

# POSSIBILITIES OF INCREASING THE CONTRIBUTION OF INTERNAL AUDITING IN THE DECISIONAL PROCESS

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**Abstract:** The internal audit is more and more considered to be a basic pillar which sustains the basis of the decisions which are adopted in the managerial plan. As a natural consequence of this fact, at the theoretical and practical levels, we could remark a continuous preoccupation as far as the increase of the contribution for the internal audit in the decisional process is concerned, aspect which is also sustained, among others, by the multitude of the debates and of the controversies between the specialists in the domain. In this context, the present material debates the problem of the realization of a performing activity of this nature by debating some aspects concerning the adequate integration in the structure of the organization and the bigger implication in its current activities. The integration of the audit department in the organizational structure of the entity has a complex character, and the corresponding problems have been analysed on two distinctive plans: the need of satisfying the exigencies concerning the independence and the auditors' professional competence. As far as the implication of the internal auditors in the current activities of the entity is concerned, we have taken into consideration, on one side, the missions of consultancy which had been realized in the benefit of the management, and on other side, the settlement of an adequate relation with the financial auditors.

The necessity of the fundament of the economical decisions with the help of pertinent information, also credible in conditions of low risk in view of the efficient management of the economic entities, constituted the premise of the appearance and the evolution of the activity of internal auditing. This aspect is emphasized within many reference works in the field, from the content of which we consider relevant the opinion expressed by the renown specialist [Flesher D.L., 1996] according to which the necessity created the internal auditing and still it makes that this one be an integrant part of the modern businesses. In the same specialist states that no important business can escape the internal auditing, considering that, if until now it hasn't been introduced it will have to be, and if the things continue to evolve as at the present moment this will happen sooner.

Ever since its appearance and up to present, one of the main problems that provoked debates and controversies among specialists, was **the integration of the department of internal auditing in the organizatory structure of the company**, so that it many correspondingly fulfil its specific objects. The complex character of this problem is generated, mainly, by two significant aspects, largely presented in the speciality literature, and namely: the assurance of the independence of the activity of internal auditing and of the internal auditors.

The satisfaction of the exigencies referring to independence suppose the subordination of the audit department to an hierarchic level which, according to the Professional Norms concerning the internal auditing, "allows the auditors to exercise their responsibilities" and, at same time, assures "their impartial, without prejudices

attitude, and also the avoidance of the conflicts of interests”.

As a reaction to financial disasters appeared in the United States in the year 2000 (Enron, World Com, and others) and, afterwards, in the European space (Parmalat), were brought again into debate the auditing committees and their importance within the companies. In the opinion of the majority of the specialists in the field, the exigencies, concerning the independence of the internal auditing, under the aspect of the proper exercise of this one, but also in what concerns the offering of a more efficient support to the entity’s management, can be satisfied at a superior qualitative level through the subordination of the department of the internal auditing to the auditing committee.

Besides, in our opinion, the subordination of the department of internal auditing to the audit committee represents an efficient solution also in what concerns the implementation of the made recommendations by the internal auditors. We argument this opinion through the fact that their transposition into practice is made by the managers and is followed by the audit committee, thus delimiting the doer from the one that verifies the realization of a certain operation.

It is also retained the fact that the positioning of the internal auditing in the subordination of the audit committee represents an efficient solution that answers to a multitude of exigencies and, at the same time, a significant evolution concerning the integration of the internal auditing at the level of the company, comparatively to the traditional variant of subordination to its management.

The audit committees generated, though, intense debates, inclusively in countries with tradition in the field. In this sense we notice the fact that, in the work *Research Opportunities in Internal Auditing*, edited in the year 2003 within the Institute of Internal Auditors in the United States, the world leader recognized in the administration of the problem of internal auditing, it is mentioned that there exist the possibility of the appearance of some tensions determined by the fact that internal auditing must satisfy, on the one hand, the demand of information of the management of the company, and, on the other hand, the one of the auditing committee, each having a perception quite different on its role, imposed by the specific activity objectives. In this context, there are imposed solutions which assure the delimitation of the informational necessities of the two mentioned categories for the fundament of the decisions, especially in what concerns the process of financial reporting of the entity.

At European level, in the position document issued in February 2005 by the European Confederation of the Institutes of Internal Auditing, named *The Internal Auditing in Europe*, it is specified that the internal auditing reports to the audit committee, and the latter must correspondingly organize the activity of internal auditing at the level of the company so that it be reflected its independence, as the unrestricted access at all hierarchic levels, in view of the accomplishment of the programmed objectives. At the same time, in the mentioned document, it is shown that the creation of the auditing committees represents a more efficient way of accomplishing the responsibilities of the company concerning the assurance of the integrity of financial situations and the corresponding administration of the risks and internal verifications.

On the other hand, the adequate positioning of the internal auditing in the organization structure is treated by the specialty literature in the much larger context of the concept of corporative management, which situates on the first level the financial markets, the information circulation and the transparency. This fact imposes the increase of the role of internal auditing in the preparation and the presentation of some

quality financial information, used by a more and more diversified range of the ones that decide.

The corporative management or the corporative government constitutes, in essence, a method of organization and management of commercial societies in the conditions of the increase of the globalisation and the necessity of finding a unitary economical language to better answer to the new exigencies of the economical environment. The approach through the angle of the concept of corporative management implies the corresponding administration of several problems referring to the activity of internal auditing, of which we present, in what follows, only those that we consider relevant in the context of the preoccupations more and more intensely manifested by European specialists and, at the same time, of the interference between the two concepts.

A first aspect pointed out by the majority of studies of this nature concerns the diversity of the situations referring to the integration of the internal auditing in the structure of the European companies. In this sense, it is noticed that, although the majority of the professionals in the field sustain the creation of the auditing committees and the subordination of the department of internal auditing to this one, the economical environment didn't react sufficiently fast in this direction. Thus, in a study made by reputed specialists [Paape Leen, 2003] within the University Erasmus from Rotterdam, on a representative sample of European companies registered at the stock market, it is shown that in a series of countries as Great Britain, Ireland and Belgium, the majority of the interviewed companies created auditing committees or similar structures, to which is subordinated the internal auditing. At the opposite end, there are placed Austria and Portugal, where the companies didn't create such specialized structures.

A second aspect that provoked lively controversies and debates is represented by *the products and the services* provided by the internal auditing. We have in mind, in this sense, both the permanent diversification of their range, being known that, at present, they aim the production of the operational, financial, of quality, and of others, auditing, and also other activities, as are those of consultancy, risk evaluation or support of the management in the current administration of the entity, and the implications of certain services on the independence of the internal auditing, as is the case of the consultancy activities on which we will come back in what follows.

In third place, it is taken into consideration the fact that the management structures of the companies, analysed through the angle of administration councils, can be delimited into two categories, which constitute, in essence, two prevalent systems in the European space, and mainly:

- The dual system, that, as the name suggests, is structured in two components, one with supervision attributions and other referring to the management of the entity, being characteristic to the countries in Continental Europe, especially France and Germany.

The supervision council is independent to the management, well informed and, at the same time, strong, because it has the necessary competence to refuse the current disadvantageous operations and even to discharge the management. It realizes the supervision of the entity, and especially of the activities developed by the management council. At the same time, it also is active in what concerns the internal auditing function, following the development of it for the management support.

The management council is made only by persons with responsibilities in directing the entity's current activities.

- *The monist system*, characterized by a single administration council, or, in other words, with a single pillar, is met in several countries, representative in this sense being Great Britain.

In a usual way, within these structures there are created committees in accordance with the knowledge and the experience of the members of the administration board, in the practical activity the most frequent being those of nominalization, remuneration and auditing.

In the same order of ideas, we consider useful to expose the main guide marks that must be taken into consideration at the creation of an auditing committee, as it results from the profile literature.

➤ The rigorous delegation of responsibilities by the auditing committee, which must be made through an attentive analysis of the necessities and the culture of the entity in cause, so that be assured the necessary premises for the efficient realization of the basis responsibility of the auditing committee, which is made, mainly, by the supervision of the organization's processes of financial report, which were implemented and maintained by its management, and also the risks and verifications that are closely connected to these. In this sense, it is recommended, among others, the correct dosage of the activities that are made by the members of the auditing committee, so that it doesn't appear an overcharge of these ones with many activities or a distance of these ones from the major objectives that they have to accomplish. In the measure in which these demands are satisfied there are also created favourable conditions for the efficient interaction among the internal, external auditors and the management of the organization.

➤ The attentive selection of the members from the structure of the auditing committee, which independently and with maximum objectivity realize the delegated responsibilities. According to the report published by Tradway Commission, this desideratum can be achieved if the supervision realized by the auditing committee is characterized by information, vigilance and effectiveness. To be able to answer to these demands, the members of the analysed committee must know in detail the ensemble of the risks at which is submitted the entity, and especially at those of financial nature. More, it is imposed to have solid knowledge in the financial bookkeeping field, which facilitate them both the understanding of the connections between the proper operations and their financial report, and the formulation of questions and the evaluation of the received answers, so that the supervision can be realised in optimum conditions. At the same time, there are opinions that sustain the necessity of a rigorous delimitation between the supervision function, realized by the committee, and the decisional one, specific to the management, both referring to the process of financial report. It is very important, in this context, the capacity of the committee to notice what they observe as drawbacks of the management, when it is the case.

➤ The assurance of the committee's capacity to implement, at the level of the entity, a process that assure, on the one hand, the obtaining of the information from the parts involved in the financial report, and on the other hand, both the understanding of its own role, and of the other participants in this process. In this way, there are created the premises of knowledge and monitoring of all essential aspects referring to the risks and the verifications in connection with this problem and, more, it is assured an adequate environment concerning the effective exercising of the supervision, the possibility to ask and to evaluate the received answers and of contesting the eventual drawbacks of the management.

At the same time, it is clarified the fact that in the European space there are opinions that sustain the creation of an European Code of Corporate Management, and also of a common approach referring to the essential rules and to the adequate coordination of the stipulation from the other codes, concerning the corporate management, elaborated by the Member States. In opposition to these, there are situated the opinions expressed by specialists who elaborated the document know under name of Jaap Winter Report, one of reference in the field, in which there is mentioned that the adoption of such a code wouldn't significantly contribute to the improvement of the corporate management in the European Union. According to the mentioned report, the accent must be put on the intensification of the efforts that facilitate the convergence of different codes created by the Member States and on the attentive following of the evolutions in the United States, opinion to which we agree because we consider that the accordance of different management structures, existent at European level, would be a durative process and would demand considerable efforts.

In the context of the above mentioned things, it is obvious that the main problem that must be solved by the specialists in the practical activity, which is influenced both by regulation factors and by those specific to an adequate culture in the field, is represented by the granting of the independence of the members of the auditing committees or of the similar structures created within the administration boards, and also by their selection on the basis of some criteria that assure solid knowledge in the financial –bookkeeping field.

In their turn, the professional competence of the internal auditors constitutes another significant aspect in what concerns the integration of this activity at the level of the company. In the context of the rapid and profound changes that characterize the activity environment of the companies, the field submitted to the internal auditing become more and more complex and, implicitly, they demand increased responsibilities and competences. In this sense, there are well shaped opinion in the specialty literature, among which we cite the one of the specialists [Ratlif Richard, 2002] which, in the work *Introduction to Auditing: Logic, Principles and Techniques*, sustain that the auditors of the 21<sup>st</sup> century must be prepared to effectively audit anything: operations (inclusively control systems), duties accomplishment, information and information systems, accordance with the laws, financial situations, fraud, report and execution ways, aspects linked to quality. For the accomplishment of such desiderata, it is necessary the adequate knowledge of the audited field, the understanding of the risk and of the opportunity closely connected to it, the conception of reports that better answer to the demands imposed by different beneficiaries, and also an irreproachable professional ethic (morale).

In close connection with the presented aspects there is also the necessity of increasing the personal qualities and competences of the internal auditors, which, beside the professional ones, facilitate the integration of this activity in the life of the organization. Thus, the opinion found at various authors, among which [Moeller Robert, 1999] in the work *Brink's Modern Internal Auditing*, is in the fact that an internal can be considered a successful one if it fulfils a plurality of qualities, and namely: honesty and integrity; dedication to the interests of the organization; professional appearance; empathy; consequent role; curiosity; critical attitude, vigilance; perseverance; work capacity; trust; courage; capacity to issue judgements, and others.

In the same order of ideas, it is noticed the increase of the auditors' age, the diversity of the qualifications, as the increase of the weight of the graduates of the

superior education, as it is presented by another reputed specialist, Jacques Renard, in the work *Theory and practice of internal auditing*, what arguments in plus the fact that the missions of internal auditing are focused on the operational area of the entities and, as such, approach varied and more and more specialized. In the same work, it is also mentioned the fact that most of the auditors remain in the field between 3 and 5 years, after which, on the basis of the accumulated experience, occupy decisional functions within the entity or migrate to other organizations.

Referring to the professional training of the internal auditors in our country, we consider that, as other authors, Romanian normalizes didn't have in mind the optimum solution concerning the administration of the internal auditing. Thus, the actual national regulations give the coordination of this activity to the Chamber of Financial Auditors in Romania, professional organism that puts together specialists in the financial or external auditing field, situation that generates drawbacks both under the aspect of the proper evolution of the profession, and of the specialists' training, in the sense that it doesn't assure the extension of the internal auditing to the operational area of the entity, but it maintains it, mainly, in the financial-bookkeeping area.

Having in mind these aspects, it appears as being obvious and, at the same time, of big actuality, the creation of a national organism in the field of internal auditing, which have close connections with the professional prestigious organizations, as it is, for example, The European Confederation of the Institutes of Internal Auditing. For this purpose we also remember the fact that countries with a similar situation to Romania, as Bulgaria, Hungary, Check Republic and the order have already created such an organism.

In what concerns the implication of the internal auditing within the company, we retain as being relevant, for the approached theme, those references in the literature in the field that concern the consultancies accorded to the managers, and the establishing of an adequate relations with the external auditors of the financial situations of the entity.

Traditionally, the consultancy missions are realized by prestators outside the entity. On the weight of the more and more active implication of the internal auditing in the life of the organization, the managers appealed more and more to the internal auditors, in view of the solution of the current problem concerning the administration of the organization. At the same time, in the speciality literature in underlined the fact that the consultancy missions exercised by the internal auditors allow a continuous dialogue with the management of the company, which facilitates the permanent adapting to its needs. In a study realized by the Institute of Internal Auditors in the United States, it is also pointed out the fact that it is imposed the keeping of an equilibrium between the assurance missions and those consultancy made by the internal auditors, because of the fact that the latter can be appreciated as breakings of their independency, in the sense of their implication in the operational activity of the company. In our opinion, the equilibrium between the assurance activities and those of consultancy can be assured by the identification of the specific information needs of the management and of the auditing committee, and this because the consultancy activities are more frequently demanded by the managers, while the assurance missions have a high weight in the relation with the members of the auditing committee. Through such an approach there also could be attenuated the tension generated by the fact that the internal auditing activity serves for two masters-the management of the entity and the auditing committee.

The establishment of an adequate relation with the external auditors of the financial situations constitutes an important premise of realization of a process of financial report, characterized through an increased level of credibility, which assure for all users of financial-bookkeeping information the fundament of the economical decisions to a qualitative superior level. It is known the fact that the external auditors, named in the European space statutory auditors, express, at the end of the approach, their opinion concerning the image that offer the financial situations in what concerns their making, under all significant aspects, in accordance with a general frame, identified by financial reporting. On this purpose it is imposed, among others, a corresponding understanding of the internal verifications, of financial nature, implemented by the company. In this way, it is necessary a complementarily between the approach of the internal auditors and the external ones. In this sense, within the meeting organized by the Auditing Committee of the European Commission, in March 2003, at which participated representatives of the bookkeeping profession from the countries members EU, regional professional organisms as the Federation of the European bookkeeping Experts and the European Confederation of the Internal Auditing Institutes and others, there was underlined the necessity of the responsibilities division concerning the offering of assurance within the process of financial report between the internal and external auditors. At the same time, there was mentioned that it is imposed the implication in double sense specific activities, through the marking of reciprocal verifications, as the creation of a common set of standards of financial reporting. In such conditions, the implication of the internal auditing in the relation with the external auditors can be realized through the superior capitalization of the advantages given by the knowledge in detail of the activities of the company, among which we present the most significant, mentioned within the document mentioned previously concerning the internal auditing in the European space, and namely:

- the permanent access to the executive management and to the administration council;
- the wider sphere of the activities of internal auditing which don't limit themselves only to the internal verifications concerning the financial reports;
- the identification and the evaluation of the risks associated to the operations of the entity before that these found themselves in the financial reports;
- the possibility of the effectuation of recommendations referring to the management of the risks and the internal verifications of the organization, as the following of their solution by the management, and others.

The actual regulations in our country stipulate only an implication of the external auditors in the activity specific to the internal auditing, and we have in mind in this sense the stipulation in OUG no. 75/1999 concerning the activity of financial auditing, republished, with the ulterior modifications, according to which “with the occasion of the independent exercise of the profession of financial auditor, these also effectuate the evaluation of the function of internal auditing. This refers both to the degree of adequation of the area of comprising the applied connexed programmes, and to its performances, to determine the measure in which the financial auditors can rely on the results of the internal auditing in the development of their activity.”

In the context of the things we presented, we express our opinion that the establishing of an adequate relation between the internal and the external auditors, in the sense of the best correlation of the developed activities, can substantially contribute to the reduction of the fees for the external auditors, and, at the same time, it creates the

premises of the increase of the audit quality with good consequences on the quality of the financial-bookkeeping information offered by the company.

Concerning the analysed problem, we also mention the fact that the references to the specialty literature took into consideration only the specific approach within the organizations, others than public ones. Also, we specify that, for the societies at which we refer, the bases of the activity of internal auditing were put relatively recent in our country, through the Minimal Norms of Internal Auditing, elaborated in the year 2000, which didn't constituted a corresponding background for the companies in what concerns the organization of the internal auditing, even their name being suggestive in this sense. The second stage, under the aspect of the normalization, is represented by the assimilation of the International Standards of Internal Auditing, edition 2004, elaborated and published by the Institute of Internal Auditors, under the name of Standards of Internal Auditing, becoming obligatory starting with the 1<sup>st</sup> of January 2005, which offer only a general background referring to the internal auditing.

Having in mind these last aspects and, at the same time, the main preoccupations in the field of the European specialists, **we consider that the internal auditing will represent** both for the normalizers in our country, and for the specialists in the practical activity, **a field that will followingly generate debates and legislative proposals** referring to the identification and the implementation of the best ways of integration and implication of this activity in the process of fundament of the economical decision.

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