Annals of Spiru Haret University.
Economic Series
Since 2000
ISSN:2393-1795 ISSN-L:2068-6900

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Issue 1/2022

THE ECONOMIC REFLECTION OF THE INTERNAL AUDIT FUNCTION DEPENDING ON THE MANAGERIAL ASSISTANCE

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How to cite: RUSU, B., HURLOIU, L., HURLOIU, I., & ILINCUȚĂ, L. (2022). "The Economic Reflection of the Internal Audit Function Depending on the Managerial Assistance." *Annals of Spiru Haret University. Economic Series*, *22*(1), 439-447, doi: https://doi.org/10.26458/22128

Abstract

The control environment, which is largely determined by management policies and the operating style of the entity, is fundamental to the way the controls are carried out within an organisation. In order to obtain a full understanding of the control environment, the auditor should focus more on the high-level policies and practices of the audited entity and less on the detailed controls within individual operations. Professional scepticism is of great importance when assessing the control risk. The auditor must apply it when verifying how the internal controls, implemented by the management of the entity, have acted in the direction of reducing the specific inherent risks.

Keywords: *internal audit; managerial assistance; audit program; International Accounting Standards.*

JEL Classification: H83, H12, M42

Introduction

Internal audit, as defined by the International Institute of Internal Auditors, is an independent and objective function, which gives an entity assurance over the level of control held within their operationsand enables management to improve the company's activities. Internal audit helps the entity to achieve its goals by evaluating, through a systematic and methodical approach, its risk management, control and governance processes and making proposals to enhance their effectiveness.

1. The internal audit function

If the auditor is not satisfied with the controls established by management to mitigate these risks, he may decide that the control risk is higher than he initially assessed. In this case, the auditor initially recognisesthat there is an inherent risk of fraud when collecting proceeds from entertainmentor the delivery of goods and services for example.

The auditor will evaluate whether the entity's accounting policies are appropriate for its activity and in accordance with the applicable accounting financial reporting framework and the accounting policies used in the relevant sector of activity.

The auditor must take into account the following elements, when he intends to obtain an understanding the control environment:

- The ethical values and integrity of management;
- The objectives set up by the management and risks implications involved in achivieng these objectives;
- The operating style of management (eg: through codes of conduct and manuals of procedures) and the organizational structure;
- How responsibilities are established by management (eg: through the organizational structure and through the separation of tasks);
- The policies for maintaining the competent personnel, respectively the recruitment policies and improvement of the professional training;
- Management oversight of the control procedures and the way the accounting system operates, including review of operations and budget monitoring (including internal audit);
- The way in which management of the entity ensures compliance with the laws and regulations.

When preparing the audit program, the auditor will consider the specific assessments of the inherent and control risks, as well as the level of certification required to be provided by the detailed audit tests.

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Furthermore, the auditor should consider the duration of the controls tested and the detailed procedures, the assistance expected from the entity side, the assistants'availability and involvement of other auditors or experts.

Professional scepticism is of great importance when assessing the control risk. The auditor must apply it when verifying how the internal controls, implemented by the management of the entity, have acted in the direction of reducing the specific inherent risks.

Basically, the audited entity proceeded to the direct substantive testing through the audit procedure, namely "inspection" which represents the physical examination of the tangible assets. This type of audit sample is most often associated with the inventory audit, as physical examination provides useful and reliable audit evidence.

Identifying the inherent risks associated with the entity's activities is achieved by managing change: people change, methods change, organizations and policies change and as such, risks change.

Risk assessment means identifying and analysing the relevant risks in meeting the objectives, in order to know how they should be managed.

Risk assessment is part of the operational process and must identify and evaluate "internal and external factors" that could affect the organization's objectives.

External factors include changes of the economic conditions, change in the regulatory framework, political factors or changes in technology.

The identification of the risks associated with the entity's activities must take into account the forms of internal control, respectively the existence and the functionality of the relevant procedures. Each activity should have a procedure developed that will contain internal controls, therefore if this is missing, the activity presents potentially greater risks than those for which procedures are developed.

This is based on the fact that the execution personnel, not having a consistent procedure, will have difficulties in understanding the activity and implicitly implementing it in practice.

The auditor should establish a global materiality to ensure proper planning and guidance of the audit missions.

The 240 International Audit Standard makes a difference between fraud and error and describes two types of fraud which are relevant for the auditor, meaning the misrepresentations resulted from the wrong representation of assets and the misrepresentations resulted from the fraudulent financial report; it describes the responsibilities reverted to those in charge with governing and managing the entity

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in order to prevent and detect the fraud and it establishes the auditor's responsibilities for detecting the significant misrepresentations due to fraud; it requires to the auditor to maintain a professional sceptic attitude admitting the possibility for a significant misrepresentation to happen due to fraud, no matter how much experience in what the entity and honesty and integrity of management and of those in charge with governing the auditor has; it asks from the commitment team members to discuss the susceptibility for the financial situations of the entity to contain significant misrepresentations due to fraud and it asks the commitment partner to take into consideration the aspects which are about to be communicated to the members of the commitment team who are not involved in discussions;

Therefore, the manager's responsibility is maximum in what preventing, fraud investigating, bribe, corruption, setting up the necessary measures when the first warning signs of these appear is concerned.

The main responsibility for preventing and detecting the fraud and errors belongs to both charged with governing and to the management of the entity.

The responsibilities charged with governing, and respectively, with the management can vary depending on entity and from country to country.

The management, under the supervision of those in charge with governing must set up an adequate climate, must create and maintain an honesty culture and high ethical standards and must settle proper controls for preventing and detecting the fraud and errors from the entity.

Those in charge with governing an entity have the responsibility to guarantee, by supervising the board, the integrity of the accounting systems and of financial reports of an entity and to assure themselves that there are adequate controls, including for risk monitoring, for the financial control and in accordance with the law in force.

The government of an entity is responsible for establishing a control environment and for maintaining politics and procedures which help achieve the assurance objective in the best conditions possible, and for ordered and efficient development of the activities of the entity.

This responsibility includes the implementation and assurance of permanent functioning of the accounting and internal control systems which are meant to prevent and detect frauds and errors. Such systems reduce, but cannot eliminate the risk of the appearance of misrepresentations, either these being caused by fraud or errors. Consequently, the management assumes the responsibility for any remained risk.

This 240 IAS standard asks the auditor:

- to carry out procedures in order to obtain information which can be used for identifying the risk of some significant misrepresentations due to fraud;
- to identify and evaluate the risks of some significant misrepresentations due to fraud at the financial situations level of assertion; and to evaluate the internal controls projection due to the entity for those evaluated risks which could have as a result a significant misrepresentation due to fraud, including the relevant control activities and to determine if they have been implemented;
- to determine the global answers in order to approach the risks of some significant misrepresentations due to fraud at the financial situations level and to take into consideration the appointing and supervising the personnel; to take into account the accounting policies used by the entity and to include an unexpected element in selecting the nature, the moment and the extent of the audit procedures which are about to be done;
- to project and make audit procedures in order to respond to the risks of avoiding the controls by the management;
- to determine the responses in order to approach the significant risks regarding significant misrepresentations due to fraud;
- to take into consideration if an identified misrepresentation can show if it is about a fraud;
- to obtain written declarations from the management regarding the fraud;
- to communicate with the management and with those in charge with governing;
- The 240 International Audit Standard standard offers:
- guidance referring to the communication with the regulating and implementing authorities;
- guidance, if the auditor comes across unusual problems which bring forward the auditor's ability to continue the audit as a result of a misrepresenting which results from fraud or suspicion of fraud;
- establishes documentation requirements.

During the audit mission, the materiality used preventsperforming certain testes over areas that do not have a significant impact on the audit opinion.

At the conclusion of the mission, a possible exceedance of the materiality will cause the auditor to propose correction of the errors identified or to mention them in the audit report.

In order to determine the materiality level for an entity the auditors can use as a basis equity, net income or turnover. These elements are known as the baseline, against which materiality is determined in absolute or relative values.

The auditor's findings could have an impact:

- on the results of the exercise;
- on the disclosures of the balance sheet and income statement

The net result of the exercise is used as a reference. If its size is not important, this could be changed to another reference base, such as the operating result or the company's self-financing capacity.

Increased attention is also given to the exceptional items that will be grouped together so they would only refer to the current financial year.

Last but not least, the auditor must review the previous results to avoid using an abnormal net result as a basis for materiality.

The findings result from an inaccurate classification of accounts or an unjustified net-off between debtor and creditor balances. If two bank accounts, one in a credit position and the another in a debit position, are compensated, the importance of the compensation is determined by comparing it with the total of the respective positions.

The elements specific to materiality are as follows:

1) The needs of the users of the annual accounts;
2) The characteristics of the company;
3) The characteristics of the elements considered significant.

The annual accounts of an entity are providing information to different categories of users: shareholders, associates, staff, creditors, tax authorities, unions, clients, statisticians, economists, financial analysts, etc. Therefore, the auditor will set up materiality considering the needs of different users.

Risk assessment is an important phase in carrying out the internal audit missions. As such, in order to complete this phase correctly and effective, it is necessary to involve experienced internal auditors, who know well the audited entity and the methodology around risk assessment.

If the auditor is aware of errors identified in previous years audits, he will consider these when setting up materiality levels. If previous experience indicates the possibility of material errors, then a different audit approach might be required.

The auditors calculate a numerically expressed size, known as "precision" which is also used in calculating the size of each selected sample. This is determined by applying a percentage between 80% and 90% on the difference between the materiality level and the estimated value of the error.

If the auditor has suspicions or discovers errors or irregularities, he needs to quantify the extent of the error or irregularity identified.

The auditors do not set the precision level as the difference between materiality and the estimated error as it would lead to an insufficient sample size. This is because the auditor may have underestimated the error, and the formula is only valid when there are no errors in the sample.

Any error found leads to an increase in the sample size required to achieve the planned procedures.

The revision of the audit plan is the responsibility of the partner, who must ensure that it contains sufficient activities designed to achieve the audit objectives. Therefore, he must verify that the plan is in accordance with applicable policies and standards, including whether the professional scepticism used by the auditors is justified in the working papers. For example, the partner will analyse how the level of materiality was determined and alsohow the risk assessment was carried out. He will also check whether the planned analytical procedures are the most appropriate.If he is satisfied with the content of the plan presented by the audit team, he will then approveit. Otherwise, he will discuss with the auditors to make the necessary adjustments.

If changes to the general audit plan and the audit program happen, then the first change appears in the general audit plan and audit program which is reviewed during the course of the audit. The audit approach is continuously reviewed during the engagement to respond to changing conditions or unexpected results of audit procedures performed. The reasons for significant changes must also be documented.

We can conclude that the internal audit function has become a managerial assistance function whereby internal auditors help managers, at any level, to master the other functions within an entity and all accounting activities.

The general objective of a financial audit is to provide assurance that the financial statements examined presents a fair view of the economic operations of the entity and are prepared in accordance with the relevant laws and regulations.

Providing an absolute assurance over the financial statements, even if it is possible to achieve, requires a costly activity. However, to reduce these costs, there is the possibility of performing audits based on tests. In this context, the auditors, through their reports, seek to provide a reasonable assurance - not an absolute assurance - that the financial statements examined are complete and prepared in accordance with the relevant laws and regulations.

The auditors are not responsible for the prevention and detection of corruption, fraud and errors, even though the annual audits can prevent mistakes and possible negligence. The responsibility for the prevention and detection of corruption, fraud and errors, as well as for taking appropriate measures, rests with the management of the audited public entities.

However, even under these conditions, the auditors must be alert when they find weaknesses in the internal control environment, inconsistencies or errors in the financial accounting records, unusual results or conditions, which indicates the existence of fraud, lack of probity or corruption.

Conclusion

The conclusions to be drawn are the following:

The auditor should review and evaluate the conclusions drawn from the audit evidence obtained as a basis for expressing an opinion on the financial statements. This review and evaluation involve taking into account the fact that the financial statements have been prepared in accordance with an accepted general financial reporting framework, which could be the International Accounting Standards, or relevant national standards and practices.

In practice it was found that the implementation and improvement of the effectiveness of the relevant departments' records are not consistent. Thus, a permanent control over the link of the accounting records of the receipts was ensured in the context of the existence of a clear situation of the locations where the activity is supported.

In conclusion, the auditor appreciated that, based on the verifications made, the communication carried out with management and the information contained in the self-evaluation report are slightly erroneous, due to the lack of clear records of the activities supported.

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