

## Research on the evolution of controlling tasks and their delimitation from audit tasks

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**Abstract.** *The management decision process is becoming increasingly complex in the current stage, characterized by shorter product life cycles, increasingly higher variety of products and services, rapid changes in technology, low predictability of customer preferences and a larger number of markets and distribution channels. The increasingly large-scale application of financial reporting based on the International Financial Reporting Standards (IFRS) causes debates on the relation between external accounting (financial accounting) and internal accounting (management accounting, controlling, internal reporting). The purpose of this article is to present the evolution of controlling tasks in a public or private entity and to delimitate them from those of audit. The main structural differences between controlling and audit as well as the advantages and disadvantages of integrating internal and external accounting are hereby identified.*

**Keywords:** controlling, auditing, planning, accounting information, management approach, integrated accounting.

**JEL Classification:** M21, M41.

**REL Classification:** 14B, 14I.

## 1. Introduction

The increasingly larger scale application of financial reporting in accordance with International Financial Reporting Standards causes debates on the relation between the external accounting (financial accounting), internal accounting (management accounting), controlling and internal reporting. The purpose of this paper is to discuss two concepts that have not yet received the proper attention in the scientific Romanian literature: controlling and “management approach”. The fundamental idea behind these concepts is to use information generated by internal accounting in financial reporting and to provide investors with an overview of the company “through the eyes of management”. Such an approach reduces information asymmetry, promotes transparency and communication, reduces external reporting costs and ultimately helps boost confidence on the capital markets.

The present article presents the important role played by accounting information in the decision-making process of the management and other decision makers outside the company as a result of internal and external accounting data harmonization. The article is structured as follows: the first section briefly presents the methodological approach; the second section discusses the role of accounting information in the management decision process, its advantages and drawbacks. The following two sections deal with external accounting, respectively internal accounting as sources of information for controlling, management and external users. Subsequently two perspectives are presented: controlling and audit. The critical analysis section identifies the main structural differences between controlling and audit, brings arguments and counterarguments concerning their fitness for purpose.

## 2. Methodological approach

In terms of methodology, this paper provides a critical and comparative analysis of two possible connections between external and internal accounting: “management approach” and integrated accounting. The differences between the two approaches are presented, together with the advantages and disadvantages generated by their implementation. For the purposes of this research, a literature review has been carried out, based especially on the Germanic area, where the contributions related to controlling have a longer tradition.

Companies should be constantly looking for new resources to gain customers’ trust, as Cînda et al. (2010) argue. Financial reporting is one of the strategies used by companies to gain trust and legitimacy. In this context, the accounting information has specific advantages and disadvantages. First of all, one of the

advantages is that the accounting information uses the formalization in data collecting and reporting, creating a common language through which the members of an organization can communicate. Galbraith (1973) notes that formalization allows the sharing of information through a smaller number of symbols, facilitating the coordination between the different departments that must provide input for the decision making process.

Secondly, the accounting information can help managers to better understand their tasks and to reduce uncertainty before making decisions (Chong, 1996). On the one hand, uncertainty represents a lack of information compared with the informational needs in making decisions. On the other hand, uncertainty is even greater when managers are less able to foresee the consequences of their actions. Burchell et al. (1980) discusses the various roles of information in decision making, depending on the level of uncertainty.

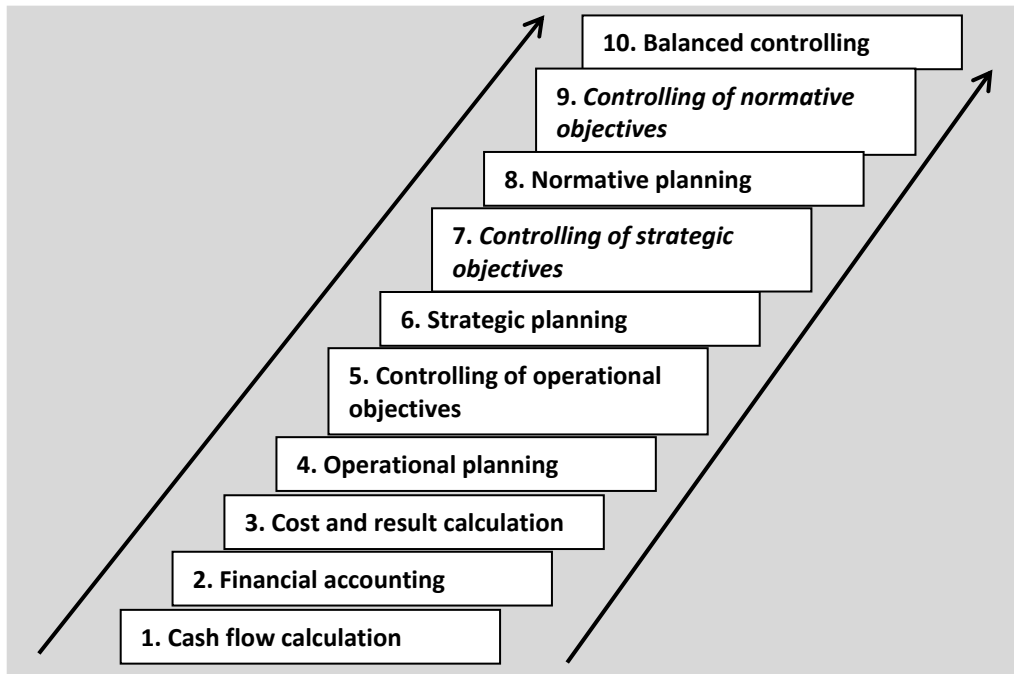
With the help of accounting information, the financial impact of each option available for the decision maker can be quantified, so that the manner in which the objectives could be achieved can be evaluated and ultimately, better decisions can be taken.

### 3. Evolution of controlling tasks

The turbulences and uncertainties of the modern business environment have made professional management at the beginning of the '70s to resort to strategic planning, to the use of *early warning systems*. Even since the '80s the specialized literature has been discussing about the relation between the concepts of strategic planning and strategic controlling (see, for example, Pfohl / Zettelmeyer, 1987, p. 164).

Recent years have also seen the increase in requirements regarding normative management, a balanced assessment of economic, environmental and social aspects and of corporate social responsibility. Following the consequences of the financial crisis from 2007-2008, the attention has focused mainly on the latter and has revived the discussion regarding the professional internal controlling.

Figure 1 presents the ten stages (of development) of the management systems and, thus the evolution of controlling tasks.



**Figure 1.** Evolution of controlling tasks (Source: Mann, 1988, p. 56)

#### *Cash flow calculation*

Managing an organization based on liquidity, respectively on the cash register, is *the simplest form of management* and is currently used only by private households.

#### *Financial accounting*

Ever since the Middle Ages, through double entry bookkeeping a successful management system has been developing, used in companies for documentation purposes and, equally, for planning and decision making. Currently, financial accounting and annual financial statements are no longer enough as they lack future vision. Only a planned balance sheet and, by logical connection, a planned profit and loss account and a planned cash flow can eliminate this shortfall (Eschenbach and Siller, 2014, p.87).

#### *Cost and results calculation*

Cost calculation (management accounting) has the task of recording costs and outcomes (income) from the operational activity. The calculation of costs and actual results, using a structure that is *not influenced by external standards* and whose utility is assessed entirely by the management, complements the management accounting system in terms of content, however the company's future orientation and steering possibilities occur only by carrying out costs and results calculations.

*Operational planning*

Operational planning mainly includes individual activity plans and the budget, with its components, represented by the planned profit and loss account, planned cash-flow and planned balance sheet for one financial period.

*Controlling of operational objectives*

Operational planning requires the control over the operational budget. Controlling however is more than a simple combination of planning and control. The controlling of operational targets should ensure a functional system of result analysis, alignment of operative objectives, planning, coordination and information, plan implementation and control over budget execution.

*Strategic planning*

Strategic planning mainly includes planning of strategy (strategies) at company level. Strategic planning requires a controlling of operational targets in order to assess strategy effectiveness on the basis of profitability indicators (productivity, operational result or company result).

*Controlling of strategic objectives*

Strategic planning requires strategic control, monitoring of the effectiveness of various strategies. Assessing the effectiveness of strategies in relation to its effects in the form of costs and results indicators, i.e. through financial accounting, is overdue. Controlling of strategic targets must ensure a functional system of analysis of competitors, opportunities and risks, company strengths and weaknesses, the development and implementation of strategies and the control of their effectiveness, before all these aspects are reflected upon the annual financial statements, costs and results calculation and cash-flows.

*Normative planning*

The normative planning stage is concerned with the content of the company mission, the way it respects its values and ethical standards, the organizational culture and the conflict resolution culture. The results are brought about by the people who will be involved in the normative business approach not only as “result providers”, but also as representatives of values and reasons.

*Controlling of normative objectives*

It must ensure a functional system of analysis of the strengths and weaknesses of the company’s culture and management, of opportunities and threats, as a result of changes in moral requirements, alignment of normative objectives, development and implementation of normative structure and mission statement and the control of their effects, before they produce effects on the operational and strategic control.

### *Balanced controlling*

Balanced controlling represents the highest level in the controlling development process and aims to integrate and balance (approximately) the three levels of controlling taking into account the normative, strategic and operational elements. Periodically, the compatibility and balance between the three plans (normative, strategic and operative) is being examined and a correlation is made, such as:

- Are the representation of moral values, the company's mission statement and the strategy up to date?
- How can the structural measures included in the company's mission statement be implemented?
- How can the objectives and operational indicators be derived from the company's mission statement?
- What are the effects produced by the operational decisions, respectively by the employees' conduct in the operational activity, on the strategic and normative positions? (Eschenbach and Siller, 2014, p. 88).

#### **4. Delimitation between controlling and accounting tasks**

Controlling has a special relation with accounting because it resulted from accounting and it cannot fulfill its tasks in the absence of accounting data.

Accounting is structured into external accounting (financial accounting) and internal accounting (management accounting). Both are database systems for controlling and therefore, must match the controlling standard in terms of quality. In the working process, controlling needs financial and management accounting data under the following circumstances:

- Controlling needs data from receivables accounting to evaluate the provision for depreciation of receivables (risk of insolvency);
- Controlling needs the balance sheet for the calculation of operational indicators;
- Controlling needs the fixed assets registry as an auxiliary tool for checking the investment plan;
- Controlling needs data from management accounting to identify the breakeven point;
- Controlling needs the process costs for benchmarking;
- Controlling needs data related to profitability calculations per segments of sales in order to advance proposals for product range optimization.

Figure 2 presents the essential characteristics of the internal and external accounting, in relation to controlling.

**Figure 2.** *Accounting versus controlling*

Criteria	External accounting	Internal accounting	Controlling
Operating mode	Based on numbers	Based on numbers	Based on values, strategy, numbers and recipients
Focus	Numbers must be accurate	Numbers must be accurate	Numbers must be transformed into measures
Timeframe	In relation to the past	Future/past oriented	Future oriented
Orientation	On documents and decisions	On documents and decisions	On decisions
Principles	Accurate accounting principles	—	Controlling principles
Culture	The numbers are reported	The numbers are reported	The numbers are reported, explained, and "sold"
Deadlines	Exact	Exact	Approximate, but in time
Priority	Accuracy has priority over timeliness	Accuracy has priority over timeliness	Timeliness has priority over accuracy
Language	Specialized language	Specialized language	Specialized language translated into the recipient's language
Legal basis	Yes, normed structure	No, no norms	No, no norms
Output (examples of deliverables)	Lists of accounting balances, personnel accounts, list of assets, annual financial statement	Costs calculation, costs allocation, calculation of result at the end of or during financial period	Reports, proposals of measures, checks, planning system
Recipients	Owners, creditors, customers, tax authorities, suppliers, auditors, management, controlling	Owners, management, supervisory bodies, employees responsible for controlling	Owners, management, supervisory bodies, accounting employees
Stipulations	Accounting Law, Company Law, IFRS, tax laws, etc.	Organized according to the specific of each company	Organized according to the specific of each company

Separating the results calculation between internal and external accounting is an impediment for managing the company. In order to provide relevant and consistent financial data to third parties (external users) detailed explanations are required in the activity reports (for example, the method of calculating actual and planned indicators requires organizational efforts and creates complexity in the internal mechanisms of settlement).

For this reason, group level accounting tends to standardize internal and external accounting, especially through IFRS. At the same time however, the businesses operating at an international level must continue to take into account the various frameworks and local accounting rules.

## 5. Delimitation between controlling and audit tasks

Auditing represents a subsequent check of completed operations, made by people that are not directly or indirectly dependent of the process or responsibility area that is monitored.

In Figure 3 we present the most important features of internal audit versus controlling.

Internal audit and controlling are elements of the monitoring system (internal control system, see Schneider, 2000, p. 68).

**Figure 3.** *The delimitation between internal auditing and controlling*

Criteria	Internal audit	Controlling
Beneficiary	The company's management, supervisory bodies	Management structures from all levels
Activity basis	Position delegated by management, audit plan	Position delegated by the management
Duties	Selective, based on issues and audit plan	Selective, based on need
Organization	Functional position	Preferably operational position (hierarchical, of line organization)
Main objectives	Control and monitoring	Complementing the management
Relationship with company structures	Independent of process	Integrated in process
Tasks	Preservation of wealth, compliance	Increasing wealth
Time of action	Ex-post	Ex-ante, ex-nunc (for the future)
Working method	Examination, control, proposal of measures	Planning, regulation, coordination, control, proposal of measures
Key aspects of consulting	Orientation towards the internal control system	Orientation towards business
Recipients	Management, supervisory bodies, auditors, controlling	Management, supervisory bodies, auditors, employees, internal auditing
Stipulations	Article 160, paragraph 2) Company Law	None
Principles	Audit Standards	Controlling principles

The internal control system aims to ensure compliance, functional and economic safety of records, processes and operational assessments on the basis of integrated controls during or subsequent to processes.

The internal control system comprises all the measures aimed at ensuring the assets of an entity, at guaranteeing the accuracy and reliability of accounting data and at supporting compliance with business policy (Hoffmann, 2000, p. 171).

The most important *components of an internal control system* are mainly:

- goal-oriented activity;
- alignment of objectives and tasks according to the principle: tasks = skill = responsibility;
- clear organizational principles;
- transparent processes;
- clear instructions and work processes;
- system inherent controls;
- control cycles (plan-do-check-act);



- separation between the structures that formulate instructions, the ones that implement them and the ones that record them (functional separation);
- double check principle (preferably: triple check principle);
- regular audits (audits of standardized terms) for compliance with the internal control system.

While it is an integrated part of the internal control system, the highest priority from internal audit's perspective, as an independent process, is the check, monitoring and evaluation of the effectiveness and proper functioning of the control system.

The main aspects of checking (auditing) have changed during recent years and have developed and expanded as a result of the permanent growth in the complexity of the organizational environment.

#### *Internal consultancy*

The next stage of the extension of internal audit is represented by internal consultancy.

The knowledge, experience and know-how of the employees working in audit must be used to offer management consultancy. The difference from controlling is that the main task of controlling is information processing and analysis. The task of internal auditors is mainly to offer consultancy based on audits ( see Hannemann et al., 2008, p. 656).

In order to carry out the audit tasks under optimal conditions, a close cooperation is required between internal audit, the organization, IT department and controlling. *The cooperation* between auditors, controllers and management can be outlined as follows:

- controllers inform internal auditors about significant deviations, thus being able to trigger special checks;
- internal auditors offers consultancy on the main aspects to be checked during the planning of checks, together with controllers;
- the checks carried out by the internal audit are finalized with reports on undesired deviations and with improvement proposals. However, due to the fact that the audit activity is not periodical and there is a large time gap between the audit and the implementation of the recommended measures that are often time consuming, controlling should offer support to the internal audit;
- controlling in itself is a subject of audit (for example, the audit of controlling usefulness, effectiveness, etc.)
- in companies where, due to reduced size, a stand-alone internal audit department is not economical, external specialists can be used, such as

auditors, or controlling can assume the most important functions of internal audit; also top management and/or supervisory bodies monitor controlling's work.

#### *Financial audit*

Financial audit is the past-oriented evaluation of the relevance, reliability and compliance of accounting records, taking into account the functionality of the internal control system and the objectives agreed by management. The accounting data represent the basis of examination, the results and processes are the object of investigation (see Hoffmann, 2000, p. 177 and seq.)

#### *Operational audit*

The increase in decentralization and in the international interconnection of organizations call for a higher degree of focus on a unitary, overall, process evaluation vision from the internal audit.

Operational audit represents a future-oriented, independent and systematic evaluation of operational activities, aimed at increasing profitability, reaching the objectives and complying with management's directives. Also in this case, the evaluation basis is represented by accounting data. The operational audit's goal is to identify the errors, gaps and weaknesses in the internal control system, the lack of plausibility and the irregularities, and to recommend corrective and improvement measures.

Such a process oriented check is no longer intended as an isolated examination, for example a comparison between actual and baseline, but as an evaluation of the organizational structure as a whole and of the effectiveness of the coordination, regulation and control mechanisms.

These measures will be the basis for system improvements regarding individual examination objects, specific fields of activity or the entity as a whole (see Krey, 2001, p. 55).

Frequently, however, even expanding the audit activity to operational audit is proven to be insufficient in the case of operational processes and organizational structures with a high degree of complexity, as is the case, for example, of international organizations. These have complex systems of planning, information, communication and coordination. This situation leads to the concept of management oriented audit approach – namely management audit.

#### *Management audit*

Management auditing serves the management as support for business policy. In this context also the systematic evaluation of second and third level managers is taken into account, detecting to what extent the company's objectives have been met or not.

## 6. Critical analysis

In the following we will discuss the advantages and disadvantages brought about by the “management approach” vision; the advantages and disadvantages of a full integration of internal and external accounting and the differences between “management approach” and integrated accounting.

Choosing a “management approach” has both advantages and disadvantages (described below in accordance with Wagenhofer, 2006). First of all, among advantages we count the fact that the information that is reported is considered to be the most relevant by management. Secondly, the costs of obtaining data are reduced, because no additional data is needed for external reporting. Thirdly, the information reported can be easily verified from the outside, because the financial auditor must only examine whether the data matches internal reporting.

The disadvantages of the “management approach” include, in terms of external accounting, the reduced comparability of data – different companies generally use different indicators. In terms of internal accounting, a major disadvantage is that internal reporting can be negatively affected. For example, the company might be tempted to internally report other information than the one that would actually be optimal, only for preventing external users to receive such information. Last but not least, of the design of the internal accounting system has to also take into account its potential external effects.

Similarly, Funk and Rossmanith (2008) mentions arguments for and against the integration of internal and external accounting. In terms of internal accounting, implementing an integrated accounting is welcome for several reasons. First of all, the major benefits belong to capital market oriented companies, because the integration of internal and external accounting in compliance with IFRS contributes to the improvement in communication and management for these companies. Not only at the level of the entire company, but also at the subordinated levels of management, integrated accounting through the controlling divisions contributes to the development of plans that are appropriate for achieving the financial objectives communicated externally. At the same time, through integrated accounting, with the help of controlling specialists, the management becomes more capable to discuss with investors and external analysts, can motivate past evolutions and explain forecasted ones. Also for unlisted companies, integrated accounting can be an equally effective possibility of communicating the financial information, both for immediate and strategic goals.

However, there are several counter arguments for the full integration of internal and external accounting in the context of financial reporting in accordance with

IFRS. These counter arguments result from the conceptual perspective of the International Financial Reporting Standards, oriented on the decision making of foreign investors. Thus, in certain cases, the provisions regarding accounting and valuation in accordance with IFRS can contravene internal reporting requirements. There is also a risk that managers, precisely because of the implementation of a “management approach” under IFRS regulations, will try to distort certain internal information that will be transmitted to external accounting and will become the basis of their future evaluation (Roman/Mocanu, 2011).

The two perspectives presented, the management approach and the integrated accounting, are structurally different, these differences being highlighted by Funk and Rossmann (2008). Unlike the management approach, where the use of specific internal information for external financial reporting is mandatory, the integration of internal and external accounting represents controlling’s decision regarding the internal reporting of the result. While in the management approach, the information provided by controlling is exported in external accounting, in the case of integrated accounting internal and external results must be matched as much as possible and as far as it is relevant from an economical point of view (Roman and Mocanu, 2011). Through the management approach, internal accounting becomes an information source for external accounting. Therefore, the indicators used primarily for objectives of the internal accounting acquire a double role, being also used in external accounting.

## 7. Conclusions

The decision process of management is becoming more complex in the current context, characterized by shorter product life cycles, an increasingly variety of products and services, rapid changes in technology, low predictability of customer preferences and a higher number of markets and distribution channels. This paper has debated the role of information offered by the external and internal accounting in the decision making process of the management and also of external users. Two perspectives have been presented on the meeting points of external and internal accounting: the so-called management approach and the integration of internal and external accounting. The management approach requires management to include the information obtained from internal accounting in the financial reports presented to investors and other external users. Thus, the company is presented “through the eyes of management”. On the other hand, the key feature of integrated accounting is the match between the result calculated in internal accounting for planning, coordination and control tasks (controlling attributes) and the result published in external accounting. Both perspectives have advantages and disadvantages, and the discussions regarding the difficulties of

implementing one or the other remains open. The data and information generated by accounting (internal and external) and controlling represent the raw material for auditors, crucial for the audit mission.

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