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THE IMPORTANCE OF RISK MANAGEMENT WITHIN THE INTERNAL AUDIT ACTIVITY

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ABSTRACT: Today entities must pay particular importance to the risks they face, risks that influence the activities carried out. This requires the functioning of some internal audit departments which have as aim the planning and conducting of audits. Internal audit through the activities it carries out covers both the internal control system evaluation and the risk analysis in order to achieve the intended objectives. The risk analysis is an important step in the audit process which aims to identify, assess and manage risks in order to administer them to remove unwanted effects. Under these conditions, internal audit focuses ever more on risks, on how to implement risk management to lead to the entity's increased performance.

Keywords: internal audit, risk, objectives, performance, management

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Introduction

The business environment has experienced a rapid and revolutionary change with consequences that reach organizations around the world. In the last half century due to the growth of trade and investment flows we are increasingly talking about globalization.

When the market economy becomes increasingly complex and globalized, the reliability of accounting and financial information acquires critical importance in the correct perception and dominion of the economic flows by companies, shareholders, directors, employees and creditors.

Management responses to global competition have included the improvement of quality and the initiatives of risk management, the reorganization of structures and processes, as welll as greater

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accountability. But all these need more time, trust and relevant information for the decision-making process.

In such a climate, there is no surprise that the internal audit function is seen as the most comprehensive of functions that helps the good governance and supports the managerial processes, such as: monitoring of controls; evaluating the effectiveness of strategies; identification, assessment and reactions to risks of the business.

The importance of risk management within the internal audit activity

The audit activity in Romania is relatively recent and it is part of the reform process of public sector organizations management, with a view to improve the performance of the entities' activity, to increase effectiveness and efficiency in using allotted resources.

Internal auditing is a profession that has always redefined itself out of the very desire of meeting the ever-increasing needs of entities.

The emergence of internal audit is relatively recent and falls during the economic crisis of 1929 in the United States of America. Affected by the crisis, companies have required a review of all accounts to reduce fees and other costs categories to improve performance. However, many U.S. firms were using the services of the External Audit Cabinets, independent bodies that aimed to certify the financial statements.

To fulfill their duties, the audit offices conduct a series of preparatory activities such as: inventory of assets, inspection of accounts, checking of balances, making various polls. As these activities increased the cost of the audit, companies have decided to carry out the preparatory activities and to achieve the certification they appealed to the Cabinets of External Audit, which were entitled to supervise all activities.

Under these conditions the internal auditors have appeared, members of the audited entity who conducted auditing activities but without preparing summaries or conclusions, recommending solutions to the management to meet the objectives.

So, internal auditing is an independent and objective activity of assurance and consultancy, carried out in order to streamline the organization's operations. It assists an entity in achieving its objectives by implementing a systematic and disciplined approach in evaluating and improving the effectiveness of risk management, of the governance control and processes (Ghiţă and Briciu, 2009).

Internal audit achieves its objectives if there is an internal organized control system, formalized, consisting of procedures, procedural guidelines and codes of conduct.

Internal audit is one of the most important factors influencing corporate governance, thus it has the role of assuring the management of an entity that the risks which occur during the carrying out of the activities are controlled/managed by internal control mechanisms.

Being a basic component of the structure of entities, internal audit aims to better management of material and human resources, as well as better coordination of departments within companies in compliance with observing the corporate governance standards.

The results of the internal auditing activity materializes in reports and other documents, based on legal provisions related to the internal activity, the orders and decisions of the management, and the reports and other documents are presented only to the entity's management, with the required measures and with the obligation to monitor the way in which the the recommendations are fulfilled within the entity.

In today's world conditions we should pay increased attention to risk management as it aims to define, identify and assess emerging risks and to provide solutions in terms of their management.

The concept of risk management is relatively new, being discussed in the business environment in the late '90s (Opran, Paraipan and Stan, 2004). But risk management would not exist without approaching the concept of risk; the word risk comes from the Italian word "riscare" which means "to dare."

Today risk can be defined as:

► "a continuous decision making process monitoring the results of the decisions that will reduce to an acceptable level the impact or uncertainties resulting from the exposures to risk borne by various entities" (Jean-Paul Louisot);

► "a business process that aims to ensure that the organization is protected from risks and their effects, thereby involving their identification, quantification and administration" (Antonio Borghesi);

► "the threat that an event or an action will adversely affect an organization's ability to achieve its objectives and to successfully execute its strategies" (Phil Griffiths).

In Romania, under the legislation in force risk management processes are carried out both in all public sector entities and in the entities from the other sectors.

Organizations are faced with a multitude of risks, positive and negative, internal and external, which can never be fully considered. It is therefore necessary to become aware of risk in the economy of organizations and understanding it in a way as correct as possible in order to manage it.

The implementation of a risk management that takes into consideration the above metioned facts, clearly contributes to increasing the performance.

The role of internal audit in risk management is achieved through the auditing misions aimed at: identifying and assessing risks; ensuring that risks have been assessed in a manner as correct as possible; effective management of key risks; assessing the risk management process; preparing management to respond to risk; improving the entity's decisions; increasing the performance of the audited entity.

The risks that may arise within an entity can be grouped into several categories, as shown in Figure 1.

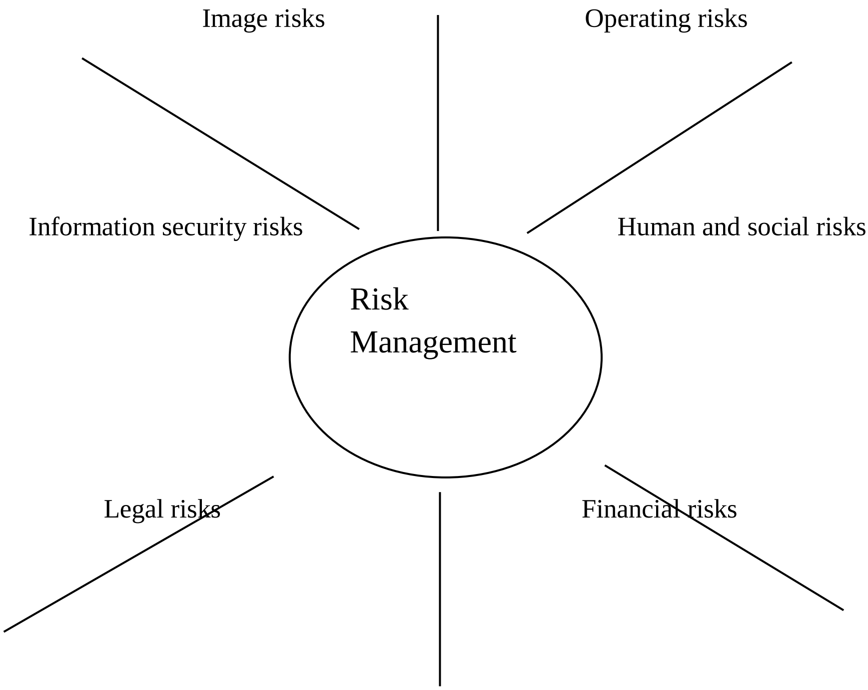

Fig. no. 1 - Risk Management Department

Source: Marcel Ghiţă, Sorin Briciu (coord) – Guvernanţa corporativă şi auditul intern (Corporate governance and internal audit), Editura Aeternitas, Alba Iulia, 2009, p. 239;

Risk management is a process that requires a lot of effort but which is an essential component in the success of the organization, contributing to increasing the value added.

Every manager must think about the issue of risk management, because, otherwise, the activity they perform will suffer.

Risk management involves the completion of certain activities, namely:

- Identifying the risks, an activity which aims at detecting and recording all risks;
- Risk assessment means to identify and analyze the internal and external factors that influence positively or negatively the entity's objectives. This activity being essential for the entity's management, it must be carried out consistently;
- Risk control involves initiating controls and risk response activities;
- Risk analysis and reporting aims to: identify the dangers from the audited entity; preventing, eliminating or minimizing them; evaluating the internal control activity of the audited entity; as well as reporting to the management.

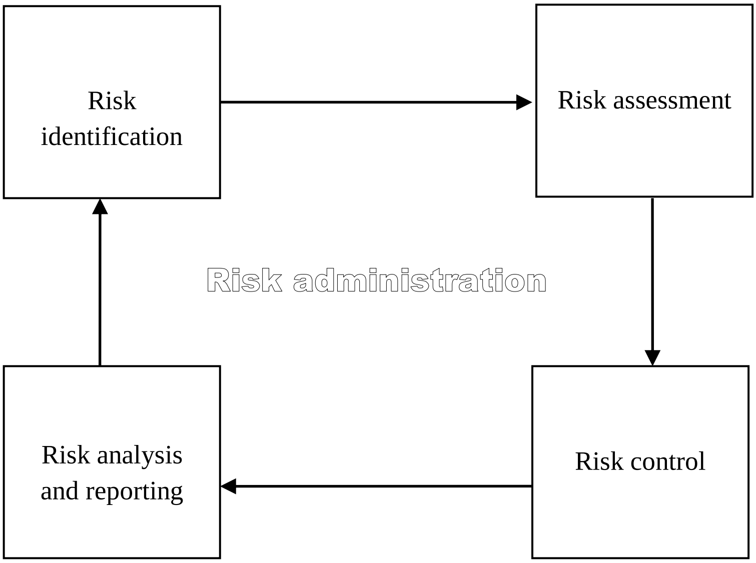

Fig. no. 2 - The risk administration process

Source: Made by the author after the source - Modern Risk Management Strategies for the Romanian State Treasury

Based on the results obtained from the risk analysis, the internal audit activity evaluates the effectiveness of controls concerning the entity's governance, the information operations and systems from the entity.

This evaluation covers the following aspects:

- the reliability and integrity of financial and non-financial information;
- the effectiveness and efficiency of operations;
- the protection of the assets;
- the observance of the law, regulations and contracts.

Carrying out the auditing missions should be based on the risk assessment process that must be done at least once a year and related to which the internal auditor should consider the management's and Council's recommendations.

The evolution of risk management had a significant impact on internal audit and represented a jump with important implications, namely (Ghiţă and Briciu, 2009):

- drawing the attention of the internal auditors from the past to the present and from the present to the future;
- concentrating the internal auditors on the risks of the present and future transactions, eliminating the controls on the accomplished transactions;
- the support given to management, dealing with the current obstacles, on which depends the success of the entity, and thus the information obtained by the auditors is of greater value to management.

The goal of risk management is to help the entity understand the risks to which it is exposed, so that they can be managed so that they do not materialize.

Internal auditors conduct reasonable assessments when they have facts, but it may happen that when they intervene it may be too late because certain events have occurred and the risks have emerged. It is therefore necessary for auditors to act before the risks producing phenomena occur, to intervene where the risk assessment shows them some problems.Thus, internal auditors:

1. determine to what extent the goals and objectives concerning the operations and programs have been defined; whether these goals and objectives are consistent with those of the entity;

2. review the operations and programs to determine to what extent the results match the established goals and objectives and whether these operations and programs are implemented or performed as intended;
3. establish, in order to assess the controls, the extent to which management has established adequate criteria to determine whether objectives were met. If these control assessment criteria are appropriate, the internal auditors use them in the evaluation that make. If they are not adequate, the internal auditors collaborate with the management to develop appropriate criteria for assessing the controls.

For the entity's management it is essential to identify, evaluate and establish the acceptable risk tolerance by implementing some control procedures.

Internal control represents the totality of control activities exercised within the entity, which constitutes into a managerial control system, which is under the coordination of general management and is carried out by the line management (directors, service chiefs, heads of office) and the organization's entire staff (Ghiţă, 2009).

If concerning the definition of the concepts the separation was made between the two terms, currently, there is a problem in understanding the internal control system, being the subject of internal audit, including all the internal control activities carried out within the entity and the risks associated to them.

Definitions of internal control have been made by various institutions (The American Institute of Certified Public Accountants-1978, The Order of Accounting Experts from France-1977, The Accounting Advisory Committee in Great Britain-1978, The Canadian Institute of Authorized Accountants-1995, The White Book of the managerial refom within the services of the European Commission), in summary they refer to all the elements implemented by the people in charge from all levels to have control over the functioning of the organization's activities in relation to the set objectives.

Therefore, internal control is the responsibility of each employee and it is part of the management function structure.

Internal audit cannot be achieved without internal control and there is no internal control without well-established procedures.

Analyzing the risks the entity has to face, the implemented control activities, the internal audit committee will make recommendations for improving the activities carried out and for removing the dangers.

With the help of internal audit strategies are identified, the approach of risks is correlated with the actions taken to identify the best solution and to evaluate the risks in order to optimize them.

The improvement of internal audit should be seen as being complementary to improving management. Nonetheless, management must understand that internal audit is one of its instruments and to respond accordingly.

Conclusions

By analyzing the above-mentioned facts, we see how the importance of internal audit within entities is becoming more important and how risk management is becoming increasingly necessary.

Internal audit, though risk management not only prevents the risks, but also makes an entity to function effectively as a result of a structured and organized approach.

By administering risks, entities will be able to remove the dangers to which the activities conducted are subjected, contributing thus to their smooth running.

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