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**Abstract:** The sphere of internal audit activities has seen a continuous evolution that has frequently generated debates and controversies among specialists. The study realized in this context intends, firstly, a brief overview of the main stages of evolution and, secondly, it intends to highlight the pronounced interdependence of the positioning of internal audit and the nature of the entity's specific objectives and activities.

**JEL classification:** M40, M42, M14.

**Key words:** internal audit, sphere of activity, positioning, specific objectives, audit committee, managerial needs.

### Sphere evolution of internal audit activities

As it is known, the establishment of IIA was a significant moment for the development of internal audit. However, immediately after the establishment of this professional body, the public perception of this activity was the extension of work performed by external auditors, considering that internal auditors have a relatively modest role in the life of the organization, having only „*a limited liability in the total management spectrum*”<sup>1</sup>.

This mentality has persisted for a long time and we believe that it was maintained, inter alia, by the placement of internal audit department in the organizational structure of entities, which in most cases it was subordinated to the chief accountant. Concurrently, both in the theoretical and in the practical work, there is quite evident the confusion between internal and external audit, based on the dominant concerns of the entities that had as a priority to inspect and to certify the accounts.

Even if this subordination limited the internal auditor's work to accounting issues, the fact that he is employee of the unity represented the background for raising the interest for all types of operations performed by the unity, increasing its concern to make them more profitable.

Moreover, in economic organizations, it is found an accentuation of the distance between their management and actual activities, issue that laded to the need to develop some controls to ensure the management more efficient of the business. In this context, the internal audit has the capacity to complete and to improve the forms of control established by means of an evaluation carried out independently.

<sup>1</sup> Moeller, R, and H.N. Witt, Brink's Modern Internal Auditing, 5<sup>th</sup> Ed., New York: John Wiley & Sons, Inc., 1999, pag. 73.

Therefore, in order to meet new practical requirements, the regulatory factors, they were concerned about the continued expansion of the activities of internal audit, from the accounting and financial issues to the operational sphere of the entity. With this in view, we consider, as a first significant step, the review realized in 1957 by IIA, of the Declaration regarding the responsibilities of internal auditors<sup>2</sup>, which carry the considerable expansion of the activities performed by internal auditors for the entity's management, including in their range a number of new services:

- the review and the assessment of the validity, of the appropriateness, and the application of accounting, financial and operational controls;
- the indication of compliance with policies, plans and procedures established;
- determining the degree responsible for any losses of company assets, and how they are protected against assets;
- the ascertainment of the reliability of accounting data and other information about the organization;
- the quality assessment of responsibilities assigned.

The process of extending the sphere of the activities undertaken by internal auditors continues depending on the requirements of reality, so that the said document, which is considered a landmark in the field, is subject to a subsequent revision in the years 1976, 1981 and 1990, showing, once again, the rapid development of the internal audit profession.

The rules adopted by the organisms specialized were accompanied, in parallel, by debates and controversies on the subordination of internal audit function and, concurrently, in terms of a strict definition of the role fulfilled by it in the complex process of managing the organizations.

Thus, in a first stage, the internal audit department was subordinated to the financial Directorate of the entity, which was considered an important step forward, proving its viability, by the fact it is still found in the practice of many organizations. This dependency, which although apparently creates the impression of limiting the exercise of internal audit, provided an appropriate framework for its manifestation in a universal manner to the entity. It is, in fact, the main motivation for the *longevity* of such organizational structure.

Subsequently, many organizations have considered more appropriate the subordination of internal audit function to the General Directorate, justifying this by the universal character of its concerns, and a series of studies on this subject have pointed out that, in some economic environments, such as the French environment, this trend has become significant.

The latest developments, characterizing particularly the Anglo-Saxon and the American environments, emphasize, however, that the proper exercise of internal audit in operational field, and the support more efficient to the organization management, can be achieved by subordinating it to the audit committee. Moreover, the supporters of this approach argue their opinion affirming that this solution represents also an appropriate way regarding the independence of the function.

Delimitation of internal audit position within the entity and the nature of its specific objectives

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<sup>2</sup> Statement of Responsibilities of Internal Auditor.

As mentioned previously, the subordination of internal audit function to the audit committee is an opinion shared by a growing number of specialists from which we stand, at least because of the considerations observed onwards.

In general, if within the board of administration is formed such an audit committee is assumed from the beginning a specialization on a separate domain, which means an extra competence and, implicitly, a better understanding of the managed issue.

The audit committees consist of independent persons to whom any relationship with the entity is prohibited, except that which derives from this quality, which means that the work will be characterized by a maximum objectivity. This is absolutely necessary especially as regards the correct interpretation of recommendations made by internal auditors and, subsequently, to track their implementation.

The use of a common language which represents a considerable advantage to identify and evaluate the risks to what the organization is exposed, because it is known that in this regard, the management has specific ways to solve the issues that, sometimes, can be more difficult to reach by the internal auditors which, in this regard, are at the beginning, using such management techniques from a little time.

The IIA Recommendation made by the U.S. Congress in April 2002<sup>3</sup> provided for all companies listed on stock exchanges, in addition to the requirement of the existence of internal audit function and the fact that this vests to the audit committee.

Also, we notice that the audit committee report is considered by some experts as a common practice among the most progressive corporations, which aim to achieve an adequate structure and control processes, and to develop the internal audit function. In this regard, Mautz & Neumann believe that: *“for most persons, the audit committee represents a bridge between the board of administrations and the auditors... To fulfill their responsibilities to shareholders and the large public, the members of the audit committee had become more interested and better informed on issued of auditing. The management has also become conscious of the need to protect itself through a proper attention given to internal controls and effective audits. Consequently, it has become more receptive to auditors suggestions and to the information requirements of audit committees.”*

Accentuating, also, the importance of audit committees and their role played in establishing an appropriate relationship between the boards of administration and the internal auditors, Brink & Witt<sup>4</sup> ascertain that: *“in most cases, the internal auditing group has gone to very high levels in all operational areas, and has set itself as a valuable part and on top of the organization. Increasingly, the internal auditor serves the board of administration – usually through its audit committee.”*

Actually, according to approaches developed under IIA, the internal audit represents an independent and an objective activity that gives to an organization the assurance regarding the degree of control over operations; it guides it to improve its operations and contributes to adding a value. Also, it actively contributes to achieving the targets, to manage the risks and the related controls, the business government

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<sup>3</sup> The Institute of Internal Auditors (IIA), Recommendations for Improving Corporate Governance: A position paper presented by The Institute of Internal Auditors to the U.S. Congress April, 8, 2002 (Altamonte Springs, FL: The Institute of Internal Auditors, 2002).

<sup>4</sup> Brink, V.Z., and H.N. Witt, *Modern Internal Auditing* (New York: John Wiley & Sons. Inc., 1982), pag. 42

processes and to increase their effectiveness by making proposals and appropriate recommendations.

As you can see, the internal audit has become the main instrument of the entity in terms of monitoring the risks and ensuring the quality control devices, being considered by many experts *a first line player* in this direction.

Regarding the risks, we can keep in mind that the main steps taken by auditors are delimited on the following lines of action<sup>5</sup>:

- to evaluate the risks existed in the areas subjected to the audit and to report the results obtained to management or to the audit committee or to both structures;
- to develop a plan in order to ensure a systematic evaluation of all the risks to what the organization is exposed;
- to betake the attributions related to risk management activities if the management has difficulties regarding the solution of these issues;
- to facilitate the risks assessment by self-assessment techniques;
- to assess the risks associated to different development projects of the entity, and stop their implementation when they are not controlled to a predetermined acceptable level;
- assistance given to management in order to implement a model of risk within the organization.

At their turn, the controls imposed on the organization's level represent the object of the internal auditors concerns in the following activities<sup>6</sup>:

- to effectuate conformity tests and to report the finding to the management and only in special circumstances to the audit committee;
- assistance given to management in planning some ample assessments, including control test;
- to facilitate the controls understanding and development in the entity's functional areas, using control self-assessment techniques;
- to identify significant control weaknesses, including those founded on the top of the organization and to communicate these aspects to the audit committee;
- the implementation of computerized testing techniques, such as the continuous monitoring of controls or their effectiveness;
- assistance given to management in order to elaborate the report regarding the internal controls effectiveness.

With all these issues and the change of views regarding the subordination of the internal audit department within the entity, becomes a significant ability of internal auditors and principally of the department manager, responding to requests received from both management and the audit committee. In this regard, the literature emphasizes the possibility of tensions caused by the fact that internal audit should *serve to two masters*, which have a different perception, imposed by the specific objectives by each of them, on how the internal audit function adds value to the organization.

Thus, in light of the audit committee, the organization value can be enhanced by improving the quality of all information in its products. In turn, the management of different hierarchical structures believes that the desideratum mentioned can be

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<sup>5</sup> Research Opportunities in Internal Auditing, Edited by: Andrew D. Bailey Jr., Audrey A. Gramling, Sridhar Ramamoorti, IIA, 2003.

<sup>6</sup> Op. cit.

achieved as the internal audit becomes a factor of change at the operational level. With this in view, it is noted that the audit committee members are less interested by the effectiveness of operations realized at the entity level, focusing more on the opinions expressed by the auditors regarding the adequacy of control devices, confirming that the data provided by managers are reliable, the laws and regulations were respected and also that the assets are protected. Moreover, the leaders of various hierarchical levels pursue, in particular, that the recommendations received from the auditors to provide opportunities regarding the deployed operations, which principally target the reducing of costs and, implicitly, to encourage the efficiency. They are concerned about the findings of controls instituted only if they affect it evaluation to the heads of the hierarchy. As such, their priority is represented by the efficient and effective conduct of operations they coordinate.

Also, we note that, in reality, the beneficiaries of activities performed by internal auditors are more numerous. In this regard, we consider the external auditors, the suppliers and the customers of the entity and even regulatory factors of various activities which, also, have specific information needs.

External auditors consider that an internal audit carried out rigorously and that is characterized by a high quality is a major factor of substantially reducing the extension of their approach, made in order to develop the statement regarding the entity's financial situations.

In turn, the entity's customers and suppliers, ongoing analysis of current contracts and prospects for joint activities, give special attention to the findings of internal auditors of the partner unit regarding the reliability and the security of information provided by the system representing the interface between them and the business partner.

In relation to regulatory factors, is known that there are a number of areas that are characterized by a significant regulation, made by specialized bodies documented, inter alia, by using the results of internal auditors.

### **Some aspects regarding the specific activities of internal auditors**

In literature, are found also opinions that do not agree the execution of some activities provided by internal auditors. In this respect, it's invoked their compatibility with the main services vested to them, representing those offering their endorsement as insurance. Thus, as it is known, the internal auditors perform consulting services for management, which may call into question their role of independent analysts of the effectiveness of the governance processes of the entity.

In such circumstances, we consider that the involvement of internal auditors in consultancy services is a benefit as they are not involved effectively in the implementation of the recommendations elaborated. In addition, because the practice of internal audit subordination to the audit committee is expanding being imposed as could be observed by the regulations issued in this regard, appear the backgrounds through which these experts are kept *away* from the beneficiaries of consultancy services and, thus are diminished the fears regarding the independence that must characterized them.

In the same context, we mention also that similar views were expressed in terms of monitoring the activity, sustaining that this is a component of the control processes established within the organization and, therefore, may raise questions about the role of internal audit, which is reflected both in the position of part of control systems and the insurer regarding their effectiveness.

In this case, we consider that the fears expressed are not justified, because the monitoring realized by internal auditors is different from the one made by managers through its independent character and, consequently, it provides assurance on the processes audited.

Also, in the general context of government organization, starting from the premise that there are more numerous the parties involved in this process, coming mainly from outside the enterprise, there are specialists who believe that providing internal audit services by external partners (outsourcing) brings more independence and, thus, contributes more to improving the overall governance process.

### **Conclusions**

The evolution of internal auditing activity aims, at a main landing, the ongoing expansion of the sphere of action. This trend is favored, significantly, by the position of the department within the organization. Thus, the added value conferred to entity by internal audit can be maximized, among others, by ensuring an adequate subordination within it, which ensures the premises of an effective approach.

Concurrently, the activities included in the sphere of internal audit must ensure, through the objectives established, the information needs of managers, of audit committees and of all other parties having interests in the organization.

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