

The Internal Audit – Key Pillar of Corporate Governance

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Abstract: The internal audit elaborates recommendations in order to improve the government process for the fulfilling of some strategic objectives, amongst one can mention: the promotion of ethic values within the patrimonial entities, the insurance of accountability, the efficient functioning of the legal entity management, the efficient communication of the risks and information on the internal control to the structures within the economic entity, the effective coordination of activities, the information communication within the management, between the internal and external auditors, as well as the good management of the relation with the Board of Directors. The study is based on the relation between the internal audit and the corporate governance, within the context where the internal audit became an essential pillar for a modern company, because it highly reflects the efficiency by properly using human resources and materials, a better coordination between various departments in a legal entity. By ensuring the fact that the economic entity respects the corporate governance standards, the internal audit establishes the development of an integrity reputation, the development of business relations based on trust.

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JEL Classification: G32; G33; C39

1. Introduction

The internal audit confers the economic entity a positive role within the community, ensuring a public image, by strengthening its serious image. Romania is a member of the European Union; the companies must develop the internal audit activities if they want to successfully compete on the Unique European Market. The governance concept came out from the business environment in the main market economies, first of all as an acknowledgement of the fact that the important financial institutions have a strong influence on the growth of the societies they finance, and on the other hand, as a result of the notorious financial failures. It has been thought that if these legal entities had been more transparent and if there had

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been more efficient ways of supervising leaders' responsibility, the arising problems would have probably been less exigent.

The governance concept heads towards the developing countries, because the stock exchange listing varies and the investors strongly want to discover new markets in order to place their funds. The investors become exigent regarding the information quality and the governance standards they ask from the economic entities and the markets on which they intend to invest their capitals.

Thus, there has been a need to correlate corporate governance and the internal audit within a company, no matter what its dimensions are. The relation implies interconnection, interdependence and mutual influence.

2. The Internal Audit – Pillar of the Corporate Governance

The internal audit must be professional, independent, it must possess the resources needed for the development of its tasks according to the implemented standards, based on risk management, corporate governance control and it must create the best equilibrium between the insurance activities and consultancy. The internal audit is an essential pillar of corporate governance together with the audit committee, the risk management and the external audit.

Based on this model of corporate governance, one reaches the center of the Board of Directors of corporations, and the internal auditors have a clear way towards the Board of Directors agenda, which must function according to known and accepted rules, which reflects business transparency.

The internal auditor represents a strong ally to audit committees, being one of the parts that are trustful to offer credible and relevant information, and that it would impartial through the advice and conclusions it might offer.

The corporate governance principles impose the understanding of the necessity to implement the internal audit within the governance structures. These continuously developing expectations represent an opportunity for the superior management to search for and train internal auditors that would be able to provide a strategic judgment, which is to bring added value for the organization. The implementation of the internal audit unquestionable incorporates risk management, the internal control system and the governance processes, which are interrelated. (Ghiță, Iațco, Brezuleanu, Vorniceanu, pp. 55-56)

The published annual internal audit report must present the implemented internal control systems in order to manage the internal and external risks. Though, the Board of Directors can provide the needed information about the functioning of the internal control system by using information regarding the risk management and the reporting process, but most of the data are provided by the internal and external

audit and the audit committee. *The internal audit is the most important method of reporting the functioning of the internal control system*, the reason why the teams of internal auditors base themselves on the Board of Directors requirements, in the private sector, or on the requests of the managing director in the public sector.

The internal audit can be considered a function of the corporate governance, as it is more and more accepted as a company function, with an important role within corporate governance. It is formed within corporations as an independent and objective function, though it may also be subjective, through its human side. *This represents an independent, objective, ensuring and consulting activity, designed to create value and also to improve the operations of one company.*

It assists the company in reaching its objectives by implementing one systematic and disciplined approach for the evaluation and improvement of the risk management efficacy, the control and the governance processes. (Bunget, Florea-Ianc, Ghiță, Nicolau, Pereș, Pereș, p. 54)

In practice, every company aims at implementing the three desiderata, namely *corporate governance, risk management and internal control system*, thus *the internal audit is the key component of this corporate ideals surveillance* but it also has an important role in management education, in finding efficient solutions, the auditor must possess a deep understanding, be used to corporate governance, by being the best expert in assuming the major role within the company in order to support the management and gain the company success.

The corporate governance is an attempt to implement some risk analysis, verification, evaluation and control systems, with the object of developing an efficient management. The “corporate governance” concept is supported by the internal audit, with an important role in the assistance of the internal control system reorganization and in the general management advisory. The remaining manager requirements are the installing the system designed to prevent frauds within the company, and the responsibility of the internal audit remains the supply of its own assistance, evaluating risks, corporate control strategies, making suggestions, recommendations, lowering the fraud danger, improving the control strategy.

The economic crises generate by financial scandals on European and American ground have emphasized the fact that accounting frauds are assigned to the absence of proper control, which is provided by the companies’ internal regulations. Thus, the strong relations between frauds, corporate governance and the role of internal audit are emphasized.

3. The Role of the Internal Audit within the Corporate Governance System

The internal auditors' role is to follow the company general strategic objectives, to help it to excel in a viable, ethic manner. They evaluate and improve the agreement, control and risk evaluation systems in the company, providing the company the ability to operate with a reasonable certainty.

The data selected for the financial situation must be transparent, giving the internal auditor the possibility to elaborate suggestions concerning the way this data should be secured so that it could not be used by other individuals excepting the authorized personnel, *he must conceive the deep understanding of the society, the deep understanding of the society, through experience and training levels and education that help individuals to evaluate business situations.*

Any type of corporate governance, irrespective of the configuration method and the reference market, in order to be considered as efficient, must predict convenient control mechanisms, which are to intervene in predicaments and protect the interests of every user category. In order to define its own role concerning the ethic model of an entity, required by the corporate governance principles, the internal auditors take into consideration the following issues: (Boulescu, Gădău, pp. 191-194).

The role of the internal audit and auditor regarding the ethic model varies depending on the existence or absence of an ethical culture within the entity and depending on its development level, on the description of the nature of the entity governance process; the development of a relation between the governance process and the ethic culture of the entity; mentioning the fact that any individual in conjunction with the entity and especially the internal authors are obliged to promote and defend the ethics; specifies the features of a strong ethical model.

The company can adopt various legal forms, structures, strategies and procedures to ensure itself that it obeys the regulations in force and respects the general rules on the business environment, the ethical principles and the expectations of the civil society.

The practice adopted by the company regarding its governance represent the result of a unique and evolving culture that influences the roles, conditions behaviors, induces objectives and strategies, measures performances and defines responsibilities.

The internal audit should add values to all the activities in a company, fostering the identification and evaluation of the risks existing at any level. This should be done by evaluating the essence of the risk management economic process, hoping that there are specific clear and coherent management policies and behavioral norms.

4. The Governance – Internal Audit Relation. Convergence Points

Corporate governance includes elements such as the transparency of the internal and external audit, the existence of very precise terms for the financial reporting, managers' responsibility for the data veracity within financial reports or the total communication and transparency of the financial results. A first convergence point can be synthesized: *if the internal audit's role is to objectively evaluate risk, governance is related to the concept of risk management.*

A second converging point of view takes into account the fact that, using corporate governance, one aims at *growing the company performance and the harmonization of the various interest groups.* Following the huge rumbles in the financial environment, the final conclusion is that a more efficient company governance/management system is needed, and that this system is to be certified/evaluated through internal audit. In this case, the audit activity must take the shape of an objective examination of one company's activity ensemble, with the view of the independent evaluation of its management, of the practiced internal control, as well as of its leading processes. Corporate governance specifies the distribution of rights and responsibilities amongst various individual categories within the company, such as: the Board of Directors, the directors, the shareholders and other categories, and *sets the decision making rules and procedures regarding one company's activity, and the internal audit evaluates the quality of these decisions.*

From the third point of view, corporate governance refers to promoting correctness, transparency and responsibility within any company. All the pertinent data on the company must be presented correctly and in-time, including the financial situations, performance and propriety, both within the company and its external links. Thus, *the role of the internal audit is to evaluate how relevant the financial and non-financial are the data provided to the leading members of the economic entity,* in order to be conscious of the realities of that company and to respect the transparency principle. The fourth, the aim of the corporate governance system is to protect the shareholders' rights and their fair treatment, including the minority and the foreign shareholders. The achievement of a coherent internal audit according to the norms elaborate by the Finance and Audit Committee comes to reach this objective, *turning the shareholders into the main incumbents of these audit activities.*

From another point of view, *the risk management techniques represent the support needed for the maximization of the company values, also providing help to the objectives of corporate governance.* The financial control of the managers' activity represents an important part of a corporate governance code and it consists of minimal requirements for the managers and executive officers (risk exposure, performance indexes, etc.), for censors and auditors (employment, payment etc.). From this point of view, *the role of the internal audit is to evaluate the adequacy*

degree of the financial and non-financial controls disposed by the leaders of the economic entity, and if they are applied and to what extent, with a view to growing the efficiency of the companies' activity. The good functioning of these processes is based on the company's maturity as it requires the existence of in-time accepted decision networks and they imply a high volume of work in order to be maintained.

5. Conclusion

The implementation of strong corporate governance is vital for the fulfillment of this objective, together with the insurance policy of a transparent management, by identifying the most favorable governance system. Through the delimitation and the separation of the management process stages, but also of the executive functions from the non-executive ones, an efficient decision making system is promoted and a responsibility clarification. The clear separation of functions within a legal entity can represent the solution to high-quality governance, which allows the transparency and efficiency growth. The internal audit will be under public steam because it is the function that can bring transparency surplus in such a controversial world. Its presence in such a context corresponds both to "the principles of corporate governance", so that it ensures the transparency of organizational transactions, and to the management need to bring more safety, which allows it to correctly and efficiently put into effect the strategy of the company.

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