THE COMMUNICATION OF INTERNAL CONTROL SYSTEM WEAKNESSES - NECESSITY AND RESPONSIBILITY

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Abstract:

In terms of its mission, the control is an inherent part of management, being a specifically human activity, especially useful serving both the management, business partners, public institutions and public.

Especially in the last period, amid the economic and financial crisis manifested in recent years, the control has evolved and evolving both by the improvement of organization and management systems and by the response to continuous development of the environment in which it operates.

The control activities are an integral part of the management process by which the entity aims to achieve their objectives.

The research methodology consists essentially in a literature review and recent regulations in the analyzed field.The objective of this study is to highlight the way in which shall be communicated the deficiencies of internal control systems, to the persons responsible for their governance, inclusively in the banking system.

Keywords: *internal control, audit, internal audit, banking system, risk management*

JEL Classification: M48, G32, G38

1. Introduction

The etymology of Control comes from the Latin "against rolus", which means "checking a duplicate of the original act."

In its semantic sense, control is a "continuous or periodic review of activities of a situation, to follow her progress and improvement measures."

There are, however, in the literature, a number of understandings for the term 'control'.

Thus, in the French specialized literature, control is "a check, a careful inspection of the correctness of a document."

In Anglo-Saxon sense "the control is the supervisory action of someone,of something, a detailed examination or power to lead as a tool for regulating mechanism."

In the other words, the control involves a continuous moral and material monitoring, as well as mastering an activity, a situation, a phenomenon.

According to the International Standards on Auditing issued by the International Standards Board Auditing and Assurance Board (IAASB) of the International Federation of Accountants (IFAC), the internal control is defined as "the process designed, implemented and maintained by the persons responsible with governance, management and other personal with the aim of providing reasonable assurance regarding the achievement of entity objectives regarding the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations".

From the practical, it appears that the controls is a characteristic of management, a tool for analyzing the real situation of the business and remedy of any errors that occurred during the activity development. The most common meaning attributed to the control is verification, monitoring that is frequently associated with knowledge activity, thereby providing management the necessary premises to effective and efficient coordination of activities carried out within the organization level.

Under the aspect of its mission, the control is an inherent part of management, being a specifically human activity, particularly useful serving both the management, business partners, public institutions and public of course.

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Especially in the last period, amid economic and financial crisis manifested in recent years the control has evolved and evolving of both through organization and management systems improvement as well as continuous development in response to the environment in which it operates.

The control activities are an integral part of the management process by which aims to achieve the entity objectives.

Joseph J Mossis, president of the Institute of Internal Auditors from the United Kingdom said in 1991: "It is clear to those who practice within the internal audit function that this should play a vital role in helping management to take in hand the reins of internal control activities."

The internal control is an ongoing process designed to provide a reasonable assurance for achieving performance - effectiveness and efficiency of activities - for information - credibility, integrity and timely provision of the necessary financial information and the management - and compliance - compliance with applicable laws and regulations, and internal policies and procedures - which, to be effective, requires implementation of the following three functions: risk management, compliance function and internal audit function. Internal control also includes the organization of accounting, treatment information, risk assessment and their measurement systems.

The risk management is the process of systematic application of management policies, procedures and practices in order to establish the context, identify, analyze, evaluate, treat, monitor and communicate the risks within the organization.

The internal bank audit is the audit organized within a credit institution as part of the monitoring of the internal control system and the evaluation of the adequacy of level of own funds according to the risks that banks are exposed in order to ensure an independent evaluation of the adequacy of policies and procedures and how they are met.

An effective corporate governance is dependent on risk management so that they understood the problems that occur within the organization and internal control in order to achieve its objectives.

The role of internal auditors is on the one hand to support the organization to identify and monitor risks they expose themselves and on the other hand to understand and supervise the internal control system functionality - the fundamental element in the implementation of corporate governance principles.

2. The Internal Control System at the Romanian Credit Institution Level

At the Romanian banking system level, National Bank of Romania issued in December 2013 the Regulation no. 5/2013 on prudential requirements for credit institutions, Regulation which entered into force from January 1, 2014.

This Regulation shall cover:

a) the management of credit institutions, the internal assessment of capital adequacy and conditions of outsourcing activities of credit institutions;

b) some aspects of the own funds of credit institutions;

c) capital requirements silencers;

d) the consolidated supervision of credit institutions;

e) the conditions for approving the use of internal rating models to determine the capital requirements for credit risk;

f) the requirements for prior notification of the use of the standard approach for operational risk, approving the alternative standardized approach for operational risk and the conditions for approving the use of the Advanced Measurement Approach for the calculation of capital requirements for operational risk;

g) the conditions for approving the use of internal models to determine capital requirements for market risk;

h) Some issues related to the application of Regulation (EU) no. 575/2013 the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) no. 648/2012.

Thus, the internal control of a credit institution requires under Regulation no. 5/2013 on prudential requirements for credit institutions:

- the existence of a solid framework for the internal control;
- the existence of independent control functions.

The credit institutions should develop and maintain a robust and comprehensive framework of internal control, including control functions independent of specific appropriate authority in order to achieve their functions.

The necessity for the internal controls is required to cover the banking company as a whole, including the activities of all operating units of support and control functions.

In order to implement a robust framework for the internal control in all areas of activity of a banking company, it is necessary that the business units and support functions, to have main responsibility for establishing and maintaining adequate internal control procedures.

To ensure an appropriate framework for the internal control is essential to check the control functions independent of compliance with policies and procedures in force in their respective fields. Into the control functions are included: a risk management function, compliance function and internal audit function.

According to the Regulation no. 5/2013 on prudential requirements for credit institutions, a control function is considered independent under the following conditions:

a) its staff has no power which fall under the activities that control function expected to monitor and control their;

b) the control function is separated from organizational point of view from the assigned activities in monitoring and control;

c) the coordinator control function is subordinate to a person who has no line management responsibility of activities which control function monitors and controls. The coordinator of the control function should report directly to the management body and other relevant committees and should regularly participate in their meetings;

d) staff remuneration which carries the control function should not be linked to the performance of control activities at function monitors and controls, but by the achieving of the objectives related to those functions.

At the same time the control functions should have an adequate number of qualified staff (both in the credit institution - the parent and the subsidiaries within the group).

The staff which must have appropriate authority should be qualified on an ongoing basis and should receive appropriate training. Staff should have at their disposal corresponding support systems and data with internal and external access to information necessary to fulfill their responsibilities..

At the level of internal control system of the credit institutions in Romania are organized risk management functions, compliance and internal audit respectively.

The function of the risk management contains the risk control function from each business line.

These functions are independently organized both between themselves and to the business lines that monitor and control.

The functions of the internal control system are in subordination of a leader of the Bank which has no responsibility on the management of monitored and controlled activities by them, and reporting lines operate directly from these three functions by the management of the credit institution.

3. The Communication of Weaknesses in Internal Control to the Charged Persons With Governance and to the Management

In most of the times, the customers accuses the auditors by the lack or absence of effective communication with those charged with governance or management entity in aspects related to the events that occur during the development of the audit mission.

Although the audit report involves hard work and assiduous, the customers rarely realize the resulting benefit from the auditor ‚work', the added value of its services.

They are aiming at reciprocal and effective communication for understanding the specific and complementary aspects identified by the auditor within the performed audit mission.

On this background, was born the question: What is the utility, added value that it brings the auditor communication with those charged with governance at the level of audited entities? Thus, the Standards Board International Auditing and Assurance issued ISA 265, "Communicating Deficiencies in internal control to those charged with governance and management" in which fundamental emphasis is placed on how the information is communicated by auditors to those charged with governance of the audited entity.

According to the author, is essential an effective and mutual communication between the auditor and those charged with governance under the following aspects:

- On the one hand, this communication supports the auditor to obtain all documents, information necessary to conduct the audit mission in order to express an fair and fundamental opinion on the audit report at the end of audit mission;
- On the other hand, understanding the information and issues arising during the audit mission may be particularly useful to those responsible for the governance of the audited entity and contribute to the development of constructive relations without affecting the independence and objectivity of the auditor, which of course should be manifest throughout the audit mission.

ISA 265 emphasizes aspects of the auditor's responsibility into communicate to those charged with governance and management of deficiencies in internal control, identified weaknesses during the audit mission.

For efficient communication, it is imperative that the auditor should have a clear and precise understanding of internal control that serve to identify and assess risks of material misstatement.

The internal control weaknesses can be detected by the auditor both in the assessment of risks to which the audited entity is exposed and at any other stage of the audit mission. These deficiencies is imperative to be communicated to the auditors of those charged with governance and management of the audited entity and there is no constraint to require the auditor to communicate their other relevant aspects of internal control identified by him during the audit mission.

Internal control issues are considered by the auditors into their approach establishing appropriate procedures for audit but not in the expression of an opinion on the effectiveness of internal control..

Regarding the concept of "deficiency into internal control that exists when (IAASB, 2012):

a. A control is designed, implemented and operated so that it cannot prevent or detect and correct misstatements financial statements at the appropriate time; or
b. Missing a necessary control to prevent or to detect and correct misstatements in the financial statements at the appropriate time."

Thus, based on professional judgment, the auditor shall determine whether the identified one or more deficiencies in internal control over its audit mission and to communicate those responsible for the governance and management of the audited entity.

It is also necessary to determine whether some of the deficiencies are significant deficiencies, either individually or in combination with other. At making these assessments, the auditor should be edify on all identified issues during the audit mission, a significant role in this regard starring their discussions with the management of the audited entity in order to have a correct understanding of identified problems by both the auditor and the management of that entity.

In these discussions, the auditor may obtain a number of other valuable and relevant information for audit purposes like (IAASB, 2012):

- „Understanding by the management of the causes of existing or suspected deficiencies
- The exceptions resulting from deficiencies that management might not be noted, for example, misstatements that were not prevented by the relevant control information systems (IT)
- A preliminary indication from management of its response to these identifications."

In the auditor's communication of aspects related to the internal control weaknesses occurs the professional judgment on their assessment as significant or not, into the impact that its can have on both the audit results and in the assessment of entity audited performance, and not insignificant or last, into assessing the fairness and quality of entity management.

Therefore, in the author's opinion, the effective and accurate communication of deficiencies related to the internal control by the auditor to the responsible persons for the management and governance of the audited entity has an important role into the smooth running of the audit mission, to identify all aspects and essential information in order to formulate a real and compliant opinion into the audit report at the end of audit mission.

4. Conclusions

Behold, if we start from the semantics, the control is a "continuous or periodic review of an activity, a situation to track its progress and improvement measures", consider the fact that regardless of sector, companies can implement mechanisms to make this "analysis" (procedures, regulations, policies, systems, etc.) with the involvement of all "stakeholders", from management down to the last employee.

Still of semantics, this analysis aims to "follow" here therefore the role of monitoring what has happened, is happening or will happen, given the types of controls that includes either preventing or detecting and correcting ultimately where appropriate.

The relationship of internal control - internal audit makes us to appreciate the fact that the internal audit intervenes in the continuous or periodic monitoring of the activity and so it has the role of verify the effectiveness of the internal control system.

The question that arises is: internal auditing versus control or consulting? These two components of the internal audit cannot be defined because on the one hand in a process of conformity assessment processes and procedures of the audited entity, with internal and external regulations and norms can emerge the improvement and efficiency opportunities, situation where internal audit can act as a consultant and on the other side during a consulting assignments may arise situations which is identified deficiencies related to compliance with applicable regulations in force.

By the nature of his profession, the auditor should always be responsive and open to both aspects, and hence the added value that management wants and expects to get it.

We believe that all economic entities have implemented some form of internal control, be it at least required by law (for small entities) and for more complex forms or large entities operating regulated markets some authorities, such as the case of credit institutions, which must make efforts to adapt adequately to internal systems, business models given the important role in preventing and resolving fraud and limit excessive exposure to risk.

Therefore, we consider that it is a necessity, being also the responsibility of the auditor achieving an effective and transparent communication of deficiencies related to the internal control to those charged with governance and audited entity management, identified deficiencies during the audit mission as a background factor on formulate an accurate and real opinion which the auditor have to submit into audit report prepared at the end of its audit mission.

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