

THE IMPORTANCE OF INTERNAL AUDIT IN OPTIMIZING MANAGEMENT PROCESSES

Adelina DUMITRESCU – PECULEA, Lecturer, Ph.D.
National University of Political Studies and Public Administration
dumitrescu.peculea@snsa.ro

George CALOTA, Lecturer, Ph.D.
“Athenaeum” University of Bucharest
gcalota2003@yahoo.com

Abstract

Future development directions are a continuation of that which already exists, are driven by the wish of continuous improvement and are influenced by the realities of the moment. This is why, nowadays, not only questions regarding the quality and productivity of the governing act, but also of government receptivity concerning society's problems are raised (Denhardt and Denhardt, 2009: 4-5). Although real progress in public administration reform has been measured, in order to find new solutions to its problems and challenges, we consider that an integrated process approach throughout should be regarded as a key part of this system.

Reducing the issue to organization level, this integrated approach questions should be seen as a starting point for the identification of necessary instruments for management modernization and efficiency growth. Thus implementing modern management processes and integrating audit and internal control activities into organizations should provide better images of the internal processes within organizations of the public sector, and provide better information to management decisions altogether.

Governance models for public institutions establish relationships between these components, building a working information system meant to ensure the reaching of organizational objectives and financial and process efficiency.

Keywords: *Internal Audit, Management, Internal Control, Governance Process, Public Administration*

JEL Classification: *M4, G3, H7.*

1. Introduction

The growing importance of the public administration in our society implies deep knowledge of its processes in order to guarantee the basis for its rational and efficient organization and function. The still unfinished reform process of the Romanian public administration has two main components, namely, the elimination of cultural and national boundaries as part of the harmonization process with the European public administration on one hand and internal process optimization, as the main instrument of fulfilling its objectives on the other. For the latter component, internal public audit and internal control are instruments of strategic importance. Their strengthened position within public organizations ensures reform acceleration at organizational level and also at the general level of the entire public administration, thus contributing to the above mentioned harmonization process.

Organizational development of public institutions is another aspect which can be improved and optimized with a major contribution by internal auditors. Organizational development¹ reflects the way an organization evolves from the point of view of human resources and internal structure, as an adaptation to its natural growth. For it to be a real support for the internal activities within the organization, it is essential that this development should be a sustainable one (Maniov, 2001: 142-143). In the past years a certain lack of sustainability has been observed in growth and development the Romanian public administration.

2. Audit serving management

The relationship between organs of the public administration, namely public institutions, and internal public audit must be intrinsic, natural and organic, in order to ensure sustainable growth along with the society it serves.

Due to the assisting function that internal audit has, this activity allows the persons in charge of the entities to better manage their activities. Therefore, this notion of assistance and counseling, fundamental characteristic of what we understand by audit serving management, which distinguishes internal audit from any „police (Renard, 2002: 53)” action, is recognized today by most and has a tendency to develop. Seen also as an attribute of leadership, audit represented by the internal auditor must be close to management, as management must allow itself to be aided or, rather, assisted by the internal auditor in order to solve problems of an entirely different nature, namely the ones pertaining to the decisions taken in order to have better control on the activity.

¹ Organizational development is a term whose origins lie in the private sector.

Thus, we can state that assistance and counseling are attributes of audit, while control is an attribute and an obligation of the entities' management. An Anglo-Saxon principle regarding the need of control states that „people do what they must do when they know they will be controlled” (Zecheru and Nastase, 2005: 299), while audit is not a repression instrument, but a function of any institution meant to ensure its functioning according to the standards regulated by laws and rules.

In this sense, audit is a tool of management, which must ensure the functioning of the institution. Audit must not only discover errors in the mechanisms of applying the laws governing the public activities, but also errors in the laws themselves, thus optimizing the entire public system. This optimization is particularly important if we take into consideration the fact that the public system works with public funds originating from the taxes and fees collected.

Starting from this idea, it is crucial that public sector investments are made according to the Principle of the Three “E” (economy, efficiency, efficacy) (Arens and Loebbecke, 2006: 916). Investment assessments¹ must take into account other aspects than their public utility. The implications on the national economy gain importance in such times. The investment must not only respect this principle, but must ensure that its effects in the economy respect this principle. In case the investments do not succeed, they can be considered a waste of public funds. Hence, the role of audit is to prevent this from happening.

Audit is not, generally, a key function of the economic entities, but rather a complementary one, with the role of supporting management. Audit must give an objective opinion on the events and realities within an entity, usually being connected to aspects pertaining to accounting and controlling (Dumitrescu, 2008: 41-43), focusing on the activity that the entity is performing. Still, in order to reach the objectives proposed during the crisis period, the entity must be prepared for the worst, which means that audit must regulate the activity of the institution during prosperity periods and must foresee what could happen during recession periods. Hence, the role of audit does not consist merely of the retroactive regulation of the public activity, but also of characteristics oriented towards regulating future activities. In this sense, one must consider all types of audit. Hereinafter, we shall indicate how the three types of audit can help to optimize the process of spending public funds. When we are talking about optimization, we are not referring to a Pareto optimum of resource allocation, but to a process optimization (Lipsey and Chrystal, 2002: 373).

¹ We will refer to these investments also under the aspect of public expenditure.

As soon as it is admitted that an internal auditor „counsels”, „assists” and „recommends”, but does **not decide**, his obligation is to represent a means: to do everything in order to help improve the control that each manager exercises over his activities and thus, in order to aid in reaching the objectives of the entity. We underline the above because the internal public audit compartment has advantages that management doesn't, such as:

- It has reference norms which confer upon it the authority to verify;
- It has methods and instruments guaranteeing efficiency (Renard, 2002: 54);
- Has independence of the spirit and autonomy, which allow it to conceive all hypotheses in order to finally formulate the best adequate recommendations;
- It is not distracted in its research and thinking by the constraints and obligations of a permanent activity or by the daily management of a service (Renard, 2002: 54).

Thus, in order to support management, a means is necessary, which to offer it an objective view over the activities within the entity. In order to formulate such an opinion, a long time and a team of specialists with very good training are necessary.

3. The audit and governance system

The key to success of every organization lays with the establishment by the management of a correct set of objectives. This will ensure a direction, a focus point and a hierarchy of the activity. The objectives must cover everything that the organization must accomplish and may include the improvement or even the development of key activities and high performance governing systems.

What for the private sector became a practice that ensures to investors the certainty of obtaining long-term good returns from the investments made, namely corporate governance, may also be applied to the public sector in order to assure society that the administration acts in its interest. The two problematic have a common background: the assurance that the organization management is high-performance and it makes all efforts within the limits imposed by law, ethics and the good practices¹, which can be certified through the efforts submitted by the internal audit.

In essence, internal audit may play two roles (Ghita and Spranceana, 2006: 106-107). The first role manifests in the initial stages of introducing a

¹Even though there is the shareholders' tendency to impose to management the pushing of these constraints, this proves, on long-term, to be damaging to the organization, because the market does not tolerate unethical, illicit actions or actions outside good practices, for unlimited time.

solid governance system, when internal audit has the great opportunity to counsel and advise management with respect to the advantages of introducing good practices and of supporting their effects on the introduction of policies, mechanisms and procedures. The second role internal audit plays when auditing the governance system on the basis of which it supplies and assurance regarding its conformity and efficiency and makes recommendations whenever improvements in the manner of applying or functioning of this system will be required. This aspect will bring value to the organization.

3.1. *From transaction processing to the management process*

The concept of corporate governance is defined as being: „entirety of principles, rules and norms through which is ensured the administration and management by the managers of the enterprises, in the interest of the current and potential investors of the respective entities” (Feleaga, 2004). In the business practice, two directions of corporate governance were created, the Anglo-Saxon and the European ones, which have as basis the continuous fight between the shareholders and the other groups of influence on the corporation (stakeholders). Jean Tirole speaks, in this sense, of shareholder value versus stakeholder¹ value (Tirole, 2001: 1-36). The governance model is dictated by that part which has more influence in the current business practices. The entity’s governance is considered, fundamentally, a problem of socio-political nature, for the understanding and interpretation of which we must resort to knowledge of company law, history of national economy, sociology of organizations, enterprise finance, financial markets and portfolio management, accounting and audit.

Also, OECD states, regarding enterprise governance, that it „represents the system through which the enterprises are guided and controlled”. Thus, the structure of the enterprise’s governance regulates the distribution of rights and responsibilities between the different categories of participants in society, such as the board of directors, the managers, the shareholders and other stakeholders, explaining in detail the decision-making regulations and procedures.

¹The stakeholder-type model is present in most European countries, except certain states in the north of the continent and Great Britain. For this model, the objective to be reached is less the maximization of the shareholders’ wealth and more the **protection of the interest of the entirety of parties involved**, one way or another, in the life of the enterprise: employees, trade partners, shareholders, managers.

3.2. Transaction processes at the level of organizations

The processes occurring within organizations are very complex, many times taking the form of continuous cycles, whose purpose is the continuous improvement of their performances. From the point of view of their object, we distinguish between the following cycles:

- *Decisional cycles* on the basis of the information offered mainly by the financial – accounting and internal audit department; analyses and scenarios are executed, in order to determine, define and implement the best action modalities in view of ensuring a constant development pace of the organization;
- *value-creation cycles*, which have as subject external influence factors (customers, suppliers etc.) and which, through the internal processes (production of goods and services) that take place within the organization, ensure short- and medium-term sustainability of the entity’s development (Renard, 2002: 22)¹;
- *financial cycles* constituted of incomes and expenses through which the short-term activity of the organization is ensured.

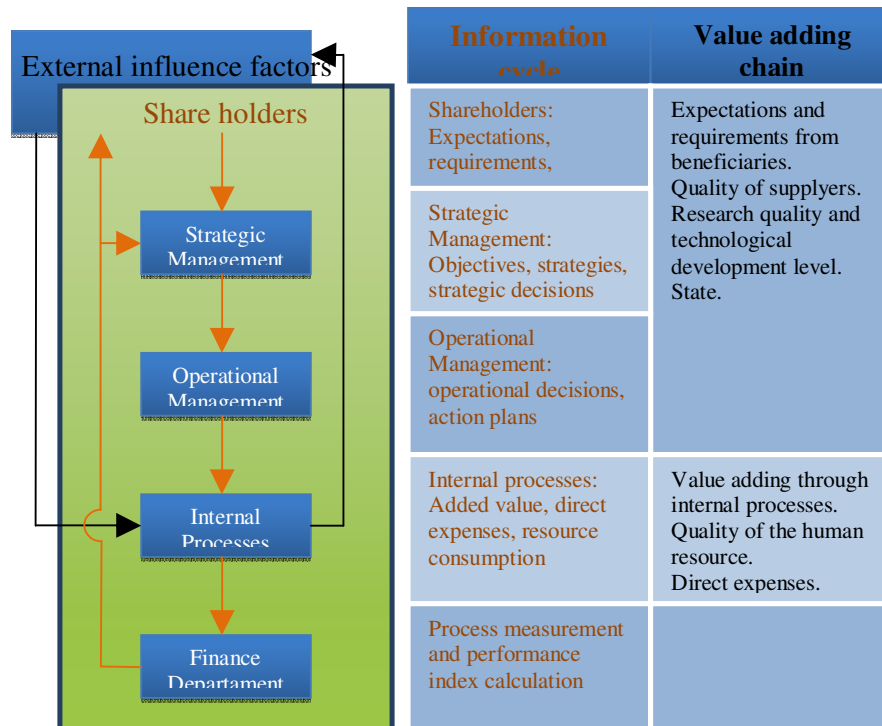


Figure 1. – Decision cycles and value creation cycles within organizations (Source: Dumitrescu, 2012: 41)

¹Internal public audit brings plus-value to the entity.

In figure 1 are represented the decisional and value-creating cycles. Both cycles have as starting point the demands and expectations of the factors of influence (for the decisional cycle – the shareholders, who bear the entire financial risk of the organization and for the value-creating one - the beneficiaries and the suppliers). Within the decisional cycle, strategic management establishes the objectives and strategies for the fulfillment of the shareholder's expectations and demands and transmits them to the organization's operational levels. On this basis are elaborated, by the operational management, action plans destined for the managing and optimization of the internal processes, in view of adding a value as high as possible with costs as low as possible, in order to finally satisfy the shareholders' expectations and demands and of the external influence factors. The results of this process are measured periodically and analyzed by the entity's financial accounting department, in view of comparing them with the objectives set and of presenting these results to the shareholders.

In what concerns the value-creating cycle, it is decisively influenced by the following factors:

- quality of suppliers;
- quality of researches and the level of technological development;
- quality of the internal audit ¹;
- the state (legislative framework, taxation level, bureaucracy level).

Also, the internal processes are influenced by the quality of the staff involved. By optimizing the internal processes, depending on the above-listed factors, a high degree of beneficiaries' satisfaction is obtained, together with the undertaking of social responsibility. Through the slight transformation of the above figure, we can obtain a rather simple model for the financial cycles occurring within an organization. Analog with the above-mentioned, we can say that through the continuous and constant optimization of the internal processes, an increasingly higher difference is obtained between the organization's incomes and expenses, within a certain time-frame. This is presented in figure 2.

The cycle of an entity's incomes is relatively simple because on the basis of the orders issued by the beneficiaries, goods and services are produced and delivered, for which the organization later receives the equivalent value. Between the volumes of orders, the price paid for the delivered goods and services and the beneficiary's satisfaction degree there is a direct, non-linear connection and, at the same time, an inexplicable one, from the economic point of view, with the aid of the phenomena governing the demand and supply of goods and services on the market.

¹See previous footnote.

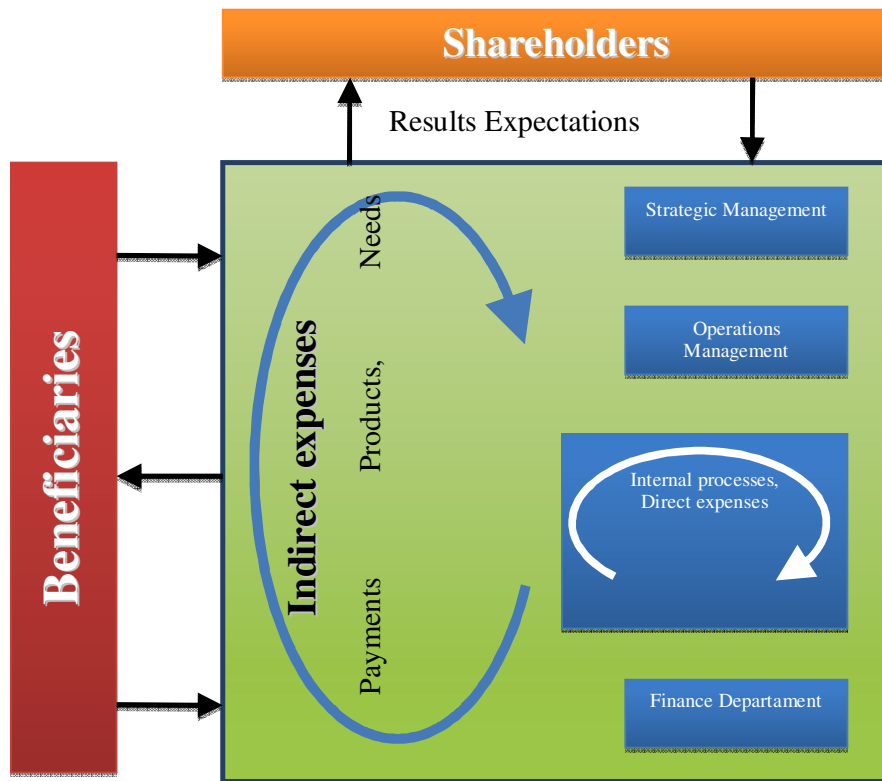


Figure 2. – Financial cycles of organizations
(Source: Dumitrescu, 2012: 42)

Unfortunately, the expense cycle is much more complicated than the income cycle and it depends, to the point of determination, on the organization's internal structure. However, what can be said is that the optimization of the internal processes and, implicitly, the reduction of the direct expenses in an organization are much easier than the attempt to reduce the indirect expenses (Dragan, 1980: 33).

Due to the optimization of the internal processes and to the implicit increase of the difference between the incomes and expenses, the shareholders' satisfaction degree also increases, together with their demands and expectations with respect to the organization. Between the three cycles shortly described above there is, hence, a functional, strong and stable connection, which leads to the sustainable development of the organization. The quality of the relations between management, shareholders and the other external factors of influence, which we generally call governance, is, therefore, determinant for the organization's market success.

4. Conclusions

The role that internal public audit must play for the sustainability of internal processes in the public administration is obvious. In this regard, it has the duty to support public management and the associated decision making processes and the establishment of a balance between above factors mentioned in this paper.

Internal audit is a collection of activities and actions undertaken by specialized structures at the level of public organizations, whose object is the measurement and improvement of quality and performance levels of the management, and the good administration of public funds and public patrimony. The goal of internal public audit is to performance improvement at the level of public organization; its conclusions must give to the management sufficient information for the accomplishment of this goal. The main followed aspect is efficiency, regarded as the quota of process inputs to process outputs. Lack of efficiency can be traced back to either

- lack of internal procedures,
- unclear internal procedures,
- unclear, missing or overlapping responsibilities,
- misleading or misinterpreted information, and so on.

Internal public audit plays an essential role in the relationship of the institution with both shareholders and stakeholders, because it is the only one capable to guarantee that the organization functions according to the constraints of efficiency, effectiveness and economy. Through different types of audit, the information needs of these two interest groups (shareholders and stakeholders) can be satisfied regarding good management and good governance, thus avoiding conflicts between the organization and its different influence circles.

References

1. **Anheier H. K.** (ed.), (2013), *Governance Challenges and Innovations. Financial and Fiscal Governnace*, Oxford University Press, United Kingdom.
2. **Arens, A. A.; Loebbecke K. J.** (2006), *Audit. O abordare integrată*, Ediția a 8-a, revizuită și adăugită, Editura ARC, București.
3. **Calota, G.** (2011), *Activitatea financiar – contabila, obiect al auditului intern in transportul rutier*, Editura Sitech, Craiova.
4. **Denhardt, R. B.; Denhardt, J. V.** (2009), *Public Administration: An Action Orientation*, Editia a VI-a, Thomson W. Wadsworth Publishing, Belmont, USA, pp. 4-5.
5. **Dragan, C.M.** (1980), *Calculatia costurilor*, Editura Academiei R.S.R., Bucuresti.

6. **Dumitrescu, A.** (2012), *Audit si contabilitate: baze ale performantei in administratia publica*, Editura Economica, Bucuresti.
7. **Dumitrescu, A.** (2008), “Contabilitate, controlling si audit”, *Tribuna economica*, vol. 19, nr. 15, pp. 41- 43.
8. **Feleaga, N.** (2004), “Despre guvernanta corporativa a intreprinderilor si despre contabilitate”, *Economistul*, nr. 1656(2682) din 7 iulie 2004.
9. **Ghita, M.; Spranceana, M.** (2006), *Auditul intern in sistemul public*, Editura Tribuna Economica, Bucuresti.
10. **Lipsey R. C.; Chrystal K. A.** (2002), *Principiile economiei*, Editura Economica, Bucuresti.
11. **Maniov, V.** (2001), *Bazele managementului dezvoltarii durabile*, Editura Presa Universitară Romană, Timisoara.
12. **Renard, J.** (2002), *Teoria si practica auditului intern*, Ministerul Finantelor Publice, PHARE, Bucuresti.
13. **Tirole, J.** (2001), „Corporate Governance”, *Revista Econometrics*, vol. 69, nr. 1 (ianuarie 2001), pp. 1-36. www.jstore.com.
14. **Zecheru, V.; Nastase, M.** (2005), *Managementul, “obiect” de audit intern*, Editura Economica, Bucuresti.