

## Improving public sector performance by strenghtening the relationship between audit and accounting

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**Abstract.** *If twenty years ago the financial activities of any Romanian enterprise were the sole responsibility of the accountant, nowadays the relationships of the economical entities within theirselves and with their environment are too complex to be handled just by accounting departments. Around accounting there have appeared a significant number of activities like Controlling and Auditing which are meant to link Accounting with the strategic management. In this regard the paper approaches the relationship between internal public audit and accounting which improves decisions making process in public sector. The research methodology aims to study these relationships and determine how they can work to the benefit of increasing public sector performance. The conclusions of the research shape aspects of accounting and auditing improvement as main strategic components for insuring performance in the public sector.*

**Keywords:** audit; controlling; accounting; public sector performance.

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**REL Code:** H83.

## 1. Introduction

Modern management is more and more influenced by the need to build an integrated model of leading an economical entity, best described by *Management by Systems*. In its quality of a „complex, dynamic, open, autonomous, market oriented, productive and social system” (Thommen, Archleitner, 2001, p. 38, Evans, Davis, 2005, pp. 758-775) the economic entity is composed of several subsystems having determined actions and relationships between them, exchanges resources with its environment and is disturbed by internal factors (unsatisfied employees, damages to equipment) and by external factors (legal environment). We speak here of economical entities and not enterprises because the systemic definition from above can be extended to public institutions, non-profit organizations and so on.

The concept of *management by systems* implies the leading of an entity by determining the relationships between these subsystems and of the relationships of the entity as a whole with its environment, in order to reach its function optimum (Thommen, Archleitner, 2001, p. 824).

The essential assumption or reaching this optimum is that the processes and relationships within the entity and of the entity with its environment are measurable, and that the measurement can be carried out with an accuracy as good as needed. This function is mostly taken by the financial and accounting department, thus building a subsystem of its own, with the purpose of measurement.

There are two main critics to the concept of “management by systems”. One of them regards its applicability: economic entities are too complex to be described by an “equation”, and the IT infrastructure has not yet evolved to be able to give the necessary support for managing an entity by the laws of the *theory of systems*. The second critic regards the fact that measuring the relationships mentioned above cannot always be carried out with a sufficient accuracy.

However, it is this author’s opinion that the concept of Management by Systems is a matter of the future. The ERP (Enterprise Resources Planning) and CRM (Customer Relationship Management) software that is being developed gets stronger and stronger and the hardware support for these software is getting more and more powerful by the day. Measuring and modeling an economic entity will be eventually carried out with accuracy close to the needs and rigors of management by Systems. This paper proposes a model of the financial department in its role of measurement subsystem. Also, this paper introduces the notion of Controlling to public institutions in Romania, as a mean to interpret accounting reports and give to the public management the necessary decisional infrastructure.

## 2. The difference between accounting and audit

Accounting represents the recording, classification and synthesis of economic events in a logical manner, with the purpose of giving financial information as a support for the decision process (Arens, Loebecke, 2006, pp. 13-14). In order to be able to give relevant information, which is always of a quantitative nature, the accountant must know very well the principles and rules on which the processing of the supplied information relies in order to build up a system that insures the correctness, promptitude and efficiency of the recording of facts and events. Thus, accounting must be regarded as a tool of management which follows internal processes in all their stages starting with conception.

Also, in auditing accounting data it is most important to determine whether they accurately reflect the economic events that have produced during the financial exercise (Arens, Loebecke, 2006, p. 14). It is required also from the part of the auditor to perfectly understand the principles and rules that the accounting records rely on, because the audit really verifies the compliance of the records with these rules and principles.

This is only the first of three stages of public audit mission complexity (Pollitt, Bouckaert, 2011, p. 86 ). Extending the approach to verifying not only accounting data, the second stage complexity turns to some issues of public sector performance like efficient use of resources (Jaliu, 2009, pp. 12-13). The third stage lives the field of accounting addressing the mechanism which generate performance in public institutions.

Next to a very good understanding of accounting, the auditor has got to have the experience of gathering and interpreting evidence. It is exactly this experience that differentiates auditors from accountants. The auditor's activity reflects into identifying adequate auditing procedures and testing parameters.

## 3. Accounting, Controlling and Audit

The measurement of system performance (Iancu, 2012, pp. 103-124) is in the case of social and economical systems a permanent and indispensable function for assuring the fulfillment of entity objectives (for public administration, Iancu, 2012, p. 110). We will now try and define each of the components of the measuring subsystem of the entity, namely, accounting, controlling and audit.

*Accounting* is a permanent activity within the system, supplying information at regular time intervals about the performance of the system, its finality being the balance sheet. In evaluating the activity of the system, accounting suffers from legal constraints and therefore is not suitable for the processing of the supplied information (Dillard, Yuthas, 2002, pp. 49-64). Accounting gives quantitative

information about incomes and expenses applying to the studies period of time for companies in the private sector, and about the taxes to pay according to the fiscal result. Information given by accounting is of an objective nature because of their quantitative character and of the legal constraints.

On the other hand, *Controlling* (Horvath, 2007) is a permanent activity of evaluation of the data supplied by accounting and by the environment. From the point of view of the system behavior the functions of Controlling are:

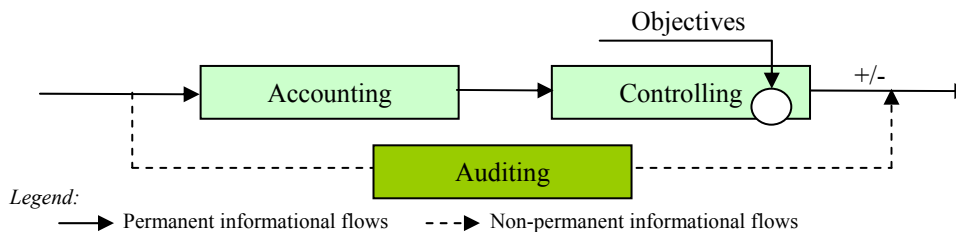
- establishing analysis and synthesis methods of data;
- analysis and synthesis of the data supplied by accounting or by the environment, their comparison with the objectives of the entity and offering coherent reports to the strategic management in order to sustain its planning activity;
- reevaluation of data for determining and preventing abnormal or anti-systemic events, and data processing errors.

As a general rule we can say that it is the goal of Controlling to define, build up and verify the system. The results of the Controlling activities are, in distinction from accounting, both quantitative and qualitative, and they are not constrained by legal aspects, but by aspects of a mathematical and procedural nature. Controlling is an activity covering the entire entity, and is part of the strategic management, having among others the function of supplying coherent information.

Controlling does not refer to the characteristics of the product, but to the concordance between planned activities and the progress of their implementation, using as metric the financial and accounting support of the organization (Brătianu, C. in Foerword to Horvath & partners, 2007).

Also, *audit* is an activity of a permanent or non-permanent, periodical or non-periodical nature, of gathering information about the system and evaluation according to a well-defined set of criteria (Arens, Loebecke, 2006). Establishment of the optimal moment of auditing is a very important issue of the system, but it is not the central issue of this paper. Within the measurement subsystem of the organization, the audit has two very important functions:

- Verifying the conformity of analysis and synthesis methods used by the controlling department with the actual state of the system and reaching verdicts about their validity and opportunity in order to insure the coherence of its conclusions with the process that they refer to;
- Verifies the legality of accounting records, as basis and information source for controlling. Fiscal control has the same function. The difference relies in the fact that observations of audit are relevant only to the organization and are being directed only to the strategic management and controlling, while observations made by the fiscal control regarding possible nonconformities of records are being sanctioned.



Source: Dumitrescu (AMIS, 2010, pp. 337-343).

Figure 1. The relationship between accounting, controlling and audit

We can thus say that the audit is a sort of “over control” for the organization. The audit needs to assure the objectiveness of controlling and report to the strategic management the possible nonconformities in the elaborated methodical approach. The conclusions of the audit are almost always of a qualitative nature, trying to determine from a causal approach the relationship between the effects of different existing states of facts to the procedural errors of the measurement subsystem.

Any system formed of accounting, controlling and audit which works according to the diagram from Figure 1 can contribute to the improvement of management performance in public institutions. Such systems are being successfully implemented in large private owned companies and multinational corporations. Accounting measures events taking place within the public entities. The quality of this activity is crucial, not only from a legal point of view, for the sake of financial statements, but also because measured data is used by controlling for the financial reports it makes for the hierarchically superior levels. These reports aren't written according to legal requirements, as they must describe as exactly as possible the processes taking place within the entity. This is why controlling is using its own set of procedures and methods. Audit must thus verify the basis by which both accounting and controlling are working. For accounting it must ensure that the measurement is carried out as exactly as possible, and for controlling both the correctness of the used methods as well as their application.

#### 4. Conclusions

Although accounting, controlling and audit are very often mistaken one with each other they have very distinct function within the organization. Accounting gathers information, controlling processes them and audit verifies the coherence of the accounting and controlling activities with the processes within the organization. We consider that audit activities should cover not only the aspect of legality of accounting records, but especially the conformity of the

methodical approach of controlling in order to insure that the management decision and planning functions have the right basis for their activities.

It must be mentioned that the sphere of interest of the internal public audit is not limited only to verifying financial statements, but includes according to the law of internal public audit (Law no. 672/2002 republished, MO no. 953/2002) all fields where malfunctions can occur, which can lead to a decrease in performance. However, for the purpose of this paper, it is exactly the financial aspect of internal public audit, which is relevant.

This paper is especially useful for public institutions in Romania, where the procedures and methods controlling have not yet been institutionalized, and audit procedures apply only on accounting records. This paper is intended to be the basis for a larger study of the role of audit and controlling in Romania's public institution of today and tomorrow.

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