



Internal Control Organization Procedure

Radu Dorin LENGHEL

Faculty of Economic Sciences Cluj-Napoca, "Dimitrie Cantemir" Christian University of Bucharest, Email: radulenghel@yahoo.com

Abstract *Internal control represents the totality of policies and procedures adopted by management, which contribute: to the fulfilment of managerial objectives, to the prevention and detection of frauds or errors, to the accuracy and exhaustiveness of accounting entries, as well as to the preparation in due course of financial accounting information. Internal control represents a managerial instrument which assures the fulfilment of objectives of the entity, being an ongoing process in which administrative management, executive management and the whole staff of the entity participates, and by which is provided a reasonable assurance on the achievement of objectives of the entity. The entity has to elaborate its own strategy of control, in view of avoiding risks, which can determine unwanted deviations from the policies and objectives established. The control strategy will mainly aim at: integration of control in process and structural components of organization of the entity; definition of objectives of control; establishment of the types of control which will be applied, of the methods and procedures which must be used within them; elaboration of control plans or programmes; training of staff with control assignments; methods of evaluation and revaluation of control results; effectiveness of control in the light of the criterion costs or benefits.*

Key words:

The concept of internal control, objectives of internal control, components of internal control, methodology of internal control, structure of internal control system, procedure of organization of internal control.

JEL Codes:

M14, M16

1. Objectives and components of internal control

a. Internal control objectives

In the meaning of legal regulations regarding internal control (Order of the Minister of Public Finances no. 3055/2009), the internal control of the entity has the following objectives: conformity with the legislation in force; application of decisions made by the management of the entity; good functioning of the internal activity of the entity; reliability of financial information; effectiveness of operations of the entity; effective use of resources; prevention and control of risks of not achieving the objectives set etc.

Therefore, the internal control procedures have the following objective:

- on one hand, follow-up of the registration of the activity of the entity and of the staff behaviour in the framework defined by applicable legislation, the values, norms and internal rules of the entity;
- on the other hand, the checking whether the accounting, financial and management information communicated correctly reflects the activity and the situation of the entity.

Internal control applies throughout the operations carried out by the entity, as follows:

- Prior to the realization of operations (which is carried out for the purpose of preventing the carrying out of operations, which do not fulfil the conditions of conformity and legality);
- During the operations (which supposes checks between departments, employees, following the separation of tasks and assignments of employees);
- After the completion of operations (which represent checks on the method of observance of the legal provisions regarding the management of material and money values), in which case the checking is designed, for instance, to analyse the profitability of operations and to acknowledge the existence of conformity or possible anomalies, which must be corrected.

Internal control represents the totality of policies and procedures adopted by management, which contribute: to the fulfilment of managerial objectives, to the prevention and detection of frauds or errors, to the accuracy and exhaustiveness of accounting entries, as well as to the preparation in due course of financial accounting information. Internal control represents a managerial instrument which assures the fulfilment of objectives of the entity, being an ongoing process in

which administrative management, executive management and the whole staff of the entity participates, by which is provided a reasonable assurance on the achievement of objectives of the entity.

Accounting and financial internal control is a major element of internal control.

The accounting and financial internal control aims at the assurance: of conformity of accounting and financial information published, with the rules applicable to this information; the application of instructions elaborated by the management in connection with this information; the protection of assets; the prevention and detection of frauds and accounting and financial irregularities; reliability of annual financial statements published and of other information communicated to the market.

b. Components of internal control

For the persons in charge with the organization and implementation of internal control we consider that it is extremely useful to know and understand the components of internal control.

In order to reach its objectives, internal control has the following components closely connected between them, respectively:

- A clear definition of responsibilities, resources and adequate procedures, methods and systems of information, appropriate instruments and practices (control environment);
- A system which aims at, on one hand, the analysis of the main identifiable risks regarding the objectives of the entity and, on the other hand, the assurance of existence of procedures of management of these risks (evaluation of risks);
- Appropriate control activities, for each process, conceived to reduce the risks susceptible to affect the realization of the objectives of the entity (control activities);
- Internal broadcasting of pertinent, reliable information, whose knowledge allows each person to exert his/her responsibilities (information and communication);
- A permanent supervision of the internal control device and an examination of its functioning (monitoring of controls).

The control activities are part of the management process, by which the entity aims at reaching the objectives proposed. The control aims at the application of internal control norms and procedures, at all hierarchical and functional levels: approval, authorization, checking, evaluation of operational performances, securitization of assets, separation of functions etc.

Among the current control activities there are: observation, comparison, approval, reporting, coordination, checking, analysis, authorization,

supervision, examination, separation of functions and monitoring. Apart from the control activities integrated in the management line, specialized controls can be organized, carried out by structural components specially created (commissions, financial management control departments etc.), whose activity is carried out based on a plan conceived by taking into consideration the risks.

Control activities are carried out in the whole entity, at all its levels and positions.

The management of the entity establishes for each activity what are the most appropriate forms and activities of internal control, in view of limiting risks.

Internal control is found in the structure of each activity and must be formalized by procedures, based on the job descriptions and the checking questionnaires.

As for the method of implementation of internal control activities, we can see that in most entities, they are not formalized (are not specific internal control procedures).

2. Structure of internal control system

The internal control system has to be developed and implemented by the manager, up to the level which allows him a better control on the functioning of all activities, in view of realization of objectives set.

The management of the entity establishes for each activity, what are the most appropriate forms of internal control, in view of limiting risks and to provide a reasonable assurance that the objectives of management are fulfilled.

The structure of internal control system is made up of the assembly of internal control forms, which can function in economic agents.

Internal control is found in the structure of each activity, being a process carried out by all employees, so it is not a distinctive department in the entity.

The organization of an internal control system, specific to economic entities is compulsory only for public entities.

Regardless of the moment of exercise, internal control carried out with competence contributes to the avoidance of financial or accounting irregularities and to the consolidation of the patrimony integrity.

The internal control environment in economic entities is made up of the following forms of control: hierarchical control; reciprocal control; self-control; financial accounting control; financial preventive control; financial management control.

3. Internal control implementation procedures

In practice, procedures are of vast diversity and are regulated by normative acts bearing different denominations, such as: law, ordinance, code, Charta, decision, methodological norm, instruction, precision,

circular letter, regulation, standard etc. Thus, among the best known procedures, the following can be mentioned: the procedure of organization and carrying out of competitions for filling in the positions; procedure of evaluation of individual professional performances of management and execution bodies; procedure of calculation of salary rights; inventory-taking procedure; accounting entry procedure; procedure of drawing up and reporting of financial statements; procedure of organization and exercise of own preventive financial control, hierarchical operational control and management control, etc.

The procedures can be formalized or not, depending on the complexity of their object and of the degree of regulation need.

The procedures comprised in normative acts, whether they have a general degree of applicability or regard wider or strictly specialized sectorial fields, to become internal procedures (internal control element), they have to be particularized by internal administrative acts which envisage a series of elements such as: the organization of the entity, the relations between structural departments, informational circuits, competences and responsibilities of persons etc.

The procedures issued by the manager of the entity can indeed become viable internal control instruments only if the important requirements below are fulfilled.

Thus, the internal procedures must be: defined for each activity which is carried out in the entity; fully integrated in the components of the entity organization system; mentioned in written documents; simple, complete, precise and adjusted to specific object; regularly updated; brought to the knowledge of the staff involved, including under the form of software documents; well understood and especially, well applied.

In order to be certainty that the internal procedures will be well applied, it is necessary to perform a good and permanent control for this purpose.

The entity has to elaborate its own control strategy, to avoid the risks which can determine unwanted deviations from the policies and objectives set. The control strategy will mainly aim at: the integration of control in process and structural components of organization of the entity; definition of objectives of control; establishment of the types of control which will be applied, of the methods and procedures which must be used within them; elaboration of control plans or programmes; training of staff with control assignments; methods of evaluation and revaluation of control results; effectiveness of control in the light of the criterion costs/benefits.

These internal control activities come in different forms. The most frequent control activities are: observation, supervision, comparison, analysis, evaluation,

validation, reporting, monitoring, coordination, supervision, counter-signing, checking, authorization and approval.

Depending on the moment in which it is exercised, it can be: preventive, carried out before the approval of operation, and having a diversity of concrete forms, among which the best known are preventive financial control and the checks issued by the legal department or other specialty department; hierarchical operational (simultaneous), executed by persons with management positions during the process flow; subsequent, usually made by the financial management control department, but also by the managers on different levels.

It is noteworthy that to control means an act of assistance, materialized in the guiding of the person controlled in new and difficult tasks, the adoption of appropriate behaviour in relation to his strengths or weaknesses: a motivating act by which the controlled person understands that his/her work is important and that his/her efforts, difficulties or performance are not ignored; a checking act, on one hand, the checked person must know that at random periods, someone definitely checks the realization of the task, and, on the other hand, any checking has to be completed in a written document (check, note, report etc.), necessary for appreciating the quality of the control and knowing the frequency of control acts.

4. Internal control methodology

Internal control methodology implies going through the following stages:

- Formulation of objectives to be controlled;
- Delimitation of objectives on each form of internal control;
- Identification of persons competent to make controls on each form of internal control;
- Identification and analysis of sources of information for the realization of internal controls;
- Application of checking procedures and techniques specific to each form of internal control;
- Establishment of irregularities and deviations related to the object to be checked;
- Elaboration of control acts specific to each form of internal control;
- Revaluation of acknowledgements of internal controls;
- Establishment of efficiency of internal controls on the line of prevention and removal of deficiencies acknowledged, but also on the line of perfection of the activities acknowledged.

5. Conclusions

As for the procedure of organization of internal control in the context of current accounting regulations, the following conclusions can be drawn:

- Each person responsible of an economic entity has the obligation to create at its level an internal control system;
- The manager of the entity can resort to professionals for the conception, development and implementation of internal control;
- Control activities are carried out in the whole entity, at all its levels and positions;
- The management of the entity establishes for each activity, what are the most appropriate forms and activities of internal control, in view of limiting risks;
- Internal control is found in the structure of each activity and must be formalized by procedures, based on the job descriptions and the checking questionnaires.
- From the legal regulations (Order of the Minister of Public Finances no. 3055/2009), it does not clearly result what are the procedures and policies of implementation of internal control applicable to an economic entity;
- the types (forms) of internal control are not presented in detail, only a classification of them is presented in the legal regulations, by the time in which it is exerted (prior to, during and after the completion of operations);
- in the legal regulations only a certain form of internal control is developed, represented by the internal accounting and financial control as if the other forms of internal control did not exist;
- as for the components of internal control, they are presented in another form, but similar to the already dedicated models of internal control (Coso and Coco);
- as for the methods of implementation of internal control, only some general aspects are presented;
- in the legal regulations the general objectives of internal control are presented, not developing

- objectives differentiated by each form of internal control;
- in the legal regulations no specific procedures or techniques of checking internal control are presented, proposing that they are represented by: inspection, observation, investigation (interview, interrogation), confirmation, calculation, analytical procedures etc.;
- as you can see, the legal regulations attribute a significant importance only to one of the internal control components, which is the internal accounting and financial control, from where results the detailing of the general objectives of the internal control of financial and accounting function;
- yet, the management of entities must not limit the scope of internal control, only to internal accounting and financial control, because the scope of internal control is much wider than the scope of internal accounting and financial control;
- the organization of an internal control system, specific to economic units is compulsory only for public entities;
- as for the method of implementation of internal control activities, we can see that in most entities, they are not formalized (are not specific internal control procedures);
- regardless of the method of organization of internal control, the manager has to choose the most appropriate forms, techniques or procedures of internal control in the fulfilment of managerial objectives.

Bibliography

1. Lenghel R.D. (2011). *Financial Control and Audit*, Editura Risoprint, Cluj-Napoca.
2. Lenghel R.D. (2011). *Internal Control and Audit*, Editura Risoprint, Cluj-Napoca.
3. Order of the Minister of Public Finances no. 3055/2009 for the approval of accounting regulations compliant with European directives further amended and supplemented.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.