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Management and Internal Audit in the Current Context

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Abstract *The article on "Management and internal audit in the current context" brings in the reader's attention the concept of internal audit and its interdependence with risk management, in the effort of companies to create value and manage risk effectively.*

Key words:
Internal audit, risk, management risk, residual risk, risk appetite
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1. Introduction

In the present context, because of the risks that exist in a competitive market and the legislative environment found in a continuous change, it is necessary to understand correctly the concept of internal audit, thus there is a need for management to put pressure on the companies' internal audit departments in their efforts to create sustained added value.

The Internal audit reviews and evaluates the process of risk management and internal control system implemented by the management, in order to provide[1]:

-reasonable assurance regarding the risk management and internal control system functionality;

-counseling, aimed to bring add value and improve the management activities of the entity, risk management and internal control, without the necessity that the internal auditor assumes the management responsibilities.

Internal audit is a part of a system that does not perform internal control, but an independent evaluation of the processes that take place within the entity and gives a reasonable assurance to the general management about the functionality of the internal control system.

The audit is part of the internal control system, but it is something else, namely a form of additional assessment of all activities taking place within the organization, provided to the management in support to the decision making process.

The use of the term 'audit' is relatively recent, is appeared during the economic crisis of 1929 in the United States, when the organizations had to pay large sums for external auditors who certify the accounts of all listed companies.

To distinguish between external auditors from audit firms' into those of the company, the first were called external auditors and the other ones internal auditors, because they were part of the enterprise.

With time, the external auditors have given up on making transactions on inventory and inspections of accounts, and began to realize analyzes, comparisons and justify the reasons of failures, offer advice and solutions to those who were responsible for the company's activity; thus, there were set goals, tools and specific techniques and reporting systems for internal auditors, in comparison to the external auditors. Auditors were still used because they acquired the necessary knowledge and tools in finance and accounting.

Within the organization, the financial accounting function means all activities that provide resources needed to accomplish organizational goals and that records and highlights its economic results.[2]

Strongly represented in any business, this function presents by means of financial indicators the performances and capacity of a company on the battlefield of business.

In this function, there are three main activities:
- the financial one, which refers to procuring and

[1] Ghiță M. (2009). *Audit intern*, Ediția a II-a, Editura Economică, București, p. 24.

[2] Căprărescu, Gh., Stancu, D.G., Aron, G., (2013). *Managementul organizației*, Editura Universitară, București, 2013, capitolul 7, p. 72

registering the financial resources needed by the company;
-accounting, which refers to registering all the economic phenomena within the company;
-financial control management: this activity, which some management experts consider part of the financial activity, includes the whole process of checking compliance with rules relating to the existence, integrity, use, and retention of material and money values that the firm has in possession.[3]
Financial resources play an important role in the organization, in addition to the human and material ones, sustaining the smooth conduct of its activities[4]. Strongly represented in any business, this function illustrates through economic and financial indicators, the company's performance and its ability to fight the competition.
The new internal audit function will keep its financial-accounting connotations and certification accounts activity.
In the current context, managers need to understand the responsibility they have to organize their own internal control within the entities they manage and therefore should be involved in organizing activities as efficiently as possible.
In practice, the entities face big, medium and small risks that evolve continuously; in these circumstances, the management should find control activities that will help them in managing the risks and avoid undesirable effects.
When risk creates effects, the activity of the department at issue it did not work, or it was exceeded by the situation.
Under these circumstances, the management will generally trigger a monitoring or inspection activity, based on an order or decision, to solve dysfunctions caused by the risks within that compartment.
The risk, analyzed in the context of fulfilling the objectives, offers advantages or opportunities, as well as disadvantages or threats. Thus, if the risk has a negative impact on the objectives, then it remains a threat, and if the risk has positive connotations, it will provide opportunities that can be ignored or exploited.
Risk is defined as the threat that an action or event will adversely affect an organization's ability to achieve its objectives and to successfully execute strategies.
In this definition we can observe that the risk necessarily produces an impact on the objectives in a negative way.

[3] Căprărescu, Gh., Stancu, D.G., Aron, G., *op.cit*., 2013, capitol 7, p.72 din Nicolescu, O., Verboncu, I., *Fundamentele managementului organizaţiei*, Editura Universitară, Bucureşti, 2008.
[4] Căprărescu, Gh., Stancu, D.G., Aron, G., op.cit., 2013, capitol 7, p.72.

2. Conclusions

The research conducted on the evolution of internal audit can summarize that, over time, the concept of internal audit has showed the following trend in evolution:

Table 1. Short history of Internal Audit[5]

1. Verification of accounting records	1950
2. Conformity assessment	1960
3. Examination of procedures	1970
4. Assessment of controls	1980
5. Report on Internal Control System	1990
6. Evaluation of Risk Management	2000
7. Improving Risk Management	2001
8. Reporting activity carried	2002
9. Adding plus value	2003
10. Strengthening the internal audit function	2004/2009
11. What next?	2010/2012

Verification of accounting records. The auditing team must be responsible for checking records, ie whether they were correct or not. In these circumstances a measure of the performance of the internal audit activity was represented by the number of incorrect accounting entries identified.
Conformity assessment. Internal audit teams assessed the extent to which parties respected financial procedures, using checklists, tasks undertaken during the financial-accounting. Because they had to make unannounced inspections and examine records to identify abuse of procedures, these teams were called successful groups.
Examination of procedures. An interesting development of the internal audit activity occurred in 1960, when this activity began paying more attention to correct procedures. The role of internal auditors was to analyze the documents, checking accounts, identify problems and formulate appropriate recommendations to eliminate the causes of the problems found. More auditors found errors or problems that were caused by a lack of clarity or misinterpretation of procedures, proposing solutions to improve them. The internal auditors' opinions were very helpful to the management, opening new horizons in what internal audit should mean.
Assessment of controls. This progress was possible in the moment in which the attention focused on procedures has been extended to many other tools of control. Under these conditions, the performance of an entity is not only perceived as the result of compliance

[5]Adaptare după sursa: Pickett K.H.S. (2004). *The internal auditor at work – A Practical guide to everyday challenges,* Jhon Wiley&Sons, Inc., Hoboken, New Jersey, p.10.

with the manual procedures, but the result of the interaction of all instruments of control that the staff is equipped for the job. The internal auditor goes beyond routine and becomes an advisor for the management regarding different types of control that could be implemented in the entity.

Report on internal control system. A new stage of development of internal audit emerged as providing an independent opinion as a result of the evaluation of internal control systems within the entity. At this stage, between 1980-1990, were first used many techniques and tools of internal audit, their improvement being achieved in the internal audit process.

Evaluation of risk management. The year 1990 was marked by widespread use of the risk management system, thus obviating the criticism of entities that were the center of attention because of scandals, lack of efficient management or due to events that have had a negative impact on their business. The use of new and effective operational risk systems puts the focus on the importance that the corporate governance has upon all types of businesses and public services. As a result of these developments, many entities have paid attention to the implementation of internal audit and risk management systems. Under these conditions, the internal auditors had to examine and evaluate if the risk management processes implemented by management are appropriate, sufficient and effective, then they had to develop reports and recommendations to improve them.

Improving risk management. During that period when the internal auditors' activity had begun to be characterized by uniformity, due to the implementation of internal audit standards, a new international trend was beginning to manifest when talking about bigger entities. This trend is based on the widespread use of the concept of risk management. Spreading this notion among managers of different entities, there were some concerns about identifying risks, evaluating risks and implementing internal control measures that would lead to the achievement of the strategic objectives of the entities. Thus appeared the counseling component of the internal audit activity.

Reporting activity. Although internal auditors work was done on the basis of standards and supporting the entity's management in achieving their objectives, in practice appeared the need reporting the results of internal audit to the highest levels of management. At first, it was intended that this reporting be done in the form of an annual report of the internal audit activity. So, through their recommendations, internal audit has the ability to change the managements' agenda, i.e. the implementing of concrete measures that should lead to the achievement of the targets.

Adding plus value. This term was defined by the IIA as 'organizations exist to bring added value or to create opportunities for their owners, their customers and other stakeholders. This notion is the reason for their existence. The value results from providing products and services and the use of resources to promote the products and services. Collecting data in order to understand and evaluate risks, the internal auditors acquire a thorough knowledge of the operations and opportunities for improvement, which can be extremely useful to their organization. They can therefore provide valuable information in the form of advice, counseling, written communications or as other products, all of which must be properly communicated to the management or operating personnel responsible.'

Specialists consider necessary to establish a basic strategy that will lead to adding value. This strategy should include:

- getting the most out of internal audit activity, as reflected by the ratio between the impact achieved as a result of implementing the recommendations and the running costs of the internal audit;
- management support in the implementation of a control system within the entity;
- establishing a general framework on which the audit committee can relate, a strategy for the activity of internal audit in the company and a guarantee for the management committee members and sources underlying recommendations;
- identify key success factors given current developments and trends of the business entity.

Currently, in countries with developed economy, internal audit represents a qualified system capable of issuing an opinion concerning the relationships, processes and/or system management. The internal audit involved in supporting and strengthening the management processes, is mainly aimed to methodical and responsible operation in order to achieve the performance levels set out, focusing on strengthening the managerial control.

Internal audit, through the activities they carry, bring added value both by assessing the internal control system and risk analysis associated with audit work, and by the recommendations contained in the reports prepared and submitted with the purpose of achieving the objectives of the organization. Thus, it represents the tool that can eradicate amateurism. Shareholders, investors, employees, public institutions etc. Request information on how management decisions determine the outcomes of the entity and are even interested to have insurance/guarantees on the quality of the leadership process.

Internal audit is based on a flexible frame of reference, widely accepted, that has the ability to adapt to the legislative particularities of each country, respecting specific rules that define different sectors of the entity.

What next? Based on studies, specialists[6] in internal audit point out that currently "Internal audit is at a crossroad and by 2012 there will be set a new strategic approach, based on the holistic management aspects of risk management." These statements are based on the current situation of internal audit departments from major national and multinational entities that, although they have significantly improved the ability of managing financial risks, are facing new challenges coming from the market and shareholders that is aligning the activities at the current level of maturity in terms of risk management.

Residual risk is the risk that remains after exercising internal control that has to be accepted and monitored in order to maintain within the limits of the risk appétit, also called net risk.

There will always remain a residual risk because it cannot be eliminated entirely without consequences, and is not indicated. Originally, the residual risk equals the inherent risk, but then it begins to decline by applying control systems.[7]

Risk appetite represents the level of exposure that the organization is willing to accept, that is the risk tolerated by the organization, i.e. the residual risk.

In conclusion, the viable risk management solution is to find a balance so that the residual risk is equal to the risk they are prepared to tolerate, the risk appetite.

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