

5<sup>th</sup> World Conference on Educational Sciences - WCES 2013

## The Role of Internal Audit regarding the Corporate Governance and the Current Crisis

Dragos Laurentiu Zaharia<sup>a</sup>, Andreea Lazar, Doina Maria Tilea<sup>c\*</sup>

National Research and Development Institute for Biological Sciences<sup>a</sup>, Senior Lecturer Faculty of Finance, Banking and Accountancy<sup>b</sup>, Faculty of International Economic Relations, *Dimitrie Cantemir* Christian University– Bucharest<sup>c</sup>

---

### Abstract

Internal audit should become a pillar supporting corporate governance, and, generally, any management act, as well as a paramount instrument used to identify risks that entities might take when performing their activities in an environmental turmoil. On the other hand, the performed activities are more and more numerous and diversified, and their extension often overpasses the basic perimeter of the entities out of the origin countries inclusively.

© 2013 The Authors. Published by Elsevier Ltd.

Selection and/or peer-review under responsibility of Academic World Education and Research Center.

*Keywords:* governance, audit, control, efficiency, regulation

---

### 1. Introduction

At the European Union level, it is essential to have a uniform and coherent approach to effectively treat the weaknesses related to corporate governance. Divergent rules adopted by the Member States may lead to the need for regulatory arbitrage, which could undermine the internal market or create new obstacles to the proper functioning of the latter.

The role of internal audit regarding the corporate governance and the current crisis requires for certain recommendations related to some measures that should aim at both outlining the corporate governance framework and avoiding to take excessive risks through (Balaceanu, 2012):

- increase of efficiency related to monitoring the risks assumed by councils;
- improvement of risk administration status and assurance of efficient surveillance provided by the risk governance superintendents

The recent changes of the corporate governance concept in the U.S.A, Canada and U.K. try to improve the role of Audit Committee.

In its communication since 4 March 2009, the European Commission announced that it would examine practices and rules of corporate governance within the international financial institutions, in the context of the financial crisis, and, where appropriate, would make recommendations or propose regulatory measures.

In June 2010, the Commission published a green paper on corporate governance in financial institutions and remuneration policies, attaching an working document which reviewed the corporate

---

\*Dragos Laurentiu Zaharia, tel: +40-074-618-1806; Andreea Lazar, tel: +40-072-421-4966; Doina Maria Tilea tel: +40-072-271-8240;  
*E-mail address:* dlzaharia@yahoo.com; engfraro@yahoo.com; alinat75@yahoo.com;

governance mechanisms and infrastructure in the financial services sector, which contributed to excessive risk-taking and that have been highlighted by the financial crisis.

The non-binding character of the majority of the corporate governance principles has contributed to the failure to comply with the principles of the credit institutions, their implementation being mainly left to self-regulation and shareholders' external monitoring. The deficiencies that prevailed during the crisis have demonstrated that these mechanisms do not work properly in practice. In particular, in the absence of a clear framework of corporate governance and a well-defined supervision role, the supervisory authorities could not monitor or control the implementation of corporate governance standards by the credit institutions.

The OECD has recently stated in the Economic Outlook, that "the crisis in the euro area remains a key risk to the global economy."

In its communication on 9 December 2010, the European Commission announced that it is considering legislative measures at European Union level to close and strengthen the sanctions regimes in the field of finance. At the macroeconomic level, a solid system of risk governance would contribute to avoid any new crisis.

To better highlight the results of a comparative analysis of the corporate governance codes and their development degree in certain E.U. member states, we shall have a closer look at table no. 1.1. below:

*Table no. 1.1.*  
Analysis of the corporate governance codes

Analysed criterion	Romania	France	Germany	Italia	The Netherland
Code of corporate governance	Bucharest Stock Exchange Corporate Governance Code 22 January 2009	Recommendations on corporate governance revised 2011	German Corporate Governance Code as amendment on 26 May 2010	Corporate Governance Code (Codice di Autodisciplina) 14 March 2006	Dutch Corporate Governance code 10 December 2008
Role of internal audit	Lack of clear provisions	Insufficient provisions	Insufficient provisions	Provisions 8.C.7. hold responsible the persons in charge with the review of the internal control procedures for playing the role of internal auditors.	Insufficient provisions
Position of internal audit	Lack of clear provisions	Insufficient provisions	Insufficient provisions	Indirectly, the persons who play the role of internal auditors, being held responsible for internal audit assessment would subordinate to the Council of auditors and The Committee of internal control.	Audit function subordinates to the top management.
Organisation of the internal audit process	Lack of clear provisions	Insufficient provisions	Insufficient provisions	The board is responsible for assessing the efficacy of internal control system, without requiring for internal audit	Council of Surveillance Committee of Audit Internal Audit

				function implementation that should take it reasonably on granted.	
Management	<ul style="list-style-type: none"> <li>• one-tier board system</li> <li>• two-tier board system</li> </ul>	<ul style="list-style-type: none"> <li>• mainly two-tier board system, but the one-tier board system is also possible</li> <li>• one-tier board system</li> </ul>	<ul style="list-style-type: none"> <li>• one-tier board system</li> <li>• two-tier board system</li> </ul>	The traditional model, made up of the members of the Board and the Council of Auditors, prevails, but it may happen to have both one tier board and two-tier board systems.	<ul style="list-style-type: none"> <li>• mainly, two-tier board system, but it is also possible to have</li> <li>• one-tier board system</li> </ul>
Type of regulation	The "apply or explain" principle	Voluntary application	The "apply or explain" principle may influence companies to swerve the provisions of the code provide that they should make proof of solid arguments in reports .	The "apply or explain" principle	Infringements are allowed only in case of contingencies.

**2. Concept and quantified added value of internal audit**

Thanks to its performed activities, internal audit adds value both by analyzing the risks to which the entity is exposed and by the recommendations in the internal audit report drawn up at the end of the mission. The Mission of internal audit cannot give a full assurance that there is no dysfunction or that the activities subject to audit are protected due to the special internal control, but, it can give reasonable assurance that the management risks are identified and that they are kept under control.

“An effective audit depends on the way in which the information is collected, analyzed and reported. The result can verify the compliance with the non-conformities or indicate the rules, standards, or regulations. “

Internal auditors must have a good understanding of the business that the entity performs, in order to be able to monitor the situation and to assess the changes to which the entity itself is subject. They must be aware of the changes, help identify new risks the managers may face even though managers are still responsible for identifying them.

Internal auditors are promoters of the value added in terms of avoidable losses because of their actions, but also of the values for which they make efforts to generate savings and opportunities. To highlight specific savings generated by the action itself of internal audit, auditors must try to quantify the results achieved from the implementation of the recommendations recorded in the internal audit report. Thus, if the recommendations to improve the system of internal control through their deployment exempt the entity from the payment of certain amounts, then we have a direct, tangible savings that can be easily quantified. However, most of the quantification process is hardly doable.

It is hard if not impossible to quantify the added value of the entity; it resides in the internal audit report issued and recommendations regarding both risk assessment and the organization of the internal control system.

The added value of entity through audit action assumes the establishment of criteria for its

measurement. Because it is very hard to evaluate the provision of internal auditors in physical money, internal auditors have to demonstrate that they create “financial value,” too.

The audit committees are in charge with monitoring the effectiveness of internal audit and finding ways to quantify its value. However, in Romania there are no Audit Committees established at the level of organizations, but only at the level of the Ministry of Finance.

Some departments have established internal audit performance indicators with the aim of highlighting the value added by the work that they performed, such as: work planning, departmental performance (quality of the findings and recommendations submitted to the managers).

### 3. Conclusions

Improving the management process of organisational entities, in all its complexity, requires knowledge and the application of more modern principles aimed at ensuring the functioning of the entities concerned, in terms of performance and competitiveness. For this goal, it is necessary that the good practices of management be permanently filled in with new items, conceptualized and implemented in the functional structures of the entities.

The internal audit field covers the disciplined and systematic approach to evaluate and improve the effectiveness of risk management and control. Auditing a field is a complex process which is carried out by reporting the material proof to specific standards in order to define the findings on which the wording of the opinion is based upon. Thus, the findings and recommendations result from the analytical examination of the data and proof information.

In fact, the internal audit issues faced with the challenge to analyze and evaluate the management in terms of system and process, to provide insurance in respect of the degree of internal control activities and, at the same time, to give advice that will lead to the improvement of the situation, consists of several domains subject to auditing which, in turn, can be divided into objects and sub-objects, also subject to auditing, such as processes, activities or distinct elementary operations.

Internal audit through internal audit reports stands for a sort “true business card of the organization,” which will be considered by the representatives of the European Commission, international financial agencies, as well as the Court of Accounts of Romania. These bodies through the activity of monitoring the progress of the economic entity are expected to find in the established internal audit structures a useful channel of information, independent and objective. Therefore, the quality of the internal audit reports issued are of special importance which depends on the professional competence of internal auditors, their relationship with the top and the line management, as well as the performers themselves ( Tudor, 2009).

The resources of the internal audit may be insufficient due to the following reasons:

- ✓ Management does not respect the role and the contribution of internal audit within entities;
- ✓ Management subsidizes internal audit to keep the balance of some short-term forecasts;
- ✓ Management uses the resources of internal audit to reach short-term goals, to control possible crises or to subsidize special projects.

It is not enough that the internal audit function own its proper budget; it also needs to attract and keep qualified staff. Under certain conditions, to attract qualified staff can be a problem bigger than any budgetary constraints.

The importance of the internal audit function is underlined by its evolutions and international recognition through the establishment of several bodies which include national institutes and members, holders of an internal auditor certificate.

Internal audit is considered to be the last level of the entity's internal control. The head of the audit division must share information revealed by external providers of assurance and consulting services, with a view to avoiding duplication of work and getting a proper audit area. Although the development of the relations between the external and the internal audit involves a series of advantages on both sides as well as for the audited entity, one must admit that, in practice, the lack of cooperation is historical.

Managers and internal auditors are of the same *barricade*, having common objectives, namely to achieve the proposed targets. Managers must understand the recommendations made by the auditors and be aware of the support they receive in controlling risks.

Risking to be sceptical in appreciation, we believe that to achieve internal audit within an entity requires in-depth knowledge of the business and organisation, the conceptual framework of accounting at national and international level, of the principle postulates, norms and rules of assessment, technical instruments and last, but not

the least, of the International Audit Standards. Under the inevitable public pressure, internal audit has a duty to bring a surplus of transparency in such a controversial world.

The conclusion we may draw from this study is that the importance granted to the internal audit function is not impressive, and the legislative provisions to regulate it are not comprehensive in accordance with the European corporate governance codes. Subsequently, we assume that a paramount importance should be given to internal audit at the European level.

### **Bibliography**

1. Bălăceanu Cristina, *Tranziția de la guvernare la guvernanță*, Pro Universitaria Publishing House, Bucharest, 2012, p. 27
2. Marcel Ghiță, Ioan Bostan, *Introducere în teoria și practica auditul intern*, Universitas XXI Publishing House, Iași, 2004, p. 366.
3. Munteanu V., scientific supervisor, *Auditul intern la întreprinderi și instituții publice- teorie și practică*, Pro Universitaria Publishing House, Bucharest, 2009.
4. Russell J. P., *The Internal Auditing Pocket Guide Preparing, performing, reporting and follow-up*, American Society for Quality, Quality Press, Milwaukee 53203, 2007, p.5.
5. Tudor Diana Ligia, *English for Business Purposes*, Editura Universitară, București, 2009, p. 107
6. *Commission staff working document - Corporate Governance in Financial Institutions: Lessons to be drawn from the current financial crisis, best practices (Document de lucru însoțitor al Comisiei – Guvernanța corporativă în instituțiile financiare: Lecții învățate din actuala criză financiară, cele mai bune practici)*, SEC(2010) 0669 final  
[http://www.oecd.org/document/47/0,3746,en\\_21571361\\_44315115\\_49095919\\_1111,00.html](http://www.oecd.org/document/47/0,3746,en_21571361_44315115_49095919_1111,00.html)  
<http://www.wecgi.org/codes/documents/>.