

# INTERNAL AUDIT-MANAGEMENT TOOL OR A SUPERIOR FORM OF INTERNAL CONTROL ?

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## **Abstract:**

*Internal audit and internal control are two forms of verification of financial and economic activity with completely different content that uses similar concepts, information, and procedures.*

*This has determened the public managers of public entities to take in some cases measures regarding the organisation and operation of those departments which have led to malfunctions in the financial and economic activity of the entity.*

**Keywords:** Regularity audit; system audit; performance audit; internal control; managerial control; audit risks.

**JEL Classification:** M41, M42, M40

## **1. General considerations**

The „audit” term comes from the Latin "audit" which means "to listen".

The audit as a form of the economic-financial analysis statements appears as early as 1929, in the economic crisis, when U.S. businesses felt the need to certify their financial statements and to orient themselves towards the measures that should be taken for economic recovery.

Initially there were established "External Audit Practices" and later "Internal Audit Practices".

In 1941, in Florida-USA, it was created the „Institute of Internal Auditors-I.I.A.” which included members from over 120 countries.

In Europe, the „internal audit” as a tool for checking and certifying final financial accounts is introduced in 1950, and since the 1970s have been generalized rules for internal audit of I.I.A. that became standards for internal audit.

In Romania, the first forms of internal audit appears in 1999, and its enacment is achieved through the Law No. 672/2002.

## **2. Regulation of the internal audit activity in Romania**

By the Law No. 672/2002 internal audit is defined in Romania by taking in a large degree the definition given by I.I.A. from the United States.

For the purposes of this normative act (article 2, letter a) the public internal audit is "an objective and functionally independent activity, of assurance and advice, designed to add value and improve the operations of the public entities; helps the public entity to meet its objectives through a systematic and methodical approach, evaluates and improves the efficiency and effectiveness of risk management, control and governance processes."

Law No. 672/2002, chapter II, article 3, paragraph 1, introduces the obligation for public entities to introduce in the organizations the internal audit departments, having as main goal the improvement of their management.

The Internal Audit departments within public entities are managed according to the same methodology enactment of Central Harmonisation Unit for Public Internal Audit, from the Ministry of Finance.

In this context, the MFP Order no.38 / 2003, with subsequent amendments, established methodological norms for the exercise of the public internal audit.

Through the normative acts regulating the internal audit was established the main duties of the audit, audit types and all the stages of the internal audit development.

The main purpose of the audit mission is to ensure the manager that the tasks set will be made in terms of efficiency, effectiveness and economy, with legal and internal regulations provisions.

In terms of the main objectives in the calculation of audit assignments, they consist of:

- a.** The compliance of the operations made in the audited activity with laws that govern the field;
- b.** The analysis of the driving systems and internal control in order to eliminate the aspects causing prejudices and financial infringements within the public entity;
- c.** How to use the examination criteria of economy, efficiency and effectiveness in achieving the objectives of the entity.

According to these objectives, it is determined the type of applicable audit mission:

- a.** Regularity audit;
- b.** System audit;
- c.** Performance audit.

Regardless the type of audit, an audit mission involves:

- a.** Preparing the audit mission;

- b. Intervention on the spot;
- c. Internal audit report;
- d. Follow up on recommendations.

In the first stage, "preparing the audit mission," the auditor uses the following documents:

- Order of service;
- Declaration of Independence;
- Notification on the start of the mission;
- The summary list of the auditable objects;
- The strengths and weaknesses chart;
- The official note of the opening session.

In stage "intervention on the spot" are used the following documents:

- Checklists;
- Tests;
- The sheet of the problem identification and analysis;
- The sheet for finding and reporting irregularities;
- Note centralizing the working documents;
- The document of the meeting closure.

In stage 3 to prepare a draft report and also, where appropriate, the minutes of the conciliation meeting.

In the last stage is developed the "recommendations tracking sheet" with timelines and responsibilities.

### **3. The concept of internal audit in relation to the other forms of audit and control**

The audit implementation in Romania, since 2002, as a result of the rules laid down by Law No. 672/2002, created many confusion and interference between the internal audit, external audit and financial control.

This confusions were generated by the fact that all these forms of audit and control uses the same terms, using largely the same tools and techniques of information, collection of information and in the end, all the findings are included in a report.

If between internal audit and external audit the main difference lies in who performs the mission and the purpose given, the differences between internal audit and control are numerous and substantial.

Thus, in the case of any internal audit mission, the auditor make findings, determines and establishes failures, the causes and effects and makes recommendations, while in case of control, instead of the recommendations are set those responsible, the violated laws and the damage made.

In the concept of public entities, when there are indications that in the work will be any law violation, it would require opening a mission of audit.

But in the case of audit missions, the auditor may make recommendations so that in the case in question, it is necessary to carry out a control to uncover facts causing damage and financial infringements.

Misunderstandings are enhanced with the application of MFP Order No. 946/2005 concerning the internal control management, through which the management control was limited to financial control and not the control the entire managerial activities.

Although, in all public entities it is applied the managerial control with phased deployment, procedures, registries, the control is being monitored by the Ministry of Finance regarding only the financial side.

This confusion was reinforced by Law no 94/1992, as amended, concerning the organization and functioning of the Court of Auditors.

Thus, in the desire to equalize the salaries of the employees at the Court of Auditors, through amendments to the Law No. 94/1992, the Court of Auditors controllers became auditors.

The control documents of the Court of Auditors are called "audit reports" but in their structure and content, they do not comply with the audit procedures but those of an act of control.

This has created problems in the capitalization of the Court of Auditors controls that cannot establish damage, but can only make recommendations.

Thus, the two regulations, the MPF Order No. 946/2005 and the amendments to Law No. 94/1992 of the Court of Auditors, have amplified the confusions between audit and other forms of control.

To overcome shortcomings in the implementation of internal audit, we consider it is necessary to institutionalize it and create their own rules of procedures that meet international standards of internal audit.

#### **4. Audit Risks**

Analogies between audit and other forms of exacerbated control as shown above, and the normative acts regulating the field, emphasized some positive aspects in the use of common methods to increase the results of the audit or control.

At the stage of "preparing the audit mission", the auditor shall collect information, identify and analyse the risks.

In this way there can be identified financial risks, legal risks, operational risks, commercial risks, risks relating to the security of information, etc.

Depending on the risks set, the audit examines the risk factors and appreciate their share.

In the literature and in the methodological norms issued by the Ministry of public finance are considered risk factors the following:

- a) Assessment of internal control;
- b) Quantitative Assessment;
- c) Qualitative appreciation.

The sum of the weightings of the risk factors, should be 100.

Level risk assessment is determined by the existence or procedures, financial impact or vulnerability.

The level of risk is determined by the existence or nonexistence of the procedures, the financial impact or of the vulnerability.

According to the identified risk factors, their weight and the level of assessment it is determined a score used in the preparation of the table "strengths and weaknesses".

In the literature are considered:

- Small risks, all risks who score between 1.00 and 1.80 (exclusive);
- Average risks, all risks that have a score between 1.80 and 2.20 (exclusive);
- High risks, all risks who score over 2.20.

At this stage of identification and analysis of risks, the auditor in accordance with the Ministry of Finance Norms is forced to prepare the following documents:

- a.** Risk identification with reference to the audited objectives, objects and the main identified risks;
- b.** Establish risk factors and assessment weightings;
- c.** Determining the risk level;
- d.** Determine the total score;
- e.** Ranking operations on the risk analysis;
- f.** The strengths and weaknesses chart.

The auditor activity would be simplified if the public entity would have applied and implemented the MPF Order No. 946/2005, particularly in terms of preparation and implementation of operational procedures, the establishment of the risks register and of the strengths and weaknesses chart.

The existence of these documents enables the auditor to prepare a detailed audit engagement of the mission, with the possibility of creating a truly useful and effective mission for the manager.

The many documents that should be made at the beginning of the audit mission leads to prolongation of the mission, and sometimes in the detriment of "intervention on the spot".

For these reasons I believe that at the basis of the audit mission themes must stay one single generic document called the " risk settings," which should refer to the audit objectives, auditable objects, risk factors (F1, F2, F3), the share of risk factors (P1, P2, P3), total score, ranking factors (high risk, medium, small) and the employment degree (high, low).

We present below the document regarding the "establishment of the risks".

### ESTABLISHMENT OF RISKS

Nr. crt.	Audited Objectives	Audited Objects	Identified risks	Risks factors			Share risks factors		
				F <sub>1</sub>	F <sub>2</sub>	F <sub>3</sub>	50%	30%	20%
0	1	2	3	4	5	6	7	8	9

Level of appreciation			Total score			Ranking			Degree of confidence		Comments
N <sub>1</sub>	N <sub>2</sub>	N <sub>3</sub>	1,00 ↓ 1,80	1,80 ↓ 2,20	2,20 ↓	HIGH	MEDIUM	SMALL	HIGH	LOW	
10	11	12	13	14	15	16	17	18	19	20	21

This document replaces the other six documents that used to be achieved by the auditor in the information stage regarding the risks, giving him the opportunity of a thorough analysis and the preparation of topics to facilitate the work of the auditor and to maximize the efficiency of the audit mission.

### CONCLUSIONS

The emergence of internal audit as a form of analysis and verification has been for the manager "a godsend" by the fact that by applying it renounced at the internal control which involved numerous baffles from the establishment of those responsible up the recovery of the damages.

Under the recommendations guise and their implementation, the manager considers that it has taken all measures for their entry into legality.

This was because of the misunderstood of that audit role in the Romanian economy, checking the management of public and private property of the State which is not carried out by any of its specialized team.

Thus, the control bodies of the Ministry of Public Finance made only fiscal control, and the Court of Auditors, in accordance with the constitutional provisions, only the formation, administration and use of financial resources and not asset the way public and private management of State is made as stipulated in the old Constitution.

The disappearance of internal control, in some public entities being abolished subsequent internal control Departments, being kept only preventive control and enhance the use of internal audit which doesn't give the possibility to establish liability was generated also by the creation of audit institutions at the level of all the States of the European Union and the establishment of EUROSAL.

No account has been taken of the fact that in certain European countries (England, Germany, the Czech Republic, Norway, Denmark, Netherlands), their legislation provided the establishment of special committees at the level of the parliaments which examines the audit reports, give deadlines for elimination of the deficiencies, and failing, to notify to the specialized bodies, and in others (Spain, Portugal, France) beside the audit institutions, there are specialized bodies performing control over the management of public and private patrimony of the State.

According to all above, I believe it is necessary the institutionalization of the internal audit on the one hand, and the creation of a body at Government level specialised into the audit of the state property management.

I also believe that it is necessary to create a central control body to carry out the management control of the public entity and not only financial control, enabling the monitoring of public administration expenditure.

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