



## Roles and Responsibilities in the Proper Implementation and Functioning of Internal Control of Public Entities

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**Roles and responsibilities in the proper implementation and functioning  
of internal control of public entities**

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**Abstract** *The notion of performance is associated with an ideology of progress, of always doing better. As far as the performance of public entities is concerned, this is harder to quantify than for example, the performance of a company. However, in order for the public sector not to face a budget deficit with inappropriate management or inappropriate resource use, internal control can help with solutions for improving its activities, solutions to reduce inefficient spending and ways to use resources as efficiently as possible.*

*This paper attempts to capture the links and interfaces between the best known and current models that can help organizations to define, design, implement, and develop risk management and the internal control system. This is "The COSO Cube" model presented in 2013 in the COSO Framework & SOX Compliance paper and the "THREE LINES OF DEFENCE IN EFFECTIVE RISK MANAGEMENT AND CONTROL" presented by The Institute of Internal Auditors in January 2013.*

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**JEL classification:** *H11; H83; H89; M42*

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## **1. Introduction**

Each organization has a well-established basic mission and objectives that it strives to touch them. In accomplishing these mission and goals, the organization is confronted with events and circumstances which may jeopardize these objectives. These potential unwanted events and circumstances creates risks to which the organization is subject. Thereby the organization needs to identify, analyse, define and address them. Depending

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on their impact, some risks may be accepted as they are (in whole or in part) and others must be mitigated in whole or in part, to the point where they are at an acceptable level for the organization.

There are a lot of procedures and methods used to identify and mitigate risks, merged into one instrument known as the, internal control system. Basically, the internal control model set up in the COSO cube and the three lines of defence model will be presented. These models, though developed by different organizations, are not foreign to one another, but complement each other and have the same purpose, which is performance.

The COSO's Internal Control Model (Integrated Framework) describes and outlines the core components of the system, the principles to be followed and the necessary factors which of the organization must take into account to manage its risks effectively by implementing a viable internal control system. However, it does not provide much detail in determining who is responsible for carrying out the specific duties. Clear responsibilities must be defined in such a way each individual structure and member from the organization to understand its role in addressing risks and control. It is also necessary to establish the issues for which the structures are responsible and to establish ways in which they can coordinate their efforts between them so that there are no "loopholes" and no unnecessary or duplication efforts.

The model of the three lines of defence approaches the way in which specific risk and internal control tasks are applied and how they can be properly assigned and implemented within an organization, regardless of its size or complexity or activity. Thus, the leadership has the responsibility to understand the differences between the roles, responsibilities and specific tasks and determine how these can best be allocated to the organization, in order for the organization to achieve its goals.

## **2. Sections**

International legislation in the field of internal control is founded on general principles of good practice, accepted and promoted by the IIA (International Institute of Internal Auditors) and INTOSAI (International Organization of Supreme Audit Institutions), organizations which provide members with opportunities for professional and technical cooperation.

Thus, according to the general principles of good practice promoted internationally, the concept of internal control is associated with a broader meaning, this being regarded as a managerial function and not as a proper verification operation. With the help of the control function, the organization's management notes the deviations of the results from the set objectives, being

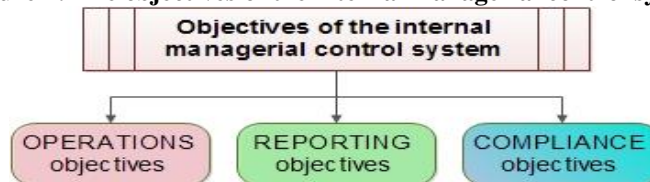
able to analyse the causes and to order the correction or prevention measures. The way in which the general principles of good practice are implemented in control systems is specific to each country.

In Romania, the necessity and the obligation to organize the internal control in the public entities is regulated by the „Government Ordinance no. 119/1999 on internal / managerial control and preventive financial control”. By this ordinance, internal control is the responsibility of management, and that is defined as the set of all forms of control that are performed at the organization level, including internal audit, fixed by driving, taking into account the organization's objectives and legal regulations, in order to manage public funds economically, efficiently and effectively. Also includes organizational structures, methods and procedures used.

Even if internationally and nationally the definitions of internal control are multiple and numerous, these are not in fact contrary. All emphasize that the control is not really a single function, but a set of management principles that must be learned by all those responsible at all levels, to ensure that the entity's objectives are achieved.

The good organization of an internal control system within the public entities should consider the pursuit and realization of three categories of general objectives, as follows (Fig. 1):

**Figure 1: The objectives of the internal managerial control system**



Source: own projection based on the „*Managerial Internal Control System implementation manual*”

These categories of general objectives are:

• **operational objectives:**

- refers to the tasks of the entity, analysing the effectiveness and efficiency of the entity's;
- follows, the use of resources in conditions of economy, efficiency and resource efficiency;
- oversee the protection of the entity's resources, inappropriate use or loss;

• **reporting objectives:**

- ensure the reliability of external and internal information;

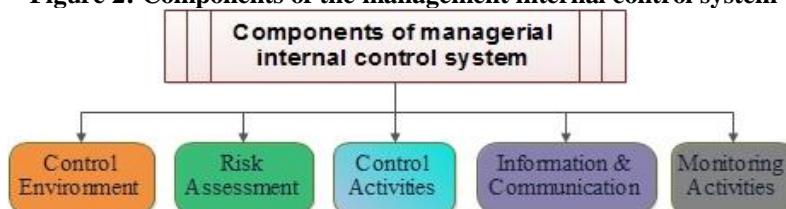
- follows, keeping a proper accountancy record;
- follows, the quality of the information used in the entity, or the dissemination of this information;
- aim to protect documents against: dissimulation of fraud and distortion of results;

• **compliance objectives:**

- monitor and ensure compliance with internal laws, regulations and policies;

The entity defines its own strategy by setting the general objectives, which then results from the specific objectives. In carrying out the activities necessary to accomplish the objectives of the entity, the staff must take into account the components of internal managerial control, namely its standards according to the general requirements. The specialized literature divides the 16 managerial internal control standards on 5 major components of the managerial internal control system, thus (Fig. 2).

**Figure 2: Components of the management internal control system**



Source: own projection based on the „*Managerial Internal Control System implementation manual*”

The relationship between the objectives of the managerial internal control, its components and the organizational structure of the public entity is nuanced in COSO's specifications in the revised 2013 Internal Control Framework. Through this schematization, it is desired to show a three-dimensional link between the objectives of the control system, its components and the organizational structure of the public entity. Thus, through the COSO Cube (Figure 3), it is observed that the three categories of objectives of the internal control system apply to the five components at all organizational levels of the public entity: by departments, directions, services, offices, including work stations.

**Figure 3: The COSO Cube**



Source: „The 2013 COSO Framework & SOX Compliance”

For the proper functioning of the entity as a whole, as well as of each activity / operation, the management of the entity, through the internal managerial control system, establishes, implements and operates through a variety of procedures, means, actions and provisions. This set of elements forms the specific managerial internal control instrumentation that can be classified into six large groups as follows: „*objectives; means (resources); informational system; organization; procedures; control*”.

Therefore, by using internal control, the entity may analyse the results obtained. The comparison of the results achieved in accordance with the established objectives is based on a set of control forms exercised at the level of the entity in order to ensure the management of funds in an economical, effective and efficient manner

Build, implement and develop an effective internal control system is a lengthy process that requires significant efforts, involvement and responsibility from the entire staff of the entity, but especially from the leadership staff. Implementation and development of the internal control system in any entity involves a number of processes, activities that require responsibility, appointment of the responsible personnel and, last but not least, the setting of the deadlines for carrying out the activities.

The process of internal control is an activity that mainly targets the entity's responsible internal parts, such as: entity management, internal auditors and all of its staff. However, in addition to the internal parts of the organization, there are also external parties that are interested of the impact, adequate functioning and efficiency of the internal control system.

At internal level of the public entity:

**Managers**

All staff members of the organization play an important role in carrying out internal control work. But especially, entity management has overall responsibility for appropriate design, implementing corrective measures, supervising the proper operation, maintaining and documenting the internal control system. The governing structure of entities may include boards, committees or responsible persons who have different roles, tasks, duties, business objectives, entity objectives, legislation and regulations.

In Romania, according to the regulations in the field <sup>1</sup>, the those responsible for the correct implementation and proper development of the internal control system as well as the establishment of the main responsibilities within the public entity's internal framework are:

- Leader of the public entity
- Chairman of the Monitoring Committee
- The Technical Secretariat of the Monitoring Committee
- Members of the Monitoring Committee
- The compartment manager
- The risk responsible
- The person who identifies the risk
- Those responsible for designing system and operational procedures

#### **Internal Auditors**

The management of an entity must dispose of or create a distinct internal audit unit as part of the internal control system that it uses to monitor the effectiveness of the internal control system. Internal auditors monitor the functioning of the internal control system and provides periodic evaluation reports that include information on the optimal operation of the system. Audit reports contain information with strengths, weaknesses, and recommendations for improving troublesome operations. In order for these evaluations to be objective, the independence and objectivity of the audit unit must be ensured.

Therefore, internal audit provides an independent and objective assurance service as well as advice that adds value and improves the operations and activities of the organization. It helps the entity achieve its core mission and goals, using a systematic approach to all operations, managing to evaluate and improve the efficiency of all processes.

Although internal auditors are a valuable asset in internal control, internal audit does not replace internal control. In order for the internal audit function to be effective, it is necessary for the internal audit unit's staff to have an independent position vis-à-vis the entity's management. The way of working must be in an impartial manner, and staff must be fair and honest, and subordinating them to the highest level of authority within the organization.

These allow internal auditors to submit impartial opinions on their assessments and objectively submit proposals to remedy the deficiencies.

In addition to the monitoring role of the entity's internal control, well-trained staff from internal audit structures can help streamline external audit engagements, providing direct assistance to the external auditor. The nature, specific scope, duration and planning of external audit engagements can be optimized if the external auditor can rely on the work of the internal auditor. Hence, internal auditors continuously contribute to the effectiveness of the internal control system through their assessments and recommendations, with a significant role in the efficiency of internal control. However, internal audit has no management responsibility for the design, implementation and development of the internal control system.

#### **Staff members**

Also the internal staff of the entity contributes to the internal control process, which is an explicit or implicit part of each person's attribution. All staff have a role in performing the control themselves and are responsible for reporting operations with problems, non-compliant or compliance with the code of conduct. Staff responsible of execution often applies the internal control measures, verify the correctness of the operations performed, correct incorrect operations, and identify issues that can best be addressed by known measures in performing daily tasks.

#### **External parties**

The second largest stakeholder group in the entity's internal control are external parties such as external auditors, legislators and regulators in the field. They also contribute by legislative and regulatory adaptation and optimizing internal control regulations. However, the external parties are not responsible for the design, implementation, smooth operation or development of the organization's internal control system.

#### **The Court of Auditors and external auditors**

Tasks of Court of Auditors and external auditors include the assessment of the functioning of the internal control system and informing management of the findings. However, the assessment of the internal audit system by the external audit, is determined by the mission.

The external auditors' assessment of internal control implies:

- determining the importance and vulnerability of the occurrence of risk for which control is assessed;
- analysis of inappropriate use of resources;
- non-compliance with ethical standards, economic, efficiency and effectiveness objectives;
- non-fulfilment of liability and non-observance of laws and regulations;



- assessing the suitability of the structure control system;
- testing the effectiveness of controls;
- reporting evaluations made and discussing the necessary corrective actions.

The external audit institutions are interested in ensuring the existence of strong internal audit units. Internal audit units are an important element of internal control, as they are a continuous means of improving the operations of an organization. Where it is found that the internal audit units, did not ensure independence, have poor efficiency or no such units, external audit institutions need to provide assistance and guidance for the development of internal audit units and to support their independence. Such assistance could include the posting of specialists, the conduct of courses, the exchange of training materials and the development of common methodologies and work programs.

Also, external audit institutions need to develop a good working relationship with internal audit units. Thus, shared experience and knowledge can be shared and complemented. Taking into account the internal audit reports and the recognition of their contributions in external audit work, can foster this relationship. Internal auditing may reduce external audit work and avoid unnecessary duplication of work. External auditing institutions must ensure that they have access to reports, work papers and internal audit activity. Both external audit institutions and external auditors have an important role in contributing to and achieving internal control objectives. In particular, they pay attention to "fulfilling liability" and "keeping resources safe".

#### **Legislators and regulators**

Legislation must provide a better understanding and common to both the definitions of internal control and the objectives to be met. Legislation also improves the policies that stakeholders must follow to fulfil their roles and responsibilities.

In July 2015, the I.I.A. releases the paper „LEVERAGING COSO ACROSS THE THREE LINES OF DEFENCE” to help organizations strengthen their governance structures by providing guidance on how to designate and assign roles and specific responsibilities. This paper aims at correlating the internal control model proposed by COSO <sup>2</sup> with the Model of the three lines of defence.

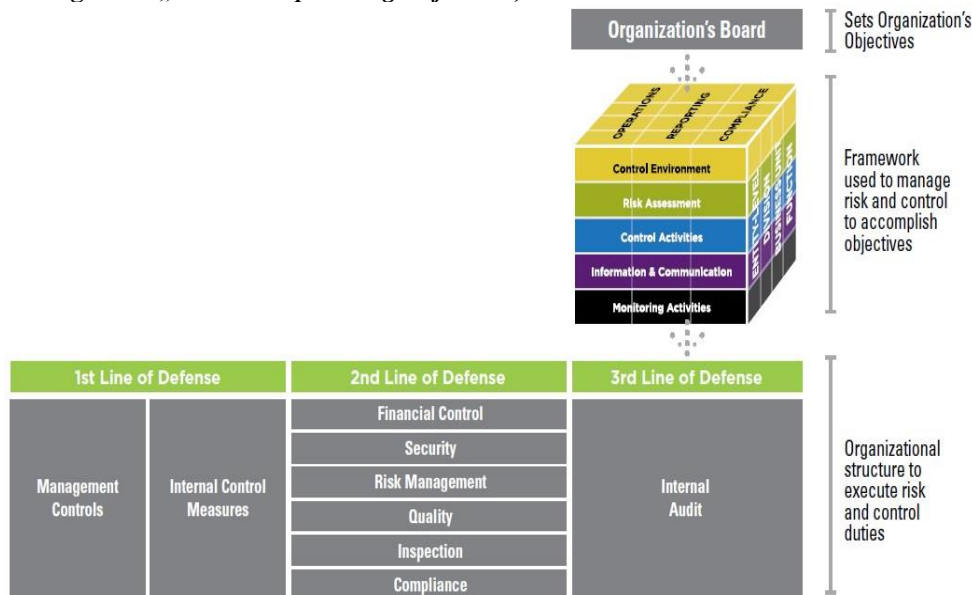
The internal control model promoted by the COSO (Integrated Framework) (Fig. 2) outlines the components, principles and factors needed by the organization to effectively manage its risks effectively by implementing an internal control system. However, this model does not provide much detail in determining who is responsible for the performance of specific duties. Clear responsibilities must be defined in such a way that each structure and individual of the organization understands its role in addressing risks and

implementing controls. It is also inappropriate to establish ways in which groups can coordinate their efforts with each other so that there are no "loopholes" or unnecessary or unintended duplication of efforts.

The model of the three defence lines addresses how specific risk-related and internal control tasks are applied and how they can be assigned and implemented in an organization, regardless of size or complexity. Leadership needs to understand the differences between roles, responsibilities, and specific tasks, and determine how best they can best be attributed to the organization for the organization to achieve its goals.

The model helps to understand and clarify the roles and responsibilities of the organization's groups, structures or individuals. Its fundamental premise is that, under the supervision and directives of senior management and the board of directors, three large separate groups (or lines of defence) must be formed within the organization to achieve an effective management of risks and to achieve adequate internal control. Schematically, these relationships are shown in the figure below (fig. 4).

**Figure 4: „Relationship Among Objectives, The Framework and the Model”**



Source: „LEVERAGING COSO ACROSS THE THREE LINES OF DEFENCE, July 2015”

The basic responsibilities of the three groups (or "lines of defence") are:

- **1st.** To know, hold and manage risks and internal control;
- **2nd.** Monitoring risk and internal control in support of management;
- **3rd.** Providing independent assurance for the director and senior management on the effectiveness of risk management and internal control;

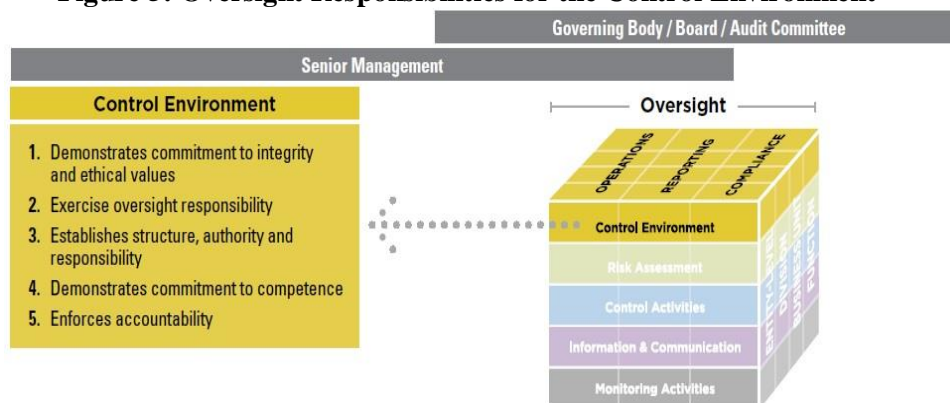
Each of the three lines of defence has a separate role within the organization's entire governance process. When each group performs its role effectively, it is more likely that the organization will be successful in meeting all of its goals. At the same time, when the organization is structured, according to the three lines of defence, it works more efficiently, as risk management and internal control are more likely to be managed effectively.

### The roles of the senior management and the board of directors in the model

Top management and board of directors have an integrating role in this model. The senior management is responsible for selecting, developing and evaluating the control system under the supervision of the board of directors. Although neither senior management nor board of directors, is not considered to be part of one of the three lines of defence, these parties have full responsibility for setting the organization's objectives. It is their responsibility to define high-level strategies, setting general objectives and the task of establishing optimal organizational structures. In addition, they are ultimately responsible for the activities of the first and second line of defence.

As shown in the figure below, both senior management and the board of directors have the greatest responsibility for the control environment in organization by applying the top five managerial internal control standards.

**Figure 5: Oversight Responsibilities for the Control Environment**

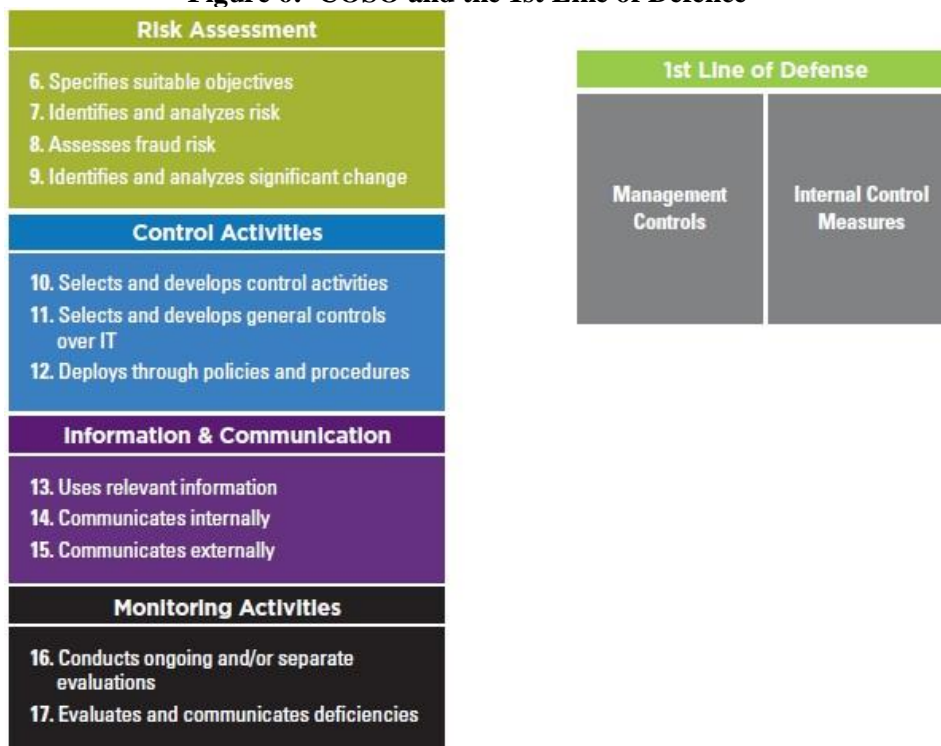


Source: „LEVERAGING COSO ACROSS THE THREE LINES OF DEFENCE, July 2015”

**Roles of the first line of defence: Operational management**

The first line of defence in the model is made up of first line and middle line managers who have the task of knowing and managing risk management and internal control. Operational managers develop and implement risk management and control processes in the organization. This approach consists in identifying and assessing significant risks, in order to perform the activities as planned, to highlight inappropriate processes, to identify deficiencies and to communicate the results of the activity. Operational managers must be sufficiently qualified to carry out these tasks. They have significant responsibilities for 4 major components of the managerial internal control system that aggregate 12 internal control standards, as shown in the figure below.

**Figure 6: COSO and the 1st Line of Defence**



Source: „LEVERAGING COSO ACROSS THE THREE LINES OF DEFENCE, July 2015”

**The responsibilities of the second line of defence: Internal monitoring and surveillance functions**

The second line of defence within the system includes the leadership of various areas with associated risks and compliance functions set by management to ensure that first-line risk management and risk management processes are properly designed and function as planned.

This is where management functions are separated from front-line management, but they also fall under the control and guidance of senior management. The functions of the second line are responsible for continuous monitoring of the control and risks. The second line collaborates with operative management to help define strategy, to provide its own expertise, to implement policies and procedures, and to help create an overall picture.

Under management supervision, the second-line staff monitors specific controls to determine whether they are working properly. The monitoring activities carried out by the second line, targets three categories of objectives: operational, reporting and compliance.

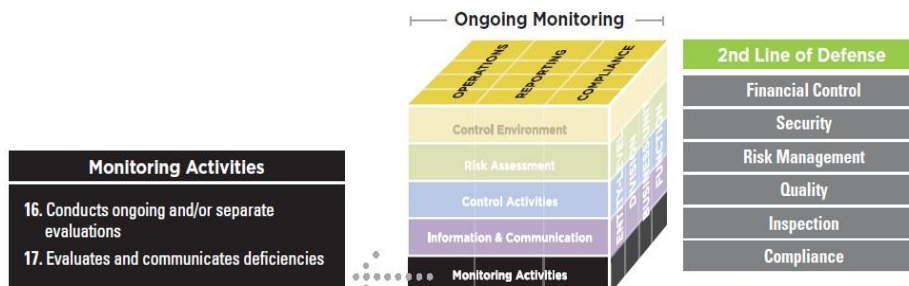
Personnel responsibilities in line 2 vary greatly depending on the nature of the organization but include at least:

- Assisting management in designing and developing processes;
- Define monitoring and measurement of success compared to expectations;
- Monitoring the adequacy of internal activities and control activities;
- treatment of critical issues and emerging risks;
- Identify and monitor known issues;
- Identifying changes in organizational risk appetite and risk tolerance accepted;
- Provide guidance on the risks of management and control processes.

Each function at this level has some degree of independence from the activities of the first line of defence, but by nature, is still management functions. Secondary management functions can directly develop, implement, and modify the organization's internal and risk control processes. They can also act as decision-makers for certain operational activities to the extent that they need to be directly involved.

For efficient operation, it must have a proper stature, with well-trained leaders. Stature derives from authority and direct reporting lines that respect the command. The second line of defence is schematized in the figure below.

**Figure 7: COSO and the 2nd Line of Defence**



Source: „LEVERAGING COSO ACROSS THE THREE LINES OF DEFENCE, July 2015”

**Third line of defence: Internal Audit**

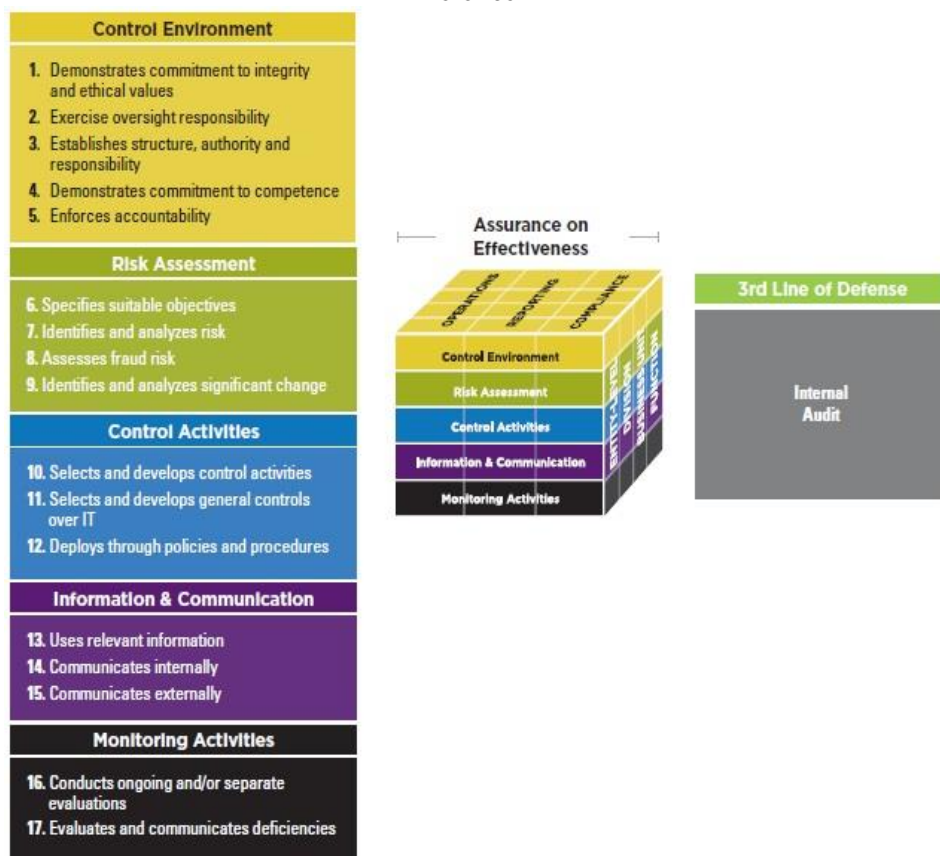
Internal auditors represent the organization's third line of defence. Internal audit provides an assurance service on the efficiency and effectiveness of governance, good risk management and internal control. The scope of internal audit activity may include the entire spectrum of activities and operations of an organization.

What distinguishes internal audit from the other two lines is its objectivity and high level of organizational independence. In most entities, the independence of internal audit is achieved through the direct reporting relationship between the audit director and the board of directors. Due to this high level of organizational independence, internal auditors can provide objective assurance.

Internal auditing actively contributes to effective organizational governance, ensuring that certain goals are met while its independence and professionalism are guaranteed. Internal audit work should be a priority for all entities.

So the internal audit has significant overall organization responsibilities, analysed through the entire spectrum of components of the internal management system that totals the 17 internal control standards, as shown in the figure below.

**Figure 8: COSO and the 2nd Line of Defence**



Source: „LEVERAGING COSO ACROSS THE THREE LINES OF DEFENCE, July 2015”

### 3. Conclusions

Each organization must clearly define its organization, risk management and internal control system. In this way, reduce unnecessary shortcomings or duplications of assigned tasks, related to risk management and internal control system.

This paper attempts to capture the links and interfaces between the best known and current models that can help organizations define, design, implement, maintain and develop risk management and internal control system, with the help of the "COSO Cube" model presented in 2013 in the COSO Framework & SOX Compliance paper and "The Three Lines of Defence in Effective Risk Management and Control" presented by the IIA.

However, in order for a system of internal managerial control to function properly within an organization, it is very important that it be fully assimilated into the organizational culture of public entities so that all staff become aware of both their own responsibilities and the benefits it brings. As long as the implementation of the managerial internal control system is perceived as an additional activity to the job specific duties, the chances of success are greatly diminished. It is not enough that it exists only in documents, with existing standards and methodologies.

The managerial internal control system must be designed as a living body, depending on the size and complexity entity's activity, to which all the staff are involved in the implementation and development process, and it is absolutely necessary for them to understand clearly and their responsibilities.

A real problem at the level of entities may be the lack of qualified human resources and their fluctuation, a problem that creates deficiencies in the process of implementation and development of the managerial internal control system. It is therefore very important to carry out training courses in the field of internal control and risk management all staff.

My conclusion indicates that the organization itself, its structures and staff, and organizational culture have the greatest influence on the effective functionality of all processes, activities, and goals. A leadership-based entity with an emphasis on human development by engaging, consulting, participating, guiding and involving all staff actively seems to be the best condition for achieving success.

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