

INTERNAL AUDIT REGULATIONS IN ROMANIA AND THEIR CONVERGENCE TO EUROPEAN EXIGENCIES

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ABSTRACT: The aim of our approach is to clarify the role and position of the internal audit in the functioning of the organizational systems within the present social and economic context. On the one hand, the research had in view a systematization and reassessment, and, on the other hand, a synthesis and analysis of the opinions found in the specialty literature about the above mentioned subject and the regulations established by the various professional organizations and national and international authorities existing in the field of research. The internal audit is a dynamic process that should evolve together with the society and should be strongly connected with its economic stage.

Key words: internal audit, corporative governance, management-audit relation.

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Introduction

The role of the internal audit in Romania, i.e. that of **assistant in the managerial activity** does not fulfill our expectations and it is not similar to the one existing in other countries with relative tradition in setting up theories and developing this component of the financial audit.

In order to simplify the issues, we can say that this is the result of the fact that the internal audit activity is quite new in our country (10 years have passed since the first regulations have been issued in this field).

As a matter of fact, the problem is more complex and it represents a vast area of research. Solutions are needed.

The internal audit – Fundamental Element of Corporative Governance

The most famous cases of bankruptcy in the private sector were generated by false pretences in the field of business administration and inadequate financial engineering. At their turn, people lost their confidence in the management (and especially the top management) more and more. This lack of confidence was inevitably extended upon the state institutions. Their competent organisms in the field should have ensured if not a good way, at least the correct way of developing this activity.

Specialists drew the conclusion that - as a matter of fact - these failures were determined by a series of factors such as: incompetence, defective assignment of the roles and responsibilities within the organization, the ignorance of the risk management principles, and internal auditors' recommendations, the inefficiency of the external audit and last, but not least, the managers' greed and baneful interface between the economic and political systems (electoral campaign financing for "business development").

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The crash of important transnational companies strongly related to the way of functioning of the stock broker institutions forecast the world economic crisis, a crisis that can be an existential problem for the virtual capitalism. The need for setting up modern assessment and monitoring structures became essential within the present context, and made it even more necessary to apply uniform standards in the field of management organization, internal control system assessment, and the **strengthening of the principles of corporative governance in practice**. We emphasized the interest in the improvement of the internal control, internal audit and risk management seen as fundamental elements of the governance and applicable through an integrate approach of the principles and concepts of the corporative governance. In the Unites States, the regulations about the application of these principles were made possible by setting up the Integrated Risk Management Code, COSO-ERM model, in 2004. The aim of the implementation of this regulation framework was that of avoiding the emergence of significant disorders similar to those existing in the past.

Romania became member of the European Union three years ago and it still makes efforts with a view to implementing the principles of the corporative governance in the management of organizations that imply integrity, transparency, liability and competence in management activities. The need for governance resides in the separation of interests between those who manage the organization and the potential beneficiaries of the organization activity. In other words, management should fulfill their obligations in a correct and qualified manner with a view to protecting the interests of the interested factors in a beneficial way for the society.

Internal Audit Regulations in Romania

The internal audit activity has been recently introduced in Romania as essential part of the effort of modernizing the financial management in our country. Mention should be made about the fact that the effort in this respect was focused in the field of internal public audit.

After the adherence act to the European Union was signed, in 1993, and the request in this respect was made (1995), Romania received recommendations about the audit activity organization.

First of all, the financial audit activity was set up through the Government Ordinance no. 75/1999 regarding the Financial Audit, modified, completed and approved by Law no.133/2002. Subsequently, the Chamber of Financial Auditors of Romania was set up in accordance with the normative framework imposed by the law. CFAR is responsible for the financial audit activity at national level.

As far as the internal public audit is concerned, following the recommendations of the European Commission, the Government Emergency Ordinance no. 119/1999 about Internal Public Audit and Preventive Financial Control brought changes for control and the audit system in Romania, and especially for the internal audit and control, stipulating the fact that the departments for administration financial control set up in the public sector in 1991 will be abolished through the internal financial control reorganization according to Law no. 30/1991 about the financial control and Financial Guard functioning and organization. Internal audit compartments were set up instead.

Governmental Emergency Ordinance no. 119/1999 regarding the internal audit and preventive financial control is a first doubtful stage that mixed up two distinct notions from the very beginning.

This transformation had positive effects since the internal audit compartments were set up immediately in public entities and their specialists started to be preoccupied with the understanding of their new responsibilities and differences between the control and audit activities, and the new concepts. This explains how a new category of specialists emerged in Romania: the internal auditors.

At the same time, the transformation of the departments in charge with the administration financial control into internal audit compartments had negative effects, too. A large number of managers understood the internal audit system as mechanism of control since it was established on

the basis of a Romanian control structure existing in the past, now bearing a different name, that of audit. Mention should be made about the fact that the administration financial control that should have been made within entities was made by the internal audit for a while, and in several entities the administration control activity was completely abandoned.

During 1999-2003, on the basis of the normative framework set up through the Governmental Emergency Ordinance no. 119/1990, the internal audit inspections were set up and they became responsible with control actions/inspections reported as internal audit activities.

This period of time was a stage of confusions in this respect. There were many problems related to the understanding of the concepts and to the internal control and internal audit prerogatives, but it was also a stage that contributed to the clarifying of their role, position and orientation towards European standards.

At the moment, the internal public audit is regulated by Law no. 672/2002 regarding the internal public audit expounded through its application norms in 2003 about the activity in public institutions with extension upon other organizations governed by the state. Mention should be made about the fact that the introduction of the public audit activity in Romania was not imposed by the European community. It was not a take-over or adapted activity. Hence, many solutions specific to the peculiarities of our national economy can be found in this field of activity. We should also add the fact that the Code of Internal Control adopted through the Order of the Ministry of Public Finance no. 946/2005 that comprised the standards of management and internal control for public institutions and development of managerial control systems was set up in accordance with the American pattern.

The external assessment of the functioning ability of internal public audit activity is performed by the Central Harmonization Unit for Internal Public Audit and the hierarchically superior unit for the subordinated structures by verifying the observance of the specific and general methodology norms, the internal audit standards, the healthy practice in the field, and the Code of Professional Ethics.

The internal audit activity was initially focused on accounting issues, but it became nowadays a powerful instrument for risk tracking activities significant for economic entities and the development of their activities. Similar to the financial, economic and even the administration financial control, at the present, the internal audit activity is subordinated to the management of the economic entity and has a well established role and position.

The Need to Find Optimal Ways for Internal Audit Standardization and Implementation in Romania

The internal audit is a profession based on a well known reference framework in the entire world, even if it should be adapted to the legislative framework, regulations peculiarities specific to every country, specific rules governing the variety of activities existing in the world and the size and culture specific to the economic entities because of the various environments where it became applicable.

The framework of reference for the internal audit includes the standards for professional practice for audit and the Code of Ethics of the Internal Auditors.

According to the stipulations of the Governmental Emergency Ordinance no. 75/1999 republished, the Chamber of Financial Auditors in Romania sets up internal audit norms completely aligned to the international standards in the field.

Starting from the stipulations of the above mentioned article, the Chamber Council approved the Internal Audit Norms that include the internal audit standards set up and published by the Institute of Internal Auditors and procedures regarding the general framework for internal audit mission development.

The International Standards on Internal Audit in Romania are applied as standards on internal audit to which professional norms on internal audit activity were also added.

Despite the evolution towards a higher involvement in the managerial assistance in time, the internal audit function suffers from contradictions and malfunctions inherent to any kind of beginning.

Within this context, **the internal audit represents an essential instrument for an optimal performance of the activity of an entity through the contribution it brings to the act of identifying the digressions and lack of balance in the field.** Auditors' recommendations represent a powerful support for the strengthening of the organization stability, to the accomplishment of objectives, risk administration and efficient usage of the financial resources of the entity. **As a matter of fact, the internal audit brings safety assurance and counseling to the management for the benefit of the functioning of the organizational system.**

Nevertheless, as part of the accounting financial audit, **the internal audit gives a higher degree of trust to the management performance for all those who have an interest with regard to the entity, trust to both the operational and accounting & financial reports of the organization.**

The organization cannot have performance when irregularities and damages in patrimony are detected, as well as when the activity is not developed according to the law. **The internal audit assessment has in view the functioning of the organization as a whole, as a unitary system made up of a sum of functional sub-systems.** Practically, the internal audit approaches sub-systems with a view to giving insurance that the system is working. The internal audit efficacy is rendered by **its capacity to prevent the flaws and to give to the management recommendations in order to remove them in due time.** The internal audit characterization should take into account the fact that this activity represents a fundamental pillar for the corporative governance. Romania undergoes a stage of consolidation of the internal audit function that is carried out through the partnership between the internal auditors and the management within organizations.

Mention should be made about the fact that the internal audit activity is based of legal regulations. There are three types of internal audit, but the regularity audit is the most developed into practice. As far as the performance audit is concerned, mentioned should be made about the result emphasized by the Public Internal Audit Committee in a meeting in the end of 2008, after an internal audit mission: a step towards a performance audit has been done. The performance audit implies an advanced stage of an audit mission approach: it is an assessment in depth of the leading and internal control systems with a view to establishing if they are functioning in an efficient and coherent way from an economic point of view, in order to identify deficiencies and recommendations in this respect. It is significant to mention that if the financial audit (regularity audit that verifies the accuracy of the financial and accounting documents and their legitimacy) is registered in all countries in the European Union, the performance audit is registered only in Belgium, Finland, France (in France, it is called the performance and manager's audit), Germany, Ireland, The Netherlands, Great Britain. The performance audit is an instrument at the manager's disposal used to detect the best practices in the field (highly recommended to the manager). As far as the components are concerned, the profitability audit is concerned with the administrative activity, if this is developed in accordance with the good practices and managerial politics, if there were registered minimum expenses comparatively with the expected results; the audit of efficiency in using the human, financial and other resources has in view the assessment of the informational systems for performance and insurance measurement with a view to retrieving the flaws that were identified for performance achievement according to the estimated cost; the audit of achievement efficacy related to objective fulfillment implies the analysis of the real impact of the activity comparatively with the expected result, and it shows the degree of accomplishment of the expected objectives and results. In our opinion, an intense research activity **meant to identify ways of internal audit standardization and implementation, adapted at the maturity level in risk administration within economic organizations in Romania is needed.**

Confusions about the Internal Audit Role and Position

The managerial culture about the role and position of the internal audit, and the impact of this activity upon the management performance are characterized by impercipience. Managers' confusions about the place of the internal audit within institution, the difference between the internal and external audit, audit and control, and the state of vagueness with regard to the regulations that govern this activity make us draw the conclusion that we have a significant field of research. In practice, it has been demonstrated that the internal auditor has missions concerning the administration control, fraud detection activities, and missions concerning the act of establishing prejudices and guilt. These confusions might have a double cause: on the one hand, mention should be made about manager's training (as it has been mentioned above) and, on the other hand, the issue of communication between the internal auditor and the manager plays a significant role. The internal auditor might encounter shortcomings in the approach of the problems related to the management, in explaining the specific type of activity, the limits of his prerogatives and the role he has to fulfill. It was highly demonstrated that the internal auditor should have good skills in communication both during his missions when he comes into contact with those who are controlled, and in his relation with the organization management. The internal auditor should be the connection between management and the audited structures in risk identification and administration.

In our opinion, the above mentioned confusions are also deepened by several legislative incoherencies, such as the Law no. 672/2002 regarding the Public Internal Audit, article 2(b), where it is stipulated that: "the internal control is the assembly of the forms of control, including the internal audit established by the institution management". The internal audit has precisely the mission to assess the internal control of the entity (it cannot make this assessment from the inside); another example is Law no. 94/1992 on the Organization and Operation of the Court of Accounts, article 1(2), where it is stipulated that "the control function of the Court of Accounts is accomplished through public external audit procedures"; it therefore extends the confusion between audit and control. As it has been mentioned above, the first regulations about this activity, i.e. the Governmental Ordinance no. 119/1999 about internal audit and preventive financial control mixed two distinct notions and made the confusion possible from the very beginning. Thus, in practice, the result was the setting up of departments of audit and control differently subordinated comparatively with the auditor's subordination, in general. As far as the subordination is concerned, the internal audit department is directly led by the manager, and that brings the internal auditors' relative independence: total independence towards the audited structures, but subordination to the management. The fact that other activities are carried out by the same compartment implicitly determines a different level of subordination.

We strongly believe that it is necessary to analyze the possibilities of finding optimal ways with a view to increasing the management awareness towards the internal audit role seen as component of the accounting financial audit, for the benefit of the activity of the entity, including through clear, coherent and regulations that can be easily applied.

Another remark should be made about the fact that the legislative efforts have been done in the field of the internal audit of the public institutions, but the private companies are confronted with a lack of regulations in the field. Excepting the big transnational companies with activity on the Romanian territory and specific departments for the internal audit activity (having in view their origin in other organizational cultures), the private companies were not preoccupied with the setting up of this activity. We assume that the role of the internal audit was not completely understood. The activity is not seen as being beneficial for the entity, but useless, generating supplementary costs. Managers of the public institutions regard the setting up of these compartments as a simple obligation playing the role of generating increased functioning costs. Taking into account this stage of development of the capitalist society in Romania, it might become useful to adopt a mandatory law with regard to the internal audit activity in private companies. It can be a useful solution with a

view to quickening the understanding of the impact that the internal audit might have upon the managerial performance.

Methodology of Research

On the one hand, our research had in view a systematization and a reassessment, and, on the other hand, a synthesis and analysis of the ideas found in the specialty literature in this field of activity, and the regulations set up by the various professional organisms and the competent national and international authorities in the field.

We therefore believe that the concept of internal audit will be easily positioned and adequately perceived as essential instrument for the activity performance optimization within entities owing to the contribution it brings to the process of digression and unbalance identification.

With a view to fulfilling the proposed objectives, we employed a constructive-deductive and inductive methodology and found arguments for our assertions, critical opinions and opportunities. We set up a counter-vision discourse about the internal audit that has recently become a powerful instrument in detecting the main risks that threaten the development of the activities within entities.

Final remarks

The analysis of the current stage of the internal audit at international level, with strong emphasis on the situation in Europe, represents a significant field of research and a point of reference meant to provide a view upon what we want to apply in our country.

The internal audit is a dynamic process that should evolve together with the society itself. It should be strongly connected with its economic stage. The approach from a historical perspective of the stages of the internal audit activity in developed countries help us to avoid the mistakes that have already been made in theory and practice, and to find specific solutions adapted to the peculiarities of the Romanian economy in the future and nowadays.

The issue concerning **the contribution that the internal audit brings or should bring to the management presents a huge interest nowadays.** Several factors that might affect the efficiency of the relation between audit and management can be easily identified: the managerial culture, deficiency in communication, legislative incoherency or even lack of regulations, the degree of adapting the audit system to the stage of the economic development, but also the insufficient academic debate upon this topic. We strongly believe that many contributions might be brought in this field for a better understanding of the relation between management and audit both in theory and practice. The solutions in this field of research will be outlined when the factors that influence this process will be deeply approached.

This short presentation attempts to offer an analysis about the internal audit-management relation from various perspectives, and especially from the point of view of the accounting and financial activity that deserves to be scrutinized. We identified several arguments and possible solutions with a view to supporting this activity, solving its problems of functioning and increasing the efficiency of this relation employing a vast field of research.

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