

The Future of Knowledge in the Internal Audit

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ABSTRACT: In the last years the focus of internal audit has shifted away from business toward financial controls. In the future internal audit departments need to align their contributions to the organization's strategic objectives. The purpose of the internal audit which is organised within the entities is to provide counselling to the general management and to assess the functionality of the internal control system, activities by which it brings an additional value to the entity which is audited. The optimal functioning of the entities on the basis of an integrated internal control framework imposes the existence of a *proper control environment* which should promote the ethical values, be transparent, accept good practice standards and set responsibilities on the same line with the strategies and policies approved by the superior level management.

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1. The Prerogatives of the Organization of the Internal Audit Activity

The internal audit activity is conducted based on certain professional standards which are accepted at international level. However, this common framework has a consultative nature depending on the specific culture of the organisations and on the national culture.

It is a proof on professionalism for the internal auditors if the activities they conduct manage to be closer and closer of the *International Standards of Internal Audit*.

There are countries which have taken up the English language in the current practice out of the wish to observe not only the Internal Audit Standards but also their spirit. For example: Sweden, Norway and Finland.

The internal audit is a function which is recommended to be organized within the structure of the entities, regardless whether they work in the public or private system.

In Romania, the internal audit is regulated by means of the law in the public system, but it remains a permanent challenge for the private system as well.

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2. Redefinition of the Manner of Organization of the Internal Control

In order for an internal audit function to be efficient it has to rely on the *Management and internal control system* within the entity, as it represents the object of activity of the internal audit. In case the internal control system within the entity is not organized and does not function according to the principles of the international standards, then the internal audit function will not be able to be efficient.

In consequence, the organization of the internal audit activity neither reduces nor eliminates the internal control. On the contrary, in the context of the general international good practice principles, *the control is associated with a broader sense*, as it is seen as a *managerial function* and not as a simple checking operation.

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values, be transparent, accept good practice standards and set responsibilities on the same line with the strategies and policies approved by the superior level management.

The internal control is present at all the levels of the entity and is manifested under the form of self-control, chain control (on phases of the process) and hierarchical control. From the point of view of the time when it is carried out, the control may be concomitant (operative), ex-ante (feed-forward) and ex-post (feed-back).

For a proper understanding of the internal control concept, seen from the light of the general good practice principles accepted at international level and in the European Union, we give the definition adopted by the European Commission, as follows:

The internal control represents the entirety of policies and procedures conceived and implemented by the management and the staff of the public entity, with a view to providing a reasonable assurance in order:

- to reach the objectives of the entity in an economical, efficient and effective manner;
- to observe the external rules, the policies and the rule of management;
- to protect goods and information;
- to prevent and track down embezzlements and errors;
- the quality of the accountancy documents and the production of reliable information, in due time, concerning the financial and management segment.

The management process¹ materialized in the managerial functions of forecast, coordination, organisation and training has as support the continuous carrying out of the control-evaluation function, which, in essence, consists in the comparison of between the results and the objectives, tracking down the causes which led to the positive or negative deviations that were found and in taking the necessary corrective or preventive measures.

The performance of the control-evaluation function is no longer seen as an exclusive prerogative of certain specialized control persons/structures, quite the contrary, *the control is considered as*

being a process which is dissipated in the whole entity and, within which, each person, beginning with the general manager/credit chief accountant and ending with the last employee, is *responsible for carrying out a certain type of control*. The control activities may be grouped as follows:²

- *strategic control* concerning the accomplishment of the general objectives, which reverts to the superior level leaders;
- *tactical control* of the fulfilment of the derived objectives, of the first rank, out of the general ones, carried out by the medium level leaders;
- *operational control* with regard to the attainment of the derived objectives, of the second and third rank, out of the general ones, which reverts to the inferior level leader;
- *self-control* is carried out by each person in part, leader or executor, in the accomplishment of the objective of the entrusted tasks.

Among the current *control activities* we find: the observation, notice, approval, decision, decree, sanction, planning, checking, analysis, expenditure budgeting, safety of assets, task apportionment, reporting and monitoring.

Besides *the control activities which are integrated in the management line* specialized controls may be organized, carried out by specifically set up structures (commissions, control compartments, etc.), whose activity is conducted based on a plan conceived by taking into consideration the risks.

In practice, *control does not mean*:³

- re-doing the work of the subordinate employees;
- setting up traps in order to uncover the errors;
- to permanently conduct an excessive surveillance/checking of what is being carried out.

At the same time, *control means*:⁴

- an act of assistance, materialized in the guidance of the controlled person in the new and difficult tasks;
- a manner of adopting a proper conduct in relation to the strong or weak points of the controlled person;
- an act of motivation, in the sense that the controlled person should understand that his/her work is important and that his/her efforts, difficulties or performances are not ignored;
- an act of checking the achievement of the tasks at random periods and which has to be finalized with a registered written document (notice, note, report, etc.), which is necessary in order to rank the quality of the control and to know the control frequency.

The own internal control system existing in every entity has to be developed and perfected up to a level where it should enable the leadership to hold the best possible control on the functioning of the entity in its whole, as well as on each activity with a view to attaining the set objectives.

The general manager/credit chief accountant, as well as the other persons who fill a leading position within the entity, are responsible for the creation and functioning of that system of internal control which should provide a reasonable assurance that the objectives shall be reached.

The managerial responsibility exerted by the management of an organisation supposes that, within the limits of certain internal and external constraints, with the purpose of the efficient, effective and compliant attainment of the set objectives, it should communicate and be liable for the inobservance of the managerial obligations in compliance with the type of legal liability.

In the organisation of the managerial activity, the managers have to bear in mind the following *fundamental principles*:⁵

- the general manager/credit chief accountant is responsible for the accomplishment of the objectives of the entity;

- the general manager/credit chief accountant can delegate his/her authority without, however, being relieved of the general responsibility;
- there is no managerial responsibility without corresponding authority;
- the responsibility needs transparency and liability;
- the control system has to rely on checks and corrective measures within the entity, but also on external evaluations.

The managers should no longer wait for someone from the outside to come and organise the control system within their own entities.

In the period of the planned economy they have been used to a system in which the Romanian Court of Accounts, the Ministry of Public Finances and other external control bodies came systematically in order to carry out background controls concerning their own activity.

At present, *the managers have to understand* the responsibility they bear to organize their own internal control system, within the entities they run, as well as *the fact that the responsibility has been entirely transferred to them*, and this requires their involvement in the effective organisation of this system.

For the public system, the role of the Ministry of Public Finances and/or Court of Accounts is to estimate whether *the implemented internal control system is working and is capable of preventing or stopping possible un-economical uses of funds and to identify potential weak points in the management of the funds they administrate.*

Given these conditions, the management shall have to “coin” audit activities which should allow them to control the risks which appear and evolve permanently and to limit their consequences, by means of a *flexible internal control system* which should be reduced or easily developed in certain areas or compartments within the entities.

The assurance of implementation of the new *System of public internal financial audit—SPIFA in Romania* was made by setting up the *Central Harmonization Unit for Public Internal Audit—CHUPIA*, in 2003, and the *Central Unit of Harmonization of the Financial*

Management and Control Systems—CUHFMCS, in 2005, both within the Ministry of Public Finances.

The main purpose for setting up the CUHFMCS was that of supporting the general management within the public entities to define and organize *their own System of internal control*.

Based on these grounds, in 2005, the CUHFMCS within the Ministry of Public Finances has issued the *Code of Internal Control*,^{6*} which includes *The Standards of management/internal control at the public entities for the development of the managerial control system* and contains regulations concerning the obligations and the responsibilities of the management in each public institution, out of which we mention:

- The leaders of the public institutions shall rule *necessary measures for the elaboration and development of the managerial control systems based on the international control standards*, including for the elaboration and development of procedures in written form for each activity;
- The management has the *obligation to identify the risks* and to conduct actions which should maintain the risks at an acceptable level;
- *For potential necessities of carrying out certain point inspections or control activities*, the managers may set up *commissions* or—if necessary—control compartments which should function permanently or on certain time frames, with a view to solving the dysfunctionalities or the irregularities found within the entity.

The internal control standards represent an important contribution for the knowledge of the *general good practice principles in the field*, based on which the entities may set up structures of enforcement of the financial management and internal control systems.

For the public system, based on the Order of the Minister of Public Finances no. 946/2005 for the approval of the Code for internal control, the leaders of the public entities have to have the necessary measures for the elaboration and/or development of the managerial control systems of each organisation, including the procedures, made formal on activities, taking account of the particularities of

the legal, organisational, personnel, financing framework and of other specific elements.

The objectives, actions, responsibilities, deadlines, as well as other components of the respective measures shall be included in *programmes of development of the managerial control systems*, elaborated at the level of each public entity. The programme shall also include, in a distinct manner, the actions of professional training, both for the people in leading positions, as for the ones in executive positions, and their manner of organization.

With a view to monitoring, coordinating and methodological guiding in regard to the own managerial control systems, by means of an act of internal decision, the leader of the public entity sets up working groups *with tasks in this sense, if this becomes necessary.*

The structure, manner of organisation and work, as well as other elements concerning the set up working groups are established according to the activity load and complexity in each public entity, by its leader.

3. The Organisation of the Internal Function of the Audit

After signing the European Agreements for accession in 1993 and submitting the application for accession to the European Union in 1995, Romania received recommendations with regard to the organisation of the audit activity.

First of all, the financial auditors were set up by the issue of the *Government Emergency Ordinance no. 75/1999 concerning the financial audit activity*, published in the Official Monitor no. 256 on 04.06.1999, which was subsequently approved and completed by the Law no. 133/2002, published in the Official Monitor no. 598/2003.

Then, *the internal audit and the internal control* are set up and introduced for the first time in the control and audit system in Romania, by the *Government Ordinance no. 119/1999 concerning the public internal audit and the preventive financial control*, published in the Official Monitor no. 430/1999, approved and amended

by the Law no. 301/2002, published in the Official Monitor no. 339/2002.

The evolution of the internal audit activity in Romania, corroborated with the recommendations of the European Commission was materialized in the issue of the *Law no. 672/2002 concerning public internal audit*, published in the Official Monitor no. 953/2002, which thus sets the status of the *function of internal audit* and of the *profession of internal auditor* in the entities in the public system.

On the basis of the law, the following units have been constituted:

- *The Central Harmonization Unit for the Public Internal Audit*—CHUPIA, under the direct subordination of the minister of public finances;
- *The Committee for public internal audit*—CPIA, beside the CHUPIA, which is a committee having a consultative character;
- *the internal audit compartments* within the entities in the public system which have managed a budget exceeding 100,000 euros in the last 3 consecutive years.

By issuing this law, in Romania, approximately 1,800 out of the 2,400 public institutions had the obligation to set up internal audit compartments (directorates, departments, offices, compartments), and which include more than 5,000 positions of internal auditors, out of which, at present, only approximately 3,700 are occupied by internal auditors.

The purpose of the CHUPIA within the Ministry of Public Finances was to organise the implementation of the internal audit in the public system in Romania, at the recommendation of the European Commission.

According to the normative framework, the tasks of the CHUPIA are the following:

- to elaborate, run and apply a unitary strategy in the field of public internal audit and to monitor this activity at national level;

- to develop a normative framework in the field of the public internal audit;
- to develop and implement uniform procedures and methodologies based on international standards, including the internal audit manuals;
- to develop the methodologies in the field of managerial risk;
- to elaborate the Code concerning the ethical conduct of the internal auditor;
- to approve the methodological norms which are specific to the different fields of activity in the public internal audit sector;
- to develop the system of reporting the results of the public internal audit activity and to elaborate the annual report, as well as syntheses based on the reports received;
- to carry out public internal audit missions of national interest with multi-sectorial implications;
- to check the observance of the norms, instructions, as well as of the Code concerning the ethical conduct of the internal auditor by the public internal audit compartments and it may initiate the necessary corrective measures in cooperation with the leader of the concerned public entity;
- to coordinate the recruitment and professional qualification system in the field of the public internal audit;
- to approve the appointment/dismissal of the heads of the public internal audit compartments within the public entities;
- to cooperate with the Court of Accounts and with other public institutions and authorities in Romania;
- to cooperate with the public financial control authorities and organizations in other states including the European Commission.

Besides the *general norms of conduct of the internal audit activity*, also *the norms of management counselling* have been elaborated, in a distinct manner, by means of which the internal audit comes to support it, for the identification and in depth knowledge of the functioning of the internal systems which are so necessary to the line management, which is responsible for their implementation.

Taking the tasks of the internal auditors into consideration, we mention that *the internal audit has to be seen in the mirror with the internal management and control system within the entities.*

By means of the activities it conducts, the internal audit adds value to the audited entity by the analysis of the risks associated to the auditable activities and the assessment of the internal control system, as well as by the recommendations included in the internal audit report, drafted and forwarded with a view to ensuring the attainment of the objectives of the organisation.

The receivers of the internal audit reports may or may not take into account the recommendations of the auditors, but they know they take certain chances when they do not take them into consideration.

The internal audit cannot issue a certificate that all the activities are protected or that there are no dysfunctionalities within the entity, even because of only one reason—*the relativity of the internal control*—which is its object of activity.

The isolated internal auditors are inefficient, their value is given by the value of the team, which ensures them the force they have to have available.

The internal audit is a function which has been continuously redefined along the years out of the wish to match the permanently changing needs of the entities. Focused at first on matters of accountancy, the objectives of the internal audit have moved towards the evaluation of the internal control system of the entities and towards finding the major risks of the entities in reaching the pre-set targets.

In the public system, the internal auditors have the major responsibility to the mass-media and the public, just like, in the *private sector* they answer to their clients. Thus, if the external control structures should find deviations from the normative framework, misapplications of funds or even embezzlements, the public may ask whether in that particular entity the *internal audit function* exists and functions, in compliance with the principles of the corporate government.

The leadership of the entities has to be effectively involved in the organisation of the management and internal control system

through collaboration with the *line management*, responsible for the assessment of its functionality in the organisation of the internal control, and with *the internal auditors*. The synergy between these components shall represent the value added to the managerial decisions and a guarantee of the fact that the pre-set targets shall be attained maybe even at performance parameters.

Based on these grounds, there is an imposition to constitute a *system of continuous professional qualification of the internal auditors* out of the need to overcome the phase of the *regularity audit* and to make the transition towards the *system audit and the performance audit*, which require a very special professional qualification, especially by an in depth knowledge of the auditable field.

In the public system, the professional qualification has begun to be organized since this very year and it has to be supported by the training of the trainers and of the structures which can ensure the elite necessities of training of the internal auditors—for example *The Centre of Excellency in the Financial Management and Internal Audit—CEFMIA*, which has its premises within the *Athenaeum University—Bucharest*, having the purpose of organizing activities with a view to ensuring the continuous professional qualification of the internal auditors.

The internal auditors' professional competences provide real benefits for the entity, through a systematic evaluation of the procedures and operations carried out in the entity, based on the audit standards and on the best practices.

A major concern for the internal audit, for the relation with the management and with a view to ensuring the independence and the objectivity of its activity, is represented by the systematic update of the *Internal Audit Chart*; a document which regulates the manner of conducting the specific activities of the internal audit within the entities.

By referring to the current state of implementation of the internal audit, we consider that Romania is on the right way, which comes in support of the creation of an efficient internal audit function at the level of the public entities, according to a good practice in the European Union.

In the context in which the internal audit activity is recognised as being a complex activity, we can state that, at present, we are in a *phase of consolidation of the internal audit function*, the proof being the conclusive results recorded by achieving the added value and improving the activities developed in the public entities, but also by making the management, in general.

NOTES

¹ Virgil Mihuţ—Methodological Guideline for the development of the internal control in the public entities, website of the Ministry of Public Finances See: www.mfinante.ro (Last Accessed on April 16, 2016.)

² Virgil Mihuţ—Methodological Guideline for the development of the internal control in the public entities, website of the Ministry of Public Finances, See” www.mfinante.ro (Last Accessed on April 16, 2016.)

³ Ibid.

⁴ Ibid.

⁵ Ibid.

* Order of the Minister of Public Finances no. 946/2005 concerning the Code for internal control, which includes the standards of management/ internal control at the public entities and for the development of the managerial control systems, Official Monitor no. 675 on the 28th of July 2005.