

Internal Audit – Managerial Control Relation

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Abstract

The hereby article analyses the merger between the internal audit and the management control, starting from a mathematical function analogy. On the one hand, this reasoning emphasizes the internal audit's impact (*domain*) over the control (*co-domain*), as a function within the management process and on the other hand, it reveals the internal audit's connections with the management control's structure and with the General Manager.

In the first case, the divergent "lens" using its influence over the other management functions is the managerial control and in the second case, it is the General Manager in person, the one who, being in direct contact with the internal auditor receives and reacts to his observations, conclusions and recommendations.

The audit is an independent and objective activity aiming to internalize added value and to consolidate the management's control system, thus permanently updating the activities' improvement process, that achieve the company's mission. The management control consists in the continuous monitoring and correction of the specific internal process, in order to gain a coherent and unitary direction of the entire organizational system, in relation to all the fundamental objectives.

The conclusion at the end of the article, is that, following the missions assumed and undergone within the company, each internal audit's elements (findings, conclusions, recommendations, specific methodology, etc.) can be associated with elements within the internal / managerial control system (skills, responsibilities, operational procedures, standards, decisions of correcting the „course”, according to the pre-determined ending, etc).

Keywords: internal audit, audit findings, internal / managerial control, corrective actions.

JEL classification: M10, M40

Introduction

A mathematical function is defined as a relation through which each element from a set, generically called *domain*, is associated to one single element from another set, called *co-domain*. This maximum generalization representation can be applied to all exact sciences. Starting from the mathematical function analogy, we hereby propose to emphasize all the connections between the internal audit (*domain*) and the management control (*co-domain*), as well as the ricochet

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impact of the internal audit's specific elements (findings, conclusions, recommendations, etc.), over the entire management process. We will also try to underline the influence that the internal audit has over the General Manager² and through him, over all the other managers, regardless of their hierarchical level. After all, the basic component of the control system is given by its human-organizational aspect, meaning by all the managers as rights owners (skills) and obligations (responsibilities), that create together the internal control structure, as well as all the hierarchical-functional relations, through which the control is implemented within the company.

Committed to management development, the internal audit acts objectively, methodically and responsibly, in order to systematically develop the management process' performance level, by mainly focusing on the control's strengthening. Through its highly-specialized performance, the internal audit can be the management's essential instrument of professional development. The shareholders, investors, mass-media, State's structures and other civil institutions, the public services beneficiaries, tax payers, etc., are increasingly interested in finding out ways of management decision-making, that influence the company's results and in obtaining guarantees concerning the quality of the management's process/system. The analysis of the transformations concerning the internal audit's definition, as well as our attempts to clearly identify the essential content that is presently associated to this syntagm, requires a preliminary clarification of the internal audit's functions, as well as one concerning its main characteristics. It is therefore necessary to establish the audit's "products", its use for the company, as well as its attributes, which are, nonetheless, associated to this activity.

On the other hand, the control consists in all the management team's activities and approaches, performed in order to measure/evaluate the company's results, for comparing the performances achieved with the pre-determined objectives / standards, to establish and eliminate the negative offences, as well as to integrate the positive offences, aiming to finally correct the entire company's orientation, according to its fundamental targets.

Each internal control standard defines a minimum of management rules (requirements) that must be implemented within the company. After all, all the standards represent the referential system based on which the system's efficiency is evaluated, the risks that may affect the objectives' achievement are identified and the corrective or strengthening measures of the control device, are established (Certo, 2000).

Therefore, the control involves the continuous monitoring and improvement of the entire company's system, according to all its fundamental objectives and applicable standards, in order to develop the general efficiency. If we imagine that the company is a ship sailing to a guiding compass course³, than its internal control system can be compared to its steer, to the mechanism through which the ship is constantly kept on the pre-determined direction (Griffin, 2002).

² The internal audit coordinator, the company's Manager.

³ The fundamental objective's assembly.

We hereby present a graphic of the internal audit's action over the management process, as well as over the internal control pyramid's structure.

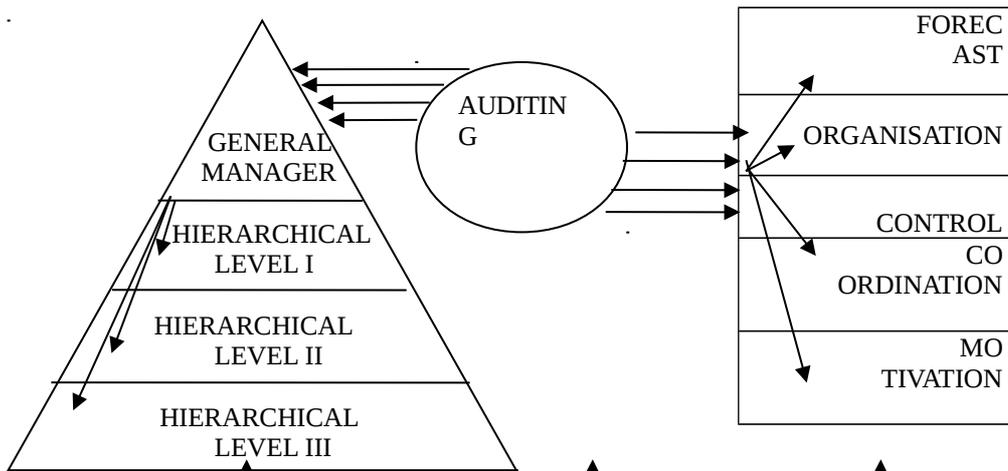


Figure 1. Internal audit – managerial control relation

1. Managerial control, internal audit “object”

The control implementation represents an important function of the Manager and it can provide him permanent answers concerning the company's evolution and performances. The control was and remains an important responsibility of the Manager, that cannot be delegated, regardless of his hierarchical level. The management control responsibility means: (i) “... *correcting the company's activities, so that the pre-determined performances' characteristics (significant) are kept under acceptable limits. When this correction does not occur, than the company has no information concerning the performances' quality of its pre-determined targets. As the “ship's steer”, the control ensures the company's development on the pre-determined path*” (Griffin, 2002); (ii) “...*a corrective (organizational) process, that sets standards according to the company's needs of achieving the targets, process that consists in the comparing of standards with the present performances and in the applying of corrective measures, if case*”; (Williams, 2003); (iii) “...*monitoring the activities, in order to make sure that they are performed according to the plans and to correct the significant breaches*” (Robins, DeCenzo, 2001); (iv) “...*determining the measure in which the initial plans have been successful or not*” (Dubrin, 2000); (v) “...*the Manager's systematic effort of comparing the performances with the pre-set standards, plans or objectives, so that it determines to what extent the achievements comply with these standards, if there are corrections needed and if the resources have been used in the most efficient way/possible efficiency for the objectives' achievement*” (Mockler, 2000).

According to the analysis of the above-mentioned paragraphs, the results are a set of conceptual elements that can mutually & accurately create and define an extremely dynamic, complex organizational phenomena. In a larger context, the term of “control” refers to the verification / examining of a problem, activity,

situation, etc., thus aiming for a potential correction, if the evolution does not occur according to the requirements. At the same time, the control involves a continuous monitoring, aiming for a better operational situation management, in order to prevent undesired events and internalize added value within the company. The control has always represented an important means of knowing the state of fact, the objective reality, but also a correction lever of the deficiencies, malfunctions, etc.

In time, as an organizational phenomena, the control systematically developed its domain of application, as well as its ways of “expression”. At present, the control is implemented in all the company’s activities, it formulates qualified procedures, takes into consideration all the data/information/knowledge within the company, the entire patrimony managed, as well as all the employees. As the management’s fundamental attribute, the internal control is perceived at the same time, as being both: first-level skill and responsibility that must be permanently implemented for the management’s continuous improvement, meant to fight against the risks threatening the objectives’ achievement.

There are only general provisions for the public entity’s management, that can be identified in the European regulations and therefore, the ways of implementing remain at the Manager’s decision. In this situation, the Manager is free to implement specific internal control activities. The subtle effect of such a vision seldom created the impression that the organizing and undergoing of internal control, can be optional. In order to counteract such false conclusions, we hereby mention that the control’s function must be found in a formalized version (operational procedures), job descriptions, etc.; if case, these procedures will have check-up lists, internal documents with detailed descriptions of the procedures/instructions for the achievement of the controlling activities.

The control’s evaluation involves the systematic verification of the way in which the operational procedures are created and applied, aiming to adjust the organizational system. The conception regarding the control’s role and methodology, has been permanently and successively redefined. One of the most important levers through which the management achieves its fundamental role, is represented by all the responsibilities / skills / attributions and work relations, for the control’s implementation. The internal and the overall results of the compartments, are therefore evaluated; following the performances’ “homologation” process in relation to the pre-determined objectives, after identifying and analyzing their causes, than the related corrections will be finally implemented. These corrections aim either to integrate the positive offenses, or to eliminate the deficiencies and causes that generated them (Nicolescu, 2011).

The control is an attribute that cannot be delegated, it is a management function, a means of acknowledging and managing the reality, as well as an instrument for correcting the deviations/offenses. Therefore, regardless of the hierarchical level, the Manager cannot transfer its controlling responsibilities to another person, unless by risking to lower his invested authority and the ability of relevantly and deeply knowing the operational situation from his area of responsibility. The Manager is responsible with a set of specific responsibilities and skills, through which it controls his area of responsibility. However, due to the large amount of activities, the Manager must seldom transfer a part of his skills / responsibilities, to other collaborators / employees. The delegation does not hold

harmless the person who transferred the responsibilities / skills of his job description. The delegation's advantages consist in the fact that they allow the Manager to focus over the most important tasks. In parallel, the implementing factors develop their responsibilities and initiative.

Through the control process, the Manager evaluates / measures the results and compares it to the pre-determined objectives, identifies the negative/positive aspects, identifies and applies corrective measures and manages to develop the efficiency, fights against indiscipline, waste, develops the responsibility, stimulates healthy mentalities concerning work and initiatives. (Zecheru, Nastase, 2005) The control's fundamental role stands in the general effort's coherent and unitary focus over the accomplishment of the pre-determined objectives, by permanently showing the ill-judged consumption / distribution of the resources, the malfunctions, the breaches, anomalies, deviations, centrifugal tendencies, etc., and by therefore implementing the required corrections.

The Manager establishes the internal means of controlling each group of activities, aiming to limit or to eliminate the specific risks. Internal control devices can therefore be organized, by taking into consideration: (i) the internal activities' auto-control consisting in each executor's verification of the instructions/internal procedures / applicable norms' implementation, in his area of activity; (ii) the mutual control, consisting in the verification of each output's characteristics, by the one who takes it as input, in his activity; (iii) the hierarchical control, consisting in the implementing of specific verifications at each level of responsibility, aiming to achieve the objectives assigned; (iv) the partnership control, consisting in the development of cross verifications, through delegated skills. According to the specific activities, the high-level management can also establish other forms of control, by therefore completing the respective device.

Any organizational process can be considered as being a transformation of *inputs* (resources/factors) into outputs (products / services / works). This transformation involves several stages/phases, meaning a procedural chain. According to a pre-established algorithm, within this interconnection, each employee receives an *output* (a result of an *upstream* developed process), that he processes in order to send it further for completion. In other words, an employee's *output* becomes an *input* for his co-worker. The hierarchical control mainly aims for the operational dimension of the company's on-going processes; it takes place at the same time with the controlled activities, in order to eliminate, as much as possible, the malfunctions, resources' waste and generally, any kind of inefficiencies and anomalies. The job description plays an important role in the undergoing of the hierarchical process, as it is a document that describes each employee's work responsibilities, both explicitly as well as in-detail (Zecheru, 2013).

The Manager is responsible with the internal control's organizing and undergoing, in accordance with the specific skills. It must not be understood that the General Manager is the only responsible for internal control; a company must have "a pyramid" of specific responsibilities, as each Manager and executor is in charge with a unitary and coherent set of internal control responsibilities and skills.

The General Manager relies its responsibility on its collaborators' / employees' responsibilities, according to the domain coordinated by each of them. We can actually identify a pyramid of responsibilities / skills and therefore, an internal control pyramid (OMFP 946/2005).

2. Internal audit, factor of the managerial control's continuous strengthening

In its most comprising definition, the internal audit is an independent and objective activity, aiming to internalize added value, by permanently presenting its approaches, the improvement process of the company' specific activities (Ghita, 2009). There are a series of opinions and approaches that can be drawn from the specialty literature that are seldom in contradiction and are insufficiently argued / systemized. We will therefore present our own point of view concerning the three functions and the four characteristics⁴, in order to conclude a final definition.

In our opinion, the internal audit represents a real support for achieving the objectives set, thus bringing a distinct – methodic and systemized – contribution, that consequently aims to develop the management process' efficiency and especially to strengthen the control at all its hierarchical levels. The auditor offers an insurance concerning the audited domain in accordance with the professional norms and standards in force, so that, at the end of the process, he will present the creditworthiness of his research, thus assessing (qualified opinion) the performance level, or the measure in which the investigated entity complies with the requirements. Following this process, the General Manager will rely his decisions on the way in which the audited structure was performed and especially on the auditor's insurance (GO no. 1086/2013).

As a conclusion, the internal auditor's role is based on all his functions. According to The Institute of Internal Auditors' statement, three significant functions that distinguish this activity from other similar, are taken into consideration. The three functions are: (i) insurance, (ii) consulting, (i) general support. From an action plan's point of view, the internal audit derives from its pragmatically proposed objectives, as well as from the objective result, meaning the audit report containing each case' findings, conclusions and recommendations.

The first two above-mentioned functions, take place through the General Manager's direct assistance, targeting mainly the internal control system's development. The third function targets the company as a whole and focuses mainly on the development of efficient process management and on the relations representing its specific activity domain, as well as on the added value internalization. Certainly, the insurance and the consulting function are interdependent, meaning that the insurance missions frequently generate consulting activities and vice-versa. As a background activity, as well as to complement the two above-mentioned functions, the internal auditor implements general supporting function skills, for the entire company's benefit.

⁴ Universality, independence, deontologic dimension and time.

The insurance function is generated by the independent evaluation of the risk management, control, or company management processes. Usually seen as a valuable judgment, this evaluation is generally presented as a firm and undoubtful statement of the audited domain; the insurance statement materialized the auditor's conviction and attitude towards the audited entity's state of fact, thus being able to compare it with the judge's decision. If, besides his opinion, the internal auditor does not give a reasonable insurance concerning the audited company's quality and/or its performance level, than the auditing can be considered just a simple verification, or a consulting procedure like any other. Of course, there can be both: insurance and consulting missions, as well as mix missions (with double role). The fact that the auditor offers a reasonable insurance at the end of his mission, represents a high-level responsibility for him, and therefore we can confirm that this aspect completely separates the audit from other similar activities, thus giving it a special distinct role. Nonetheless, we should mention that the internal audit focuses mainly on recommendations and less on granting insurances.

As a further information concerning the risks and material⁵ aspects, the insurance represents a specific contribution of the internal audit, that aims to lower as much as possible the level of uncertainty. The insurance statement must provide enough safety elements and full justifications to the audit coordinator, concerning the capacity of the audited structure to counter certain risk generated effects. The insurance may be explicit⁶ or implicit⁷ and is aimed at supporting the auditor's effort to anticipate the events that may affect the achievement of the organizational objectives.

The consulting function derives from the need of formulating recommendations, aiming to internalize the added value within the company. From an action plan's point of view, the recommendations determine the quality's adjustment within the audited domain. The internal audit mainly consists in granting qualified assistance to the General Manager, in order to develop his capacity and achieve a high level of efficiency. The consulting activity definitely differentiates the internal auditor's work from any other activity, such as verification, control, inspection, etc. and represents the main engine that brings added value to the company.

The auditor acts only according to the General Manager's decision. It therefore identifies the solutions meant to develop the general efficiency and at the same time, the auditor may consider himself the "co-pilot" of each of the low-hierarchical level managers. He presents his solutions (recommendations), which he promotes in order to improve the instruments used⁸, the rules, procedures, internal instructions, etc., aiming to strengthen the internal control / management system.

The general responsibility of achieving the target, belongs exclusively to the management. At the same time, the auditor's recommendations may be validated in order to become tasks, but only after they will be included into action

⁵ Materiality consists in the permanent classification of problems, according to their importance.

⁶ Made also in writing.

⁷ Generated from the auditor's conclusion expressed in the final report.

⁸ Techniques, methods, systems, approaches, etc.

plans. Of course, as they are not mandatory, the internal auditor's recommendations are only for consulting matters. Therefore, the internal auditor's responsibility concerning the recommendations, is strictly limited to the reasonable presentation of approaches that would improve the general state of fact and especially the internal audit. In this regard, the auditor's conclusions are actually simple premises for the final decision factor. The auditor supports its recommendations by presenting arguments based on auditing standards, on good practice in the domain and on its professional reasoning. For a more objective argumentation, the internal auditor also relies on its independence and on a certain detachment from the constraints and obligations of a routine activity⁹.

The general supporting function involves three aspects on which the internal auditor's action is developed, meaning: (i) risks identification, analysis and evaluation, existing around the organizational processes, as well as around the results; (ii) the internal management control's continuous strengthening, at all the hierarchical levels; (iii) developing the capacity of managing all the specific organizational processes and relations. The three above-mentioned responsibilities involve a permanent collaboration with all the audited structures. The respective approaches represent a coherent whole so that the modification of one, consequently determines the modification of the other. The contribution of these three approaches is unequal and heterogeneous in terms of general result – keeping the company as a whole, in its effort of achieving the specific objectives.

Conclusions

The relation between the internal audit and the management control may be presented from two different complementary perspectives, as resulted from the above-mentioned graphic. The first analysis will emphasize the internal audit's impact over the management process. In this case, the management control, as an activity, represents the divergent "lens" that permanently lightens the entire management process, and especially the management's functions. The second approach focuses on the connections that the internal audit generally has with the hierarchical pyramid and especially with the audit's coordinator. In this second case, the divergent "lens" is the General Manager himself, the one for whom the final report is issued, containing all the internal auditor's findings, conclusions and recommendations, meant to strengthen the internal control's system.

In our case and in the mathematical function analogy, the *domain's* elements (internal audit) are the findings, conclusions, recommendations, audit report and the specific methodology, etc. According to this logic, the *co-domain's* elements are the following: (i) in version no. 1: regulations, operational procedures, strategies, etc; (ii) in version no. 2 – decisions, skills, responsibilities, etc. The relation between the *domain's* and *co-domain's* elements, takes place by identifying the malfunctions, risks, irregularities, etc, by establishing their causes and inherent

⁹ The internal auditor is not and cannot be involved in the organizing and performing of its undergoing activities.

consequences, as well as by formulating recommendations that internalize added value within the company and by strengthening the management's control.

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