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# INTERNAL AUDIT: DEFINING, OBJECTIVES, FUNCTIONS AND STAGES

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**Abstract:**

*This article aims, through a detailed presentation as to provide clarification for a better understanding of what internal audit definition, objectives, functions and stages of its development mean. It is also exposed a brief history about the emergence and development of internal audit and regulatory framework. I also plan to linking theory and practice by reference to documents used: both the evidence considered and especially those prepared by the auditors in connection with the performance audit and its use in the audit report.*

**Keywords:** *internal audit, efficiency, effectiveness, risk audit, system audit, performance audit, regularity audit.*

Audit term comes from the Latin word audit - auditare, which has the significance „ to listen”, but about the audit had been talking since the time of Assyrians, Egyptians, from the reign of Charles the Great or Edward I of England.

The occurrence of internal audit and external audit is closely linked to development of the economic crisis of 1929 in the United States, according to the specialist Jacques Renard, when businesses were fully affected by the economic secession. Employers were interested in reducing taxes and fees so that all accounts containing transactions generating taxes and fees,, have been thoroughly analyzed in order to find the possibility of reducing the taxable supply or transactions for which fees were paid improperly”.

As previously stated in the paragraph we realize how far we are in time from 1929 and paradoxically how similar we are affected by the current crisis.

Audit practice has a considerable experience as we use various terms such as: inspection, control, revision, checking, auditing, and supervision.

Each of these terms implies:

- comparing the actual situation with the situation that should be;
- establishment and analysis of the deviations and risks;
- proposal or recommendation of measures to contribute to the achievement of the entity or to provide correct information.

These terms may have a different scope and may be based on some specific investigation techniques and procedures.

Audit period, generally comes from the Latin word „audire”- to listen and inform others. In Anglo-Saxon countries today, the term signifies an overhaul of accounting and other information, performed by an independent professional in order to express an opinion on the regularity and sincerity audited information.

Audit in general, is a systematic process of objectively obtaining and evaluating the information or statements to assess their degree of compliance with predetermined criteria, and communication of results to interested users.

The audit consists of checking and certifying the financial statements by an independent expert to provide an opinion on the facts and accuracy of the data contained therein. The role of audit is to provide users with information on the principles and accounting practices and accounting and presentation of financial statements accurate picture, clear and complete financial position and financial performance of the company.

After the analysis of audit data definitions the following general features can be drawn:

1. The audit is a process, a set of operations, collection, analysis and evaluation of information (audit trail) to obtain reasonable assurance on compliance of such information or statements with predetermined criteria.

In essence an audit process is:

- fair audit evidence-gathering (just the character of the evidence relates to the quality and effectiveness of the types of samples collected) and sufficient (sufficiency of evidence refers to the amount collected) necessary to express an opinion or to formulate a recommendation;
  - correspondence assessment or inconsistencies between different types of collected samples;
  - setting the deviations regarding the pre-set criteria.
2. The audit is facing accounting policies and work procedures used in the entity with a set of criteria, such as International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), national accounting rules, internal procedure manuals, tax regulations, etc To be useful, these confrontations have to be based on justifiable and verifiable information.
  3. Auditors are competent professionals who have achieved that status based on exams. Examination of the information is not made at random, as it is by intuition auditors professional standards (codes of ethical conduct established by the profession and the Seventh Directive of the ECA in 1984. professional standards and technical standards work).
  4. Auditor's conclusions are summarized and systematized in the reports that are made available to those who are interested.

In 1999, the International Institute of Internal Auditors (IIA) in the U.S. has issued a new definition of internal audit, following a study of 800 students, coordinated by auditors from Australian universities, such:

Internal audit is an independent and objective activity, an organization that gives assurance as to the degree of control by the operations, a guide to improve operations and contribute to an adding value.

Internal audit helps the organization to achieve its objectives by evaluating a systematic and methodical approach to its risk management processes, control and management of the entity and making proposals to strengthen their effectiveness.

In the vocabulary "The words of the Audit" is given the following definition: "The internal audit function within an organization exercised in a manner mandated independent evaluation of internal control. This approach specifically compete with good risk control over the charge.

Internal audit is an independent activity, objective of assurance and consulting designed to create value and improve an organization's operations. It assists an organization in achieving its objectives by implementing a systematic and disciplined approach in evaluating and improving the effectiveness of risk management and control.

Internal audit profession is based on a flexible frame of reference, recognized around the world, which is adapted to the specific legislative and regulatory framework of each country, in compliance with specific rules governing the various sectors and culture organization.

The reference of internal audit includes:

- a) the concept of internal audit, which indicates some essential elements:
  - internal audit carry out assurance and advisory ;
  - its areas of responsibility are risk, internal control and management entity;
  - purpose of internal auditing is to add value to organizations;
- b) code of conduct, which provides internal auditors principles and values that enable them to focus their professional practice according to the specific context;
- c) rules (standards) for professional practice of internal auditing, which guides its auditors to carry out missions and management activities;
- d) arrangements for implementing that comment and explain the rules (standards) and recommended best practices;
- e) support for professional development, consisting mainly of theory papers and articles, the documents of meetings, conferences and seminars

The audit literature is structured in different ways and different criteria.

#### **A. Depending on the objectives:**

##### **1. Regular or compliance audit.**

Its objective which is to establish if they met certain criteria defined by a competent authority. These criteria are usually specific entities or sectors of activities such as:

- compliance with management decisions or policies;
- compliance procedure manuals relating to the conduct of operations;

- compliance with contract terms;
- legal compliance and other external restrictions (such tax audit can be considered a compliance audit);
- ensuring exhaustivity, reality and accuracy of information;
- security assets;
- ensuring an atmosphere of moral- ethical thing etc.

2. **Audit of effectiveness or performance.** In this type of audit criteria are not fixed, they change each time depending on the reasoning of auditors that look at what are the best, effective, reliable and timely solutions based on emerging internal and external cyclical. Effective audit can be viewed from two angles: management audit and operational audit.

3. **Financial audit** relies in collecting audit evidence about the entity's financial statements and use these samples to assess their compliance with preset criteria. In Romanian legislation the expression „financial audit” is used, in the VIIth Directive of the European Community Council in 1984 is used in the same acceptation the term "legal control" (legal or statutory audit).

#### **B. Depending on the affiliation of auditors the audit types are:**

- internal audit;
- external audit.

Internal audit is organized as an independent section of the structure of public and private entities, and external audit is carried out as the financial audit and contract audit conducted by independent professionals and management of auditees.

In our country, the law provides the following types of audit:

- **audit system**, which provides an assessment of depth of management and internal control in order to determine whether it works economically, efficiently and effectively, to identify deficiencies and make recommendations for their correction;
- **the performance audit**, which examines the criteria established for implementing the objectives and tasks of the public entity shall correct the results and assess whether the results are consistent with the objective;
- **regular audit**, which is examining the financial impact of actions on public funds or public property, in terms of compliance with all principles, rules, procedures and methodologies, according to legal norms.

#### **The audit objectives.**

**Any type of audit objective is to improve the use of information.**

Control and audit professionals have objectives that are interrelated and interconditioned between them, so:

- **Internal control** check activities and operations are conducted in accordance with the laws in force, in conjunction with the risks facing the organization;
- Favorable **external control** signals and how to ensure the system of internal control within the organization;

- **Internal audit** is the existence and operation of management control system and evaluate its effectiveness, and as a result may recommend giving up some control actions and develop others;

- **The external audit** shall ensure that the system outlined above exist and function within the organization. In this regard, it ensures that the tasks of internal control and internal audits to be conducted in accordance with standard practice, by different professionals and have regard to all activities and departments within the organization.

From the above results it holds the key role of the **INTERNAL AUDIT**. Thus, on the one hand, he evaluates the internal control on its functionality in relation to general management, but also in relations with external control entity received from the outside, but on the other hand, recommendations and conclusions that provides reports on which they draw, **EXTERNAL AUDIT** provides a basis for preparing and formulating an appropriate advice, taking into account the degree of familiarity with the organization and the general management degree of assurance provided by internal auditors.

Consequently, special attention should be given to this new profession of "INTERNAL AUDIT", which has already been fixed in the consciousness of professionals, through its introduction as a subject of study in the university system, all profiles and specializations, including faculty from outside the economic domain, and conducting internal audit activities of the master, which can be used for professional certification for internal auditors.

Internal audit is the activity of objective examination of all activities of economic entities in the real purpose of independent evaluation, risk management and control and their processes.

Internal Audit has as aims:

- verification of compliance of the economic entity audited policies, programs and their management in accordance with legal provisions;
- evaluating the implementation of financial and non-financial controls and arranged and performed by the head entity in order to increase economic efficiency;
- evaluating the adequacy of financial and non-financial data and information for management to know the reality of the economic entity;
- protecting those assets and off balance sheet and identify measures to prevent fraud and losses of any kind.

#### **Audit Functions.**

International auditing standards define the internal audit activity assessment as an entity organized as a service to it.

Internal audit functions are among others:

- examination;
- evaluation;
- monitoring the adequacy and effectiveness of internal control.

Internal audit review the entity's activities and services, primarily to improve them. It leads to strict policies and procedures established by that entity and it is not limited to financial matters.

Internal audit is:

- a permanent review of the entity's economic activity ;
- an independent appraisal activity for the economic entity's management, by examining the financial operations, accounting and other services on all;
- an evaluation of conformity assessment tasks and accounting records, reports, assets, capital and results ;
- a certificate or certification of financial accounting documents .

Internal audit is a function of the entity's control structure. It should not be confused with the entity's internal control structure. The two departments are separate and independent, not being in the relationship of subordination.

Those responsible for carrying out internal audits, coordination of work or commitments, the signing of internal audit reports must be of Internal auditing.

Internal auditors are permanent employees of the entity and are directly responsible to the entity's management or the General Assembly of Shareholders.

Internal Auditor: advise, assist, recommend, but not decide, his obligation is to provide a means to improve the control that each manager has on his activities and those in coordination to achieve goals.

### **Conduct internal audit**

Internal audit of public entities is performed by internal audit department, which evaluates whether the financial management and internal control systems are transparent and comply with the rules of legality, regularity, efficiency and economy.

Internal audit is exercised over all activities in a public entity, including the activities of subordinates, or under the authority in coordination with the formation and use of public funds and the management of public assets, which runs under the specific methodology of internal audit steps, procedures and documents as follows:

#### **STAGE I**

Preparing audit mission: what the following procedures requires:

1. initiation of the audit (in which they are drawn: service order, declaration of independence, triggering notification of the engagement - Internal control questionnaire);
2. collecting and processing information (summary list of objects is drawn audited);
3. risk analysis ( to prepare table of "strengths and weaknesses");
4. developing the internal audit program (program audit, the preliminary program of intervention on the spot);
5. opening session (it made the opening minutes of the meeting).

## **STAGE II**

Intervention at the premises requires the following procedures:

1. collecting evidence (to be prepared the following documents: checklist, tests, job identification and analysis of problems);
2. finding and reporting irregularities (for declaration form is completed and the reporting of irregularities);
3. review working papers (note summary shall be prepared working documents);
4. closing session (it is written the closing minutes of the meeting.).

## **STAGE III**

**Internal Audit Report: requires the following procedures:**

1. draft internal audit report (to prepare the draft report);
2. transmission of the draft audit report;
3. conciliation meeting (minutes of meeting of reconciliation is made);
4. final report (final report's preparation);
5. supervision (supervision shall prepare a list of documents).
6. dissemination of internal audit report.

## **STAGE IV**

**Tracking recommendations:** stage at which it is made recommendations tracking sheet. Based on its audited entity will be revise their work as auditors recommendations, recommendations which were accepted by the entity.

**Internal Audit Department audits** at least every three years, but not limited to, the following:

- budgetary and legal commitments arising directly or indirectly in payment obligations, including EU funds;
- payments made through the budgetary and legal commitments, including community funds
- sale, pledge, lease or rental of goods from the private sector of the state or administrative-territorial units;
- public revenue, respectively the licensing and establishment of debt instruments and facilities provided to their collection;
- allocation of budget appropriations;
- accounting system and its reliability;
- decision-making system;
- management and control systems and associated risks of such systems;
- information systems.

**Internal audit assignments** are made based on plan. The draft audit plan is prepared by the internal audit department, based on risk assessment and by taking suggestions from the head entity, in consultation with higher-level government entities, taking into account the recommendations of the Court of Auditors. The head of the public entity approves the draft internal audit plan

The internal auditor carries out ad hoc audits, internal audit assignments that exceptional, not included in the annual internal audit plan.

In carrying out audits, internal auditors carry out their activities based on work order issued by the Head of Public Internal Audit Department, which explicitly states the goals, objectives, type and duration of the internal audit, nominating and audit team.

Internal audit assignments may be the main objectives:

- procedures and operations to ensure compliance with rules, regulations and laws - a regular audit (an audit of this type is exemplified in this seminar notebook);
- assessing the depth of management and internal control in order to remove any irregularities and shortcomings of the public entity - the audit system;
- examining the impact of the set objectives and desired quality of the public in terms of the criteria of economy, efficiency and economy - performance audit.

Mission objectives are statements prepared by auditors that define what they have set out to achieve during the mission.

Public Internal Audit Department shall notify the structure that will be audited, 15 days before the onset of engagement and it will include the purpose, key objectives and duration of the mission.

Public Internal Audit Department shall also notify, topic in detail, joint cooperation program, and the periods in which the interventions on the spot, according to methodological norms.

The internal auditors have access to all data and information, including electronic ones, which it considers relevant for the purpose and objectives specified in the order of service.

Management and executive staff of the auditee is required to provide documents and information required within the timescales, and all the support needed to carry out properly the public internal audit.

Internal auditors may request data, information and copies of documents certified by natural and legal persons in connection with the auditee, and they have the obligation to provide the requested date.

The authorized representatives of the European Commission and European Court of Auditors shall have the rights equivalent to those provided for internal auditors in order to protect the financial interests of the European Union; they must be authorized to that effect by a written authorization, to prove their identity and position, and a document indicating the object and purpose of inspection or spot inspection.

Whenever the public internal audit narrowly specialized knowledge is required, the head of internal audit department can decide whether to contract for expert services / advice outside the public entity.

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