Audit financiar, XVI, Nr. 2(150)/**2018**, *270-277*
ISSN: 1583-5812; ISSN on-line: 1844-8801

Internal control systems in the European Union Member States

Carmen PÎRVAN,
Bucharest University of Economic Studies,
E-mail: carmen.pirvan@gmail.com

Ileana NISULESCU,
Bucharest University of Economic Studies,
E-mail: nisulescu_ileana@yahoo.com

Abstract

Most EU Member States have initiated reforms to improve public sector management by introducing and promoting the public internal control system focusing on the implementation of core principles on an internationally recognized internal control model. In most countries in the European Union, national control systems are based on the COSO and INTOSAI models.

The paper aims to provide a radiography of good practices regarding the implementation of internal control systems in the countries of the European Union for the implementation of healthy financial management as an integral part of good governance, both from the perspective of historical evolution and the current situation.

Keywords*: Internal control, European Union, governance, transparency, COSO, INTOSAI*

JEL Classification*: C40, D12, O12*

To cite this article:
Pirvan, C., Nisulescu, I. (2018), Internal control systems in the European Union Member States, *Audit Financiar*, vol. XVI, no. 2(150)/2018, pp. 270-277,
DOI: 10.20869/AUDITF/2018/150/012

To link to this article:
http://dx.doi.org/10.20869/AUDITF/2018/150/012
Received: 19.12.2017
Revised: 12.01.2018
Accepted: 25.01.2018

Introduction

From a semantic point of view, the control is "a permanent, periodic or unexpected verification, done in any field to know the realities and the way the activity in the respective field is performed, in order to prevent or eliminate the potential deficiencies and to improve the activity." (Popa M.D., Stănciulescu A. et al, 2009). At the same time, control means a continuous moral and material supervision, as well as mastering an activity, a situation (Romanian Academy, 2009).

In the literature of the domain, we mainly come across two definitions:

- The francophone one, according to which "control is a check, a careful inspection of the correctness of an act" (Larousse, 1975).
- The Anglo-Saxon one, according to which "control is the action of supervising someone, something, a thorough examination or the power to lead as an instrument for regulating a mechanism." (The New Merriam – Webster Dictionary,1989).

The principles of corporate governance have been extremely generally outlined, they describe the methods and systems used to manage organizations of all types and sizes, whether public or non-profit, and also private sector companies and partnerships. In this respect, Sir Adrian Cadbury defined corporate governance as "the system by which companies are guided and controlled" (Cadbury A., 1992). Although corporate governance principles do not currently aim to impose an universal model, countries being free to decide how to apply them, the long-term trend is to develop global corporate governance standards (Shleifer, R. Vishny, 1997).

Worldwide, mainly the following control models are recognized:

COSO Model – USA

„The "Organizational Sponsorship Committee – COSO" is an independent private sector organization that has brought together the skills of a large number of professionals dedicated to studying the circumstances that lead to financial fraud and to improving the quality of financial reporting through: business ethics, efficient internal controls, corporate governance (Committee of Sponsoring Organizations of the Treadway Commission). In September 1992, the COSO defines internal control as a process conducted by the Board of Directors, the management and the entire staff of the entity, in order to provide reasonable assurance that the organization's objectives are being met, taking into account: the effectiveness and efficiency of operations, the reality of the financial reports, the compliance with applicable laws and regulations. (Popescu P.V., 2017).

The COSO model is represented by a pyramid containing five essential elements: control environment, risk assessment, control activities, information and communication, monitoring, as shown in **Figure no. 1**.

Figure no. 1- COSO Model

Source: https://www.adra.com/software/internal-control-and-coso/

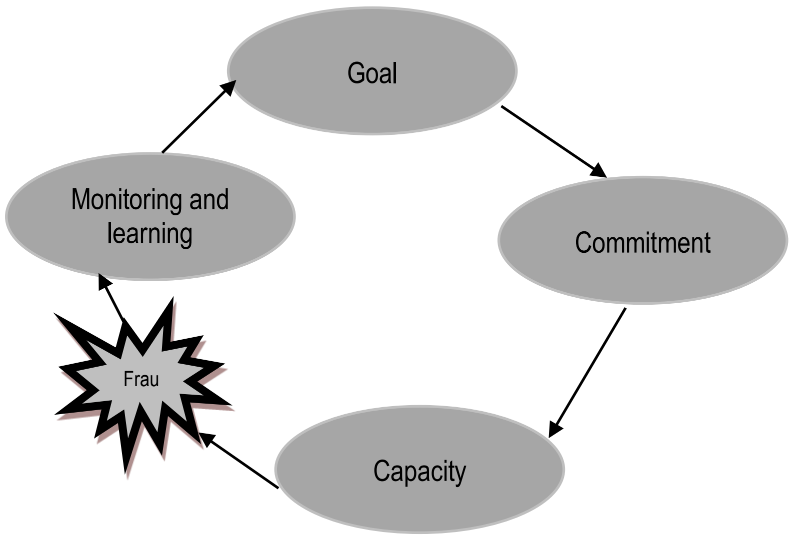
Therefore, the COSO model defines internal control as a process implemented by the public entity's management in order to provide reasonable assurance that objectives are being met, where efficiency and operations efficiency are concerned, while using reliable financial information and complying with laws and regulations.

COCO Model – Canada

In 1995, the Canadian Authorized Accountants Institute developed the COCO model, where internal control represents the organization's resources, processes, tools, tasks, culture, and everything else we can imagine, that is, all we can do to meet our goals, but these will never be met, because of relativity.

For the COCO model, the determinant factors are the control criteria and grouping these criteria according to the four elements of the model: goal, commitment, capacity, monitoring and learning, as shown in **Figure no. 2**.

Figure no. 2.- COCO Model



Source: Popescu P.V., 2017

Therefore, the COCO model complements the concept of the COSO model and defines internal control as the set of elements of an organization (including resources, systems, processes, culture, structure and tasks) that collectively help people reach their objectives, grouped in three categories: effectiveness and operations efficiency; reliability of internal and external information; compliance with domestic laws, regulations and policies.

Comparing the two models of internal control, we can conclude:

- according to the COSO model, internal control:
  - is a process implemented by all employees of an entity;
  - has a relative nature, providing reasonable assurance that the objectives are being met.
- according to the COCO model, internal control:
  - puts greater emphasis on the means deployed than on employees.

INTOSAI

INTOSAI (International Organization of Supreme Audit Institutions) defines internal control as a management tool used to provide reasonable assurance that management objectives are met.

Issued initially in 1992, the "INTOSAI Guidelines for Standards of Internal Control in the Public Sector" were updated following decisions of the International Organization of Supreme Audit Institutions (INCOSAI), 2001.

The concept of internal control is not understood the same way in all countries: there are states with specialized control institutions, independent of the controlled ones, and in other countries the responsibility for internal control is given to the administrative entities concerned. In decentralized systems, senior management managers have an obligation to report on the functioning of internal control systems. More and more European Union countries are asking these managers to apply systems to manage and mitigate the risk of failing to meet established targets.

According to the European Commission's Yellow Book, modern internal control is directed towards transparency, clear responsibilities, methodology and harmonized standards at European Union level. Transparency represents the manifestation of the principle of governance inherent to the responsibility that civil society has assigned to the state administration in order to increase revenue and expenditures on her behalf and in its interest. Transparency implies that the decisions taken and their implementation are in concordance with existing rules and standards, involving the free circulation of information and its availability to those concerned by the decisions in question and their implementation. The information is comprehensive and provided in easily understandable forms and means. (Court of Accounts, 2011).

The methodology

The aim of the research is to perform a radiography of good practices on the EU member states, regarding the application of the internal managerial control system in order to achieve healthy financial management, as an integral part of good governance, but also as the basis for performance and integrity and compliance management in the fight against corruption within the member states. The paper approaches qualitative research, descriptive and experimental studies, as well as elements of data analysis, statistics, and content analysis.

The paper outlines an image of the managerial internal control system, based on an analysis of internal control systems in the 28 EU member states. Therefore, the information extracted from the European Union website and the national websites of the 28 Member States was corroborated with the Compliance of Control Systems, 1st edition of 2012 and 2nd edition of 2014, but also with other studies on the internal control system, such as "Improving the Organizational Effectiveness of MEN and Subordinate Institutions of the Development of the Managerial Internal Control System (SCIM)" as well as the Report to the Supreme Audit Institutes of Central and Eastern European Countries, Cyprus, Malta, Turkey and the European Court of Auditors (European Court of Auditors – Europa EU, 2004).

The research starts from the premise that the synthesis of internal control systems implemented in EU Member States is important in the current context, as the European Commission is currently planning to update its internal control framework to align it with the COSO 2013 Framework which is based on concepts of governance and risk management.

Considering that the purpose of this research is to determine how the architecture of the internal control systems at the level of the public entities in the European Union states differs from country to country, we started from the synthesis of the way of realization, management and application of the system of managerial internal control in the EU Member States.

Results and discussions

To have good governance has become a priority for both public and private sector entities, in the context in which the events in the economy, or the financial problems of public companies, have brought to the attention of the corporate governance issue, so that the improvement of the internal control mechanisms has become one of the main priorities. Usually, the difficulties encountered by companies imply a situation where members of management structures were unaware of the full extent of a risk, or only a small number of members of the board of directors (usually with executive functions) were aware of it. Concerns raised by these situations have led to changes in European Union law, which imposed, on all public interest entities, the obligation to observe a code of conduct and to confirm its compliance with the annual reports and financial statements it publishes.

In order to identify good practices in the field and to determine how the internal control systems are afeected by the north-south demarcation lines and the cultural differences of the post-communist countries, we have established common practices, differences and similarities between models assimilated by the member states.

The analysis reveals that in Denmark, Sweden or the UK, the internal control system is a harmonized government approach in order to ensure the establishment, maintenance and monitoring by all public entities managers of all integrated management processes. In these countries, internal control is initiated to manage risk. We also find a decentralized internal control system based on the decentralization of complete managerial accountability and independent and functional internal audit. The manager of the organization is responsible for the objectives of the institution (financial and non-financial), setting up the internal control system, addressing risks, and providing reasonable assurance that objectives are being achieved through efficient and effective, legal and regulated operations.

The internal control environment in the UK operates within a framework of governance and financial discipline specifically designed for the central government. It is aligned with corporate governance requirements that operate in the private sector, but has been tailored to reflect single government accountability structures.

In Finland, in the early 2000's basic requirements for internal control were implemented, now the management of each organization being responsible for the internal controls needed to ensure the legality and financial efficiency, the management of the funds and assets, as well as the real and correct information for the leadership of the organization. (European Commission, 2012)

The Dutch public sector is decentralized, based on historical tradition. Regional governments (provinces) and local authorities (municipalities) run their own households, including an independent financial management. Although central government supervision is limited and indirect, the Ministry of Finance has a responsibility in setting general standards. In Ireland, internal control was defined as the entire system of controls set up by management in order to carry out the work of an efficient and orderly entity, ensuring compliance with management policies and asset protection, and it is the responsibility of the management to decide whether the internal control system is appropriate for the organization.

In Belgium, France and Portugal we find an internal control system that contains a decentralized-centralized mix of national characteristics, highlighting the different stages of development of internal control systems. Internal control in France is a good example of integrating the characteristics of the decentralized internal control system into a particular national administrative culture. In France and Portugal, which used to have strong specialized control institutions, the decentralization of control began, increasing the responsibility and accountability of public managers, internal control being centered on accounting and financial function.

In Luxembourg and Spain, the notion of internal control is considered to be represented by the entire control system in public administration and the sum of all institutions involved in the management of public funds. These countries also have specific control bodies, Intervención General de la Administración del Estado (IGAE) in Spain, or the Inspection Générale des Finances in Luxembourg, which are independent economicaly and financially of the entities they control.

In the Netherlands, the control system is decentralized; the public entities manage their activity independently, including financial management, based on the general standards for financial accounts and managerial controls set by the Ministry of Finance.

Top management in Germany assumes responsibility for establishing an adequate internal control system by supporting a control unit called "Internal Revision." In the Austrian administration, however, the Audit Court introduces internal control ("Controlling") as a matter of principle, in order to increase focus on efficiency. In Austria, the economic developments in recent years (high budget deficits, unemployment) have led to the urgent need for public sector budget cuts, and to restore balance between public spending and revenue, budget and staff controls have proven too inflexible and /or ineffective in achieving the specific objectives.

In Greece, legislation defines an internal control system as the global system of managerial and other types of control, including organizational control, methodologies, procedures and internal audit, implemented by the administration over an agency's operations to support the pursuit of its objectives in an effective, efficient and economical manner. The internal control system ensures compliance with the policies of the administration, safeguards the assets and resources of the Agency by certifying the completeness and accuracy of accounting documents, and provides reliable timely information on financial management and management (European Commission, 2012).

In Cyprus, managerial accountability refers to all the operations of a ministry/department and is not limited to the role of financial services, but there are no regulatory acts to impose internal control units within public entities.

In Malta, although there is no legal definition of the internal control system, the Audit Manual developed by the National Audit Office defines internal control as all policies and procedures designed and implemented by the management of an entity to ensure:

- achieving the economic, efficient and effective goals of the entity;
- adherence to external rules (laws, regulations, etc.) and management policies;
- the protection of assets and informations;
- preventing and detecting fraud and errors;
- the quality of accounting records and the timely production of financial information and reliable management. (PIFC Expert Group, 2004)

In Italy, the internal control system was reformed in 1999 introducing four fundamental pillars:

- ➢ administrative-accounting control – ensures the legitimacy, fairness and regularity of administrative acts;

- Management control – entrusted to a single internal structure, is embedded in a systematic process designed to assess the effectiveness, efficiency and cost-effectiveness of administrative action;
- strategic control – aims at monitoring the effective implementation of decisions contained in policy documents;
- manager evaluation – establishes a set of methodologies, processes and tools for assessing the performances of managerial staff through performance evaluation and behavior related to the development of professional, organizational and human resources (MIBAC, 2010).

In the Czech Republic there is a law project for the implementation of internal managerial control based on best practices in Europe and in developed countries using the information contained in international standards COSO and INTOSAI. Similarly, in Poland, managerial control refers to the concept of internal control as defined by COSO and INTOSAI, and includes a general set of activities undertaken to ensure the implementation of objectives and tasks in an efficient, economical and timely manner, in accordance with the legal provisions. The key references for management control are the objectives and their attainment is the basic criterion for assessing the effectiveness of the solutions adopted within the entity.

In Slovenia, the internal control system has a preventive nature, its main objective being to ensure that systems are in place to prevent irregularities, corruption and fraud. Internal control consists of a system of procedures and methods for controlling risks, which could adversely affect the legality, effectiveness and efficiency of using public funds and jeopardize the achievement of the defined objectives. The final responsibility for the actions and the achievement of the objectives and for maintaining the proper functioning of the internal control system lies with the head of the unit.

The essential of Hungary's internal control system is highlighted by an integrated approach to corporate governance, covering regulations, procedures, functional methods and organizational structures in order to achieve management objectives. Internal control should prevent, detect and / or correct events that jeopardize the achievement of objectives.

In Bulgaria internal control is established as an integrated process of an organization's activities and is carried out by the manager and the employees of the organization. Internal control consists of five interrelated components – control environment, risk management, control activities, information systems, communication and monitoring in accordance with the law. Internal audit is a management tool for monitoring. (European Commission,2012)

In Romania, the internal/managerial control code, and the implementation of the internal/ managerial control standards within public entities became mandatory, the COSO internal managerial control principles being assimilated, as well as the INTOSAI GOV 9130 for the risk management of the public entities.

Responsibility for creating and operating an effective internal control in Lithuania is allocated to the heads of the institution. In developing and implementing monitoring of financial control, the Heads must approve their own rules for financial control. They are based on the minimum financial control requirements approved by the Finance Minister. The development of the public internal control system in Latvia is closely linked to its admission into the European Union. During the pre-accession negociations, Latvia has undertaken to set up an internal audit system, covering all subordinated ministries and bodies and specifying the responsibilities of the Heads of Bodies for setting up the internal control system. There is an extensive legislative framework in Estonia; a significant part of the control environment is made up of various legislative acts, guidelines and internal rules of an organization. Different IT systems also play a very important role in organizing state administration and modeling the control environment.

In Croatia, internal control is carried out according to the methodological framework for the application of financial and control management, following the COSO model.

Conclusions

One aspect that stands out and is common to most EU Member States is the focus on more effective solutions of internal control. Practically speaking, the functioning of the internal control system in a changing environment needs the adjustment of control at each activity level and is differently designed according to the interests of the organization and to the country's historical tradition in the implementation of internal control systems. In conclusion, in the European Union, the main control patterns designed to organize the internal control system correspond to the requirements of COSO or INTOSAI, 25 of the 28 Member States adopting these requirements and standards as the basis of their internal control systems.

Although all member countries have provided the necessary legislative or organizational framework for the implementation of internal control systems, a big challenge for the effectiveness of internal control is well-rooted informal practices, simplifying and rendering internal control efficient, and the enhancement of managerial accountability being a prerequisite condition for an effective fight against corruption.

Within the European Union, the use of different "models" of internal control systems is identified as folows:

– In the northern model, ministries take full responsibility for budget expenditures, by performing appropriate checks through their own control systems, including through post-factum audits by the Internal Audit. Internal auditors are coordinated by the Ministry of Finance and mainly carry out financial audits.
– In the southern model, the Ministry of Finance plays the key role in preparing and allocating the state budget to ministries, but it also carries out ex-ante controls through its own staff from the line ministries. Within the Ministry of Finance there is the General Inspectorate which carries out the financial control of all public revenues and expenditures. In addition, internal audit units are also set up within the ministries.

Thus, research has shown that most member states (25 countries) are based on their COSO internal control systems and INTOSAI guidelines for internal control, and internal audit assimilates IPPF167 (International Professional Practices Framework – International Professional Practice Framework). However, within the European Union, there are differences in the organization of internal control, some states have a centralized approach, and in others internal control is exercised departmentally or through independent agencies/bodies.

Thus, the research revealed that there are some particularities in the implementation and functioning of control systems in different EU member states, namely:

– The German system of internal control is very different from other countries: each governmental sector and each governmental organization is responsible for developing its own control framework and the higher authority is able to instruct the lower level authority to introduce specific management systems and control as well as specific tools for their overview and monitoring.
– In Luxembourg, Spain, Greece, Italy there is a centralized internal control system where the control function is focused on ex-ante controls, delegation of tasks, internal control is perceived as a centralized collective responsibility, closely linked to the control of public funds. There are specifically designated organizations, financial controllers to control economic and financial compliance, without internal audit, but with financial "audit" (transaction-based verification), which is carried out ex-post, by financial operators, the focus being on financial control.

For the future, there is a tendency towards decentralization in the exercise of internal control, ensuring transparency requirements, establishing relevant reporting and monitoring practices, and clarifying the measurement and assessment of performance at both the organizational and individual level.

Thus, a more efficient control of public entities and equal treatment with private companies will lead to better management of the financial performance of the former, in accordance with the OECD or the European Commission's recommendations, as well as the international experience in ethics management and compliance of both the companies and the public institutions.

BIBLIOGRAFIE

1. Academia Română, Institutul de Lingvistică „Iorgu Iordan" – Dicționarul explicativ al limbii române (ediția a II-a revăzută şi adăugită) Editura Univers Enciclopedic Gold, 2009.

2. Cadbury A. – Report of the Committee on the Financial Aspects of Corporate Governance, 1992.
3. Comisia Europeană, Compendiu al Sistemelor de Control Public Intern din Statele Membre ale Uniunii Europene, 2012.
4. Comisia Europeană Compendium of the public internal control systems in the EU Member States, 2014.
5. Committee of Sponsoring Organizations of the Treadway Commission, disponibil on line : https://www.coso.org/Pages/default.aspx
6. COSO and Internal Control, disponibil on line : https://www.adra.com/software/internal-control-and-coso/
7. COSO- https://www.coso.org/Documents/ Acceptable-Use-of-COSO-Materials-20150501.pdf,https://na.theiia.org/standardsguidance/topics/Documents/Executive_Summary.pdf.
8. Curtea de Conturi, "Ghid de evaluare a sistemului de control intern în entitățile publice", 2011, p. 20.
9. European Court of Auditors – Europa EU – Report to Supreme Audit Instituitions of Central and Eastern European Countries, Cyprus, Malta, Turkey and European Court of Auditors, 2004.
10. Ghid de evaluare a sistemului de control intern in entitatile publice, disponibil on-line: http://control-intern.blogspot.ro/2012/01/definirea-sistemului-de-control-intern.html
11. INTOSAI GOV 9100 -Guidelines for Internal Control Standards for the Public Sector www.intosai.org/.../intosai-gov-9100-guidelines-for-internal-control-standards.
12. Le petit Larousse – Dictionaire enciclopedique, Paris, Larousse, 1975.
13. Marcel D. Popa, Alexandru Stănciulescu, et al, Editura Enciclopedică, 2009.
14. Ministerul Educației şi Cercetării Ştiințifice, Asociația Română pentru Evaluare şi Strategie – Îmbunătățirea eficacității organizaționale a MEN şi a instituțiilor subordonate prin dezvoltarea sistemului de control managerial intern (SCMI)" – 2015.
15. Organizația Internațională a Instituțiilor Supreme de Audit – disponibil on-line: http://www.intosai.org/about-us.html
16. PIFC Expert Group, 2004, disponibil on-line: http://www.eca.europa.eu/Lists/ECADocuments/ COOP_PUBLI006/COOP_PUBLI006_EN.PDF.
17. Popescu P.V.,Revista Curtii de conturi a Romaniei, Editia nr. 13, 2017, p. 42
18. Shleifer, R. Vishny, A Survey of Corporate Governance, Journal of Finance nr. 52, 1997, pp. 737.
19. The New Merriam – Webster Dictionary, Springfield, Massachusetts, Merriam-Webster Inc, Publishers, 1989.
20. MIBAC – Direzione Generale per l'organizzazione, gli affari generali, l'innovazione, il bilancio ed il personale Servizio II – Bilancio e programmazione -Introduzione al controllo di gestione, teoria e contestualizzazione alla realtà del MIBAC, 2010 disponibil on line: http://www.beniculturali.it/mibac/ multimedia/MiBAC/documents/1365615773593_Presentazione_Paolo_Dangeli_MiBAC_CDG_02_03_2010_finaleWEB.pdf
21. Site-uri naționale: www.nku.cz; www.rigsrevisionen.dk; www.riigikontroll.ee; www.vtv.fi; www.ccomptes.fr; www.bundesrechnungshof.de; www.elsyn.gr; www.asz.hu; audgen.gov.ie; www.corteconti.it; www.lrvk.gov.lv; www.vkontrole.lt; www.cour-des-comptes.lu; www.nao.gov.mt; www.rekenkamer.nl; www.nik.gov.pl; www.rcc.ro; www.tcontas.pt; www.nku.gov.sk; www.rs-rs.si; www.tcu.es; www.riksrevisionen.se; www.nao.gov.uk; www.revizija.hr; www.revizija.hr; www.nao.gov.uk; www.riksrevisionen.se; www.tcu.es