AGORA International Journal of Administration Sciences,
http://univagora.ro/jour/index.php/aijas
ISSN 2359-800X
No. 1 (2015), pp. 46-55

CONVERGENCES AND DIVERGENCES BETWEEN INTERNAL AND EXTERNAL AUDIT ON INTERNATIONAL CONTEXT

L. N. Nasta
C. T. Ladar

Laura Nicoleta Nasta
Economics II Doctoral School, Bucharest University of Economic Studies,
*Correspondence: Laura Nicoleta Nasta, 20A, Dorului, Corbeanca, Romania
E-mail: *alsenasta@gmail.com*

Călin Tănase Ladar
Faculty of Environment Protection, University of Oradea, Oradea, Romania
*Correspondence: Călin Tănase LADAR, 57, Ady Endre, Oradea, Romania
E-mail: *ladarcalin@yahoo.com*

Abstract:

From a company`s point of view, it activates in a very dynamic climate of affairs, in which there are permanently acquisitions and company fusions, fact that leads to the necessity of knowing extremely well the company`s internal and external business climate. Even in case of the company not participating in business fusions and acquisitions, it is obliged to submit reports regarding its activity, for the owners, for the market or in order to comply with legal requirements. All these considerations are valid also in the public sector, for maximizing its activity value.

Key words: *internal audit, external audit, governance, public sector, company.*

Introduction:

Audit means in general the professional examination of information with the intent of expressing of a responsible and independent opinion, in the report conditions of a quality standard or criteria. First, the significance of the term "audit" equaled financial audit, having the object of verifying financial reports, processes and transactions of an entity.

The types of audit that we find on international level are: financial audit, focused on controlling the financial reports; operational audit focused on evaluating the economical processes of a company; conformity audit analyzing the meeting of internal and external legal requirements; audit of IT systems; and the integrated audit which is centered on the economic activities cycle or part of it.

The audits have diverse influence on the persons in a company which have different expectations from this activity such as: upon the stakeholders; the management of the company who expect from auditor to relieve them from responsibility; upon governing staff who expect the auditors to bring added value to the organization by supplying useful tips; on the company`s creditors, which hope that the auditors will insure them that the organization is capable of paying all debts; and on the employees who need the auditors to ensure them about the security of their jobs and the future of the company.

Through financial audit is understood the examination of an independent, competent and professional accountant of financial statements of a commercial entity (or part of these financial statements), in order to express a motivated opinion over the real image of the financial situation and the performances of the commercial entity.

According to the objectives of the company, the financial audit is classified in internal and external audit.

CONVERGENCES AND DIVERGENCES BETWEEN INTERNAL AND EXTERNAL AUDIT ON INTERNATIONAL CONTEXT

The internal audit has a function that, although operates independent from other departments and reports directly to the audit committee, has its place in the company (internal auditors being employees of the company). The auditor is responsible for realizing the audit (financial or nonfinancial) in a large aria of the economic activity of the company, according to the annual audit plan.

According to the Internal Auditors Institute, the internal audit is defines as "an independent and objective insuring activity, of consultancy, destined to bring added value and to increase the operations of a company. It helps an organization to accomplish its objectives by systematic approach and methods that evaluate and improve the efficiency of risk management processes, control and governance.

The internal audit is preoccupied with the identification of important risks that a commercial activity faces, and with what can be done in order to efficiently eliminate these risks, for the company to achieve its goals. For example, the internal audit can be preoccupied by the reputation of the company when it uses cheap labor force from foreign countries or the strategic risk of producing too many products with the available resources of the company.

The external audit is done with the help of independent and external organizations to the audited company. This audit is oriented towards the financial analyze or the associated risks to the commercial activity and it is addressed mostly to the stakeholders of the company. The main responsibility of the external audit is to realize the annual statutory audit of financial statements, emitting an opinion on correct or incorrect reflecting of the company`s financial position. As part of it, external auditors examine and evaluate the internal audit activity, analyzing risks that could affect the financial statements.

The external audit can come in the form of statutory audit imposed by regulatory actions, or in the form of contractual audit which is realized by a third party, according to a contract.

The role of internal or external audit:

The main role of an internal or external auditor differs according to the main responsibilities of their functions. Despite these differences, there is a common part due to the fundamental objectives such as the aim of obtaining most certain and accurate information which has to be shared between them. An internal auditor makes various check-ups and evaluations, offering to the company`s management extremely important information for the successful progress of the economic activity. This aspect needs a high level of independence and objectivity inside the company, which makes the internal auditors vigilant to the fulfillment of management directives.

The external auditor is responsible for supplying an independent opinion regarding the correctness of the financial statements of the company, even if he is requested to do only additional audit services. These tasks can be accomplished through various means, but the preferred approach is to obtain a reasonable guarantee for the smooth running of internal control activities, rather than through making a high number of background tests over the data supplied.

The types of audit realized upon different objectives can vary even though both types of audit are done with similar procedure. While the time period targeted by the external audit is in fact regarding the financial annual end report, the internal audits perform for longer periods, according to the specific activities of the company (example: Implementation of various systems, fusions, acquisitions, etc.), and having at the same time a different focus on the informational system. Once the time period, the target and the auditors objective are established, they will act through various procedures (example: interviews, detail tests, system interrogations, etc.) in order to realize an evaluation of the internal control system and the processes targeted.

The results of an audit will materialize in form of an audit report which will be presented in a meeting with the most important stakeholders, this being the place where all the aspects discovered will be discussed, and where will be agreed upon measures to be taken and time frames for implementation of measures, in order to remediate the deficiencies found. The report will be forwarded to the users, which can be the organization or the state authorities, serving as a guarantee also, considering the fact that the users will decide based on the findings in the results of the audit.

Characteristics of the internal audit:

Internal audit means the systematic evaluation function realized in a company/organization, with the intent to analyze current activities and supply of suggestions for their improvement.

The internal audit represents the main pillar of good government. The activity of internal audit consists in a large range of activities, such as: the evaluation of the internal control system and the financial system; examination of the current operations; control of the realization of inventory according to legal demands; the analyzing of financial and nonfinancial information in the organization; detection of fraud and deficiencies.

The main objective of the internal audit is to increase the efficiency of the organization, monitoring the internal control system, doing internal checks in the company and pursuing the risk management system. By reporting to the company`s management the most important risks identified as well as the measures for their relieve, the internal auditors help the management and the persons in charge with governing to demonstrate that they are efficient and work in the benefit of the stakeholders.

The role of the internal auditors includes monitoring, evaluation and analysis of risks and inspections of the company, reevaluation and conformation with the politics, procedures and legislations in force.

The internal audit has the role of promoting and supporting the improvement and increasing of efficiency, by utilizing of “friendly criticism” and not only, by managing the deficiencies identified at the level of a structure or a process.

Characteristics of external audit:

The activity of external audit refers to the independent and systematic examination of the financial statements of the organization, by a third party, with specific objectives, which makes it compulsory to realize it periodically according to the legislation in force.

According to the C.I.M.A. (Chartered Institute of Management Accountants), the external audit is defined as a periodic examination of the recordings and accounting operations of the entity, by a third party (auditor), in order to ensure maintaining the correctness, accuracy and learning of concepts, morals, standards of accounting, legal demands, and also in order to offer a correct and true image regarding the financial statements of the entity.

The main role of the external audit is also to ensure that the operations are complete and they respect the principals and financial standards registered at the time they take place. So, this target refers to the accomplishment of statutory responsibilities that the external auditor has, supplying an opinion about the financial statements, relating if this shows a “correct and real image”.

External auditors are invested by decision makers in the organization. They have to be independent, meaning they can`t have any sort of relation with the entity that is to be audited, so their work cannot be influenced. External auditors have access to all accounting documents in order to obtain the necessary information for the formulation of an opinion expressed in an audit report forwarded to the decision makers in the company.

CONVERGENCES AND DIVERGENCES BETWEEN INTERNAL AND EXTERNAL AUDIT ON INTERNATIONAL CONTEXT

Differences between the internal and external audit;

The main differences are:

- The internal audit is a constant activity realized by a department inside the company, while the external audit is done by an independent third party, which analyses annual financial statements and issues an opinion on them;
- Internal audit is a volunteer activity, meanwhile the external audit is compulsory;
- The internal audits report is forwarded to the management, while the report of the external audit is transmitted to the stakeholders, creditors, government, etc.;
- Internal audit is performed constantly, while the external audit is performed based on the annual financial statements;
- The role of the internal audit is to reevaluate the current activities, and to improve those. The external audit follows the correctness and accuracy of financial statements;
- The target of internal audit is given by the organization`s management, while the external audit targets according to the legislation;
- Internal auditors are employees of the company as well, meanwhile the external auditors are not employed by the entity, being commissioned by the decision makers of the company;
- An internal audit can be externalized but it`s content remains the same, while the external audit is an independent activity, taking course only if the auditors are not employed by the entity audited;

Comparative chart:

Basis for comparison	**Internal Audit**	**External Audit**
Meaning	Internal Audit refers to an ongoing audit function performed within an organization by a separate internal auditing department.	External Audit is an audit function performed by the independent body which is not a part of the organization.
Objective	To review the routine activities and provide suggestion for the improvement.	To analyze and verify the financial statement of the company.
Conducted by	Employees	Third Party
Auditor is appointed by	Management	Members
Users of Report	Management	Stakeholders
Opinion	Opinion is provided on the effectiveness of the operational activities of the organization.	Opinion is provided on the truthfulness and fairness of the financial statement of the company.

Scope	Decided by the management.	Decided by the statute.
Obligation	No, it is voluntary	Yes.
Period	Continuous Process	Once in a year
Checks	Operational Efficiency	Accuracy and Validity of Financial Statement

Source: http://keydifferences.com/difference-between-internal-audit-and-external-audit.html

The internal and external audit in the public sector:

Here, the audits have to be correlated to the specifics of the public sector, following them to be quantifiable and transparent to the eyes of the public, and in the same time fulfilling its roles for economic efficiency, effectiveness, as well as ethicalness.

Governance is defined as a combination between the processes and structures implemented by the management with the intention to inform, direct, lead and follow-up the activities of the organization, towards the accomplishment of its objectives. In the public sector, governance is related to the goals established and assumed. This ensures the credibility of the entity from the public sector, establishes the equitable supply of services and insures a proper behavior of government officials by reducing the risk of corruption at this level.

In Romania, the internal public audit is exercised upon all the activities conducted by a public entity, including the subordinate entities, regarding the formation and use of public funds, as well as upon the administration of public patrimony of the state or of the territorial administrations, according to Law no. 672/2002 (of Romanian legislation in force) regarding the public internal audit, and according to the Order of the Public Finance Ministry no. 38/2003 for approval of norms regarding the exercise of public internal audits, order modified by Government Decree no. 1086/2013 – Order Of the Governments General Secretary no. 400/2015 for the approval of The internal control Code, which includes the management and control standards for the public entities.

The internal public audit is done in externalized system by certified persons in based on service contracts, this in the public entities at local level which have not established own departments for internal audit or did not enter in cooperation to ensure activities of internal audit.

The reports drafted by the internal auditors have in most cases purely formal character, the missions of internal public audit being oriented more on fund management as opposed an authentic internal audit which would serve the entities for a more efficient management as well as a source of information for them.

The role of auditing in the public sector.

Auditing is the foundation of governance in the public sector. By supplying objective evaluations over the administration of public resources in a responsible and efficient manner, the audit helps the organizations in the public sector to accomplish their responsibilities, maintain integrity, improve operational activities and none the last the increase of public trust. The role of the audit in the public sector consists in supporting the responsibilities of governance regarding identifying omissions and knowing well the internal activities and their forecasting. For the identification of omissions auditors check if the entity accomplishes its objectives, and the detection and stopping of corruption. Knowing the internal activities means assisting the decision makers by supplying them an independent evaluation of the programs, politics, operations and results of the public sector. The forecast of activity identifies trends and challenges that can appear. The auditors use instruments such as financial audit, performance audit, investigations and consulting services in order to realize each of these roles.

In Romania the external audit found after the evaluation of the internal control system regarding management and control standards for public entities, that the majority of territorial administration units and public institutions do not have organized a department for internal audit. So with no internal public audits being done, the managements of public institutions have no insurance for the good management of public incomes and spending, don`t have the possibility to improve their activities and have no support in the accomplishment of their objectives through a systematic and methodical approach, which could permit them to improve the efficiency and effectiveness of their guiding system based on risk management, control and administration processes.

Key elements of an efficient audit`s activity:

An efficient audit activity in the public sector leads to the consolidation of governance through the increase in the citizen`s capacity to evaluate the entity in the public sector. It is important to well establish the activities of audit and to hold a sufficient mandate in order to achieve its objective. The activity of audit has to have the attribute of acting with integrity for more credibility in their services according to the specifications of the established targets. The audit activity needs the followings:

- Organizational independence. This permits the audit activities to be performed without any interference from the entity audited. Organizational independence combined with objectivity contributes to the correct work of auditors and to the growth of trust in the results obtained.
- A formal mandate. The attributions and tasks of audit activities must be established by the stipulations that govern the public sector, based on legal documents. These documents must contain the procedures and demands for the report, as well as the obligation of the entity to collaborate with the auditor.
- Unrestricted access. The activity of audit must be realized with full access to employees, properties, registers and documents.
- Sufficient funds. The audit must benefit from sufficient funding according to its dimensions and responsibilities. This element cannot be left on account of the audited entity, because the dimensioning of the budget has a direct impact over the capacity of realizing an adequate audit.
- Competent management. The leaders of the audit activities must be independent and efficiently recruited, with highly qualified personnel, without having any political or management influence. The leader must know the applicable audit standards, must have the necessary qualification certified by graduation diplomas for specialized courses and must have the competence to supervise and lead in an audit job. In addition, the leader of the audit activity must have public communication skills.
- Objective personnel. The audit personnel must be fully objective, have impartial attitude and avoid conflicts of interest.
- Proficient personnel. The activity of auditing requires competent personnel, which has the necessary qualification and skills to conduct the entire range of audit activities described by their mandate. The auditors must meet the continuous qualification demands established by the standards and by the most important professional organizations.

- Support of the stakeholders. The legitimacy of the audit and its mission must be understood and supported by most officials, as well as by involved citizens and the media.
- Professional audit standards. The professional audit standards such as the I.P.P.F. adopted by the Institute for Internal Audit, support the introduction of all elements mentioned above.

In Romania, The Central Union for Harmonization of The Public Internal Audit (U.C.C.A.P.I) is responsible for the coordination of the national certification system of internal auditors in the public sector, and for the system of continuous professional formation of the internal public auditors, which are government employees in a public function part of an organizational structures in public entities.

The definition of audit in the public sector:

The roles of the audit

As an essential element of the governing structure of the public sector, the audit has the role of overview evaluator, analytic evaluator and also an assessor for the perspectives of the entities activity.

The overview evaluation. The auditors help the decision makers to make an overview evaluation upon the activity of the entity, regarding what they have to do, in the spending of public funds and in conforming to legal demands and regulations. The audit is concentrated on answers to the questions: Actions have been taken as requested?; Has the management introduced efficient inspections in order to minimize the risks? The audit activity supports the governing structures through the verification of agent’s reports and programs from financial performance point of view, and by testing these for legal and company directive compliance. Also, the overview evaluation contributes to disclosure to the public, by accessing the information regarding the evolution of activity of the public entity. The officials elected or invested as well as the managers in the public sector are responsible for the directing and defining organizational objectives. The managers have also the duty to evaluate risks and to impose efficient inspections in order to achieve goals and avoid risks. In this role the public auditors evaluate and report regarding the successes of these actions.

The overview evaluation describes the role of major part of public sector auditors in the detection and stopping the corruption, even fraud, losses or abuses and other defective utilizations of public resources and of power entrusted to government officials. The auditors monitor the efficiency of the internal management control system in order to identify and reduce the conditions that generate corruption. In most parts of the world, the audit of the public sector is responsible for the detection of suspicions for corruption inside organizations belonging to the public sector.

Detection.

The detection consists in trying to identify inefficient acts, illegal fraudulent and abusive acts, and also in the gathering evidence which can help indictment or other situation solving methods. The efforts of detection can take many forms such as:

- Audits or investigation based on complains or suspicion reports, including specific procedures and tests for identification of abusive activities, fraudulent or loss generating activities.
- Audits in the form of inspections of payment orders, bank accounts from which the payments have been made, or verifications of the informational system. These control the outputs of an organization and are connected to the internal inspection.
- Audits requested by legal commissioners, which analyze and interpret financial documents and transactions used in investigations and elaboration of case studies.
- Reviewing of potential conflicts of interests from the periods in which certain procedures, laws or regulations were implemented.

The stopping.

The stopping is the intention to identify and reduce the conditions which permit the appearance of corruption. Auditors try to stop fraud, abuse as well as other possible breeches that can affect the public`s trust through:

- Evaluation of the controls over the jobs proposed or existent;
- Evaluation of organizational risks or specific to auditing;
- Evaluating the changes proposed regarding laws, regulations and procedures to be implemented;
- Evaluation of the control activity regarding possible conflicts of interest.

The success of these efforts for detection can have as result the stopping.

The analytic evaluation of activity. The auditors support the decision makers in the entity in evaluating the programs or policies that work or not, by sharing with them which are the best practices in the field and what are the criteria of measurement, in order to find or adapt the best solutions. The audit activity helps the organizations in accepting the feedbacks thus being able to modify different policies. The auditors accomplish their work systematically and objectively, in order to develop a detailed understanding regarding the operations and for drawing conclusions based on evidence. This way, the audits can offer an interior image of the problems, resources, roles and responsibilities which, combined with the understanding of the causes of the problems and the useful recommendations, can help the stakeholders rethink the solutions the new problems.

Not only the performance of certain program can be improved, but also the aspects brought to light by a specific audit can increase the coping capacity of the public sector and the public in general, when they will be confronted with similar problems. The audits oriented towards the interior aspects, must respond to the more complex questions such as: The policies applied lead to the desired results?

The evaluation of activity perspectives. Auditors aid the organizations to asses in perspective the activity, through identifying trends and by warning regarding challenges that can appear before these could transform in real crises situations. The audit can highlight obstacles that will appear, like demographic tendencies, economic conditions, security threats, and can identify risks and opportunities that appear due to rapid evolution of science and technology, complexity of modern society, various international events and due to economic changes. These aspects represent risks on long term, which can be overlooked by the officials, and which can receive a low rate of attention due to their concentration on other urgent issues or short term problems. Also, approaching an audit based on risks, concentrates the attention of the audit strictly on the risk management factor in general, which helps identifying and stopping risks of inacceptable level.

The audits based on perspective evaluation respond to the question: What policies or implementations used will have to be reviewed in the future and what risk do they represent? When the audit of the public sector directs it`s attention towards trends, it helps taking decisions. Also, the auditors help the managers to understand and initiate the risk evaluation. Even the evaluation of the audits own risks insures the fact that the resources of the audit are being used efficient and in the areas that present the greater risk exposures.

Through these roles, the audit protects the basic public values. By offering an overview audit, an evaluation of the interior and an evaluation of activities in perspective for the entities, auditors in the public sector contribute to the transparency, integrity and equity of the activities lead by managers and officials.

Auditors do not just have to evaluate abuses of power, but have to be informed also regarding their power in the organization.

The entities in the public sector around the world are divers and present different grades of complexity. Thus, a single model of governance to sustain by the audit activity is not the best solution. Lots of structures are linked to a series of activity combinations of internal and external audit, based on needs and circumstances. However, the internal audit can have an advantage in the organization, due to its understanding and familiarity of operations, but may also influence the increase of the public trust due to the fact that its independence cannot be maintained or established with certainty. The public sector entities must constitute their means of protection in order to ensure the internal audit activities the capacity to report the important aspects to the appropriate authorities.

The maintaining of the independence of the auditors is necessary especially for the internal audit activities through the reporting to officials that have the capacity to evaluate and address any important problem. Examples for this kind of statutory demand are:

- Preventing the audited organization from interfering with the way the audit is conducted, interfering in the nomination of audit personnel and also in the publication of the report;
- Ensuring that the head of the audit department reports at the highest level in the organization in the public entity and that the requirements that imply the distribution of the report assure the transparency of the report`s findings.
- Requirements of notification towards an external entity when there are plans for the removal and substitution of the head of the audit department
- Requirements regarding availability to the public of the audit report.

Types of audit

The auditors in the public sector do audits with different types of objectives. Requests of financial report, requests regarding the complaints, performance indicators for the different functions of the public sector vary according to the legal areas and the types of activities (example: health care, judiciary, national security, child protection, etc.), and the results may take years to materialize. The means to evaluate the performance and financial regularity of the public sector vary to a great extent. Auditors in the public sector must demonstrate different types of skills, abilities and specializations. Thus, auditors must understand the systems and standards of compatibility in order to examine the financial statements; the operations of programs and the measurements of their performance in order to evaluate conformity; the success or progress of governmental activities; standards and good practice for the governance of the public sector and the management and internal control.

In some cases, the audit must evaluate the functioning capacity of existing indicators, but has to measure also the performance of independent evaluation capability of various public programs. More than that, in order to make relevant recommendations regarding the improvement of the operations, they must be capable to apply standards and politics of good practices specific to the type of operation examined.

The role of the audit committee

The climax of the audit represents the report, which is based in the corporate sector on the participation of three distinctive groups: the management of the organization, the audit committee (which can supervise also independent auditors) and the independent auditor who is an external entity to the organization audited.

A common practice of corporate management in the private sector is represented by the audit committee, which assures a strong supervision of public companies from financial point of view, and from ethical standpoint. Because this responsibility of supervision is essential to achieve an efficient governance, the entities in the public sector seek to adopt audit committees to assume a similar role.

The audit committee can enhance the independence, integrity and efficiency of audit activities in the public sector, by supplying an overview look over the internal and external audit plans, evaluating the resources necessary to the audit and securing the mediation between the auditors and the organization. The audit committee makes also sure that the results of the audit are verified and that any recommendation of improvement and actions of correction are addressed to the persons responsible or that they are resolved. In practice, the audit committees admit that 40% of the audit program contains financial information, and the rest of 60% nonfinancial information by their nature. Also, there have been identified around 200 risks regarding the register of corporate related risks, which reach from general risks through specialized risks and all the way to unforeseeable risks, “black swan” type.

Conclusions

An overall coverage of audit activities is frequently done through ensuring the complementarity between the internal and external audits.

The external auditor can use the work done by the internal auditor, if he considers that it is necessary in he`s audit, but this fact does not lead to the decrease of the external auditor`s responsibility. The internal audit acts as a tool for the verification of the economic activity, and supports through advices in various matters, the improvement of efficiency in the organization`s operations.

The audit must be a positive experience and not one that creates unrests. It is an opportunity to receive feedbacks, to find out the strong and weak points of the system.Without the transparency given by the audit, the investors in an organization can raise questions regarding the credibility and correctness of the financial statements, and can be easily determined to withdraw their investments, leading to the collapse of financial markets.

The external audit has as main objective the limitation of risks, blocking the appearance of new errors in the activity of entities, being necessary the implementation of system management and internal control, elaboration of clear procedures for all activities conducted inside the entities, as well as identifying and managing risks.

Bibliography:

1. http://www.turnkeyconsulting.com/faq/what-is-the-difference-between-internal-audit-and-external-audit
2. https://na.theiia.org/standards-guidance
3. http://keydifferences.com/difference-between-internal-audit-and-external-audit
4. https://iaonline.theiia.org/two-sides-of-auditing
5. https://www.iia.org.uk/about-us/what-is-internal-audit
6. http://www.audit.cornell.edu
7. http://www.exeter.ac.uk/finance/audit/internalauditvsexternalaudit
8. http://finance.columbia.edu/content/types-audits
9. http://www.bayt.com/en/specialties/q/61288/what-is-the-difference-between-the-internal-auditor-and-external-auditor-and-what-is-the-main-job-for-each-of-the
10. https://www.mango.org.uk/guide/externalaudit
11. www.icaew.com/.../audit%20and%20assurance/
12. http://www.cimaglobal.com/Documents/ImportedDocuments/external_audit_guidelines_practical_experience_04.pdf
13. http://www.protiviti.com/en-US/Pages/Guide-to-Internal-Audit.aspx
14. http://www.ifad.org/operations/finance/audit/guidelines/guide.pdf
15. https://www.nao.org.uk/wp-content/uploads/2013/04/Internal-audit-in-practice-case-studies.pdf
16. https://www.pwc.com/us/en/audit-assurance-services/assets/in-depth-guide-to-public-company-auditing.pdf
17. https://www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Documents/PDF/Publication%20Series/KPMG_Audit%20Guide1.pdf