



SCHOOL OF BUSINESS AND PUBLIC MANAGEMENT
THE INSTITUTE OF BRAZILIAN BUSINESS & PUBLIC MANAGEMENT ISSUES

MINERVA PROGRAM
SPRING 2011

THE IMPORTANCE OF INTERNAL CONTROL IN THE BRAZILIAN PUBLIC ADMINISTRATION

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WASHINGTON, DC – April 2011

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1. INTRODUCTION

The circumstances in which public administration is found in today's society is highly renowned for a lack of resources and increasing demands from the community, weighing on public administrators its real concerns regarding more efficient controls of organs under their administration.

This lack of resources, together with the high number of demands from the community makes expenditure quality even more pressing. Internal control thus becomes an extremely important tool inevitably detecting any deviation in administrator intentions.

The promulgation of a recent Brazilian Complementary Law 101, dated May 4, 2000, known as the Fiscal Responsibility law was a giant step forward in the search for a new public structure. It sets norms for public finances concentrating on fiscal responsibility, assuming planned and transparent actions in which one can take precautions against risks capable of affecting public deficit balances. In other words this law establishes a new pattern of governing and promotes the idea of accountability.¹

This new economical and social reality in which the objectives, structure and the very reason for the existence of the State are questioned demands behavioural changes in Public Administration. Society has started to demand new ethics and a new form of administration with more responsibility and more transparency in a more agile, more efficient and more effective State. For such it is vital that control mechanisms take strategic positions in this new historical moment.

¹ The concept of accountability emerged at the beginning of the second half of the 1980s in the countries of Anglo-Saxon tradition. There is not a concise translation of the term [accountability] to the Portuguese language. Some define it as the duty of rendering bills, others as the duty of transparency and others still as the duty of efficiency of those responsible for the accomplishment of Public financial activity (PASCOAL, 2005, p.8).

1.1 Paper Structure

The introduction puts the theme into context and for understanding this context into which internal control is introduced **chapter 2** presents past and present day forms of public administration as well as their organization and structure in general terms.

Chapter 3 deals with internal controls in the Brazilian public administration and approaches the history of internal control in Brazil delving further in general terms to present the current Internal Control System structure in the Federal Executive Power.

Chapter 4 presents concepts of internal control. **Chapter 5**, being the core of this paper deals with the objectives of internal control. In other words, it is through this control that public administration with reasonable confidence guarantees the accomplishment of targets and avoids the occurrence of impropriety and irregularities.

The limitations of internal control in Public Administration are presented in **chapter 6** followed in **chapter 7** by the internal control as seen by COSO being that the methodologies or rather basic components of an internal control identified by this commission became world reference for the theme of “internal controls”. In Brazil, the Brazilian Court of Audit - TCU² was one of the pioneer public organs to adopt such methodologies.

In **chapter 8**, examples of benefits from carrying out internal controls are shown. These results were published by the Office of the Controller General - CGU³, through its [report called] "CGU Actions in 2008 - Internal Control, Preventing and Fighting Corruption."

² Organ that aides the National Congress in the inspection of accounting, finances, budgets, operations and assets of the Union and of administrative organizations - both direct and indirect in terms of legality, legitimacy, economic viability, application of subsidies and renouncement of revenue. This activity is known as external control.

³ Federal Government organ responsible for attending the President directly and immediately concerning subjects in Executive authority areas which might be relative to the defence of public assets and increased transparency of the administration through the activities of internal control, public auditing, honesty, prevention and fight against corruption s well as the complaints department.

2. BRAZILIAN PUBLIC ADMINISTRATION

To understand the context in which internal control is found it is necessary to describe the types of public administration that have been adopted to date as well as understanding its period in history. This includes both the organization and the structure of Brazilian Public Administration.

2.1 Forms of Public Administration

Public Administration is part of an important area of Administrative Science representing the tool of the State and works as a governmental instrument to plan, organize, conduct and control all administrative actions aimed at achieving full satisfaction of both basic and collective needs.

Public Administration involves the whole administrative apparatus on which nations, states and municipal districts are molded to care for the collective interest and give the population a wide variety of public services capable of improving the quality of life as a whole.

The progress and development of a nation quietly and obligatorily occur through Public Administration. As Peter Drucker⁴, well noted, neither rich nor poor countries exist but well-administrated and badly administrated ones. This describes the size and importance of Public Administration.

Brazil's Public Administration has developed through three basic models namely Patrimonial, Bureaucratic and Managerial. These three models are pretty well described by Mr. Bresser Pereira in the white paper called "The Director Plan of State Apparatus Reform".

⁴Philosopher and economist of Austrian origin, considered the father of modern administration and one of the most renowned scholars in the phenomenon of the effects of Economic Globalization in general, especially in organizations - being understood that modern administration is like a science that deals with people in organizations, as Peter Drucker said himself.

a) Patrimonial Public Administration

In Patrimonial Public Administration the apparatus of the State works as an extension to the sovereign. The aides (servants) hold real nobility status. The positions are considered perks⁵. Public administration is not differentiated from private. Rather it is a form of public administration characterized by the privatization of the State for the inter-permeability of both public and private assets.

This way patrimonialism isn't based on safeguards (protection) of public assets in relation to private interests. On the contrary, it is based on the misuse of public assets.

Consequently corruption and nepotism are inherent in this type of administration. When capitalism and democracy become dominant, both market and civil society distinguish themselves from the State. In this new historical era patrimonial administration becomes an unacceptable exorbitance.

b) Bureaucratic Public Administration

Bureaucratic Public Administration emerged in the second half of the 19th century at the time of the liberal State as a form of fighting corruption and patrimonial nepotism. An administration model that regulates meticulous controls of middle road activities was consequently adopted.

Its development guideline orientation is based on professionalization, careers, functional hierarchy, impersonality and formality - in synthesis, rational-legal authority. Administrative controls seeking to avoid corruption and nepotism are always priority. It comes from prior distrust in public administrators and the individuals who deliver those demands. This is why rigid controls of processes are always necessary like for instance in staff admission, purchases and attending complaints.

⁵ Perks are easy benefits like public positions granted through nepotism, in exchange for political favours for example.

On the other hand, control, the guarantee of State authority becomes the very reason for being a state employee. As a consequence the State backs into itself, losing the notion of its basic mission to serve the society.

The fundamental quality of bureaucratic public administration is the effectiveness to control abuses; its downfall, inefficiency, self-adherence and incapacity of returning to attend citizens as customers. This downfall however was not clearly revealed at the time of the emergence of bureaucratic public administration because the Public services were very few. The State limited itself to maintaining order and delivering justice to guarantee contracts and property.

Bureaucratic Characteristics include norms and regulations, formality in communications, rationality and work sharing, impersonality in relationships, authority hierarchy, routine and standardized procedures, technical competence and meritocracy, operational predictability etc.

We have commonly started to use the word bureaucracy to describe defects in the system such as dysfunctions, (exaggerated annexes to regulations) excesses of formality, resistance to change, de-personalization of relationships and over-conformity to routines and procedures.

c) Managerial Public Administration

Managerial Public Administration emerged in the second half of the 20th century as a response on the one hand to the expansion of economical and social functions of the State, and on the other, to the technological development and globalization of the world economy since both left behind problems associated with the adoption of the aforementioned model.

The efficiency of public administration thus becomes essential with the need to reduce costs and increase service quality benefitting citizens. The reform of the State Apparatus comes to be predominantly guided by the values of efficiency and the quality in public services rendered as well as by the development of a managerial customs in organizations.

Managerial Public Administration brings progress and to a certain extent, rupture with bureaucratic public administration. This doesn't mean however that it denies all their principles. On the contrary, Managerial Public Administration leans on the previous administrations, conserving albeit flexibly, some of the fundamental principals like admissions, complying rigid merit earning criteria, the existence of a structured and universal system of remuneration, careers, constant performance assessment and systematic training.

In Managerial Public Administration the strategy concentrates on:

- The Precise Definition of the objectives which public administrators should achieve in their units;
- Guaranteeing administrator autonomy through human, material and financial resources placed in their hands to achieve the said objectives; and
- The Control or later checking of results.

Additionally administrative competition within the same State is practiced when there is this possibility of establishing such between internal units. In the organizational structure plan, decentralization and the reduction of hierarchical levels become essential. In short it has been said that public administration should be permeable to the largest participation of private parties thus shifting the emphasis on procedures (means) over to results (ends).

Managerial public administration is inspired by company administration but shouldn't be confused with this latter. Whereas company income depends on payments that customers supply in the purchase of products and services, the revenue of the State is derived from taxes or rather, obligatory contributions, without direct compensation. While the market controls the administration of companies, society controls public administration through elected politicians. Managerial public administration is directly and explicitly based on public interest while the administration of companies is concentrated on profit for the maximization of shareholder interests trusting that the collective interest will be attended through the market.

In this last point as in many others (professionalism, impersonality etc), managerial public administration does not differ from bureaucratic public administration. In classic public bureaucracy a very clear and strong notion of the public interest does exist. The difference however is in the understanding of what public interest means and for it not to be confused with the interest of the very State.

For bureaucratic public administration, public interest is frequently identified with the admission of State power. When under this principle public administrators end up directing a substantial part of their activities and State resources towards servicing the needs of internal bureaucracy recognized within the power of the State. The content of public policies is relegated to second place. Managerial public administration denies the public interest approach classifying it as collective interest and not as part of the State.

2.2. Organization and Structure

Public Administration can be considered as the universe of organs and people, who carry out administrative tasks including both Direct and Indirect Administration as defined by Ordinance 200/1967⁶,

Direct Administration is the set of organs that combine political people from the State in a **centralized** way, (i.e.: the Federal Union, the States, Federal District and Municipal districts), where competence for administrative activities has been attributed, and includes the Executive, Legislative and Judiciary powers.

Indirect Administration is the group of legal organizations (without political autonomy) which, linked to Direct Administration are competent for administrative activities in a **decentralized** way and in accordance with Ordinance 200/1967 which understands Indirect Administration by the following organizations: Autarchies, Public Companies, Mixed Economy Societies and Public Foundations.

⁶ This is a Law regulating the organization of Federal Administration, establishing guidelines for Administrative Reform, and which also introduces other providences.

a) Autarchies

These are organizations created by law, characterized by legal standing with their own assets and income. They carry out typical Public Administration activities but financially administrated in a decentralized form. They have autonomy though retain administrative protection. They have the nature of legal entities of public domain with typical public functions authorized by the State.

b) Public Companies

These are organizations with legal standing of private domain with their own assets and with exclusive capital from the Federal Union. They are created by law aiming to exploit an economical activity that the government understands to be convenient with the objectives of the State. It should be noted that this capital, being exclusively public can be for just one or several organizations and that their activities are governed by commercial precepts.

c) Public Foundations

Public Foundations carry out activities which although are not typical of the State are of collective interest. The most common ones work in educational areas as well as in cultural aspects and in research. They are founded under specific law and formalized with statutes, independent of any registration. They answer to ministerial supervision and are included as indirect administration organs and defined as legal entities of private domain. However, their being of public or private nature is under debate.

d) Mixed Economy Societies

This concerns the legal standing of private domain societies with the participation of private and public authority in capital assets and administration. They are directed at the development of economical activities or collective interest services pinpointed by the State. They follow mercantile society norms with legal adaptations authorizing their formation.

The majority of shares follow company style voting rights and belong to the Union or the Indirect Administrative body. Their assets can be mortgaged unlike other bodies. They are submitted to the same tax regime and subject to the principals and bankruptcy norms of private companies.

2.3 Fundamental Principles

A public leader owes obedience to the principals of Public Administration, defined in article 37 of the Federal Constitution:

"Art. 37. Direct and Indirect public administration of any part of the Union, State, Federal District or Municipal district authorities must obey the legal principals of impersonality, morality, publicity and efficiency."

Due to this constitutional precept Public Administration is subject to a special juridical order known as the order of public right or the juridical-administrative order. Its essential characteristic is on one hand the admissibility of the idea that the enforcement of the law for public agents requires necessary prerogatives to the organization being granted so that the public interest prevails above private interests; and on the other hand the assumption that public interest cannot be too accessible to those who receive authority obligation to deliver it. This is what is inferred by the fixed principles which are:

Legality: Unlike in private lives where everything is allowed unless forbidden the contrary applies in the public arena. Everything is prohibited unless expressly permitted. Legal regulation is required for everything.

Legality means that the public administrator is subject to the orders of the law and to the requirements of the common good and cannot ignore or deviate from them lest he commit invalidity and be subject to civil and criminal disciplinary procedures depending on the case.

The principal of legality should be seen in conjunction with State objectives because regulation limits leader action whereas objectives impose obligations.

Impersonality: this principal is related to the public objective itself. Administration cannot act with a view to either harming or benefitting individuals. The public interest should orientate the performance of the Administration on behalf of whosoever the administrator acts, the Municipal District, State or the Union and not the administrators themselves. As a consequence this principle prohibits self advertisement which is why, incorporated in the Constitution in paragraph 1 of article 37 is the prohibition of using names, symbols or images characterizing personal adverts in publicity actions, services or campaigns carried out with public money. What is recognized in this principal is that achievements belong not to the public authority person but to the public organization.

Morality: means to act with ethical legality. For the Administrator to violate this principal they only need administer public interests badly which can happen in three ways: through actions deviating from public objectives to pursue interests that are not those for which they should act for; through actions with no public objective; or through adopting actions with deficient public objectives disclosing crude inefficiency when dealing with interests that were entrusted them.

Publicity: this refers to the official advertising of administrative activities except clauses for secrecy foreseen in the very Constitution. Publicity was always taken as an administrative principle because it understands that Public Authority, being public should act with the greatest possible transparency so that those being administrated have knowledge about what the administrators are doing at all times.

Efficiency: this is an economical concept. It qualifies activities not norms. In very general terms efficiency means to produce with rationality. It must seek to stimulate and achieve the best results from what it has at hand and at the lowest cost. Efficiency for administrators is optimization of the means. We must remember that the public administrator is obliged to act with best results as parameters.

In the first dimension of the efficiency principle the economical requirement is inferred, being to discard any idea directly contrary. This talks about efficiency as a quality of administrative action which maximizes resources while obtaining expected results. The principal of efficiency can be equated to the traditional principal of good administration. In Public Administration this principal came to reinforce the theory that it is not enough that the administrator act just in a legal and neutral way but should fundamentally act with high returns maximizing the cost- benefit relationship.

After mentioning the general principals of Public Rights we cannot avoid looking at the principals of Public Administration brought under Ordinance no. 200/1967 which established that the activities of the Federal Public Administration must obey the following fundamental principles:

Planning: Comprehends the elaboration and updating of Governmental General Plans, sectarian, regional and general plans (Multiannual), the annual budget and the financial planning of expenditure in order to promote the economical-social development of the country and national security.

Coordination: systematic holding of meetings must be practiced at all levels through individual leadership work with the participation of subordinate leaderships along with the core institution and operation of coordination commissions at each administrative level.

Decentralization: assumes the existence of public agents charged with adequate authority for carrying out public activity, put into practice through three main routes be them in the Federal, State or Municipal areas: within Federal, State or Municipal Administrations; or from the Federal, State or Municipal Administrations to respective units when properly equipped for such and under agreements; and from the Federal, State or Municipal Administrations to the private sector through contracts and concessions.

Delegation of Competence: with the objective of ensuring speedier and more objectivity in decisions, attending people or problems closer to the facts.

Control: this should be exercised at all levels and in all organs, being accomplished: by competent leadership regarding the execution of programs and the compliance of norms; by the appropriate organs of each system regarding the compliance of general norms that regulate the term for auxiliary activities; by the appropriate organs of accounting systems and auditing regarding the application of public money in safeguarding Union Assets.

3. CONTROL IN BRAZILIAN PUBLIC ADMINISTRATION

3.1 The history of Internal Control in Public Administration

The basis of internal control in Brazilian Public Administration is under Law 4.320/1964⁷, article 76 of which establishes that the Executive Power will exercise three types of control in executing the budget: 1) legality in actions that result in the collection of revenue or covering expenses, the creation or extinction of rights and obligations; 2) working loyalty of administrative agents responsible for goods and public values; and 3) the execution of a work program expressed in monetary terms and in terms of the accomplishment of work and services rendered.

Law 4.320/1964 was shown innovative when consecrating the principles of planning, budget and control. It instituted the Multiannual Investments Budget, the Annual Budget Program and as its main objective established new budget techniques for efficiency in public expenditure.

Ordinance 200/1967 Article 6 established that Public Administration Activities would obey the fundamental principals of planning, coordination, decentralization, competence delegation and control. As for control, this would be exercised at all levels and in all organs understanding this control be done by competent leadership, internal organs of each system and by accounting and auditing system organs. Each Ministry started to have their own inspectorships of finances as a sectarian organ of financial

⁷ A law that regulates general norms for the elaboration of financial law, budgetary and accounting controls of the Union, States, Municipal districts and Federal District.

administration, accounting and auditing system and their central organ was the General Inspector for Finances of the Treasury department.

Internal control appears for the first time in the Federal Constitution of 1967 as a constitutional precept:

“Article 71 – Financial and budgetary inspection of the Union shall be exercised by the National Congress through external control, and the internal control systems of the executive power, set down in law.”

The 1988 Federal Constitution establishes the scope of internal control with more clarity whilst consecrating the Basic Principles of Public Administration in the constitutional text:

"Article 70 - Control of accounts, finances, budget, operations and property of the Union and of the agencies of the direct and indirect administration, as to lawfulness, legitimacy, economic efficiency, application of subsidies and waiver of revenues, shall be exercised by the National Congress, by means of external control and of the internal control system of each Power.

...

*“Article 74 - The Legislative, Executive and Judicial Powers shall maintain an integrated system of internal control for the purpose of:
I - evaluating the attainment of the goals established in the pluriannual plan, the implementation of government programmes and of the budgets of the Union:*

II - verifying the lawfulness and evaluating the results, as to effectiveness and efficiency, of the budgetary, financial and property management in the agencies and entities of the federal administration, as well as the use of public funds by private legal entities;

III - exercising control over credit transactions, collateral signatures and guarantees, as well as over the rights and assets of the Union;

IV - supporting external control in the exercise of its institutional mission.

Annex 1. The persons responsible for internal control shall, upon learning of any irregularity or illegality, inform the Court of Accounts of the Union about it, subject to joint liability...”

Comparing today's constitutional text with that of the previous Constitution over the inclusion of control we note that the current one isn't limited to financial and budgetary aspects alone but explicitly states that the control or inspection will act on accounting, financial, budgetary, operational and patrimonial aspects.

Accounting inspection concerns the necessary procedures for assessment and certification that organ accounting records are both appropriate and trustworthy of the actions and facts involving the budgetary, financial and patrimonial systems, as well as the validation of registered transactions and complete registrations authorized by whosoever has the right and with the exact values. As accounting is the backbone of the system of economical-financial information it constitutes an indispensable instrument in all the corners of control.

Financial inspection is responsible for ensuring that the administration of financial resources is being carried out in accordance with the norms and principals of public administration not only regarding revenues, administration and application of resources but in relation to the regularity of the renouncement of revenues as well as assistance and concessions of subsidies⁸. The Law of Fiscal Responsibility brought great relevance to attendance and financial inspection, imposing severe penalties on careless administrators.

⁸Destined to assist the maintenance of other organizations of public or private standing. They are transfers destined to cover expenses of costing of the organizations benefitted and set out as:

Social subsidies: those destined to non profit making public or private institutions of assistance or cultural character. It is fundamental that within the limits of financial possibilities the concession of social subsidies always seek to attend essential social services as well as medical and educational services, whenever the supplement of resources of private origin applied to those objectives proves more economical. The value of the subsidies whenever possible will be calculated based on service units offered or put before interested parties, obeying pre-set minimum standards of efficiency.

Economical subsidies: transfers destined to cover maintenance deficits of public companies, whether of autarkical nature or not, for expenses expressly included in budgets of federal organizations (Union, States, Municipal districts and Federal District), as well as to cover differences between market prices and resale prices for the Government, of foodstuffs or others and payments of allowances to certain producers of foodstuffs or materials.

As for budget inspection, this shouldn't stop at verification of whether or not the expenses are foreseen in the annual budget or if they were executed faithfully. It should confront these with the Law on Budget Guidelines⁹ and the Multiannual plan¹⁰ in order to ensure the execution of the programs drawn up by the representatives of the people.

Operational inspection concerns the attendance and evaluation of actions undertaken by the organ to reach their institutional objectives, especially concerning economic aspects, efficiency and effectiveness.

Finally, patrimonial inspection regards not only the control of mobile and immobile goods but also credits, income bonds, participations and stockrooms, besides debts and of facts which might directly or indirectly affect public assets.

3.2 The structure of the of Internal Control System in the Federal Executive Power

The current structure of the Federal Executive Power Internal Control System is established by Law 10.180¹¹, dated February 6, 2001 and its central organ is the Federal Secretariat for Control – SFC. This secretariat is part of Direct Administration whose attributes include taking care of auditing, inspection and assessment of administration activities.

SFC is linked to the Office of the Controller General – CGU which in turn is the Federal Governmental organ responsible for immediately attending the President directly on subjects which could, in terms of Executive Power be relative to the defence of public assets and the growth of administrative transparency through internal control

⁹ According to the 1988 Federal Constitution, Incision 2 of article 65 the Law on Budgetary Guidelines cover targets and priorities of the federal public administration, including capital expenses for the subsequent financial period, must oversee the elaboration of the annual budget law, regulate alterations in tax legislation and establish diligence policies for official financial agencies used.

¹⁰ Incision 1 of the 1988 Federal Constitution says that the Multiannual Plan will establish guidelines, objectives and targets in a regionalized form for the federal public administration for capital expenses and others thereof relative to programs of continuous duration.

¹¹ Law that Organizes and disciplines the Systems of Planning and of Federal Budget, of Federal Financial Administration, of Federal Accounting and of Internal Control of the Federal Executive Power.

activities, public auditing, honesty, prevention and fight against corruption and the complaints board.

The system is comprised, together with the Central Organ, of the sectarian organs that liaise with the National Bench of Lawyers, The Home Office, Foreign Office and Defence Ministry. The sectarian organs are technically subordinated to the central organ namely the SFC.

Article 14 of Ordinance 3.591¹², dated September 6, 2000, disposes internal auditing units in Indirect Administration, when establishing: *"The bodies of Indirect Federal Public Administration should organize the respective unit of internal auditing, using the necessary support of materials and human resources with the objective of strengthening the administration and rationalizing control actions"*.

According to Normative Instruction SFC 01/2001¹³, classified audits must be accomplished for administrative assessment, attendance, accounting, operational and random checks. Auditing tasks are carried out in a direct form when executed directly by staff within organs and internal control system units - and in an indirect way when accomplished with the participation of servants who carry out auditing activities in other organs and institutions of the Federal Public Administration.

4. THE CONCEPT ON INTERNAL CONTROL

Internal control is a process designed to provide reasonable assurance regarding the achievement of management's objectives. In addition, internal control is the group of norms, routines and procedures adopted by each Administrative Unit such as routine manual, segregation of duties, determination of attributions and responsibilities, employee training, limitation of access to assets and the limitation of access to computer systems seeking to prevent mistakes, fraud and inefficiency.

¹² A Decree that regulates the System of Internal Control of the Federal Executive Power.

¹³ Normative that establishes the content of the Annual Plan of Internal Auditing Activities and of the Annual report of Internal Auditing Activities.

However, for Almeida (2003, p. 70) " It is pointless for the administration to implant an excellent internal control system if nobody periodically verifies if the employees are accomplishing what was set by the system or if the system should be adapted to new circumstances."

Finally and additionally, we quote the definition of internal control by AUDIBRA ¹⁴:

"Internal controls should be understood as any action taken by the administration (understanding this as Head Administration just as much as at the appropriate managerial levels) to increase the probability that the objectives and targets set are achieved."

5. INTERNAL CONTROL OBJECTIVES

A system of internal control consists of policies and procedures designed to provide management with reasonable assurance that the organization achieves its objectives and goals. These policies and procedures are often called controls, and collectively, they make up the entity's internal control. Management typically has three broad objectives in designing an effective internal control system: Reliability of financial reporting, Efficiency and effectiveness of operations and Compliance with laws and regulations (ARENS; ELDER; BEASLEY, 2010, p. 290).

According to Poubel de Castro (2009, p. 67), among the main purposes of the existence of an internal control, five stand out more importantly:

a) Security in the action carried out and collecting appropriate information

Every manager should exercise caution so that actions carried out, subject to external judgement are safeguarded by controls beforehand and supported by documents of evidence within pertinent legislation and with very strict responsibility.

¹⁴ Institute of Brazilian Internal Auditors.

Information sustained by internal control speaks about actions undertaken as much as their impact on results. The important thing for the administrator who decides on and responds for the decision taken is that internal control offers safety in the decision (prior control). When concerning accounting information these should be appropriate for both internal and external users.

In the same way, once decisions are made and actions taken it is important to gauge the results with safety and caution. This attribution is typical of the concomitant internal control (managerial). The consequence of acts undertaken should be assessed periodically by internal auditing (subsequent control).

b) Promoting operational efficiency of the organ

The incentive for operational efficiency consists in providing necessary means to carry out tasks and obtain satisfactory operational performance in the organization. Operational efficiency implies establishment of standards and appropriate methods that can permit all areas to develop integrated functions in a rational, harmonic form, concentrated on the overall objectives.

Several forms of promoting efficiency exist: the selection of qualified personnel, training, career plans, performance reports, norms, and formal instructions among so many others and the manager can use these to increase and stimulate efficient operational development.

c) Stimulating obedience and respect of policies adopted

The process of adherence to policies is formed much more psychologically than objectively. People are trained to accept adopted guidelines and also use common organizational techniques and communication. The objective to stimulate compliance with policies adopted is to ensure that the intentions of the administration, established through policies and procedures will be appropriately followed by staff.

People whether considered as individuals or as part of respective sectors need to work harmoniously enabling the unit structure be directed towards the same target.

d) Protecting assets

There are three interpretations attributed to the concept of protecting assets. The first and broadest understands that assets should be protected from any undesirable situation. It is understood in this case that the protection of assets in the private sector constitutes one of the principal actions by the administration. The second interpretation of assets deals with protection against involuntary mistakes (non intentional) and finally, intentional irregularities. The most restricted of the interpretations understands that the protection of assets refers to intentional mistakes alone.

e) Inhibiting corruption

In the public sector there is continuous concern for creating controls, making the actions of the Tribunals, Public prosecution service or the Police more effective, as a form of inhibiting corruption or at least discovering deviations quicker.

Brazil is one of the countries that least fights corruption. In this context the political arena takes up controls to show that we are fighting corruption so it is no longer treated like a managerial subject. Such a situation disfigures the existence and purposes of internal control. The danger lies in hunting mistakes instead of working towards success, concerned with bad administration alone when what really matters is excellence in the administration period.

Research carried out by the international consultancy KPMG¹⁵, entitled "Fraud in Brazil"¹⁶, demonstrates the main causes and routes taken to identify fraud in the Brazilian public service. It is observed that 7% of frauds are due to bad conduct, 13% to suppression of controls by leaders, 17% to particularities in state activity and 63% due to the lack of internal control.

¹⁵ Company hired for professional auditing and consultancy services.

¹⁶ Reported by "Jornal Zero Hora", Porto Alegre, 22 May 2005, p.5.

Can we hope for better days and for higher priority control perspectives from the political world? The answer is certainly encouraging when we consider that the KPMG study demonstrates that the 51% of fraud bust is by internal control within the very sector and 26% by internal audits. There are clearly some conditioning factors for changing the Brazilian system.

Progress will come from effective performance in collaboration with internal controls, social controls (exercised by society) and external ones for which responsibility belongs to the Legislative Power aided by Audit Courts.

We can conclude that internal control is part of normal administration activities being important in both public and private arenas. Therefore, it should subordinate to the title-holder of the organ or of the organization in vinculum, having the function of accompanying the execution of actions carried out and using professional opinions to indicate preventive or corrective actions necessary with a view to avoiding losses, deviations, while assisting the good and regular execution of the budget, accounting, assets, and finances.

In short, the purpose of internal control is to guarantee the achievement of targets, protect shares and avoid the occurrence of improprieties and irregularities, through principles, techniques and internal instruments of which we highlight the following:

- Observing legal norms, normative instructions, statutes and regiments;
- Ensuring accuracy, reliability, integrity and opportunity in the budgetary, accounting, financial, administrative and operational information;
- Avoiding mistakes, wastage, abuses, uneconomical practices and fraud;

- Propitiate opportune and reliable information including that of administrative and operational character concerning targets and results achieved;
- Safeguarding the financial and physical assets for their good and regular use;
- Ensuring the adherence of activities to guidelines, plans, norms and procedures of the organ/organization.

6. INTERNAL CONTROL LIMITATIONS

Despite internal control proven to be an inhibitor of mistakes it is not infallible because it is vulnerable to bad faith and human deviousness. In this sense internal controls can only provide reasonable safety for the following examples of inherent limitations: errors of judgment; defects; collusion; cost versus benefits (BOYNTON; JOHNSON; KELL, 2002, p.322).

a) Errors of Judgment: Occasionally the administration and other people can exercise incorrect judgments when making business decisions, or carry out routine tasks in lieu of inadequate information, time restrictions, or other reasons;

b) Failures: Flaws in controls established can occur when people don't understand instructions correctly or they commit careless mistakes through distraction or fatigue. Temporary or permanent personnel changes as well as system or procedural changes can also contribute to the occurrence of failures;

c) Collusion: Individuals with accomplices - an employee who carries out an important control activity along with another employee, customer, or supplier for instance can perpetrate and hide fraud in such way that it is not detected by internal control. An example could be collusion among three employees of the personnel, production and payroll departments issuing payments to fictitious

staff; or schemes between an employee in the purchasing department and a supplier etc.

d) Costs versus benefits: The cost of internal control in an organization should not be superior to the benefits that are expected of them. As the necessary measurement of the costs and benefits are not usually available the administration should make quantitative and qualitative estimates and make judgments and evaluate the cost-benefit relationship.

The inexistence of solid internal controls encourages the increased occurrence of mistakes and operational fraud. Moreover, those committing deviations of conduct within the administration of an organization propitiate an increase in the aforementioned illicit acts like in the example patterns. Mistakes are involuntary irregularities occurring in procedures or demonstrative accounting whilst frauds are deliberate irregularities. As a rule every criminal procedure stems from intentional mistakes or "testing" of the controls involving small values. If they are not detected in good time they make way for big scams.

7. INTERNAL CONTROL AS SEEN BY “COSO”

In 1985 a commission was created in the United States and was formed of representatives from the principal professional class associations linked to the financial area. That commission was called the National Commission on Fraudulent Financial Reporting and was an independent initiative to study the causes of the occurrence of fraud in financial /accounting reports. Its primary objective was internal control.

In 1992 they published the paper called "Internal Control - Integrated Framework" which became world reference for the study and application of internal control. Later the Commission was converted into a Committee becoming known as COSO - The Committee of Sponsoring Organizations of the Treadway Commission.

COSO is a non profit making organization concentrated on the improvement of financial reports through ethics, effectiveness of internal control and corporate governance and is financed by five of the major professional class associations linked to the financial area in the United States, notably:

AICPA	American Institute of Certified Public Accounts
AAA	American Accounting Association
FEI	Financial Executives International
IIA	The Institute of Internal Auditors
IMA	The Institute of Management Accountants

The Committee works independently from their sponsors who are usually industrial representatives or accountants, investment companies or the New York Stock exchange. The "Treadway Commission" was named in honour of the first president of the commission, James C. Treadway. Today, according to COSO's website, David L. Landsittel is the current president.

For the members of COSO, the starting point for good governance is the definition and the function of internal control. With this they arrived at the following conclusion:

"Internal control is a process developed to guarantee with reasonable certainty, that the objectives of the company are achieved."

This process depends on the following categories:

- **Efficiency and operational effectiveness** (performance objectives or strategy): category related to the basic objectives of the organization, including targets, profitability, security and asset quality;

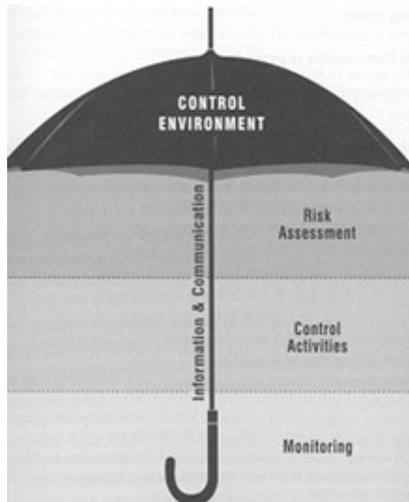
- **Trust in the accounting/financial records** (information objectives): all transactions should be recorded and all registrations should reflect real transactions, consigned by the values and correct identification;
- **Conformity** (conformity objectives). The organization and its work reach should be in conformity with applicable laws and norms.

According to the definition above, internal control is everybody's responsibility and an element that links the administration process with the main objective of aiding the organization to achieve its targets. Internal control provides a reasonable guarantee that the organization achieves its objectives though this is never absolute because of the following reasons:

- ✓ **Cost/ benefit:** every control has a cost which should be inferior to the loss due to the consummation of controlled risk;
- ✓ **Collusion among employees:** The same way people are responsible for controls, these people could take advantage of their knowledge and competences to bypass controls with illicit objectives;
- ✓ **External events:** these events are beyond the control of any organization like for instance the terrorist attacks in the United States on 09/11/2001. A fact that nobody could foresee or control.

7.1 Components of Internal Control

According to COSO the process of internal control is made up of five interrelated elements which are present in all internal controls. They are: Control Environment, Risk Assessment, Control Activity, Information and Communication and Monitoring (BOYNTON; JOHNSON; KELL, 2002, p.321).



a) Control Environment

Control Environment involving technical competence and ethical commitment is essential for the effectiveness of internal controls. The Control Environment becomes effective when the people of the organization know what their responsibilities are, the limits of their authority and the obligation to do what is correct in the right way.

The posture of senior level administration plays a decisive part in this component adopting policies, procedures, Codes of Ethics and Codes of Conduct, making these very clear to their employees. These definitions can be presented formally or informally.

Some ideas for verifying the effectiveness of the control environment within an organization can be observed as follows:

- ✓ The control environment becomes more effective the greater people have the sensation that they are being controlled;
- ✓ Certify that employees are aware of their responsibilities and their duties;
- ✓ Verify if there is an appropriate training plan and if the employees know which pattern of conduct and ethics they are to be following;

- ✓ Verify if the rightful corrective disciplinary actions are taken when the employee doesn't act in accordance with the standards stipulated by the organization.

b) Risk Assessment

The existence of objectives and targets are "sine qua non" (Primordial condition) for the existence of internal controls. They should be clear in order to better identify the risks threatening their accomplishment as well as the necessary actions for the administration of those risks.

Risk assessment is an administrative responsibility but it is down to internal Auditing to do its own risk assessment comparing it with that done by the administrators. The identification and administration of risks is a proactive action to avoid unpleasant surprises.

Risk is the probability of loss or uncertainty associated in the accomplishment of an objective. Therefore a risk identification process for each proposed objective should be carried out. Once the risks have been identified we should assess them taking the following aspects into account:

- The probability (frequency) of the risks;
- The impact on operations considering the quantitative and qualitative aspects if the risk is taken;
- Actions necessary to manage identified risks.

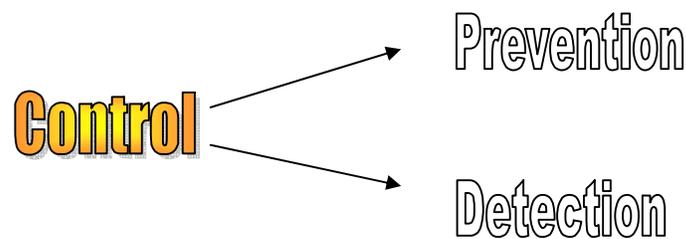
It is suggested that an auditor addresses the questions below to assist them in the process of risk identification:

- ✓ What can go right or wrong?
- ✓ How and where could we fail?
- ✓ Which assets should be protected?
- ✓ How could we be affected?
- ✓ How will we know if our objectives were achieved or not?

- ✓ Which activities are more complex and which are most regulated?
- ✓ What is our maximum exposure to legal risk?

c) Control Activities

These are types of activities that when carried out on time and in adequate ways allow risk management or the reduction of risk. Control activities were treated as internal control in the working system prior to COSO. They can be of two natures: prevention or detection activities.



The main control activities and their respective natures are:

- Competences (Prevention): activities with limits determined for an employee concerning the possibility of taking any attitude on behalf of the institution or even approving values. For instance: establishing maximum values for checks issued by cashiers; establishment of operational competences for the Credit Committee of an agency; establishment of a maximum threshold value assumed by a market operator for each investment horizon;
- Authorizations (Prevention): the administration determines the types of activities that need supervisory approval for accomplishment. Manual or electronic supervisory approval means that supervisors already verified, validated and ensured that the matter is in accordance with the policies and procedures adopted. Those responsible for the authorization should verify the documentation, question unusual items, and ensure that the necessary information for the transaction was checked before they give authorization. They should never sign a blank page or divulge their electronic password;

- Segregation of duties (Prevention): segregation is essential for the effectiveness of internal control. It reduces the risk of human mistakes as much as the risk of undesired actions. Accounting and conciliation, information and authorization, custody and inventory, recruiting and payment, administration of internal resources and those of third parties, standardization and inspection should all be segregated between employees;
- Internal Standardization (Prevention): are internal rules necessary for the operation of the organization. They should be consultable by employees of the organization and should define responsibilities, corporate policies, operational movements, functions and procedures;
- Conciliation (Detection): is the confrontation of identical information with data from different sources, adopting corrective actions where necessary;
- Performance Revisions (Detection): Accompanying an activity or process for assessing adaptation and performance in relation to target and benchmarks in order to anticipate moves that can negatively impact the organization;

Control activities should be implemented in a meditated, conscientious, and firm manner. It is also essential that adverse situations identified by control activities are investigated, adopting appropriate corrective actions.

d) Information and Communication

Communication is the flow of information within an organization which is essential for good operations and should work in all directions - from superior hierarchical levels down to inferior levels.

Information about plans, environment control, risks, activities, and performance control should be transmitted to the whole organization. On the other hand, information received whether formally or informally, internally or externally should be identified,

verified for reliability and relevance and then processed and communicated to the appropriate people.

The process is determined as formal when through internal communication systems - which can vary from complex computerized systems to simple work team meetings. The formal process is important because it puts together the information necessary to accompany operational information and conformity objectives. On the other hand the informal process takes place in conversations and encounters with customers, suppliers, authorities and employees where necessary information for identifying risks and opportunities is gathered.

e) Monitoring

Monitoring is the assessment of internal control over time in order to verify whether the internal control is appropriate and effective. It is done through continuous accompanying of activities as much as through punctual assessments such as self - assessment, random checks and internal auditing.

The controls are appropriate when the five elements of the control (Control Environment, Risk Assessment, Control Activity, Information and Communication and Monitoring) are present and working as planned.

Controls are efficient when the central administration has reasonable certainty of the degree of accomplishing proposed operational objectives, that the information stated in reports and corporate systems is reliable and that the laws, regulations and pertinent norms are being complied with.

8. BENEFITS OF INTERNAL CONTROL

The Controller General Office through special auditing in federal public organs accomplished several control actions during the financial year of 2008 notably as follows:

NATIONAL SOCIAL ASSISTANCE COUNCIL

Analysis of the council's performance in formulating policies regarding the grant and renewal of Charitable Social Assistance Organization Certificates (Certificados de Entidades Beneficentes de Assistência Social – CEBAS) issued in the 2000-2008 period. Key findings: gaps in procedural guidelines; deficiencies related to the conformity of accounting statements to applicable legal requirements.

NUCLEBRÁS EQUIPAMENTOS PESADOS (NUCLEP)

Examination undertaken at the request of the Federal Office of Attorney General of Rio de Janeiro regarding the contracting of the NUCLEP corporation for construction of sections of Petrobras's P-51 platform. Key findings: irregularities in the contracting of the company responsible for the construction work and successive interruptions in project execution.

UNIVERSITY OF BRASÍLIA (UnB)

Audit performed at the request of the university's chancellor's office to investigate alleged irregularities regarding the management of financial resources provided by the University of Brasilia Foundation and the relationships maintained with supporting foundations in the 1996-2008 period. Key findings: existence of an off-the-books payroll scheme; service providers hired without the proper selection procedures or execution of a formal contract, and staffed with significant numbers of family members of institution personnel; overbilling and overcharging of civil construction projects; uncompleted projects; irregularities in the relationships maintained with supporting foundations; use of foundations to avoid legally mandated competitive bidding procedures and to derive private gain and payments for services not rendered.

FEDERAL UNIVERSITY OF SÃO PAULO (UNIFESP)

Special audit conducted in April 2008 to investigate the use of the Federal Government Charge Card (Cartão de Pagamento do Governo Federal – CPGF) by UNIFESP’s chancellor at the time, through an analysis of available expenditure records published on the Transparency Portal for fiscal years 2006, 2007 and 2008. Key finding: of the US\$ 40,311.00 (R\$ 90,762.00) debited to the card, US\$ 27,255.50 (R\$ 61,325.00) corresponded to unauthorized charges. The amount in question was ultimately reimbursed by UNIFESP’s chancellor;

BRAZILIAN POSTAL SERVICE

Analysis conducted in conjunction with the Public Prosecutor’s Office revealed the existence of records of bribes payments from suppliers to an employee of the organization. The progress of the investigations into Operation Stamps (Operação Selo) – a scheme initially detected by the Federal Police Department in 2007 – and the corresponding efforts to bring the responsible agents to account and sanction the culpable suppliers were tracked. Key finding: continued illicit payments to third parties for advantages not authorized in the legislation governing the execution of contracts.

9. CONCLUSION

This paper intended to demonstrate that internal control is of prime importance in Public Administration considering the relevance of objectives concentrated on the assessment of government actions regarding the achievement of targets and assessment of public administrator management in economic, efficiency and effectiveness terms.

It also intended to show that internal control anchored in a set of norms and procedures, with prominence for segregation of duties constitutes a barrier against deviations of conduct without however being infallible once always vulnerable to bad faith, dishonesty and human negligence.

Internal control plays relevant parts in Public Administration, acting in an independent way and with methods and techniques that involve typical procedures in compliance with constitutional and legal attributions, mainly in orientation and surveillance of administrator activities, seeking to ensure efficient administration of revenues and the appropriate employment of public resources.

The majority of Brazilian public managers culturally reject control because they still see it as a "spy" and not an ally. However, all agree it is necessary to control what is done and this concern gained support because of the restrictions enforced by the Law of Fiscal Responsibility promulgated in 2000.

However, it was seen that the inhibiting factor that internal control represents is much more psychological than physical. In objective terms, the simple fact that the public manager knows that there is a properly accompanied efficient control system actually inhibits much more than other results achieved by the control.

It is never understated to mention that, following the teachings of Machado Jr. and Reis (2003, p. 171), internal control has as an objective to maintain the integrity of the organizational assets and therefore owes its organization, implantation and implementation, prioritizing the following:

- definition of the control environment;
- definition of the period in which the information should be rendered (one month, one week, etc);
- definition of who informs who or rather, the hierarchical level that should render information and who should receive and analyze it and provide necessary measures to maintain the administration effective;
- Definition of what should be informed, or rather, the objective of the information. For instance, the paving of a given number of square meters of highway per monetary unit cost.

Finally, all public administrators should pursue the model of the ideal State, and it becomes indispensable that employees and civil servants assume their role once and for all and become to be seen as resources because human capital is a decisive factor in the quality of performance. This is why technological investment in public organs is not only necessary but fundamental - investment in the quality of professionalization and training through continuous programs - which evidentially contributes to the elevation of efficiency standards and effectiveness of services rendered.

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