

Governance process improvement and development by audit consolidation

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Abstract. *The necessity of governance process improvement for reaching strategic objectives represents a condition in the given macroeconomic context for society's development reforms continuation. Starting from the legal framework ruling audit activities and from the role of specialized structures within the Ministry of Finance whose purpose is "the carrying out of audit missions of national interest with multi-sectorial implications", one can easily observe the permanent preoccupation for increasing and improving the quality of audit activities, fact which is also demonstrated and enforced by literature.*

The paper analyses using a holistic approach the audit system and its importance for the management accountability in organizations, especially of public ones. The analysis supports administration process optimization and contributes to the consolidation of (internal) audit activities within organizations.

The used research method is participative observation. This qualitative approach has a major role, by allowing the description and analysis of (internal) audit activities and the consolidation of its importance in the sustainable development of both the economy as well as the public administration by continuous improvement of governance processes.

The results of the research will generate a set of conclusions about the importance of audit activities for the governance processes. Also, some propositions will be made, which help public audit fulfil the requirements of the Public Finance Ministry, and improve the governance and management of public entities.

Keywords: audit consolidation, governance processes, strategy and sustainable development.

JEL Classification: G3, H83, M4.

1. Introduction

The governance structures have as main purpose the management of organization by means of specific processes and the assurance of their sustainable development. Thus, through their relationship with the organization, but also with the environment where it performs its activity, some of them of a hierarchical nature, the governance structures are meant to ensure the conceptual, strategic, formal and operational support, as well as with elements such as vision or organizational culture, which will define the organization and its place in the social and economic environment. This is valid both for the private entities and for those in the public sector.

An especially important place is occupied by audit in these structures, both the internal and the external type. Starting from the legal framework, corroborated with the specialty literature, which define and establish audit as an integral and essential part of the governance structures, offering it the instruments necessary for reaching the objectives (Dumitrescu and Dumitrescu Peculea, 2014: 103), audit acts at all levels of the organizations through missions, in order to be able to bring plus value to the organization, seen as a whole. The early detection of the possible problems, as well as the identification of the improvement possibilities for the activities, thus constituting the main concern of audit (Allegrini et al., 2009: 1-3).

The modernization of audit presupposes the consolidation of its position within the governance structures, as well as its redefining as guaranteeing factor of sustainable development of organizations. Also, it is important to redefine the image of audit, especially in the public sector, into what it represents, namely, a management support activity, an attribute thereof, which, by means of its actions, aids in the organization development, and, therefore, a migration of the employees' perception, from a coercive instrument to a constructive one.

2. The relations of audit with the organization in the context of the governance structures

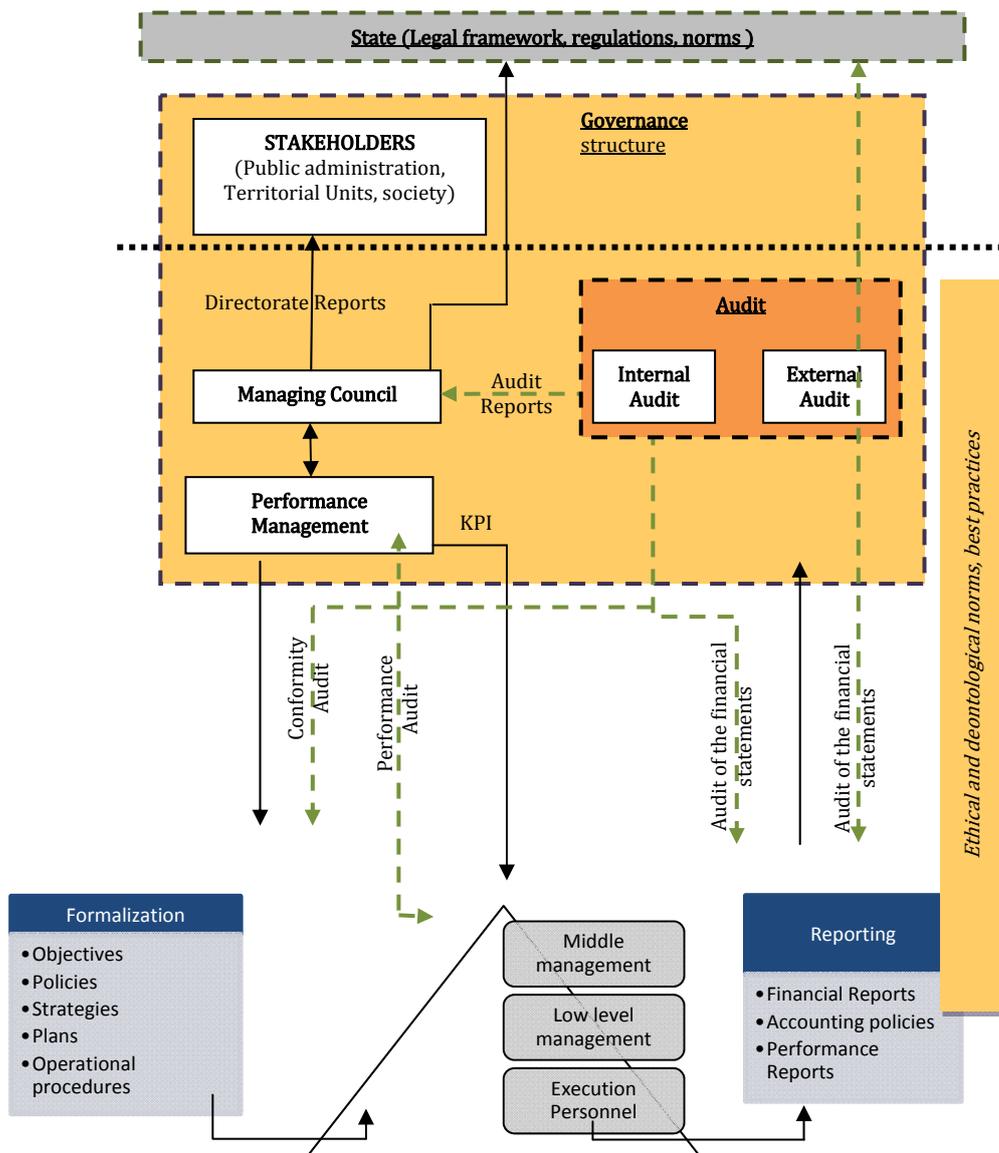
International Audit Standards (ISA) define audit as an independent activity of objective insurance and counseling, meant to add value and improve an organization's operations and processes. Using a systematic and methodical approach, this activity evaluates and improves the efficacy of risk management, control systems and governance processes (ISA; OUG 75/1999; Law 672/2002). Each audit compartment elaborates internal norms regarding the carrying out of audit activities. These norms are being elaborated according to audit standards for private entities, respectively, methodological norms for public institutions, as well as the code for ethical conduit of the internal auditor and best practices in the field.

The modern 21st century organization is complex, with actions and interactions at all levels. In this context, the existence of structures which to manage the development processes, both at the conceptual and at the strategic level is absolutely necessary, such as to ensure the sustainability of the organization's evolution (see also Abdel-Meguid et al., 2013: 283-307). In this sense, the complex structures need well-designed verification and

control organisms, which to benefit of the entire power conferred by the previously mentioned regulations (ISA; OUG 75/1999; Law 672/2002).

In the model presented in Figure 1, the environment is represented in a simplified manner by the state and the good practices in the organization’s field activity. For the purposes of the paper it is enough to restrict the model to these two components.

Figure 1. Functional model of governance within organizations



Source: Based on Ghita (2009).

The evolution in time and the development of any organization creates structures similar to the one in the figure. Of course, depending on the specific of the organization, differences may emerge. Thus, in case of companies in the private field, instead of „Stakeholders” we will have shareholders (see Anand and Moloney, 2004: 223-292). This structure represents a layered model in six layers set over a core, which is reached by adding a new layer over what already exists, as the organization develops and faces new problems and challenges.

In such a structure, the core is always formed of management and internal processes, represented in the lower part of the triangle figure. The first layer is added from the initial stages of the organization’s development, the need to formalize the activities. This is materialized through the formulation of objectives, policies, strategies, plans and operational procedures, which are sent and implemented hierarchically in the entire organization. Together with the formalization of activities emerges the need to report results. We must mention the fact that here we do not refer directly to accounting because there is a legal requirement, according to which accounting must be organized from the first day of existence of the organization, but to the need of management to use the data from accounting (financial reports) in order to determine the degree of achieving the objectives (Vera-Munoz, 2005: 115-127). To the financial reports, as evaluation report for the degree of reaching the objectives, the performance reports are added.

The third layer is represented by the adoption of the ethical standards, of the deontological norms and of the good practices in the organization’s activity field. The deontological and ethical norms are just as important in the public administration and in the private environment, but acts differently. Also, in this stage, the organization begins the process of alignment and certification to the professional standards in the activity field (Fulop and Crisan, 2013: 5-12). The fourth layer is represented by the contracting of the activities of verifying the financial situations by means of the external audit. Until this moment, we could not speak of a governance structure within the organization. Together with the adding of the fourth layer, they start to come into being.

With the introduction of the fifth layer, the one corresponding to the internal audit, the governance structure begins to shape. There are here major differences between the public and the private sector, both with respect to the instruments used and to the fields covered, public internal audit covering a much wider range of activities than the private one, also including performance audit (Fulop and Crisan, 2013: 5-12).

With the institutionalization of internal audit, the governance structure becomes final. At the same time, due to the actions of internal audit, a new concept emerges, that of performance management. We do not refer here to the institutionalization of performance management, because this does not happen in reality, except in case of the very large organizations (in general, multinational companies), but rather to certain sets of measures and actions oriented towards performance maximization within the organization. Among them, is the formulation of key performance indicators – KPI and the establishment of a performance reporting system according to the performance indicators previously set.

By means of its positioning within the organization, audit, both the internal and the external, is an essential component of the governance structure. Internal audit has, especially in the public sector, connections with all organization compartments and has the necessary instruments to reach the objectives. The instruments that internal audit has available are:

- Regularity audit – which focuses on the effects of the actions undertaken within the organization.
- Conformity audit – by means of which is verified if the operations performed in the organization are according to the internal regulations, with the standards and good practices in the field, but also with the legal provisions.
- System audit – by means of which the correct and efficient functioning of the systems within the organization is verified.
- Audit of the financial statements – is the most commonly seen form of audit. It is, in fact, also a form of the conformity audit, but it is treated separately, due to the legal requirements and to the implications on the activity of the organization.
- Performance audit – form of audit which evaluates the efficiency, efficacy and economicity of the activities performed within the organization.

Audit analyzes and evaluates all processes and activities taking place within the organization and formulates observations and proposals with respect to the possible non-conformities and problems that might appear, but also to the possibilities of improving them, which it formulates in the form of reports addressed to management. The independent and objective nature of the audit activity guarantee, together with professionalism, the moral probity and the ethical behavior of the auditor, the pertinence of these observations. Thus, by implementing the recommendations, audit is in a position to generate plus-value for the organization, through the fact that it ensures the conditions for its sustainable development.

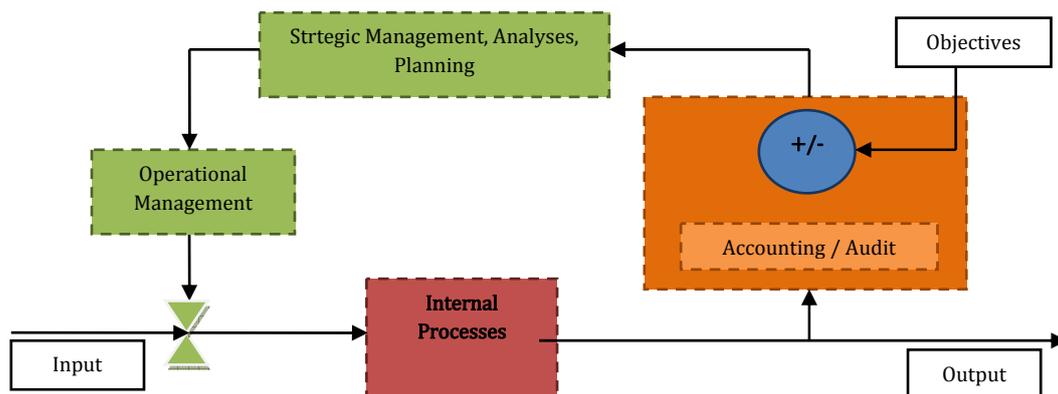
3. Modernization of internal audit and the sustainable development of organizations

The development of organizations can be considered like a train climbing or descending from a hill. The downhill train is helped in accelerating by its weight, due to inertia, while the same weight of the train has a braking effect while going uphill. Analog for organizations, during periods of economic growth, the inertia (the size of the organization) from the development process has an accelerating effect, while during crisis periods the same size of the organization possibly has a braking effect on it. In both cases, of the train and of the organization, it is the responsibility of the crew (for the organization, we refer to the layers forming the governance structure) to be able to use for their advantage the positive effects of this inertia, in order to successfully pass the climbing sectors, respectively the crisis periods.

For those organizations that found a development pace that allows them the flexibility and adaptability adequate to changes in their environment, we speak of sustainable development. This is also the main objective of governance: the management of the organization such as to ensure sustainable development. The structure presented in Figure 1

is a functional one, which presents the relations audit has within the governance structure, but also with the organization, in general, also indicating the instruments it uses and there they are employed. From the process point of view, this structure is equivalent to the much simpler structure presented in Figure 2.

Figure 2. *Organizational process control*



Source: Based on Dumitrescu, A. (2012).

Figure 2 presents an adjustment circuit with a feedback loop between the output and the input in the organization. Thus, in the process relationship, audit is on the reversed reaction loop, together with management (both strategic and operational). The financial and audit reports are used by strategic management for analysis and planning, as well as for adjusting the objectives (Magrane and Malthus, 2010: 427-443). Therefore, audit has the duty to make a statement on the sustainability of the evolution process of the organization, thus ensuring both optimum performance and long term development, regardless of the economical context.

Audit modernization is, in these conditions, a process whose main objective must be the consolidation of the position within the organization and the development of the specific instruments. The specific objectives of the audit modernization process comprise:

- Increasing the efficiency of the audit work.
- Assurance of access to professional staff of the highest quality.
- Exploitation of the opportunities offered by information technology and communications.
- Increasing the responsibility of employees in audit.
- Consolidation of the independence of the internal public audit activity within the organization, this activity can provide a pro-active value added service (Davies, 2009: 41-73; see also Davies, 2001: 77-96).

By reaching these objectives, the modernization of the audit activities and work is achieved, as well as an adequate support for management, for grounding decisions and long term development strategies of organizations. Thus, audit finds its utility not only in

the current verification actions is performed, but also in what concerns the governance of organizations, increasing their value (Allegrini et al., 2009: 1-3).

4. Conclusions

Considering the favorable context which Romania's economy seems to have achieved, organizations, both those in the private sector and those belonging to the public sector, will be able to take advantage of varied development opportunities. Still, the lessons learned following the financial crisis that has just passed, urge us to be cautious in elaborating development strategies. In this sense, the role of audit, especially of internal audit, is to guarantee the sustainability of the development process and to ensure the necessary support for management in grounding decisions and in maximizing the organizations' performance.

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