

Security Management from the Perspective of Internal Control and Audit

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Abstract

Risk management in order to implement the system of internal control and audit is to ensure integrity, transparency, and accountability, in terms of performance for any economic entity. The role of the internal audit is to evaluate and provide a substantiated and objective assurance to the general management on the degree of functionality, both on the whole internal control system and on each concrete form of its manifestation, according to the methodological and procedural framework and practice recognized in the field. Great flexibility is required in the organization and exercise of internal control and audit, because you cannot set rules for every situation encountered and also a rule if it is not topical or too rigid stagnates the process and leads to inefficiency. The result of this research is the strategy used on information security in the collection and processing of data necessary for organizing internal managerial control.

Key words: management, internal control system, organization, security

J.E.L. classification: M11

1. Introduction

The word *risk* derives from the Italian word *risicare*, which means *to dare*. In this regard, the risk is a choice, and not a destiny (Griffiths, 2018). The actions that we dare undertake, actions which depend upon the degree of freedom that we have or assume, all of the services to define everything that a human being is. From this definition, it follows that we are indeed subject to risks in everyday life, but we are in control with regard to their coordination, due to the fact that we are able to change many things, provided that we have the time and the required penchant. We are able to state that there is a risk in everything that we do, thus: one simple action, that of crossing the street, of taking a ride, of swimming, of knocking on a stranger's door, could end in misfortune or a disaster. There are risks in any activity that we undertake. They manifest in various ways, even if we refuse to admit that. However, the wisest thing we can do is to understand the risks and attempt to manage them, maybe even for our own benefit. In the specialized literature, there are several definitions of the concept of risk that we shall present hereinafter. Risk is defined as being the threat that an action or an event shall affect negatively the ability of an organization to achieve its objectives and to successfully perform its strategies (Fred, 2017). This definition highlights several essential factors, the risk is invariably a threat, respectively, meaning something that could take place, the threat refers to an event, that is, to something which must occur in order for risk to take shape, and if the event takes place, this will impact upon the achievement of the organization's objectives. From this definition, we observe that risk necessarily produces a negative impact on the objectives. Risk is the possibility or chance that something which will have an effect on the company's objectives will occur. This definition has, in addition to the advantage of being a simple and easy to comprehend definition, the word *possibility/chance*, which is a very well chosen one, considering that chance can

be both positive and negative. From the point of view of an internal auditor, the risk may be considered the heartbeat of the organization (Fayol, 2015). This analogy allows us to state that internal auditors must ensure that the organization adopts the issue of risk and manages it, rather than tolerate threats and, as a consequence of that, lose the opportunities. We strongly believe that risk management can also be a positive process, risk is not only that which takes place in an erroneous way, but also activities that one must ensure are correct or that one understood correctly. In practice, the risk may be perceived as a series of challenges, which must occur in the activities that we perform, and, especially, when we are on the verge of making decisions, in which case risk may become very grave. It is important for every organization, prior to risk assessment, to have its objectives firmly established based on real and possible risks. For these reasons, we recommend the internal auditors to always include an objective in the annual plan of internal audit regarding the assistance of managers for the improvement of the internal control system, on the basis of the risk management process, even if in practice there are major differences among entities regarding their organization (Parnell, 2013). Risk is also defined as being the uncertainty of a result, taking the shape of a probability of positive nature or of a threat, of certain actions or events, and it should be managed from the perspective of a combination between the possibility of something occurring and the impact that the actualization of this possibility would produce (Griffiths, 2018). Therefore, if the risk has a negative impact on the achievement of the objectives, then this remains a threat, and if risk holds positive connotations, these will become opportunities, which can either be ignored or exploited.

The purpose of the research is the evaluation of the main security procedures of the internal control which serve as a basis of efficient corporate governance.

2. Literature review

The concepts of internal control and internal audit, although different, contain elements that bring them closer, but also elements that differentiate them, which creates enough confusion, even among specialists. The standards of good practice in the field specify that each employee is responsible for his own internal control within the organization to which he belongs (Koufopoulos, 2012). In this sense, the internal control is found in the structure of each function of the management, of each activity and is in the responsibility of each employee, therefore it is not recommended to organize itself as a separate compartment within the entity (Kaplan and Norton, 2020). In addition to its internal control, the line management also has other control attributions that can evolve, respectively diminish or develop, depending on the evolution of the risks within the department it coordinates.

The concept of internal control has been constantly defined and redefined, at least in relation to two aspects, namely (Spencer, 2016):

1. decentralization of activities, which led to diversification control activities and the delegation of their powers to within the same structure;
2. amplification of the number of provisions, norms, rules and regulations, which provide the manager with the means of action for the proper use of resources in view increase effectiveness.

The internal control-audit system is defined as the integrated set of concrete internal control instruments, implemented at a given time in any entity, in order to achieve the established objectives. Optimal functioning of entities based on an integrated framework of internal control and audit requires the existence of an appropriate control environment that promotes ethical values, is transparent, accepts standards of good practice and establishes responsibilities in the spirit of strategies and policies approved by top management (Rothaermel, 2020).

In addition, the definition of risk management includes a specific objective (keeping risks within the limits of risk tolerance) and a specific link with certain functions of management (direct utility in developing the overall strategy of the organization, ie in planning). If the risk management aims at stabilizing the trajectory towards the achievement of the strategic objectives, the internal control aims at ensuring that, on the way to achieving the strategic objectives, the current objectives are permanently met (Amason, 2020). Risk management involves, of course, all management functions, including control, and is the responsibility of general management. As it also involves management and coordination functions, it is the responsibility of risk management to take the appropriate response. Even if it refers to the entire organization, the control function exercised within the risk management is specific and cannot replace the managerial control, which is exercised on hierarchical

levels. In other words, the internal control represents an objective possibility (attribute, attribute) of the general management, and the risk management constitutes a normative possibility of the general management, a lever of reaching the competence established by the norm (constitutive act, regulation of organization and functioning).

Risk management is embodied in the managerial functions of forecasting, coordination, organization and training is supported by the continuous exercise of the control-evaluation function, a function performed by the internal audit, which consists essentially in comparing the results with the objectives, identifying the causes that determine the positive or negative deviations and taking corrective measures necessary preventive measures (Rothaermel, 2020). Therefore, internal control is a global managerial function, and risk management involves all management functions at a specific level.

In conclusion, we can appreciate that the relationship between the notions of internal control-audit and risk management is defined by the common ownership of the terms of risk management and the current objectives of the organization.

3. Research methodology

The objective of the research is constituted by the evaluation of the main security procedures of the internal control which form the basis of good corporate governance. In the research which was carried out, 200 managers from Romania within four organizations from the following fields: *agriculture, hotels/restaurants, trade and construction* participated. The research took place from February 2021 - June 2021. The research was based upon the use of the questionnaire sent by e-mail and the size of the group surveyed for this study was the simple random survey.

We used in the research the mathematical method of maximum global utility. The stages of applying the mathematical method consist in:

Stage 1. The utility matrix is determined with the following elements

$$x_{ij}, i = 1, \dots, r \text{ and } j = 1, \dots, n. \quad (1)$$

It is calculated for each element that makes up the largest maxim criterion, as follows:

$$x_{ij} = u_{ij} = \frac{x_{ij} - x_{i \min}}{x_{i \max} - x_{i \min}} \quad (2)$$

and the minimum criterion is calculated with the formula:

$$x_{ij} = u_{ij} = \frac{x_{i \max} - x_{ij}}{x_{i \max} - x_{i \min}}, \quad (3)$$

where:

x_{ij} = element i associated element j ;

$x_{i \max}$ = minimum of element i ;

$x_{i \min}$ = maximum of element i .

Stage 2. The value of the global utility for each element is determined as the sum of all the elements that make up the utility matrix as well as the importance coefficient for each element in the matrices.

$$UG_j = \sum_{i=1}^r \alpha_i u_{ij}, \text{ where } \sum_{i=1}^r \alpha_i = 1 \quad (4)$$

Stage 3. Choose the project that corresponds to the maximum overall utility V_j ; maximum global utility corresponds.

$$\max \{UG_j\} \Rightarrow V_{j=1, \dots, n} \quad (5)$$

The research study is based on the analysis of the way of applying the main security procedures of internal control which form the basis of good corporate governance. In the process of data analysis the security of internal control was approached as a system comprised of five categories of security procedures:

S1 – The security of procedural control: is held by every employee of the entity; requires a systematic update; represents the basis of the development of the other form of control and audit.

S2 – The security of preventive financial control: performs monitoring of financial risks; it is usually removed when the procedural control reaches a satisfying level; can be exercised from an upper level.

S3 – The security of the subsequent control: is accomplished by general management decision; a control department can also be constituted; can be exercised from an upper level.

S4 – The security of internal audit: assesses the managerial control system; counsels the general management.

S5 – The security of financial audit: assesses the existence of the function of internal audit; closes the feedback of the function of internal audit; provides a certification of the final financial circumstances; assesses the way the managerial control system is organized; represents an external assessment.

4. Findings

In Table no. 1 the informational basis of the study is displayed, the proportion of the importance that managers give to each security procedure of internal control, respectively.

Table no. 1 The importance of the implementation of the procedures

APPLIED PROCEDURE	FIELD OF ACTIVITY			
	AGRICULTURE% (v1)	HOTELS / RESTAURANTS % (v2)	TRADE % (v3)	CONSTRUCTION % (v4)
S1 (c1)	16.45	22.35	27.5	12.5
S2 (c2)	10.55	15.15	11.9	23.61
S3 (c3)	8.9	13.25	9.8	10.54
S4 (c4)	23.45	16	11.82	23.55
S5 (c5)	40.65	33.25	38.98	29.8

Source: the author's own concept

The main results show that the managers of the organizations take into account firstly S5 – The security of the financial audit, and lastly S3 – The Security of the subsequent control (Figure no.1).

Figure no. 1 The importance of the security procedures of the internal control



Source: the author's own concept

Going over the calculus algorithm involved:

Step 1 – Construct the matrix of the units with the elements x_{ij} Figure no. 2.

Figure no. 2 Matrix of the units

$$\begin{bmatrix} 0.26 & 0.66 & 1.00 & 0.00 \\ 1.00 & 0.65 & 0.90 & 0.00 \\ 0.00 & 1.00 & 0.21 & 0.38 \\ 0.99 & 0.36 & 0.00 & 1.00 \\ 0.00 & 0.68 & 0.15 & 1.00 \end{bmatrix}$$

Source: the author's own concept

Step 2 – The calculation of the global utilities for each organization (Table no. 2):

Table no. 2 Results of the calculation of global utilities

GLOBAL UTILITY	RESULT
AGRICULTURE	2.25
HOTELS/RESTAURANTS	3.34
TRADE	2.26
CONSTRUCTION	2.38

Source: the author's own concept

Step 3 – In Table no. 2 it is noticeable, through the calculation of the global utilities, that the highest global utility is held by the organization in the field of activity Hotels/Restaurants.

Consequently, following the application of the calculus algorithm of the method of maximal global utilities, we may conclude that the organization in the field of activity Hotels/Restaurants had the best assessment regarding the importance of the security procedures of internal control regarding corporate governance.

5. Conclusions

The creation and the proper functioning of this process, which is a lengthy one, entails collective and individual efforts, in such a way as it can be adapted in the best possible manner to the specificity and the dimension of the entity, while also abiding by the provisions of the law and the general principles of the managerial internal control.

The security of the procedural control, which must cover between 50-90% of the overall activity of control organized within the entities. The procedural control includes self-control in all its forms: mutual control, hierarchical control and the partner's control, the former operational control, and concomitant control, respectively, which must be implemented in the operational work procedures. The operational work procedures must contain integrally the legal framework regulating the business, the control activities dissipated throughout the flux of the processes, the responsibilities, and the documents that are elaborated. Once realized, the procedures will be implemented, improved, appropriated by the executive and management staff, systematically updated, and approved by the relevant levels of management.

The security of the preventive financial control must represent approximately 1 – 5% of the overall activity of internal control within the entity and which must become an optional control at the disposal of the management. In this regard, the general management decides whether it needs this control and it determines the activities related to which it must be exercised. Overall, preventive financial control supervises the logical coherence of a chain of financial operations. The responsibility of the preventive financial auditor is joint with the management's, but only with regard to his/her fault, even if he/she was misled.

The security of the subsequent control is an ex-post control which must represent 9-10% of the overall activity of control within the entity.

The security of the internal audit – must perform the assurance of the functionality of the managerial system of control and the counseling of the general manager.

The security of the financial audit – must ensure:

- the accuracy and reality of the financial circumstances, according to the accounting regulations in force;
- the assessment of the management and control systems to the authorities responsible for observing the financial obligations or to other public funds;

The fact that the resources which are at the disposal of a public entity are always limited, forces the entity to perform a comparison between the additional costs generated by the new system of internal control and the advantages it brings before this system is implemented and developed. Given that each instrument of internal control implies both certain implementation costs and anticipated effects, the management is in the position to analyze, from the perspective of efficiency, if the implementation of the instruments of internal control, in its entirety, is justified or not. The managerial internal control can provide the management with data regarding its progress or setback in reaching the intended goals. The managerial internal control offers a reasonable, but not absolute, assurance that the public entity achieves its intended goals. The reasonable assurance implies reaching a level of trust which is satisfactory from the point of view of costs, benefits, and results, a level that is established by self-evaluation and external evaluation. Therefore, the costs of the internal control must be lower to the achieved benefit, the latter being measured by means of the degree of risk reduction in achieving the objectives.

Having in view a series of internal or external factors (which could not be taken into account when the managerial internal control was devised), the probability to achieve the objectives of the entity is damaged by the limits of the internal control, such as:

- the ongoing changes occurring in the internal and external environment of the entity;
- human errors: inaccurate interpretations, reasoning mistakes, negligence, oversights;
- abuse of authority shown by some people in management, coordination or supervising positions;
- restriction of the independence of the staff in performing the job requirements;
- control procedures ill-adapted or adapted and not applied;
- the costs of the managerial internal control. The managerial internal control must be efficient, it must not generate additional costs, and it must lead to the saving of the material, financial and human resources. Although an entity can define its own system of good managerial internal control, this can be implemented or dealt with subjectively by the staff within the entity, as a consequence of the lack of professional training.

In accordance with the legislation in this area, the managerial internal control is the responsibility of the managers of the entity, who have the obligation to design, implement and continuously develop it. The implementation of the system of managerial internal control, through its own human resources, ensures both their ongoing professional self-improvement and the removal of additional expenses for counseling in the area. In the light of the benefits mentioned above, it is considered that entrusting third parties with accomplishing the activities concerning the implementation and development of the system of managerial internal control is not advisable for the achievement of the mission of the entities.

The findings of the internal control and audit must contribute to the improvement of the activities, but this should not materialize only by recommending the addition of new control activities, even if there are risks, as they involve additional costs.

The purpose of organizing internal control and auditing is to provide reasonable assurance against risks and not absolute assurance. Reasonable assurance is more than minimal and always relates to the entity's objectives.

6. References

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