# THE IMPACT OF THE INTERNAL / MANAGERIAL CONTROL OVER ACCOUNTING

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**Abstract**

*The increasing need for information in the public sector entities, corroborated with the need to provide comparable and transparent information, have constituted consequences of the development and popularization of IPSAS standards, high quality standards inspired by IFRS, which, since 1996, have led to the development of an original doctrine on all public sector issues. The process of developing the accounting of public institutions, includes the adoption of accrual accounting in the assessment and reporting of the financial performances in accordance with IPSAS, according to which the use of accrual accounting is a principle of accounting by which transactions and events are recognized at the time of their occurrence and not at the time of their materialization in cash or cash equivalents received or paid.*

**Keywords:** financial performance, national accounting regulations, treasury result, internal control

**JEL Classification:** G3; G32; G34

## 1. Introduction

In our country, the adoption of the accrual accounting in the public sector was based on national regulations inspired, to a small extent, by the International Public Sector Accounting Standards, and in the reporting the financial performance, it is used with cash accounting. In this respect, it was necessary to group the expenses and revenues in the accounting, according to the nature of the activity, in expenses and ordinary incomes and extraordinary expenses and income. Under the new regulations, any activity engaged by an entity as part of its business or commercial activities is an ordinary activity. Ordinary activities (activities the entity carries out to achieve its fundamental objectives) include any related activities in which the entity engages in the incident promotion or the one deriving from these activities. We mention that it should be considered the distinction between the current income, ie the expenses generated from the exploitation activities, of those arising out of the ownership of assets or those related to the financing of the entity's operations.

## 2.The Implementation of the International Public Sector Accounting Standards (IPSAS) - Comparative study

However, the latter can not be included in the category of extraordinary activities. Under the accrual accounting, the effects of the transactions and of other events are recognized when they occur and not as cash is accrued or paid, and recorded in the accounting and reported in the financial statements of those periods. In other words, the income for services provided to third parties are recognized at the time of billing and the expenditure on benefits received from third parties are recognized at the time of receiving the invoices, as follows:

◦ claims, debts and capitals are recognized when rights and obligations of economic value arise;

◦ revenue is recognized when it is realized;

◦ expenses are recognized when they are consumed.

The concept of accrual accounting is adopted in accordance with the principle of exercise independence, according to which the net profit of each period should reflect the events, transactions and circumstances of that period. Information obtained as a result of

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compliance with the requirements of the accrual accounting concept, adequately reflects the financial position and performance of the entity.

The changes that took place in the public accounting system in our country, regarding the harmonization with the IPSAS standards and the European accounting directives, were profound.

We can conclude that, in the context of national accounting regulations, based on accrual accounting, the only component that has the objective of measuring financial performance is the patrimonial asset account.

Regarding the form elements we highlighted in the three reporting patterns, by performing a comparative analysis thereof, it appears that there is clear interference between the national accounting regulations and IPSAS 1 in terms of the basis for reporting and the presentation format. At the same time, there are differences in the titles of the models even though they have the same content, due to the different translations of the original texts into Romanian which has created certain difficulties in the process of reporting and disseminating the financial performances for all categories of users.

As it can be seen, from the comparative analysis of the patrimonial asset account from the point of view of the underlying elements, by applying national accounting regulations as compared to IPSAS 1 results in the following:

▪ according to the accounting regulations in our country, the patrimonial asset account presents the situation regarding the financing, the income and the expenses, but without taking into account their impact equity and the accentuation of the fiscal connotation. Contrary to these, IPSAS 1 provides more complete information on the financial performance, information that can be used by a wide range of users to make decisions on the allocation of resources;

▪ the criterion for disclosure of information according to national accounting regulations is maximal, unlike IPSAS 1 which offers a minimum of elements specific to the reporting of financial performance through the patrimonial asset account; It is noted the absence of an alternative for presenting information also through other elements of the financial statements, as well as the uniqueness of the classification of expenditures and revenues, which lead to the diminishing of the relevance and comparability of the information on financial performance;

▪ the unrealistic association, by the national accounting norms, of the concept of the patrimonial result with the economic result.

The cash flow statement is of low interest to users in measuring the financial performance on the basis of the treasury result. This is due to the divergences between the vision of the national and the international accounting norms in connection with the absence of the indirect method of determining the cash flows from the operational activity as well as the reference to the special cases, thus limiting the informational value of these situations. On the other hand, the inclusion by the accounting standard setters of the budget execution account in the set of financial statements has led to a reduction in information value of the cash flow statement as a model for reporting financial performance. The further practice of cash accounting, subsequently completed by accrual accounting, gives an erroneous perception of the information on the performance disseminated by the cash flow statement. Also, It is not explicitly recognized the situation of changes in net assets / equity, by national accounting norms as a model for reporting financial performance in the public sector, which is why its presentation is made succinctly. Difficulties in reporting the financial performance are also generated by ignoring the impact of revenues and expenditures on equity, the absence of actual accounting policies and implicitly the effects of changes in accounting policies and error correction.

Among the advantages of adopting IPSAS by our country, we can list: the significant increase in the quality of financial reporting by the public institutions, increasing the credibility and transparency of the information presented, better control and greater transparency of assets and liabilities, detailed cost information and, implicitly, performance-oriented management and resource efficiency management, more efficient service delivery, valuation of responsibilities at the level of all the resources managed by the entity. Also, the adoption of standards has also had a favorable impact on making the decisions regarding providing resources or developing new activities, assessing the financial position, of the performance and cash flows of public institutions, a greater consistency and a better comparability of the financial statements due to the fact that each standard requires the submission of uniform, detailed and specific information.

## 3. The role of internal control on the quality of the information, obtained in the financial-accounting activity of public entities

It is well known that the financial-accounting activity of any entity represents an important function as it measures the evaluation, knowledge, management and control of the assets, debts and capital, as well as the results obtained from the economic activity. Within this function, there are recorded the chronological and systematic recording, processing, dissemination and use of information on financial position, financial performance and cash flows necessary for all stakeholders. We appreciate the information that the financial-accounting activity provides to the internal and external users, both to the management of the organization for making decisions and to the other users, it is of particular importance, requiring the implementation of an efficient risk management system. The quality of the information obtained depends on the quality of the internal control that identifies the inherent errors belonging to the accounting operations, to ensure the reliability or accuracy of their transmission and the completeness of the information developed in "the upstream processes", a role exercised by:

□ the identification of significant processes and categories of operations and the accounts or groups of accounts to which these are associated;

□ identifying the control activities implemented to prevent, detect or correct risk areas, irregularities, inaccuracies and procedures related to the prevention of fraud and error;

□ the identification of legal and regulatory provisions in accounting, tax and financial matters;

□ insuring the assets of the entity's patrimony;

□ ensuring that the entity's accounting events are properly identified and documented.

Therefore, the proper functioning of the entity's internal processes, including those related to the protection of assets and the reliability of financial information, is a major objective of the internal control. We consider that, for a proper functioning of the financial - accounting activities, the entity must establish and implement sets of measures to ensure, to a possible extent, rigorous accounting and reporting, measures that make up the internal accounting and financial control. It must aim at ensuring that:

- the accounting and financial information published comply with applicable regulations;
- management's instructions on accounting and financial information have been fully applied;
- the entity's assets have been protected;
- it has been acted to prevent and detect accounting and financial fraud and irregularities;
- it has been assured the reliability of the published accounting and financial information and it has been communicated to stakeholders.

We appreciate that in order to ensure the reliability of the financial information, the internal control must be based on the internal rules and procedures approved by the entity's management regarding:

◦ initiation and approval of all financial and accounting operations;

◦ management and access to all the assets of the entity;

◦ protection and access to files and records and financial statements;

◦ inventory of assets, liabilities and equity.

Regarding the quality of the information in the accounting system of public entities, it is very important that the internal control action should aim, in particular, at meeting the following criteria:

◦ the completeness and integrity of records - all the operations in an entity must be reflected in appropriate supporting documents and recorded in the accounting in the order of occurrence of events (asset write-offs / write-downs) without omissions or transactions accounted for several times; the adequate inventory of all the elements of the entity's assets and liabilities.

◦ the reality of the records - all information recorded in the accounts and summarized in the financial statements must be based on verifiable supporting documents.

In our opinion, the proper functioning of the activity also involves protecting assets against fraud and error or poor management decisions, actions that must always concern management. It should also be taken into account the processes in which the accounting and financial information is prepared and processed through the following successive stages:

□ comparing the desired, ideal situation, with the real situation;

□ the analysis and assessment of the risks that threaten the activities of the verified entity and of the deviations from established parameters;

□ the capitalization of the results;

Therefore, the reliability of the financial information can only be achieved through the implementation of internal control procedures, which accurately capture all the operations that the entity performs.

In conclusion, the internal control of an entity's financial and accounting activity is applied to ensure rigorous accounting management and to pursue its financial activities so that the entity's objectives are not jeopardized. It targets all the processes in which it takes place the obtaining and disseminating of accounting and financial information, thus contributing to the achievement of reliable information, complying with the legal requirements in force.

## 4. The financial - accounting information covered within the internal control system

Even though the internal control activities are directed towards all the activities and functions of the entity, the quality of the financial-accounting information is a major objective. However, the control activities are not only limited to traditional checks or regulations on accounting operations or financial statements, but they also imply a wider reflection on the risks that threaten these activities, as well as the identification of the effective means of their management, such as: segregation of duties, information security system, reliability of reporting.

The quality of the financial-accounting information is particularly important for any entity, as qualitative characteristics are the attributes that determine the usefulness of the information reflected in the financial statements. There are four main qualitative features, defined as:

▪ the intelligibility - the information provided by the financial statements must be easily understood by the users;

▪ the relevance - is given by the ability to influence the economic decisions of users, which helps them evaluate past, present or future events, confirm or correct their previous assessments;

▪ the credibility - the information is credible when it does not contain significant errors and is non-biased (neutral, free of influence) and provides users with confidence that events and transactions that have taken place within the entity are faithfully reflected in its accounting and financial records;

▪ the comparability - the information must be comparable over time in order to be able to identify financial position trends and their performance.

In our opinion, for information to be relevant and credible, it must be sincere and appropriate so that the users can make decisions in a timely manner and the benefits accruing from the use of that information outweigh their cost. This information needs to be synthesized and analyzed from the point of view of its accuracy and correctness. In this respect, based on the two fundamental principles of accounting, the principle of double representation of assets and the principle of double entry in the accounts, the accounting method uses the verification balance as the bridge between the account (information provider on each asset and liability item) and the balance sheet (the overall situation of the budgetary institution's activity at a given point in time).

It performs the outlined role by performing the following functions:

a) **the function of checking** the accuracy of the economic operations in the accounts;

b) **the function of grouping and centralizing** the data recorded in the accounts, which provides information of the volume of changes in the patrimony structure, of the financial results both for the current period, as well as the cumulation of the previous period;

c) **the link between the Synthetic Accounts and the Balance Sheet -** the final balances of the synthetic asset accounts and of the passive ones are recorded in the verification balance and then taken over, processed and grouped according to the needs of the balance sheet;

d) **the link between the Synthetic Accounts and the Analytical Accounts** – the balances of the analytical accounts shall be drawn up for each synthetic account and shall verify the consistency between the analytical accounts and the synthetic accounts to which they belong;

e) **the function of analysis** of the economic-financial activity is done by grouping current account data.

So, with the help of the verification balance, it is centralized the entire economic and financial activity of the institution reflected in the accounts to provide comprehensive information on all the assets under their operative management and on the activity during a given management period. At the same time, it helps to verify the accuracy of accounting records and to check the consistency between the synthetic and analytical accounting and it is the main instrument underlying the preparation of the financial statements.

## 5. The evaluating and reporting of the financial position of the public entity

It is well-known that each entity, regardless of ownership, is required to prepare and report timely, according to legal provisions, the annual financial statements. As part of the financial reporting process, the financial statements are presented in the form of formal reports reflecting the financial position and profitability at the end of a period in the current financial year and represent the basic information source for internal control. The purpose of these financial statements is to provide reliable information on the results and the financial position of the organization and the economic reality of the transactions made, while being impartial, understandable, prudent, relevant, fair, comparable and credible.

The financial statements consist of: balance sheet, property statement, cash flow statement, the statement of changes in the net asset / equity ratio, the budget execution accounts and the annexes to the financial statements (accounting policies and explanatory notes).

*The annual balance sheet*

Being considered a static instrument, the annual balance sheet is also necessary information for the authorizing officers, its analysis being made in order to determine the financial situation of the institution compared to that of the similar units. Also, the balance sheet is also used to monitor the evolution of certain financial indicators based on the data in the financial reports.

As the main method of accounting, we can say that the balance sheet represents the fundamental information base, which comprises in its synthetic form and in terms of value, the patrimonial economic means, the sources of their constitution, as well as the patrimonial outcome at a given moment. We appreciate that all accounting information merging from the balance sheet, constitutes the support of its analysis and underpins the development and substantiation of managerial decisions, filtered through internal control system actions.

In conclusion, the balance sheet represents the most complete and accurate source of characterization of past activity, but also of the development of the forecasts for the institutions, and their quality depends to a great extent on the quality of the internal control.

*The property account*

The property income account presents the income, financing and expense statement for the current year. Revenues and financing are presented, on revenue types, by their nature or source of origin, regardless of whether they were cashed or not, and expenses are presented on the types of expenditures, by their nature or destination, whether paid or not. In the patrimonial income statement there is also presented the revenue calculated, which does not imply a payment (eg income from the resumption of provisions and value adjustments).

*Statement of cash flows*

The objective of cash flow statements is to require the disclosure of historical changes in cash and cash equivalents of an entity by means of a cash flow statement that classifies cash flows during the period from operational, investment and financing activities, as follows:

- cash flows from operating activity - include cash movements arising from current activity: receipts and payments;
- cash flows from investment activity - show cash movements resulting from purchases or sales of fixed assets: receipts and payments;
- cash flows from financing activity - are materialized in cash movements resulting from borrowings received and reimbursed or from other financial sources: receipts and payments.

In our opinion, an entity's cash flow information is useful to provide users of financial statements with a basis for assessing the entity's ability to generate cash and cash equivalents and its needs for the use of those cash flows. At the same time they are necessary for taking economic decisions, by users and impose an assessment of an entity's ability to generate cash and cash equivalents, as well as for their placement in time or for the safety of their generation.

*Accounting treatments*

Accounting treatments refer to how items in the balance sheet are measured and reflected. In the accounting of public institutions the patrimonial items are valued in four moments: entry into the patrimony, inventory, balance sheet and when exiting the patrimony.

*Attachments to the financial statements*

The annexes are an integral part of the financial statements and contain: accounting policies and explanatory notes. The explanatory notes provide additional information that is not included in the financial statements.

*Accounting Policies*

*The a*ccounting policies represent those accounting concepts related to each organization, on solving all the financial problems and require the establishment, by the management of that institution, of a set of procedures for all the operations underway, starting with the preparation of the supporting documents up to the quarterly and annual financial statements. Once the configuration of the accounting policy has been established, it can only be amended unless the normative acts in force provide for it or result in more relevant or more credible information on the operations of the public institution, which must be mentioned in the explanatory notes.

*Explanatory notes*

Explanatory notes are an integral part of an organization's financial statements and help to create the most accurate image of the assets, liabilities, outcome of the period and the financial and economic position of the institution.

*Budget execution account*

The budget implementation account shall comprise all financial transactions during the financial year in respect of the revenue received and the payments made in the structure in which the budget was approved and shall contain:

□ income information: initial budget provisions, final budget provisions - established entitlements - payments received - receivable established entitlements;

□ information regarding expenditure: initial budget appropriations, final budget appropriations - budgetary commitments - legal commitments - payments made - legal commitments to pay - actual expenditure (costs, resource consumption);

□ information on the outcome of budget execution (receipts minus payments made).

The budget execution account shall be drawn up on the basis of the data taken from the debit and credit operations of the disposable accounts that must correspond to those in the accounts opened with the Treasury or the banks, as the case may be.

**6. Conclusions**

Within the public entities in our country, the internal control system functions in a constantly changing environment due to the inherent legislative changes, but also to the influence of politics. Depending on the specificity and complexity of the institution they administer, managers must establish a set of precise and clear rules, flexible at the same time, from one situation to the next, tailored to the level of each activity, to facilitate efficient and effective control. In this context, we appreciate that for the good functioning of the public sector, the proper functioning of the internal control system and the prevention of errors and dysfunctions that may arise, the control system builders will have to focus on developing those internal control tools that may influence the activity of the entity as a whole. The functioning of the control system within public institutions must take into account the following characteristics: accountability and reporting, compliance with applicable regulations, conducting systematic operations, efficient and effective, and also the protection of resources.

Between the four characteristics and the representative elements of the internal control (control environment, risk assessment, control activities, information and communication, monitoring), there is a direct relationship at all levels of the entity, regardless of its nature or size.

Regarding the role of internal / managerial control in ensuring the reliability of the accounting system and the reality of financial reporting, given that the accounting process is the central point of internal financial and accounting control, we believe that the achievement this goal can be done through the implementation of internal control procedures that encompass all financial-accounting operations performed within the entity. Also, obtaining quality financial-accounting information leading to making the correct decisions in line with reality, assumes that, the control function, to manifest itself in all phases of economic operations both at the time when the expenses are incurred and when the income is earned as a result of their own activity.

The information that the financial and accounting activity provides to internal and external users, to the management of the organization for decision-making as well as to other users is of particular importance, which implies the implementation of an efficient risk management system. The quality of the financial-accounting information obtained, depends on the quality of the internal control to identify the inherent errors in accounting operations, to ensure the reliability or accuracy of their transmission and the completeness of the information developed in the "upstream processes".

The development of an effective control strategy requires, in advance, studies on the setting of control objectives, the types of control to be applied, the documentation on improving control methods and procedures as well as the method to evaluate controls.

However, the limitations of internal control should not diminish its responsibility for good management and performance at each organizational level.

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