

THE FUTURE OF INTERNAL AUDIT

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Abstract: Over the years, the purpose of internal audit has continued to evolve and expand, managing to successfully transition from its traditional function of monitoring financial statements to the strategic and operational efforts of checking the organization's compliance at all levels. Regarding the future, it is assumed that the internal audit will play an important advisory role, becoming an important catalyst of business development, focusing organizations on emerging risks. This transformation of the whole internal system, consisting in both control and audit, which seeks to promote a risk-centered organizational culture, is in the process of evolution, but its complexity, the conflicts of interest, the little understanding of most companies when it comes to implementing such a system as well as various issues of credibility, limit the pace of development for now. Our belief, however, is that this slow evolution is favorable for the alternative purpose of building the functions of the new internal control and audit on a more credible and relevant foundation for the organizational management.

Keywords: internal audit, internal control, risk management, value added.

JEL classification: M42, G32

Introduction

In today's demanding economic environment, both boards and management need pertinent advices from trusted sources. In this regard, external audit was mainly approached, as playing the objective viewpoint, helping the management to achieve its goals. This view was formed based on regulatory changes that sustained the important role of external audit (e.g. Sarbanes-Oxley in United States). In contrast with external audit, internal audit is still evolving to achieving in its role played inside organizations.

Strongly connected with items used in assessing the changing risk profile, internal audit function is critical in helping an institution to develop its strategies according to plans. On the other hand internal audit function often is used to ensure that the controls are practical, functional.

Recent significant business failures worldwide led to an increase demand for regulation in the business environment, in regard to transparency, accountability, governance and audit. Therefore, additional regulation conducted to an increase in the audit responsibilities and expectations.

In the light of the above, internal audit function suffered important changes, moving apart from just informing the managers to a collaboration with external audit, becoming in this respect an important activity in the organizations.

Internal auditing became during time a profession that has redefined over the years trying to keep track with the needs of changing entities. Focused at first on accounting issues, internal audit objectives were shifted to assessing the main risks of the entities and their internal control mechanisms.

In a constantly changing business environment, companies must adapt continuously to new challenges. Moreover, the experience of companies show that a good internal control system prevents more frauds than a good auditor has the potential to disclose (Arens and Loebbecke, 2006), the latter argument being the best answer to the question: "Do we need internal control?"

In this respect the practice of previous years proved that any deficiencies in risk management systems and therefore inefficient and negligent application of internal audit or control functions can trigger an economic crisis with devastating impact globally. Following this crisis became more evident that any company, regardless of size, should have internal control mechanisms well organized at all levels of the organization - from the execution of basic operations until the board or committee director. Following, Smith (2005) asserted that one of the major reasons for the collapse of large corporations during the crisis was the outsourcing of internal audit function since external auditors fail to understand well enough the business and the people who run the daily operations, unlike internal auditors who perceive the organization from an employee perspective. We dare to add that one reason was also the insufficient involvement of managers in internal control activity and risk management.

In recent years we face a change of the mentality in terms of management involvement in internal control, which became a highly dynamic management function, evolving constantly and not face the risk of lose its relevance.

In these circumstances the issue of separation of the two activities, in such a way that each to be able to prove its effectiveness and usefulness for the smooth running of the business. International practices supported continuation of both distinct internal risk management systems, requiring a clear separation between the activities of internal audit and other internal control concepts used in management in order to maintain the principle of dual control.

Methodology

Our research methodology comprise both inductive and deductive research which helps us to obtain certain knowledge regarding the internal control and audit function. In this respect the present study is helpful in understanding the present and configuring the future of research in this area. To achieve our goals we will present some theoretical concepts drawn from various scientific articles, relevant legislation, reports and standards that regulate and coordinate the work of this field. Our ultimate goal is to identify the main coordinates that will characterize the future evolution and development of the two distinct but complementary functions: internal control and internal audit.

Theoretical implications

Internal audit function, by positioning auditors near daily operations of the company, regularly assess the effectiveness of internal control activities of the company and their suitability to achieve predetermined objectives of the strategy of the organization.

Therefore, internal auditors have the responsibility to report any inadequacy of internal control management and any failure of employees when adhere to its requirements, and to recommend tasks that need improvement, while recommending the exact procedures to ensure proper resolution matters brought to its attention.

Analyzing the internal audit functions, we can point out a number of elements that are directly involved in the good functioning of the internal audit department in a company: the advice given to managers, helping employees, total independence and objectivity of the auditors (Ivan, 2009).

In regard of the internal control, this function comprises a set of mechanisms, procedures and standards that ensure the efficiency of the organization in order to achieve its objectives and the security of its assets. It should focus on providing assurances that the organization's objectives will be achieved in the following areas: effectiveness and efficiency of financial operations, the veracity of financial statements, compliance with laws and directives in the field (Arens, 2010).

Internal control is therefore a vital aspect of a business since it involves teamwork of employees at all levels of the organization and other persons directly or indirectly involved in the company (suppliers, customers, competitors, etc.) in order to achieve objectives comprised in common business strategies. According to the theory of the field there are five major components of internal control arising from the way the business is run, which included: environment control, risk assessment, control activities, information and communication, monitoring (Landes and Ratcliffe, 2009).

New directions of both internal control and internal audit

In recent years research in this field has focused increasingly on grounding causes deficiencies in the internal control system (Hammersley et al., 2008; Krishnan and Visvanathan, 2007) and the consequences of failure of internal control over the evolution of the company (Elder et al., 2009; Hoitash et al., 2008), while approaching the new role of internal audit in organizations (Spira and Page, 2003; Kagermann et al., 2008).

Driven by Sarbanes-Oxley Act of 2002 and other reforms in the field, organizations have been forced to consider new techniques in the fields of risk management and internal audit control. This particular law requires companies to adopt a common definition of internal control and to document all the functions of control, formalizing its processes so the application of standards and monitoring to be effective, all leading to the integration of increasingly strong control function in daily management (level 2 of the evolution shown in Figure 1). Consequently, the new state of affairs eroding much of the internal audit functions acquired in recent years, forcing for the need to change it in order to avoid its minimization.

In the new system imposed by Sarbanes-Oxley law, internal control is considered to be the first line of defense against fraud, overall protecting the quality of the company's financial statements. In its early stage, however, the internal control activity was an informal activity, monitored by the internal audit and not the by the management of the company (level 1 of evolution presented in Figure 1).

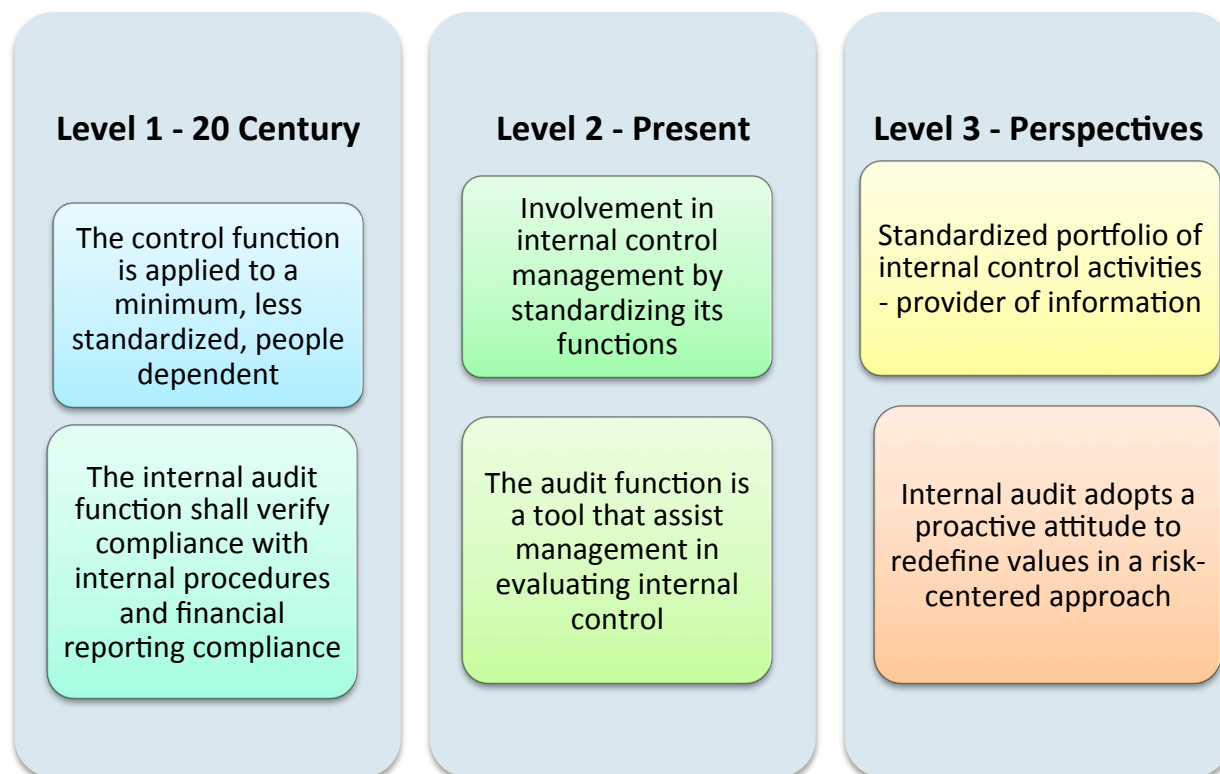
Audit function, on the other hand, is the second line of defense, that evolved over time from its primary function of compliance monitoring of internal financial procedures, towards assessing the quality of internal control in order to determine the reliability of the organizational system both financially and non- financially, which seeks to understand the role of the company, to prioritize efforts and to use their best strengths.

According to recent studies developed by large global audit companies (PricewaterhouseCooper's, 2012; KPMG, 2007; Deloitte, 2010; Ernst & Young, 2012) the future of internal audit and how it will be differentiated definitively from

internal control function lies in adopting a centered approach on risk by transforming the risks identified at the level of organization into results.

To remain useful to the business environment, internal audit function must adapt to the new requirements of companies, creating value-added for business, became a strategic advisor for managers, identifying major risks and opportunities and not least quantifying and always contributing to success of the business. Thus, at this level, which is the final stage of maturity of risk management, internal audit must take responsibility to develop a specific audit strategy, built on the company's strategic plan and after identifying the most important risks threatening the company, following exactly the level of risk tolerance stated by management (level 3 of the evolution shown in Figure 1). Therefore, the first thing to be left to internal control is standardization, the new function that must uphold internal auditing so in order to be able to redefine the values requiring a high degree of adaptability and proactivity.

Figure 1. Evolution in time of the internal control and internal audit functions



Source: Author's projection

Conclusion

Assuming the role of consultant or advisor for the company manager, comes with a number of difficulties related primarily to the power of influence. It is known that internal auditors must remain independent and in no case to be held responsible for implementing any decision. They do not influence directly the internal control or the risk management, but they can identify areas with problems and provide solutions for the managers. Internal audit function should therefore always refine the skills needed and to strengthen the ability to use the new technologies for creating maximum added value for companies and always keep a highly sensitive balance between the needs of shareholders and managers and other external stakeholders.

In our opinion, the internal auditors can have a significant influence on the improvement of risk management and internal control processes, but in order to achieve this demarche they have to convince the managers of the companies that they work for implementing quality and to lead them to implement their recommendations. Therefore, the analyzes and recommendations of the audit towards developing a viable strategy may become unnecessary given in case managers are not committed to their implementation, internal audit effectiveness being directly associated to the degree of perception of managers on auditors work. In conclusion the added value that internal audit can bring to the company, is not determined

by strictly research work and build strategy, but rather by the impact on the organization of work of the audit team, which is reflected strictly in access to resources comprised in the projects implemented and results documented.

In regarding of the internal audit skills required an obviously and significant correlation appears between the ability of audit function to be constantly connected to new, ability to quickly and effectively address emerging issues in management and the ability to inspire stakeholder confidence. Given the dynamism inherent in the field, is necessary to continue the research in this area by developing studies on the ability of audit function to overcome the stage of provider of information.

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