for assessing the management of public entities by state control bodies were:

- the issuing of the revenue and expenditure budget and its modification during the budget execution
- financial statements
- the implementation of the internal control mechanism
- the mechanism of revenue in the consolidated general budget
- the quality of financial and economic management of public resources
- planning and conducting public procurement

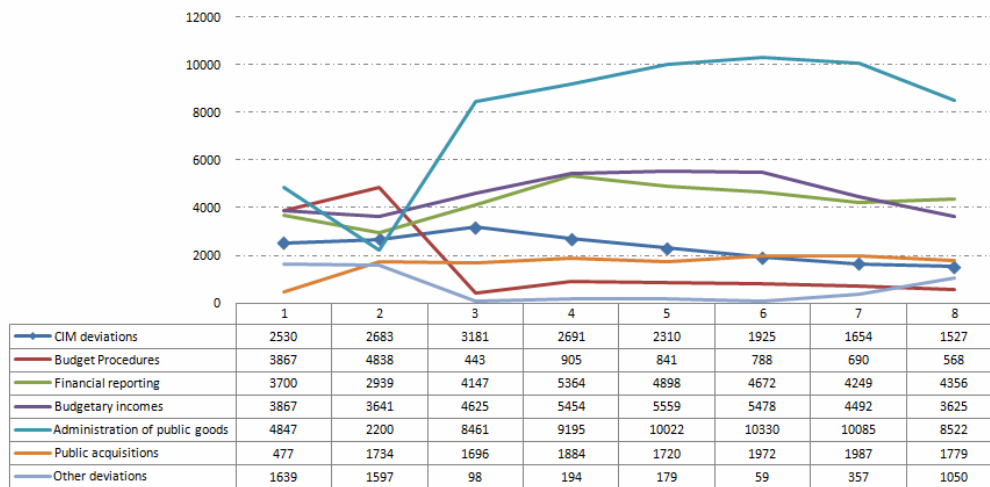


Fig. no. 2. The main deviations observed by state auditors in public entities

Source: The Romanian Court of Accounts, 2009-2016

According to the Court of Accounts' reports, internal control deficiencies have been strongly represented during their missions. Although their numbers have been declining since 2011, there have been several recommendations for improvement.

An interesting aspect observed in our analysis is represented by the situation of the quantifications of the deficiencies found regarding the internal control, which shows low values related to the observed irregularities, as can be seen in Table no.1.

Table no. 1. Value attributed to deviations / nonconformity regarding internal control in public entities (thousands lei)

Year	Additional income	% out of total deviations	Illegal payments	% out of total deviations	Financial reporting errors	% out of total deviations
2009	0	0.000%	12	0.002%	95102	0.23%
2010	0	0.000%	11	0.001%	100554	0.26%
2011	1	0.052%	0	0	112	0.20%
2012	13	0.057%	0	0.000%	89	0.16%
2013	23	0.001%	703	0.030%	8111	0.02%
2014	909	0.025%	1906	0.108%	26109	0.11%
2015	0	0.000%	1275	0.069%	2778	0.01%
2016	0	0.000%	3	0.000%	3019	0.01%

Source: The Romanian Court of Accounts, 2009-2016

According to the analyzed data, the values attributed to nonconformities regarding internal control are insignificant by comparison to the value attributed to the total of the reported nonconformities. An explanation for this would be that the errors that derive from the rest of the key bills for assessing the effectiveness of public managers are influenced by the extent to which management understands the implementation of the internal control mechanism. According to the reports, the practice also demonstrates situations in which the non-compliance is reported late, and the recovery of the established damages is not possible every time, as the legal deadlines for initiating the recovery procedures are prescribed in certain situations.

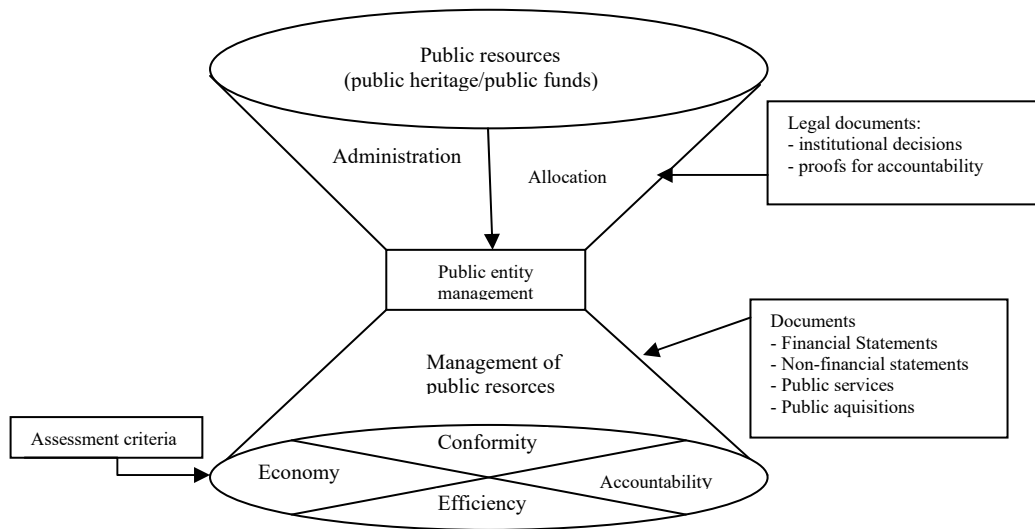


Fig. no. 3. Model for the assessment of corporate governance in public entities

According to the current economic trend, there is a strong need for increased public sector accountability. Our model synthesizes schematically the key aspects to improve the internal control of public entities. Management performance assessment can be developed starting from each concept synthesized in the model represented in Figure 3. Thus, the allocation of public resources to a managed entity implies evaluating the management of that entity and its ability to cope with the requirements of accountability, integrity and professionalism in administering with respect to compliance, economy and efficiency.

The entire process that starts from granting access to the public resource and including the operational purpose of public entities is subject to the everyday economic challenges and improvement requirements brought to light by control.

Today's demands may be defined as to implement new ideas to increase competitiveness, to promote cognitive-intensive development (Abdikeev, 2014), to develop "change management" (Axelrod, 2010) including the public sector.

Conclusions

The results of our study demonstrate that the way to implement and evaluate internal control in the Romanian public sector is still a challenge. There is room for improvement both from the managerial perspective of understanding the importance of internal control, as well as for identifying a way of preventing situations of waste of public money. We consider opportune directions like:

- setting managerial objectives and assessing achievements with proper key performance indicators,
- encouraging or impose transparency in public decision-making,
- enhancing control over budget execution,
- investigating prevention methods, starting with internal control
- quantifying the non-conformities regarding internal control regulations and exploring new ways of raising accountability of managers in the accessing or administering public resources.

References/Bibliography

- Abdikeev, N., 2014. Knowledge-based economy and innovative development. *Bulletin of the Financial University*, 83(5), pp.16–26.
- Aharoni, Y., 2000. *The Performance of State-Owned Enterprises, In the Rise and Fall of SOE in the Western World*. Cambridge: University Press 2000.
- Axelrod, R.H., 2010. *Terms of Engagement: New Ways of Leading and Changing Organizations*. San Francisco: Berrett-Koehler Publishers, pp.6-7.
- Cavaliere, A. and Scabrosetti, S., 2008. Privatization and Efficiency: From Principals and Agents to Political Economy. *Journal of Economic Surveys*, 22(4), pp.685-710.
- Chang, H., 2007. State-Owned Enterprise Reform. *New York: United Nations, Department for Economic and Social Affairs*.
- Curtea de Conturi a Romaniei, *Rapoartele publice pe anii 2009-2016*, [online] Available at: <www.curteadeconturi.ro> [Accessed 14 April 2018].
- Kaufmann, D., and Kraay, A., 2002. Growth Without Governance. Policy Research Working Paper. *The world Bank, World Bank Institute and Development Research Group, No.2928*
- Migranyan, A., 2002. Theoretical aspects of formation of competitive clusters in countries with economies in transition. *Bulletin of the Kyrgyz-Russian Slavic University*, 3(1), pp.22–29.
- OECD, 2016. State-Owned Enterprises in the EU: Lessons Learnt and Ways Forward in a post-Crisi Context. *European Commission, Institutional paper 031*.