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ORGANIZATIONAL SYSTEMS OF INTERNAL FINANCIAL CONTROL IN THE WORLD

Theoretical article

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Abstract

Beyond the multitude of definitions, internal control is found in the centre of managerial concerns worldwide. This amplification of interest towards internal control has its origin in a series of events, of which two can be mentioned: the growing business complexity and dispersal activity centres, which led to the growth and development of the delegation of competence, the only way which enables the responsible to exercise powers from a distance and entirely, bringing together the components needed by its delegates.

Regulatory domain, which has not ceased to expand: laws, regulations, rules, professional constraints, budgetary and social – all these have increasingly limited the decision makers, through a network of rules that must be respected.

Consequently, what can be done to be safe from any punishment and to ensure constant watch over the essentials?

To answer these questions, and many others, experts in the field have taken initiatives that have enabled them to define with precision the specific internal control and to set goals, creating the famous models: COSO and CoCo.

1. The COSO Model

In 1980, the American Senator Treadway initiated a major research on the internal control system and its role in the life of organizations, creating the Treadway Commission in the USA.

On the recommendation of this Commission, the Committee of Sponsoring Organization of the Treadway was created, later known all over the world under the name of COSO, which gathered many professionals in the field of external audit, internal audit and American enterprises which drew together a paper entitled Internal Control Code, which defines what internal control means, concluding that it has no direct connection with the recognized inspection and verification systems.

As I mentioned, the definition of the concept of internal control is an issue that still raises controversy, but that tends to accept internationally the same meaning of the term in English, "internal control", which means first and foremost "to have control" and then "check", and not its meaning in French, which is "to check" and then "to inspect".

In the whole complex set of means and practices that any entity uses to better manage its activities in order to achieve the established objectives, COSO, through the control framework developed, induced certain order in the field. Therefore, the definition of internal control that COSO gave in 1992 can be retained, and which is still current.

Internal control is a process implemented by the Board of Directors, management and staff of a corporate entity designed to provide reasonable assurance regarding the achievement of the objectives.

This definition proposes a number of key elements: internal control is a process, a means to achieve an end, and not an end in itself; internal control is performed all over the world and means not only policy manuals, forms and documents, but also the people at every level of the organization; internal control implies relativity in organization and it is not a magic that will lead to making perfect work; internal control management has a number of expectations regarding the provision of reasonable insurance and not an absolute insurance; internal control refers to all types of entities and activities and not only to organizations or businesses.

Also in 1992, the Commission on the next to Tradeway COSO developed a model of internal control and risk assessment, symbolically represented by a pyramid containing the essentials, namely: control environment; risk assessment; control activities; information and communication; monitoring (figure no. 1).

- **Control environment**

It represents general attitude, integrity, ethical values and behaviour of employees, philosophy and operating style of management, assignment of authority and responsibility and the system of organization and development of the Board of Directors.

The control environment is part of the institutional culture, which is influenced by the style of leadership, the value system of appropriated employees, professional competence and integrity of the people, activities and procedures, organizational structure, segregation of duties, I.T., and provides the framework within which it unfolds the different forms of internal control.

Experience has shown that changing corporate culture is accomplished in time and because of this management should oversee and monitor its evolution permanently. The control environment is one of the important elements that require businesses to organize an effective internal control system. Thus, we can face:

- *a favourable control environment, which implies the existence of a climate where ethical values are privileged, which uses, accepts and appreciates control, which means*

that internal regulations and ethical codes of conduct are taken into consideration by all factors, including the general management;

- *an adequate* control *environment*, which complies with the laws, rules, procedures, third parties, partners, employees, contracts and thus the entity's activities are kept under control;
- *a damaged control environment*, where there is no formalized procedure, where controls are avoided, there are violations of the rules of conduct and regulations of operation or even breaches of the legislative framework – all these damaging the internal control.

Structurally, the most important factors that influence decisively the control environment are: the functionality of the management structures; management policy and operating style; the organizational structure of the entities; the method of calculating the authority and responsibilities; the management control system, which also includes the internal audit function; the personnel policies and procedures; the segregation of duties.

- **Risk assessment**

Any entity is subject to the risks that can be its own operation risks or of the organization itself, the specific risks of each activity, as well as external risks. Some risks are acceptable and inherent, others, however, are unacceptable. In order to avoid unacceptable risks as far as possible and maintain a level of acceptable risk tolerance, organizations create internal control systems. The basic element of internal control of the entity is the existence of a system of analysis and risk assessment within it.

Risk assessment involves defining the objectives and conditions that need to keep in mind, in particular, for the management of change, taking into account the fact that people change, change procedures, political organizations are changing, and therefore the risks of change and, consequently, internal control is condemned to a permanent adaptation to new conditions.

- **Control activities**

These are specific elements (policies, procedures, etc.) which will enable the function, activity, operation in accordance with the general objectives of internal control.

In conclusion we can say that there is an internal control or a system of internal control within an entity if there at each hierarchical level, sub-function or operation, control activities, in order to avoid risks from those levels.

Internal control system is the framework within which the activities of control available to the management operate, which must consider and anticipate the changes to achieve the forecasting character of control on the evolution of the entity.

The main objectives of the process of internal control are: operational objectives, to ensure the efficient use of assets and other resources of the entity, as well as protection against losses; for informational purposes, to provide for the preparation of reports on time and reliable, allowing decision-making within the organization; the objectives of compliance to ensure that overall activity is run in accordance with the applicable laws and regulations, supervisory requirements and with the policies and internal procedures.

- **Information and communication**

Relevant information is the key information that is received by us, as a rule, in time and in a convenient form. It must be identified, collected and communicated in the time span so that to give people the opportunity to meet their responsibilities. Useless information should be eliminated and critical information should be analyzed. Information systems produce reports containing operating, financial and compliance information, that make possible the leadership and control of the

activities of an organization (Domnisoru, S., 2007).

Effective communication needs to take place in a broader sense and to involve all the activities and all the structures of the organization. The entire staff of the entity must receive a clear message from management regarding the need to take seriously the responsibilities that are entailed to them, but also the connections of individual activities with the work of the others.

Internal control has relationships with those who control through information and communication, supplemented by references to the external environment.

All these reach the top and management monitors and arranges for their realization. The internal control system must provide services that will be needed, and auditors should consider it. Consequently, a good internal control must look at the world around, have signals from downward and outward, know the objectives to be updated regularly and then organize to master risk.

- **Monitoring**

Practice has proven that managers at all levels, especially those who do not have formalized procedures, internal control mechanisms usually do without realizing it.

Thus, each responsible for organizing and conducting the work through tasks: definition of each, drawing up the instruments and techniques, professional training, equipment and electronic systems. In this way, the person responsible for a system of internal control to manage the function, they act systematically according to the evolution of general and specific risks.

Monitoring is a process of assessment of the quality system performance over time and is done by continuous supervision activities, separate evaluations, or a combination of the two.

Continuous monitoring is done in the course of performing transactions and includes the management and monitoring activities and other actions you take on staff to fulfil their tasks.

Scope and frequency of separate judgments will depend on the risk assessment and the effectiveness of monitoring continuous activities. The components of the COSO model, as have been presented, create a synergy that forms an integrated system that reacts dynamically to changing conditions in the external environment.

2. The CoCo Model

In November 1995, a Canadian organization is proposing a model based on the criteria of Control Committee - CoCo, which defines internal control as represented by the organizational structure that includes resources, systems, processes, culture, structure and other items which, put together, contribute to the achievement of the objectives.

For the first time, internal control is defined as a process that is realized at all levels and includes all activities, designed to provide reasonable assurance on the management function of an entity.

The definition of the CoCo model by the Canadians completes the definition of the COSO one, designed by the Americans.

Thus, in the CoCo concept model, internal control is represented by the organization's resources, processes, tools, tasks, organization culture and everything that we can imagine for the accomplishment of the objective which, because of relativity, will never be perfectly fulfilled.

One of the prerogatives of the audit is to ensure the reliability and, to a certain extent, the guarantee of the organization in the achievement of its purpose. The Canadian model recommended to encourage the improvement of control and vastly exceed the framework of an analysis of traditional controls by setting the

control efficiency criteria (Brezeanu, P., 2001).

The recommendation encourages a pattern that all individuals of the organization can use to implement, evaluate and modify their own internal control.

Effective control contributes to the success of an organization in various ways: people have the flexibility needed to adapt to the changes, then people can express their views and use their own creativity, managing the risk of inappropriate actions; have reliable information on individuals who are able to use them at the appropriate time and when it is most appropriate for them.

In accordance with the principles of the CoCo model, the smallest unit of an organization is a person who fulfils duties based on the understanding of their purpose, leaning on his ability, competences, and resources.

For correct execution of the tasks delegated to them, people need: to engage in solving tasks; to monitor performance; to monitor the external environment; to learn and accomplish tasks as best as possible and to identify changes that might be required.

According to the CoCo model, the essentials of control in any organization are: purpose, commitment, capacity, monitoring, learning organization (figure no. 2).

To understand the nature of the checks, the following concepts are important:

- *control is made by people from all over the organization, including the Board of Directors, management and other staff members*. Individuals are responsible for designing, implementing, monitoring and maintaining control, which is affected by many factors that influence motivation and organizational behaviour of people;
- *people who are responsible, individually or in a team, for achieving the objectives must be responsible for the effectiveness of control and contribution to the achievement of these objectives*. These people, whether they are managers or not, have a duty to assess the effectiveness of control regarding tasks, team or work unit for which they are responsible;
- *organizations are constantly in a process of interaction and adaptation*. Organizations constantly adapt depending on changes in the external environment (legislative system, banking system, third parties) and in the internal environment (people, priorities, rules, internal regulations);
- *I can expect from control to provide absolute assurance.* Even when I gave evidence of prudence and understanding, absolute assurance is not possible for two reasons: firstly, there are inherent limits of control, related to the possibility of errors in judgment in decision making, the production of human error attributed to dysfunction, bad faith displayed by some employees. Control allows to reduce the number of errors and malfunctions, but cannot provide an absolute assurance that there will be others; Secondly, we can and must we take into account the cost-benefit balance. The cost of control should be put in relation to the benefits, including the reduction of risks covered.
- *effective monitoring requires the maintenance of a balance between autonomy and unity*: — to keep this balance, we are often forced to move to centralization and decentralization from the imposition of constraints on the granting of freedoms; the situation in fact and adaptation to changes-to keep this balance can require more coherency for the purpose of efficiency or to

give greater flexibility to allow adaptation to changes.

CoCo model recommendations may be useful to members of the Board of Directors, managers and other persons who are responsible for the control of an organization. Let a full liberty's recommendations on how to implement the control, in the sense that they do not provide detailed procedures or policies, organizations can be given different attention each criterion stipulated for the CoCo.

Control model is a means to understand the major elements of control, including the important relationships that exist between these elements. CoCo model represents key criteria for control and grouping of these criteria, the four elements of the model: purpose, commitment, capacity, monitoring and learning.

Criteria for the purpose of contributing to the organization's orientation, refers to the objectives, risks and opportunities, policies, planning, performance indicators, and are as follows: you must establish and communicate objectives; internal and external risks that face the organization should be identified and assessed; should be established, communicated and put into practice policies which aim to achieve the objectives of the organization and the facility management of risks which they face; you need to establish and communicate the plan to guide efforts in achieving the objectives of the organization; objectives and related plans must include goals and quantifiable performance indicators.

Criteria concerning commitment contribute to the statement of the identity and values of the organization. These refer to ethical values, including integrity, policies relating to human resources, responsibilities and obligations of mutual trust: reporting across the organization must be defined, communicated and put into practice the ethical values, including

integrity; policies and practices in matters of human resources should be in conformity with the ethical values of the organization, to be consistent with its objectives; powers, responsibilities and reporting obligation must be clearly defined and consistent with the objectives of the organization; in order to facilitate the circulation of information between people, we must foster a climate of mutual trust (Dobroteanu, M., Dobroteanu, C.L., 2002).

Criteria relating to capacity contribute of the organization competence, refers to the knowledge, tools, processes, information, communication, coordination, and control activities, and are the following: people must have the knowledge, competencies and tools required to help to achieve the objectives; communication processes must support the values of the organization and its objectives; the information to be relevant and sufficient and be communicated in terms acceptable to allow people to meet responsibilities; the decisions and actions of the various parts of the organization should be coordinated; control activities should be designed so as to make it an integral part of the organization, to keep in mind its objectives and risks that could affect their performance.

Criteria relating to monitoring and learning contribute to the evolution of the organization, refers to the monitoring of external environment and internal performance monitoring, review, reassessment of the assumptions underlying the information needs and related systems, process monitoring, evaluation of the effectiveness of control, and are as follows: the external environment and internal environment must be monitored to obtain information that may signal the need for revaluation in organization or control objectives; performance must be subject to monitoring by means of goals and indicators defined in the Organization's goals and plans; the assumptions inherent in the Organization's

objectives should be periodically reviewed; information needs and related systems should be revalued when you change targets or when they are detected deficiencies in communicating information; you need to establish and apply procedures for monitoring to ensure that changes are made or actions; management should periodically assess the effectiveness of control within the organization (Ghita, M., 2005).

Control CoCo model, synthetically presented, is a useful and global way of looking at control, so in practice they have to give proof of the creativity in the interpretation and application of the recommendations. Entities may adopt this model, or they can use it to develop or modify their own pattern.

3. Organization of internal control in the EU

Organization of control in the EU can be found in the Yellow Book of the European Commission "Welcome the CFPI world" where internal control is geared toward transparency, clear responsibilities, methodology and standards aligned with the Community acquis.

Transparency is the manifestation of the principle of governance that you of the responsibility of civil society designated/assigned a State administration in order to increase revenue and undertake expenses on behalf of/or interest.

Transparency requires that decisions and their implementation is in accordance with existing rules and regulations, entailing the free circulation of information and its availability to those who are targeted in the case of decisions and implementation.

The same Yellow Book defines that the CFPI has 3 elements/pillars:
- *managerial responsibility* (for the introduction of financial management systems and control/management control);
- *an independent internal audit function* (introduction of internal audit in public entities);
- *central harmonization unit (PCU)* for the development of methodologies and standards relating to the first two components (managerial accountability and internal audit).

In order to implement the CFPI, the following stages must be taken into account: conceptualization (translating theory into concepts), development of organizational framework, development of legal framework, and establishment of a policy of staff development. In practice, these stages are interrelated, and experience shows that implementing the CFPI starts as soon as the concept has been recognized in that country.

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Book
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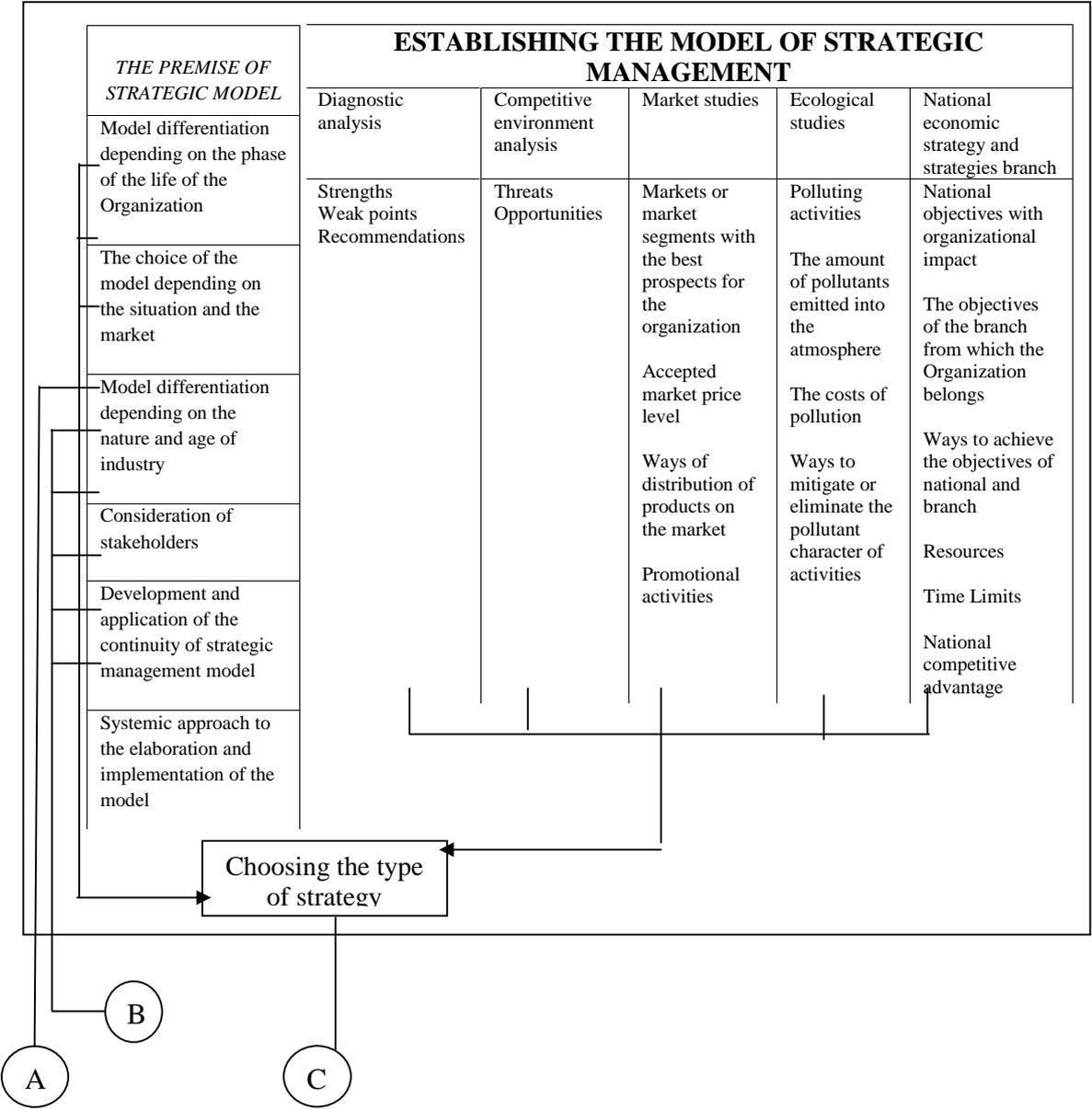[4] Brezeanu, P., (2001), *Audit and financial Control*, A.S.E. Publishing House, Bucharest.

THE PREMISE OF STRATEGIC MODEL	ESTABLISHING THE MODEL OF STRATEGIC MANAGEMENT				
	Diagnostic analysis	Competitive environment analysis	Market studies	Ecological studies	National economic strategy and strategies branch
Model differentiation depending on the phase of the life of the Organization	Strengths Weak points Recommendations	Threats Opportunities	Markets or market segments with the best prospects for the organization	Polluting activities	National objectives with organizational impact
The choice of the model depending on the situation and the market			Accepted market price level	The amount of pollutants emitted into the atmosphere	The objectives of the branch from which the Organization belongs
Model differentiation depending on the nature and age of industry			Ways of distribution of products on the market	The costs of pollution	Ways to achieve the objectives of national and branch
Consideration of stakeholders			Promotional activities	Ways to mitigate or eliminate the pollutant character of activities	Resources
Development and application of the continuity of strategic management model					Time Limits
Systemic approach to the elaboration and implementation of the model					National competitive advantage

Choosing the type of strategy

A   B   C

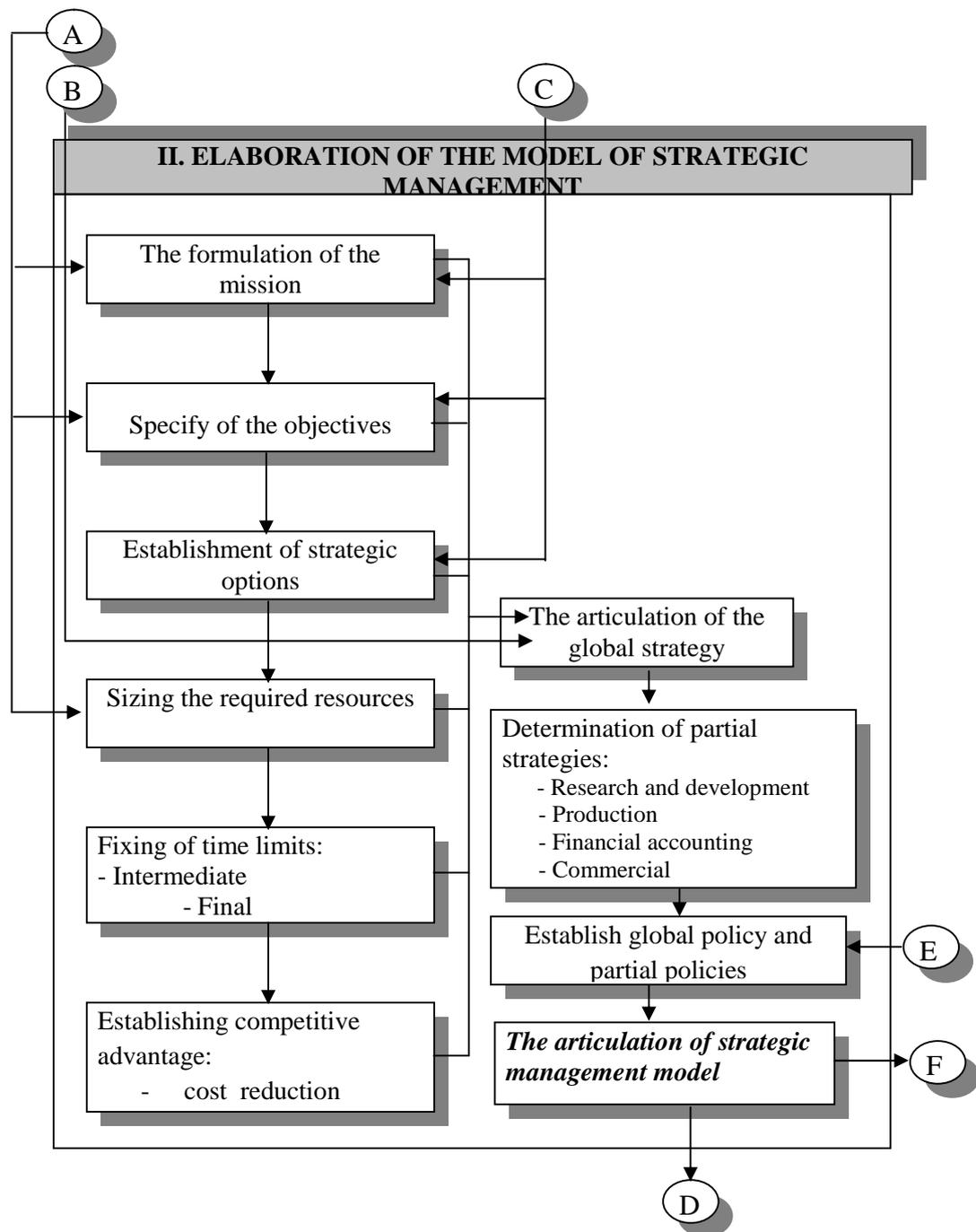*Figure No. 1* Establishing the model of strategic management

Figure No. 2 Elaboration of the model of strategic management

A

D

III. IMPLEMENTATION OF THE MODEL OF STRATEGIC MANAGEMENT

Preparation of the Organization's climate:
- Increase reaction of innovative elements
- reducing resistance to change
- changing the culture of the Organization

Ensuring the preconditions for the material, human, financial, information

Financing sources:
Own
Attracted

Natural resources (raw materials, construction materials, equipment, etc)

Financial resources

Human resources (changing the corporate culture)

Informational resources

Providing managerial conditions:

methodological system redesign

informational system redesign

the decision-making system redesign

organizing system redesign

management training

The mentioned changes planned

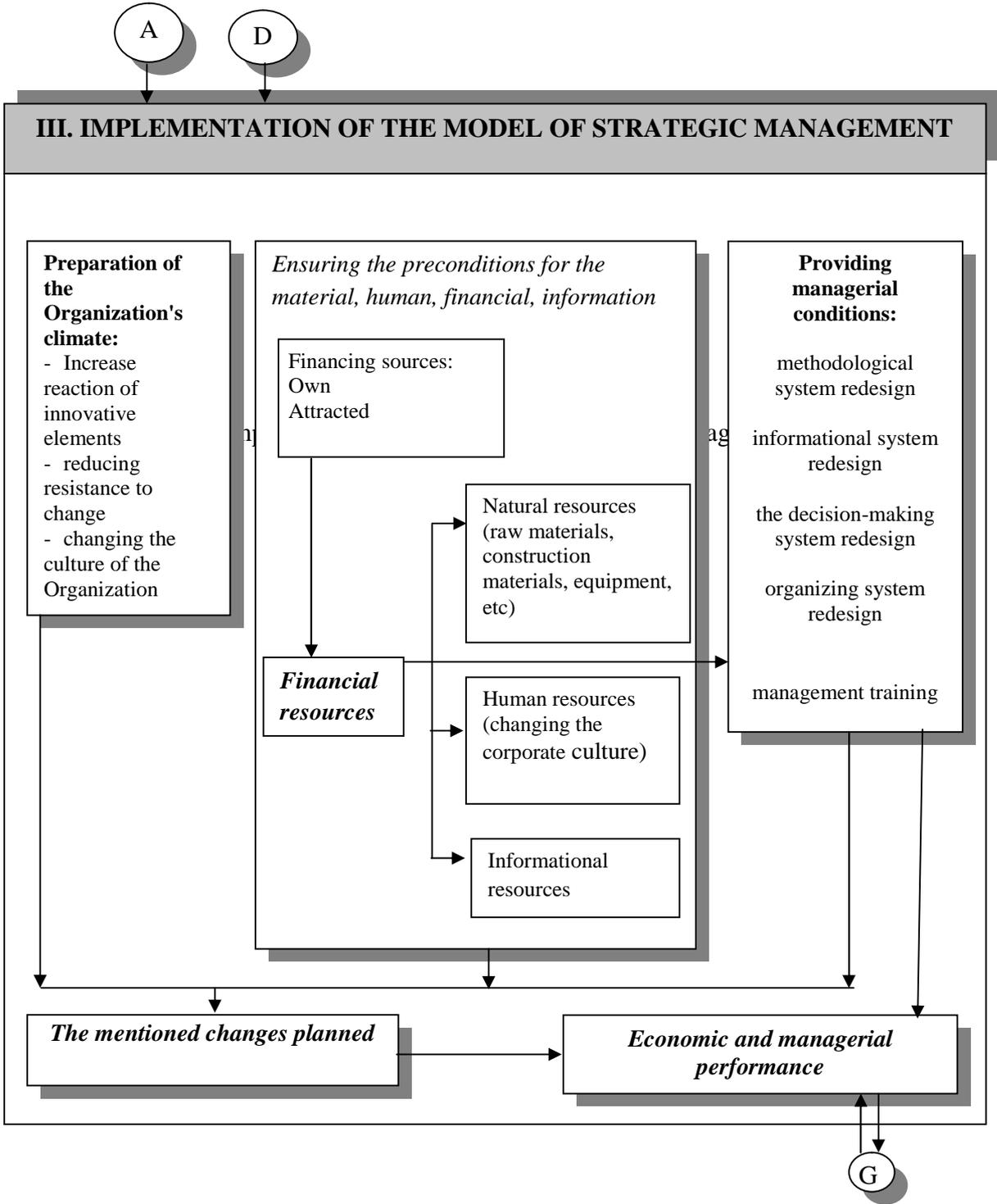*Economic and managerial performance*

G

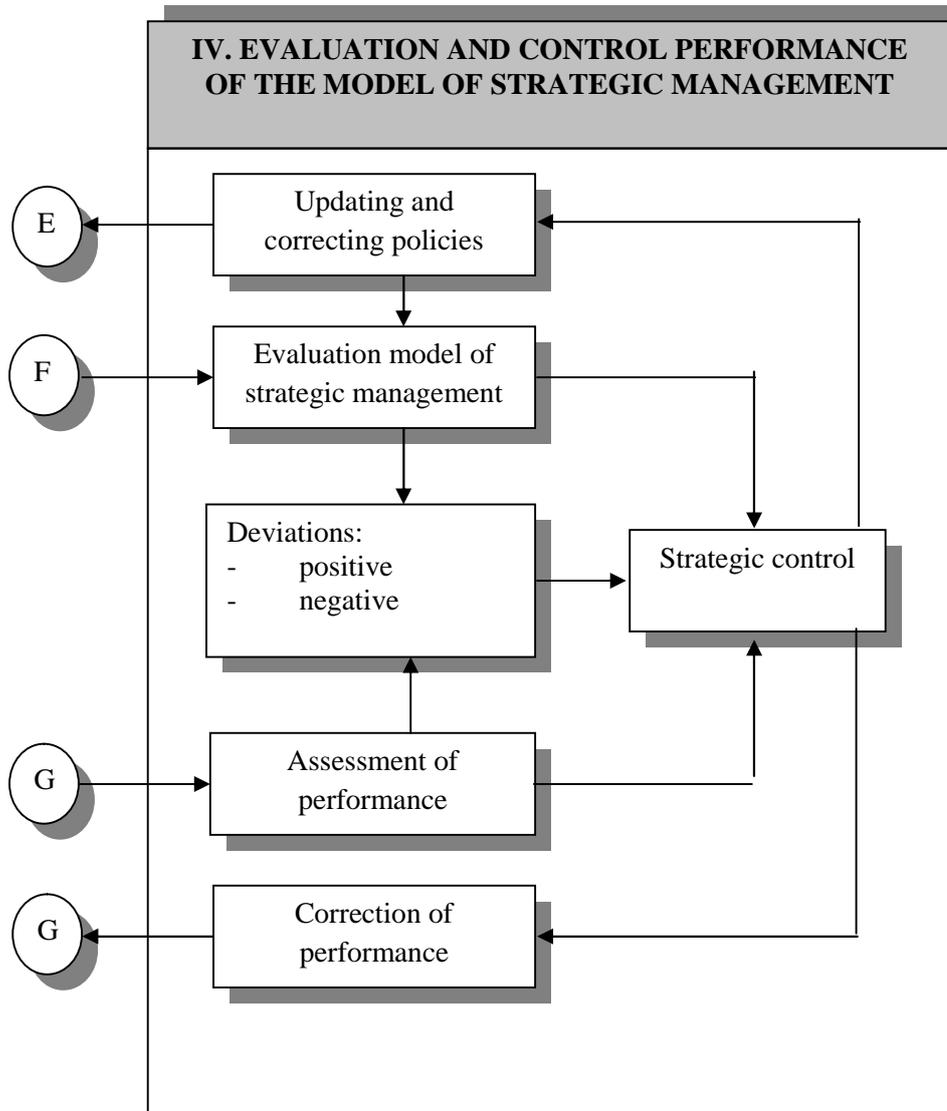*Figure No. 3* Implementation of the model of strategic management

Figure 4 Evaluation and control performance of the model of
strategic management