

IMPORTANCE OF INTERNAL AUDIT WITHIN AN ENTITY

Corina-Maria, Ducu¹

Abstract:

The efficient operation of the entity in the current economic conditions involves the practical existence of an internal audit department which aims to plan and conduct various audit missions. The implementation of this function increases the efficiency to attract and use resources, as well as the effectiveness of the processes effectuated in order to improve performance. Moreover, today, the internal audit is a powerful tool to assist management in managing the operations within the entity.

Key words: *entity, control, risks, governance, performance.*

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1. Introduction

The activity related to the evaluation of risks and of the internal control, respectively the internal audit, is a relatively new component in the entities which begins to appear more and more often due to the intensification of risks.

Risks tend to be generalized to all entities as a result of globalization. Entities, aware of the importance to maintain an acceptable level of threats, invest human and material resources in the development of the internal audit departments. They usually issue manuals with internal control procedures that are regularly updated, and the assessment of the internal control and risk management evaluation is carried out regularly according to the importance of the audited activities and the risks they are subject to.

Internationally, the internal audit has become an essential component in the structure of a modern entity. This provides high efficiency through appropriate use of human, material and financial resources, and better coordination between the various departments.

Compliance with the standards of corporate governance, directing the audit department towards risk management, implementing a system of internal control based on the existing risks, management guidance provided by auditors is a few aspects that contribute to building a reputation of integrity and leads to the proper functioning of the entity. Also, the internal audit provides the necessary prerequisites so that the entity could play a positive role in the community, ensuring a public image and strengthening its image of reliability.

2. Methodology of research

The objective of the research approach aims to present the importance of the implementation of internal audit within an entity.

The study has a predominantly theoretical character, and the scientific methodology is focused on: the analysis of the national and international regulations in the field of audit, the various articles in the literature and the reports elaborated by the regulatory bodies.

In order to achieve the objective we resorted to fundamental research by extending the theory on the aspects of risk, internal control, risk management, corporate governance, as well as quantitative research, through an analysis of the specialized studies in the field of internal audit.

Although the study is theoretical, it is a source generating practical ideas applicable in the practice of the entities interested in identifying accounting risks in order to evaluate them and elaborate some measures to counteract the negative effects.

¹ Asist. univ. dr, Universitatea "Constantin Brâncoveanu" din Pitești, Facultatea de Finanțe-Contabilitate, Pitești, corina_ducu@yahoo.com

3. References related to internal auditing

The Institute of Internal Auditors - IIA, in 1999, presents internal auditing as: “an independent and objective activity that gives an entity the assurance regarding the degree of control over operations, guides to improve its operations and contribute to adding a value. Internal auditing helps the organization to achieve its objectives by evaluating, through a systematic and methodical approach of its risk management processes, control, and governance of the organization, making proposals to enhance their effectiveness.”

IIA confers internal audit a rather complex definition that highlights the positive aspects of the function, such as:

- independence and objectivity;
- the role to perform thorough checks and controls to improve operations and achieve added value in the entity;
- expand the internal auditor's role, emphasizing his position as an advisor;
- specific activities are represented by internal control, governance and risk management processes.

Internal audit is considered to be an “internal device within the entity” which aims to ensure the necessary completion of operations, providing information with maximum accuracy and ensure the integrity of patrimony.

The French Institute of Internal Auditors considers that the internal audit represents an entity within “an independent activity of appreciating operations control”.

In Sawyer's Internal Auditing (Sawyer L.B., Dittenhofer M.A. and Scheiner J.H., 2003), internal auditing is considered as “a systematic and objective evaluation of the internal auditors on various operations and controls within the organization”.

In the International Standard on Auditing 610, “Usage of the internal auditors' activity”, it is stated that “the objectives of the internal audit function widely vary and depend on the size and structure of the entity and the requirements of management and, where applicable, of the requirements of those responsible with governance”.

From the references presented following objectives of internal audit can be drawn:

- the entity's risks are identified and minimized;
- compliance with external regulations, internal policies and procedures;
- satisfactory operational criteria are met;
- resources are used efficiently and rationally;
- the organization's objectives are effectively achieved.

4. Coordinates and approaches to internal audit practice

The practical coordinates of internal audit highlighted the already established characteristics, such as:

► Universality of the internal audit function

Internal audit functions in all entities, irrespective of their field of activity and monitor most activities. Internal control is considered to be its main activity. Due to the fact that internal audit aims to improve the system of internal control through the recommendations made to the managers, and as internal control is universal, hence, this function can take the universality feature.

As a result, internal audit is a function of management support through which auditors help managers on the basis of the monitored activities to increase the entity's performance. Considering that managers are everywhere and the internal audit assistance is extended in all areas we can talk again about the universality of this feature.

► Independence of the internal audit function

To understand this feature it is essential to start from the existence of the internal audit department in the entity. This department operates independently from the other

departments and aims at supervising all activities in order to increase performance and achieve objectives.

This is done by:

- risk assessment activities;
- establishing internal controls based on the identified risks;
- reporting the findings to management;
- advice given to management meant to improve the activities undertaken in the entity;
- supervising the implementation of the recommendations made.

According to these functions, internal audit provides an independent and objective opinion on risk management, internal control and governance of the entity.

► **Periodicity of the internal audit function**

Audit can have a permanent and regular character. The audit departments can operate all the time in an entity but there may be situations in which the conduct of audits is related to risk assessment activities. Auditors may audit the entity for 8-12 weeks and then return after a period of 2-3 years depending on the risks that the activities within the entity are subject. Thus, the internal audit activity is regularly scheduled, carried out based on standards, on schedule menus and all entries, ideas and recommendations are presented in a report assessing the overall activity within an entity.

In light of the known evolutions, internal audit has acquired various forms of life of involvement in the audited entity with functions such as:

a) Advice given to management

Internal audit is a function of advice given to the manager in order to carry out activities in the best conditions through: finding shortcomings in the processes carried out in the entity, information management and proposed solutions to correct them. The internal auditor assists, recommends and advises, but he does not make decisions, the latter remaining in the entity's management attitude.

Acting from the position of an advisor, consultant, specialist who has a number of qualities, meaning that:

- applies a series of professional standards;
- uses techniques and instruments which confer efficiency and effectiveness in the activities;
- enjoys independence and authority;
- the activity is not subject to daily pressures of work obligations.

b) Aid offered to the employees without judging them

The recommendations resulted from the entity's auditing helps employees to optimize the operations they develop. Because of this, internal auditing does not audit individuals but it focuses on the processes involved in the entity. The report issued by the auditor is very clear that there must be names of persons but that does not mean that the auditors' recommendations could have an effect on employees.

Therefore internal audit contributes to the improvement of the activities and does not judge the actions taken by the individuals in the entity.

c) The auditors' independence and objectivity

The internal audit is a function aimed at: monitoring, detecting and reporting major irregularities in an entity, and developing recommendations that will contribute to the smooth running of activities.

Throughout the course of the mission, auditors must show both independence and objectivity. The auditors' efficiency consists in the organizational independence to the management system, which allows them an objective assessment of the activities to be audited.

The auditor's objectivity consists in an impartial attitude, independence of mind and judgment, lack of compromise and removes any constraints that impede the conduct of the

activities they carry out. In other words, the auditor should see things as they are and form his own opinion which clearly reflects the situation.

5. Importance of internal audit within the entity

The field of internal audit is in continuous development and the interests for the efficiency of this function are mainly issues related to (IFAC-CAFR, 2009):

- **Monitoring internal control.** Establishing the adequate internal control is the managerial responsibility and requires continuous and appropriate attention, a reason for which internal audit is assigned by management specific current responsibilities related to the revision of controls, monitoring operations and recommending improvements;

- **Examination of financial and operational information.** These elements include reviewing the procedures used to identify, measure, classify and report such information as the investigation of specific problems, including detailed tests of transactions, balances and procedures;

- **Review of operational activities.** It involves examining the efficiency and the effectiveness of operational activities, including non-financial activities of the entity;

- **Review of compliance with laws and regulations.** This implies the possibility of examining compliance with laws, regulations and other external requirements and management policies, directives and other internal requirements;

- **Risk management.** It regards the possibility to assist the organization by the internal audit function to identify and evaluate significant exposures to risk and contribute to improved risk management and control systems;

- **Governance.** It implies the possibility of the internal audit function to evaluate the governance process regarding its objectives related to ethics and values, performance and accountability, communicating risk and control information to appropriate areas of the organization and efficiency of communication between people charged with governance, internal and external auditors and management.

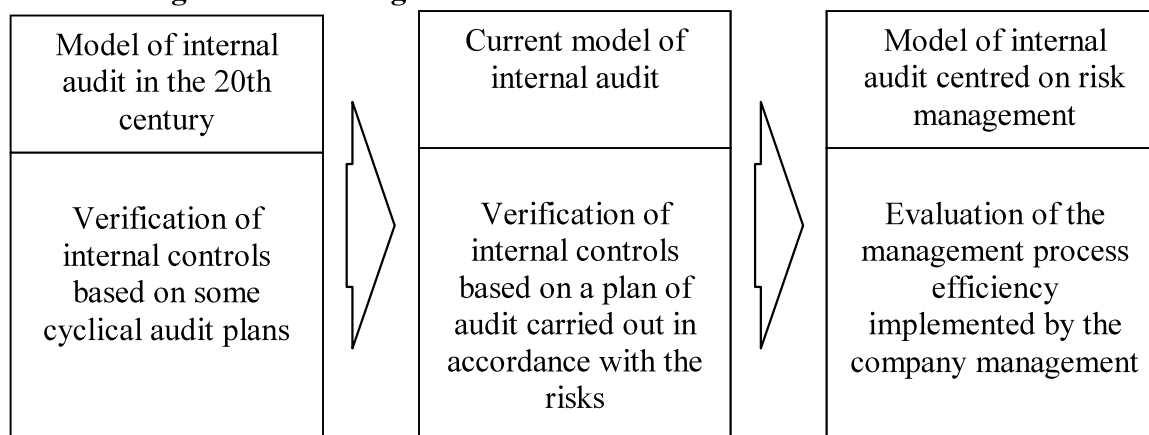
The research conducted in the field of audit presented the trends of the function for the next period, generating a transformation of internal audit. Thus, the trends cover issues related to:

- internal audit departments will focus more attention on the risks and the overall aid given to management regarding their administration;

- increase the value of internal audit in an organization is influenced by the transition from the basic audit, an activity centered on internal control of risk management.

The transformation of internal audit is presented in Figure no. 1 as it follows:

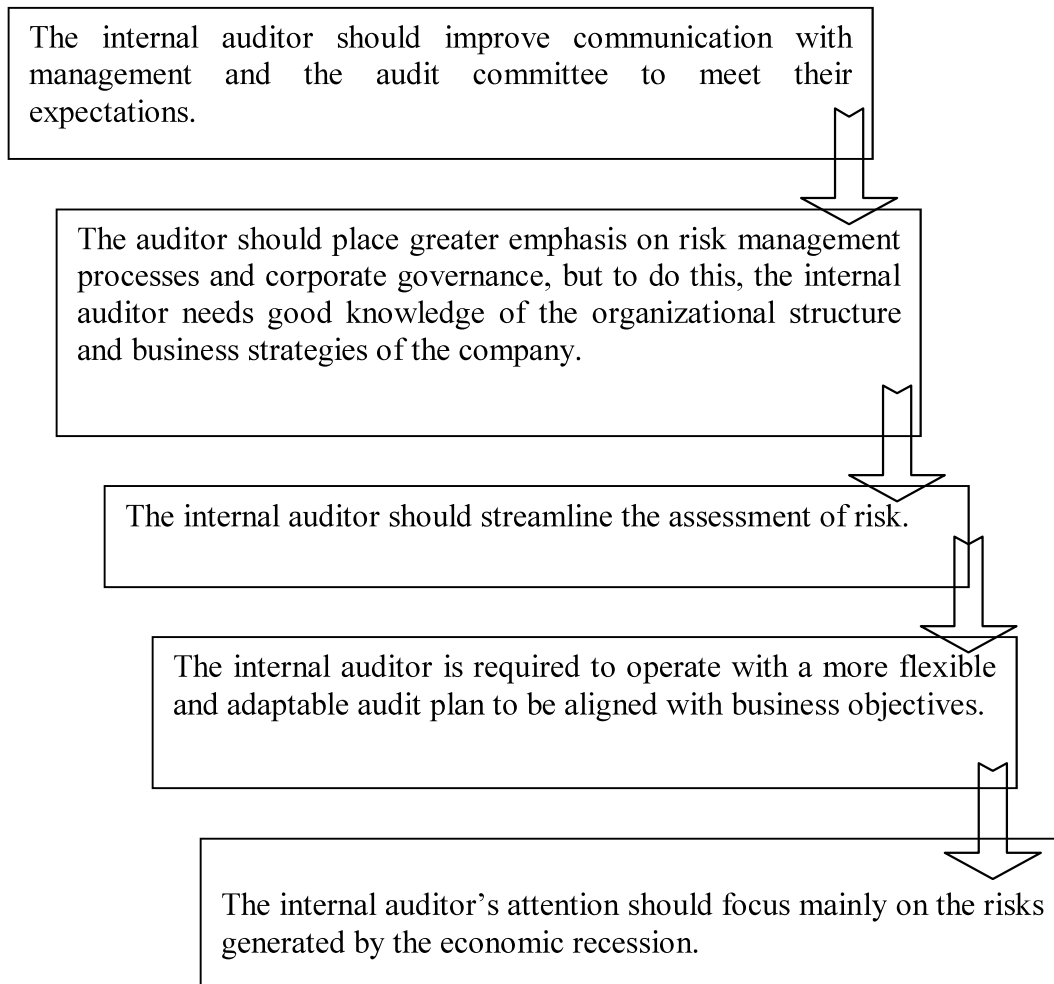
Figure no 1. Changes in the activities of the internal audit function



Source: Mihăileanu L. - Perspectives of changes in the activity of internal audit, article published in Financial Audit, no. 4/2009, p.27

The analysis made by IIA Global Audit Information Network (IIA GAIN, 2009) aimed to identify those areas where internal audit will need to focus attention in the near future. According to the survey, the areas of interest are: risk management, corporate governance, effective communication between management and the audit committee; managing risks generated by the economic crisis in an entity. But a primary position is occupied by the way in which internal audit will analyze the effectiveness of risk management and internal audit will also play an important role in identifying risks, risks that will affect the entity's business strategies.

Figure no. 2. Future strategies of the internal audit



Source: Taken from IIA, GAIN, 2009

Consequently, today, internal audit should not be considered as an internal control, but as a complex function facing aspects that regard risk management.

Efficiency is given by risk reduction activities and current exposure to risk. Conventional internal audit seeks proper risk management through internal mechanisms applied within an entity. However, today the effectiveness of the internal control system is no longer tested, but they will go on testing the ways in which management properly manages risks. Consequently, risk-based audit receives increasingly more value as a tool generating performance within the entity.

6. Conclusions

The business environment of the present period has undergone rapid changes with consequences that affect the business organizations worldwide. Due to globalization, the market economy has become increasingly complex and globalized; consequently, the improvement of the activities carried out within the entities acquires a major importance in achieving fair and efficient economic flows by the participants at the economic life.

The efficient functioning of the entity consists of: observing specific processes, the results representing the support to reach the established objectives, on the one hand, and on the other hand, it provides reasonable assurance that the planned activities are controlled.

In this approach, the audit has demonstrated its active role in supporting management processes of the entity, so internal audit is rightly considered a guide to performance when the responsible persons in the entity confers its proper place and role.

The internal auditors, through the labor they perform, are considered “the key to the success of an organization”. Their goal is to solve the toughest problems facing the entity. They are constantly struggling to find the best ways to achieve the goals established by the entity through continuous improvement of their skills.

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