

**EMPIRICAL RESEARCH ON THE INTERNAL AUDIT. PERSPECTIVE OF THE PROFESSIONALS  
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florina.mihalcea07@yahoo.com***Abstract**

*This research takes into consideration the existence of the principal-agent type relationships within the banking system, as well as the portfolio of risks related to it. Therefore, the internal audit intercedes between the stakeholders and the management of the credit entities, becoming a component of the corporate governance mechanism. In this respect the internal audit must assure the stakeholders of the achievement of the credit institution's objectives, the effectiveness of the internal control system, the risk and corporate governance management. Two directions are approached within this research. The first research direction considers the review of the professional literature at national and international levels. The second one has as research objectives the analysis of the opinion of the professionals working into a credit entity in Romania in terms of internal audit. By this endeavor, the current research identifies the real aspects regarding the internal audit at banking system level.*

**Key words:** *internal audit, credit institution, professionals, interview, Romania*

**JEL Classification:** M42, G34, G20

**I. INTRODUCTION**

The premises of the research are represented by the major role of the banking system at the economy level, the portfolio of risks to which the credit entities are exposed, the economic-financial trend at international level, the international feature of transactions, the manner of financing, the complexity and diversity of the product and service offer, the intensive use of the advanced informatics technologies and of the internet service, as well as the high degree of vulnerability. These are completed by the following characteristics of the current banking system in Romania: decrease of the number of operative units of the credit entities, decrease of the employee number and their low training in the banking system, limitation of the professional training, existing competition on the banking market and increase of cases of fraud. In this context, the credit institutions must possess a sound system of risk management, control and corporate governance in order to answer the challenges of the dynamics of the economic-financial environment in terms of cost, performance and sustainability. Thus, in the equation internal control – risk management – corporate governance, the internal audit is included, and the internal audit is responsible with adding value to the entity through the specific mechanisms. From this perspective, the undertaken research has as objective the investigation of the opinion of professionals who work within a credit institution from Romania in respect of the main coordinates of the internal audit.

The article is built in the following manner: the first section brings forward the literature review on the internal audit in terms banking system, being followed by a section that opens the research methodology. The next section includes the results of the research, and the last part is dedicated to the conclusions, research boundaries and future directions of research.

**II. REVIEW OF THE PROFESSIONAL LITERATURE**

The internal audit function is dated in the inter-war period of the 20<sup>th</sup> century, when in the United States the economy was severely affected by the economic crisis from 1929 (Renard, 2002). Through its feature, the internal audit brings added value to the entity from two points of view: it assesses the internal control system and the risks associated to the entity's activities but, at the same time, it disseminates recommendations to obtain a high degree of achievement of the organization's objectives (Ghiță, 2004). Internal audit considers all the fields of activity, from the private sector to the public one, most of the entities having set the activity of internal audit.

The national and international professional literature has limited approaches on the internal audit within the banking system, taking into consideration the strict regulation and keeping confidentiality of the information within this sector.

Greuning and Bratanovic (2003) argue that the internal audit is an instrument assuring the board and managementship of the application of the established policies and risk management.

Taking as premise the limitation of the agency theory in respect of the perception and conduct of the members of the internal audit committee within the banking system, Lobre (2015) proposes a grille to analyse the committee's declarations which leads to the improvement of being acquainted with their role in governing the entity. By analyzing the hybrid French banking groups, Lobre-Lebraty(2014) emphasized the fact that the occurrence of the audit committee improved the control capacity of the managers.

Spinossou (2016) approaches audit in terms of limiting the regulations and the stability of the banking system. Through the proposed model, the author considers that the capital rate weighted to risk diminishes the banking instability without modifying the credit offer whereas the lever rate reduces the credit offer without the need of improving the banking instability. The banking stability is improved through the lever rate only when the regulations are limited in respect of audit and banking sanctions.

The main responsibilities of the internal audit within the banking system are the following: it offers assurance in respect of corporate governance, internal control systems and process of risk management; it assesses the rightfulness of the measures of risk management interconnected with risk exposures; it assures efficient measures of managerial control upon functions, limits and undertaken actions when the limits are overpassed; it tests all aspects of functions and risk activities; it assesses the operations and gives recommendations to improve them; it makes sure that managers fully understand the set policies and proceedings and they have the necessary experience to implement them; it adds plus value to the entity (Țurlea and Ștefănescu, 2008).

In terms of the roles borne by the internal audit within the banking system, Greuning and Bratanovic (2003) identified the following issues: keeping the business safety, risk management, checking the rightfulness and credibility of the accounting and financial administration software, promotion of the operational efficiency and support for adhesion to the management policies. Also, the external audit assessment as well as the assurance that the management undertakes measures to eliminate the distortions identified into the audit report are both circumscribed to the internal audit.

Through the studies performed within the African Francophone countries, Causse and Ebondo Wa Mandzila (2014) pointed out the fact that in the audit field the extent of regulation and control of the profession was different, as well as the relationship between the audit development and quality and the level of the country economic and cultural development.

By analyzing the methods of measuring the value of the internal audit function, Zinca (Voiculescu) (2016) notices the fact that there are predominant the quantitative elements, less the qualitative ones, pleading at the same time for the use of procedures which, completing the existing ones, offer more value added to the internal audit function.

Mahdi, Arash & Fatemeh (2013) analyze the importance of the internal audit function through the perspective of its influence upon the performance of banks within the private sector from Iran. The research conclusions point out a certain degree of subjectivity in exercising the internal audit function and, in this respect, the authors plead for the recognition of the importance of the internal audit by the banking entity's management so that it could fulfill the borne efficiency and responsibility objectives.

Apart from the professional literature, the profession of internal auditor is regulated and recognized world wide through the voice of the Institute of Internal Auditors – The IIA. Since 1941, the IIA promotes, leads and offers advice and training to a community that, at present, has over 180,000 members all over the world. The importance granted by the IIA to the financial-banking system is explicit through the agency of the existence of a special certification the auditors can obtain in this field, respectively Certified Financial Services Auditor.

Within the banking system in Romania the internal audit took shape in 2003 as a result of a regulation issued by the National Bank of Romania stating the compulsory inclusion of the internal audit function within the organizational structure of the credit institutions. Both the monitoring authority and the bank management are interested in the efficient and permanent assessment of the internal audit of the banking organization but, nevertheless, in respect of the proceedings and objectives pusued for the internal audit function, these are particular for each banking entity (Zinca (Voiculescu), 2016).

At present, the internal audit coordinates within the banking system are not explicitly regulated by an internal audit law issued by the National Bank of Romania, but they are set by regulations regarding the prudential requirements specific to the system. These are completed by internal proceedings issued by each credit entity. We mention the fact that the approach related to the internal audit is substantiated on the regulations issued by the Chamber of the Financial Auditors in Romania (CAFR).

The current regulations regarding the internal audit function within the credit entities (Statute no. 5/2013 with further modifications and completions) present following coordinates of this function (Table 1):

**Table 1**

*Coordinates regulating the internal audit function within the credit entities in Romania*

Criteria	Description
➤ Organization	<ul style="list-style-type: none"> <li>• According to the regulations issued by the Chamber of the Financial Auditors in Romania.</li> <li>• Management’s stimulation for the internal audit personnel to line up to the national and international professional standards</li> </ul>
➤ Independence	<ul style="list-style-type: none"> <li>• The internal audit function should not be combined with no other function.</li> <li>• It could not be involved directly in conceiving or selecting the models or other instruments of risk management.</li> </ul>
➤ Activity	<ul style="list-style-type: none"> <li>• It is performed according to an audit plan and detailed audit programmes in terms of an approach based on risk.</li> <li>• The audit plan must be approved by the audit committee.</li> <li>• Unlimited access to documents and information related to all operational and control units.</li> </ul>
➤ Responsibility	<ul style="list-style-type: none"> <li>• To assess whether the quality level of the framework related to the internal audit is both effective and efficient.</li> <li>• To assess the compliance of all operational activities and units of the credit institutions (including risk management and compliance function) with the policies and proceedings of the credit entity.</li> <li>• To assess whether the existing policies and proceedings stay appropriate and compliant with the requirements of the legal and regulating framework.</li> <li>• To check the integrity of the process assuring the credibility of the methods and techniques, hypotheses and information sources of the credit entity used within its internal models.</li> <li>• To assess also the quality and manner of using qualitative instruments to identify and assess risks.</li> </ul>
➤ Reports	<ul style="list-style-type: none"> <li>• The findings and proposals of the internal audit in terms of significantly improving the internal controls are reported directly to the managing body and the audit committee.</li> <li>• All recommendations given by the internal audit must be subjected to an official follow-up proceeding by the managing boards in order to assure and report their completion.</li> </ul>
➤ Externality	<ul style="list-style-type: none"> <li>• It is detailed in dedicated regulations.</li> <li>• The internal audit activity in co-participation is performed using for the internal audit commitments both the own personnel working within the internal audit function and the external resources.</li> <li>• The running of the internal audit activity based on sub-contracting takes into account the situations when a commitment of internal audit or just a part of it is carried out by an external partner usually for a limited period of time.</li> </ul>

Source : Statute no. 5/2013 with further modifications and completions

The analysis of the coordinates regulating the internal audit function within the credit entities in Romania shows that they are focused on aspects assuring the achievement of its objectives.

### III. THE RESEARCH METHODOLOGY

To achieve the research objective, that of investigating the professionals’ opinion within the banking system in terms of the internal audit, we turned to the qualitative type methodology. In this respect, there were performed interviews with professionals working in various departments of the banking system from Romania. The interviews were conducted in June 2016 in a regional branch of a credit institution. The face-to-face interviews (interview-interviewee) were preset, and each of them lasted between 20 and 30 minutes. There were interviewed three professionals of different positions within the branch, respectively : R1 – credit officer, R2 – chief of the department of Human Resources, R3 – internal auditor. The interviews are half-structured and include nine questions.

The option to interview employees working in different departments took into consideration the following aspects: lending is the main activity generating profit, but also credit lending; human resources generate operational risks; internal audit has the role of assessing and improving the internal control, risk management and governance systems for the achievement of the institution's objectives; approach of management – banking risks – internal audit.

#### IV. THE RESULTS OF THE RESEARCH

The results of the interviews with the professionals working within the three departments of the regional branch of the credit entity are the following:

**Question 1: What is the frequency of the communication with the internal auditor of the institution in respect of the difficulties you encounter? What are these difficulties?**

R1 considers that within the banks the communication with the internal auditors is carried out by e-mail, whenever they get into a unit and find deficiencies. These deficiencies are communicated to the others, too in order to avoid future irregularities. For R2, the communications with the internal auditor are performed only during the audit missions they perform at branches' level. R3 communicates whenever necessarily.

In respect of the difficulties encountered by the respondents, the answers converge towards the breach of internal proceedings. R1 considers that at the level of the banking system there should not exist difficulties due to the fact that there are proceedings for all the activities carried out. Yet, the difficulties occur when these proceedings are not met or there are various omissions. For R2, the difficulties regard certain working manners included into the internal proceedings, which either lade the interaction with the client or they are not properly understood. R3 states that the difficulties are of technical, informatics and human nature.

**Question 2: What is the role of the internal auditor within your institution?**

The role of the internal auditor is that of controlling and repairing the prospect irregularities, and finding the fraud (R1). R2 argues that the internal auditor verifies the compliance with the internal regulations and assesses the manner in which they cover the generated risks, in respect of each monitored activity. Also, the internal auditor analyses and observes the performance of all economic activities carried out within the entity (R3).

**Question 3: Do you know what are the internal auditor's recommendations? What is the manner you have been informed by?**

The internal auditor's recommendations are to comply with the internal proceedings in force and to be acquainted with their modifications; they are received by e-mail, and rarely at the regional meetings (R1). In R2's view, the recommendations regard certain manners of interpreting the internal regulations and they are communicated following the internal audit missions carried out within the branches. For R3, the recommendations take into consideration the compliance with and right application of the proceedings in force in order to perform correctly all the activities carried out within the credit entity.

**Question 4: What are the main types of fraud which have been identified within your institution?**

The main fraud types identified within the department where R1 works are the currency ones (when currency is exchanged), respectively the signing of documents by the bank personnel instead of the clients. R2 states that fraud occurs within the crediting activity, the operational activity, such as in terms of cards, and internet banking services. R3 has been recently hired within this department and could not answer this question.

**Question 5: Do you know what fraud was identified during former period within your institution? If the case, could you give us more details?**

The fraud presented by R1 consists in: signing of documents by the bank employees (documents regarding the account opening, account closure, deposits, cash transfers), performing exchange operations at a different course than the displayed one, getting the money remainder by the cashier and bank impairment. R2 argues that during former period there was identified fraud in the credit activity, operational activity, such as in terms of cards, and internet banking services. R3 does not possess such information.

**Question 6: Which are the actual enterprises by which fraud is fought within your institution?**

R1 fights fraud by correctness, permanent information in respect of the current modifications of proceedings. The management processes the new regulations whenever there are significant modifications, controls of periodical documents, on-the-spot controls of cash operations and cash. The steps taken by R2 in respect of fighting fraud are the following: additional regulation of those activity segments for which fraud was found so that it should not occur; increase of the monitoring of those activities; changing the local management when, following an internal investigation, it is given proof of their involvement/non-compliance with the regulations in such fraud. R3 pleads for standard proceedings applied by all departments, settlement of problems at central level, not at local level, more transparency.

**Question 7: What information did the auditor request you in order to perform its activity?**

The internal auditor requested R1 documents with and without cash for the control of cash from the cashier's office and also from the unit's treasury. Also, the internal auditor takes an inventory of the electronic

devices of authentication in the applications of internet banking, verifies the manner of delivering the customers' renewed or new cards, verifies the video system of the unit in order to identify whether there were performed operations without the customer's presence in the bank. R2 was asked documents related to the performed operations (credits, cards, electronic services, etc). In respect of the R3, he was requested documents related to the daily activity.

**Question 8: Do you consider that any type of control carried out within your institution will contribute to the improvement of the activity you perform?**

All respondents consider that any type of control will contribute to the activity improvement. These controls contribute to the security and sustainability of the institution, meaning the regulation environment where the operations are carried out.

**Question 9: How would you appreciate the risk of fraud pursuant to the internal audit missions?**

Considering the reports received pursuant to the internal audit missions, R1 appreciates that the risk of fraud is low, but not absent. R2 states that the missions carried out by the internal audit contribute to the decrease of fraud risk at the organization level and to the improvement of regulation on certain activity segments. R3 appreciates that pursuant to the audit missions, the risk of fraud is much lower.

## V. CONCLUSIONS

The research carried out emphasises the fact that the internal audit effects its role and contributes to the decrease of risk of fraud within the credit entities, adding plus value through the agency of the performed recommendations.

The results of the interviews carried out show a very good communication between the employees of the departments and the internal auditors. In terms of the deficiencies encountered, the respondents appreciate that they are generated by the application of the proceedings of the credit entity.

The role of the internal auditor is approached by the respondents in an exhaustive and positive manner, focused on the risk management as it follows: the internal auditor controls and remedies the prospect irregularities, identifies fraud, verifies the correct and complete application of the internal regulations in terms of prevention and cover of the risks, analyzes objectively all the transactions circumscribed to the credit entity.

From the respondents' point of view, the internal auditors' recommendations take into consideration the correct application of the internal proceedings, as well as they are informed in respect of the modifications and upgradation of the proceedings. Thus, there is the assurance that all the employees from the departments of the credit institution know, understand and apply correctly and completely the internal proceedings, fact which corresponds to the principle of prudence on which the functioning of the banking system is founded. The respondents are informed in terms of the internal auditors recommendations by e-mail or pursuant to the performed missions. We consider that the pertinent, complete and relevant information at the intra-departmental and inter-departmental levels contributes to the prevention of risks specific to the banking system.

Although the credit institutions have a sound regulating framework for the management of the risk of fraud, the sophisticated manner through which the fraud is committed leads to its occurrence. The main types of fraud identified into the departments where the respondents work are the following: currency fraud, signature forgery, fraud with cards/services of internet banking etc. We notice that the fraud committed by the bank employees is against the credit entity both from financial point of view, and from the entity's reputation.

In any credit institution the occurrence of the risk of fraud brings questions related to the system of fraud risk management, emphasizing its prevention. Therefore, it is required the improvement of the internal proceedings for an efficient management of bank risks. Considering the manners applied to the department level in terms of fraud prevention, the respondents enumerated the following: correctness, permanently updated information, additional regulations for the vulnerable activities, increase of the degree of monitoring of activities subject to fraud risk, local management changing in the case when, pursuant to an internal investigation, there is proved its involvement or non-compliance with the regulations, application of standard proceedings within all departments, settlement of deficiencies at central level not at local level, increase of transparency.

Taking into consideration that the internal audit missions involve the activity of all the employees within the branch, respondents were asked the following information: the documents with and without cash, documents related to the daily activities carried out within the department etc.

In terms of the relationship between the fraud risk and internal audit, the respondents consider that pursuant to the performed internal audit missions, the risk of fraud has been reduce significantly but it is not absent. We consider that the presence of fraud risk within the context of the existence of a regulating framework of risk management where their prevention prevails is part of the particularities of the banking system. Also, the respondents appreciate that the internal audit missions contribute also to the regulation improvement on certain segments of activity of the credit entity.

In respect of the activity improvement, the respondents consider that any type of control shall have this contribution. The controls have the role to assess, identify the deficiencies in order to remedy them and prevent

them in the future, contributing to the improvement of the credit entity's activity, the achievement of the performance and sustainability objectives.

In terms of the research limits, we consider that one of them is the low number of respondents. Yet, it is known the fact that within the banking system there is applied the principle of professional confidentiality, which generates reluctance regarding the interview acceptance. To this, there adds the reformation of the banking system from Romania, which has generated the decrease of the number of operative units at regional level, as well as the decrease of their employees.

As future research directions, we propose the continuing of research through the use of other research instruments leading to the collection of a higher number of responses.

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