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FACULTY OF SCIENCES

CONTENTS OF THE DOCTOR’S DEGREE THESIS:

INTERNAL AUDIT
REGULATIONS AND DEVELOPMENTS
WITHIN CREDIT INSTITUTIONS

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KEYWORDS : internal audit, corporative governance, credit institutions, IAS, internal audit international standards, internal audit system

INTRODUCTION AND RESEARCH MOTIVATION

The objective of this scientific intercession is that of presenting the history, evolution and perspectives of the corporative governance as well as the identification of the interdependence relation and of the key role that pertain to the internal audit and to the corporative governance, the accent being laid on the particularities of the leading processes and structures within the credit institutions.

In today's world situation, a world that is under the effect of the economic crisis, there is an imperious need for people with a complete vision on the surrounding reality who should be able to identify the problems faced by the organizations and to offer the necessary solutions for their solving. By the activity that they perform, the internal auditors have the responsibility of implementing an adequate internal control system and of maintaining the risks at a low level in order to obtain better performances for the organization to which they belong. Thus, the internal audit contributes to the implementation of certain effective processes and structures of corporative governance.

The research theme proposed within the doctor's degree thesis "Internal audit regulations and developments within credit institutions" is an approach to the internal audit evolution both on a national and on an international level, to the necessity of implementing the internal audit function within credit institutions, to the developed activities, to the implied benefits, as well as to the introduction of certain effective processes and structures of corporative governance within credit

institutions, based on the internal audit results of the activity developed under the audit commissions monitoring.

The thesis also studies the relationship between corporative governance and credit institutions performance both at the financial system level (macro), and at the individual level (micro), considering the internal audit as the main instrument used for risks management.

There are opinions saying that the value added obtained by the use of the internal audit activity within an organization cannot be demonstrated, a value added reflected through the financial information elaborated and presented by the entities within the periodical reports, often noticing nevertheless that by the internal audit performance, the accounting experts elaborating and presenting the financial information are dissuaded to perform their activity erroneously, incompletely or inadequately.

From my experience and from my own observations, I can express the opinion that the internal audit developed within a credit institution adds a surplus value to the entire activity, due to certain institutional considerations. Thus, the organization and functioning of an internal control system based on adequate guidelines and procedures, motivates the organizations' employees to comply with the applicable internal regulations. These come to grant a greater importance to the compliance to the legislation, procedures and regulations in the field, becoming aware of the fact that the internal audit performs a general critical evaluation of an organization's entire activity. This evaluation of one entity's performance made by the internal audit became more and more important for all the stakeholders in an organization, because it provides an insurance on the capacity of one organization to control and manage its own operations and risks, an insurance specified after the development of

an independent activity, based on professional and ethic standards unanimously accepted at an international level.

Within this scientific intercession, the fundamental scientific research has as a main purpose the accumulation of new pieces of knowledge concerning the essential aspects of the noticeable phenomena and facts, taking into consideration a specific application within the credit institutions by means of the internal audit system designed and proposed for implementation.

The research used for the elaboration of this paper, was based on: **the quantitative research** (performed through an analysis of the information related to internal audit, internal control, risk management and corporative governance, for their description and explanation); and on **the fundamental research** (performed through the refining of the theory concerning the hereinabove specified aspects).

We cannot perform a scientific research without it complying with certain principles. The principles of the scientific research are considered to be landmarks to which the accumulated information should be also related. Thus, in the scientific performance the following principles were used: **the principle of objectifying** (refers to the object of the scientific research, to the manner in which it should be studied and to researcher' attitude towards the object of his research); **the principle of demonstration** (the results of the scientific research must be demonstrated, proved to pertain as statements related to the studied object); **the principle of correlation** (refers to the compulsoriness that the scientific results drawn from the research of an object be correlated to the data already existing in the respective scientific field or in the related scientific fields); **the principle of results evaluation** (refers to the evaluation and use method for the results obtained from the scientific research activity) and the **principle of utility** (signaling the fact that the

scientific research activity should take into consideration both a theoretic and practical use of the obtained results, in the given study context).

For the elaboration of a scientific paper it is necessary to use the existing knowledge accumulated as a result of the research and/or of the practical experience in order to introduce new procedures, systems and services or to improve the already existing ones.

Starting from these considerations, the objectives of the present thesis aim at the following:

- the analysis of the definitions elaborated by several authors in the specialty literature, as well as of the definitions elaborated by various organisms from the internal audit field ;

- the foundation of the internal audit importance by the presentation of its functions, role, objectives and covering area.

- the identification of legislation, guidelines, regulations and professional standards able to provide audit quality and the auditor profession authority;

- the presentation of tendencies and approaches in the internal audit field;

- the establishment of the connection between corporative governance and internal audit, by detailing the role of corporative governance within a credit institution and the two concepts contribution to the organization performance increase.

- the presentation of the internal audit typology

- the analysis of the relationship: internal audit – internal control –risk management ;

- the coordination of these processes in order to render the activities developed within credit institutions more effective.

➤ the foundation of the corporative governance importance within credit institutions by means of presenting the organization method, its role and objectives;

➤ the analysis of the corporative governance concept through time and the presentation of the main international currents;

➤ the identification of certain international principles unanimously accepted, able to provide the effectiveness and efficiency of the corporative governance structures and processes at a world level;

➤ the identification of the corporative governance deficiencies within credit institutions which occurred at the same time with the international financial crisis burst in 2007;

➤ the presentation of the latest trends in the field of corporative governance within credit institutions;

➤ explaining the internal audit contribution to the organizations' performance increase by the improvement of the corporative governance processes and structures.

➤ the presentation of the corporative governance main codes and models both at an international level and on the territory of our country ;

➤ the analysis of the relationship: internal audit – risk management – corporative governance within credit institutions;

➤ the coordination of these processes in order to render the activities developed within these entities more effective;

➤ the design and implementation of an internal audit system within credit institutions based on the conclusions resulting from the developed scientific research

➤ detailing the proposed audit system by the formality of the activities performed with the help of the appended documents.

➤ the purpose of the audit system proposed within the case study is to represent an useful guide for the internal auditors.

RESEARCH METHODOLOGY

The scientific methodology used within this scientific intercession combined the qualitative research to the quantitative one by thus joining the descriptive-conceptual perspective to the empirical perspective. The theoretical research approach is preponderantly deductive, starting from already existing theories, concepts and regulations concerning the internal audit and the corporative governance and by singularizing these elements within the credit institutions. The practical scientific research, having a quantitative nature, is approached especially inductively, by the emphasis of certain general conclusions, generated by the particular situations presented within the banking system, as well as by the presented case study.

The research methods used both at a qualitative and quantitative level are: the documents analysis, the comparative method, the non-participative as well as the participative external observation.

The research methodology used takes into consideration, in a first stage, the **documenting**, in order to clear certain aspects concerning the internal audit history and evolution, its role and objectives within the credit institutions, its relationship with the external audit and the internal control, as well as with the risks management within these organizations, **the data analysis and synthesis**, the use of the obtained information in order to design an internal audit system adapted to the credit institutions, as well as the **conception of certain conclusions and the enunciation of new perspectives and developments concerning the internal audit role and covering area within the credit institutions.**

The research was performed by taking into consideration and by analyzing the most important opinions and approaches within the

specialty literature, both on a national and international level; the various articles and studies, as well as the different reports of the regulation organisms in the field of internal auditor profession (IASB, IIA, CAFR, etc)

The comparative method was used for studying: the theories and concepts approaches in the field of internal audit and corporative governance, the studies and the scientific researches performed in the field through time, the relevant national and international norms and regulations, in order to identify the common elements, but also the differences existing between them.

The typological method was used for classifying the concepts and theories at the organizations' corporative governance level.

The method of the non-participative observation was used by the analysis of the scientific knowledge dynamics in the field established for research and of the regulations concerning the internal audit and the corporative governance on a national and on an international level, the researcher having no influence on the analyzed documents. Concerning the participative observation method, it supposes the researcher's positioning within the analyzed field, this fact being concretized by the case study concerning the design and implementation of an internal audit system within a credit institution, because the researcher is a financial auditor and he worked for several years within certain credit institutions.

The conception of certain conclusions and solutions was performed after underlying the knowledge in the internal audit field and in its relationship with the corporative governance, both at a system level and an individual entity level, the stress being laid on the internal audit role, objectives and new perspectives within the corporative governance of credit institutions, after seeing the normalization and regulation stage in the field.

The information comprised in the paper was processed very carefully and particularly thoroughly.

Within this thesis, the information is presented in an elegant, easy reading manner, the key concepts, delimitations, definitions from a wide variety of sources, on a national as well as on an international level, being processed and interpreted by case studies demonstrating the internal audit importance within the organizations, the stress being laid on the banking system, the internal audit being considered an effective instrument for risk managing within the corporative governance process in the credit institutions.

Under the aspect of formulation, of expressions accuracy and of this paper intelligibility, we wish for a clear, concise and easy to follow utterance.

The informational source is rich and varied, a lot of bibliographic materials being consulted, such materials consisting of: specialty books from the national and international literature, reference papers published in different specialty magazines as well as normative documents and specialty websites.

SYNTHETIC PRESENTATION OF THE DOCTOR'S DEGREE THESIS

The doctor's degree thesis is structured into five chapters, as follows:

Chapter I, named „**Excursions into the specialty literature concerning the regulations and developments of the internal audit activity within credit institutions**”, presents the stage of internal audit knowledge, both on a national and on an international level. The main

studies and research performed in the field in Europe, USA and Romania are presented.

Thus, the internal audit is considered to be the catalyst of the contemporary world business models, given its ability of transforming the specific and the potential of each business into competitive advantages. Nevertheless, although it enjoys a greater and greater importance and it is considered a crucial factor for business success, the internal audit was not the subject of major research studies. Due to these reasons, at present there is a limited number of studies for refining and spotlighting the more and more important role that the internal audit has within organizations' corporative governance. Consequently, the scientific research concerning the internal audit activity within credit institutions can be considered to be even more reduced.

Still within this chapter, two different situations are presented in detail, the first analyzing the relationship between the internal audit , the corporative governance and the credit institutions performance at a financial-banking system level (macro), and the second at an individual level (micro). The analysis of these two situations brings forward even more pregnant the evolution and role of the internal audit activity within the banking system in general and the credit institutions in particular, in terms of the corporative governance results reflected by the financial performances of the credit institutions.

The first situation presents the causes and conditions of the financial crisis initiation and evolution in Indonesia in 1997-1999, analyzing the entire Indonesian banking system from a structural and legislative point of view. The stress is laid on the emphasis of the crony capitalism negative influence on the corporative governance and its tragic effects on the banking system hit hard by the financial crisis are presented. It can be noticed that an important role in the exacerbation of

the 1997-1999 financial crisis effects from Indonesia, came to the extremely weak corporative governance within the Indonesian credit institutions, this corporative governance lacking an effective internal audit activity.

Also, the chapter presents the main issues raised by the existence of an inefficient and insufficient monitoring from the Indonesian surveillance authorities, these authorities allowing the repeated violation of the regulations concerning the prudentiality principles, this deficiency being reflected finally in the disastrous manner of risks management (without having at the basis a corporative governance founded on the internal audit activity) manifested by the local credit institutions.

The second analyzed situation, entitled " Northern Rock- the failure of a business model as a result of a weak corporative governance", presents the defective manner in which the Northern Rock management board understood to administrate the credit institution activity in the conditions in which it was an active player in one of the most representative financial market in the world: Great Britain. In this case, the paper emphasizes the fact that the principles on which an effective corporative governance is based were ignored even by those meant to monitor their implementation within Northern Rock. Thus, it is hard to imagine how they could come so rapidly from a credit institution activity sustained increase to its total collapse.

The research brings forward the major errors of corporative governance committed by the administration council of Northern Rock and also presents a personal point of view concerning a potential causality relation between the corporative governance, the risk management and the credit institution collapse.

It is to be mentioned that, after all, everything resumes to the capacity of an organization (especially when it comes to credit

institutions) of facing the risks occurred during its activity development. This capacity is given by the ability of its leading organisms of managing and administrating the risks, of having defined, approved and implemented adequate combat strategies against such risks. Or, as I said it before, an essential role within the elaboration of these strategies pertains to the internal audit founded on the approach based on the risk.

Given the importance of the aspects researched within the two case studies, there is an imperious necessity to emphasize certain new action directions in order to increase and strengthen the relationship between the corporative governance and the internal audit within the credit institutions.

As a general conclusion, you should retain the idea that the performance of an entity, be it even a credit institution, is due mainly to the existence and implementation at all levels of certain effective corporative governance processes and structures. This necessity resulted both from studying an entire banking system and from the analysis performed at an individual level. As a result, it is necessary to reinforce the corporative governance at the entities level, and the main instrument for reaching this objective is represented by the internal audit role increase within the risk management process, the present trend being that the internal audit activity become a partner for the organization's management in fighting for better results obtained in increased security conditions.

Chapter II, entitled „**The role and importance of the internal audit within credit institutions**” presents the internal audit history and evolution on an international and national level, the role, organization and objectives of the internal audit activity within public and private organizations, the applicability area, as well as the normalization and standardization process of this activity through time.

The internal audit is a function implemented in order to help the entity to reach its proposed objectives. But, in order to do this, the internal audit compartment, under the audit committee strict monitoring, must execute the analysis of the developed processes, through internal control activities, risks management and corporative governance, in order to identify the issues to which the organization confronts and to propose recommendations for their solving. The internationalization of the internal audit, the future trends in directing its interest center, transforms the internal audit in an element which is necessary to all entities and which contributes to their good functioning.

This chapter still presents the legislative and normalization framework both on an international (through the Internal Audit International Standards), and on a national level: the Government Emergency Ordinance no. 75/1999 with the subsequent modifications and supplements, the Government Emergency Ordinance no. 90/2008, the Law 672/2002 with the subsequent modifications and supplements, the Romanian National Bank Norm no. 17/2003 and the Romanian National Bank Regulations no. 18/2009 concerning the control and internal audit organization and the risks management within credit institutions.

Further, the paper emphasizes the organization method, the principles, the covering area, the role and objectives of the internal audit activity within the credit institutions. The stress is laid on the underlining of the internal audit activity role in detecting the potential risks to which the credit institutions are exposed and on the necessity of providing a superior solutions management concerning such risks minimization. Also, the thesis approaches the principles governing the internal audit activity within the credit institutions, principles stated by the Basel Committee on Banking Supervision, as well as the provisions of

the Romanian National Bank Norm no. 17/2003 and of the Romanian National Bank Regulations no. 18/2009 concerning the control and internal audit organization and the risks management, which regulate this activity in our country, in the conditions of internal auditors' complying to the ethical code, bringing forward the relation between the organizational culture based on the ethical code values, on the corporative governance and on the organization performance.

Also, the chapter treats the relationship between the internal audit and the internal control environment. The internal control role within an entity is that of offering a reasonable assurance concerning the risks management activity. The internal audit as a form of control refers to the application of coherent examination guidelines and procedures, in order to provide the activity evaluation and the functionality of all entity's compartments.

The risks management purpose is that of helping the entity understand the risks to which it is exposed, in such a manner as for such risks to be able to be managed, without materialization. In such conditions, the risk management represents a new action direction for the internal audit department, which not only identifies, manages and evaluates the risks, but also contributes to the development of the organizations' activities in maximum efficiency conditions.

The first part of Chapter III, entitled „**Internal audit –a key element of the corporative governance within credit institutions**”, presents the various forms of regulation (either under the form of recommendations comprised within several reports and codes - Cadbury Report, Turnbull Report, the Combined Code, or by the existence of certain laws that must be complied with - Sarbanes Oxley Law, an example of corporative governance on an international, as well as on a national level). Also, the corporative governance models existing in our

country are presented in terms of Law 31/1990, with the subsequent modifications and supplements, but also of the recommendations stated by the Bucharest Stock Exchange Code.

The internal audit is seen as an essential element of effective and efficient corporative governance, due to the fact that it provides an assurance on the risk management, on the control systems and on the corporative governance processes and structures within credit institutions. The internal audit acts as a catalyst of change, providing recommendations concerning the corporative governance processes and structures improvement.

Also, the paper presents new tendencies and perspectives concerning the internal audit role within the corporative governance of credit institutions, taking into consideration the more and more important role of the internal audit activity within the risk management process.

The final part of the Chapter points out the conclusions and recommendations concerning the future action directions proposed in order to provide the increase and reinforcement of the relationship between the corporative governance and the internal audit within credit institutions.

The Chapter IV, entitled „**Case study – design and implementation of internal audit system within credit institutions**” describes a practical model for the internal audit activity development within a credit institution, based on a hypothetical example. .

The proposed internal audit system emphasizes all the development steps of the internal audit activity within a credit institution, these steps being recorded within the internal audit **Register**, element representing the essence of the internal audit system developed in the practical example.

The proposed internal audit system benefits thus from the advantage of the **Register** concept, element which is considered to be essential, because it allows the deciding persons to visualize in real time the general situation of the internal audit activity, allowing the credit institution's management structures to act quickly and to correct the potential deficiencies and to easily implement measures meant to increase the internal audit department efficiency.

The internal audit system proposed within the case study is founded on the principles of RBIA (Risk Based Internal Audit), an increased attention being granted to the identification and definition of the Risk Areas, as well as to the determination of the auditable universe, these steps being essential for the efficient and effective development of the internal audit activity. Also, the role of the actions following the internal audit missions conclusion (follow-up) and of the measures for internal audit missions quality provision is brought forward, these two aspects influencing decisively the efficiency and effectiveness of the internal audit department activity.

The presented appendixes emphasize concrete examples of the manner in which the internal audit missions should be organized planned developed and monitored, transforming into useful and necessary instruments for the internal auditors in their daily activity performance.

The final part of the Chapter presents the practical appendixes that can be used and adapted by the internal auditors within the organizations in which they develop their activity.

The final Chapter describes the conclusions and proposals for the internal audit activity development within credit institutions, being obvious the fact that the internal audit gains more and more ground within the organizations' corporative governance, its action field increasing permanently as a result of the continuous political and

economical changes occurred at a world level as well as a consequence of the technological progress, managers requiring a continuously increasing quality for the services supplied by the internal auditors.

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ABBREVIATIONS

- AUS** – Standardele de audit USA
- ASB** – Auditing Statements Board
- BIS** – Banca Internațională pentru Reglementare
- BNR** – Banca Națională a României
- CAFR** – Camera Auditorilor Financiari din România
- CAPI** – Comitetul pentru Audit Public Intern
- CEE** – Comunitatea Economică Europeană
- CECCAR** – Corpul Experților Contabili și a Contabililor Autorizați din România
- CIA** – Auditor Intern Certificat
- CSPAAS** – Consiliul pentru Supravegherea Publică a Activității de Audit
- FEE** – Federația Europeană a Experților Contabili
- GAAS** – Standardele generale de audit acceptate
- IAASB** – International Auditing and Assurance Standards Board
- IAS** – Standarde internaționale de contabilitate
- IASB** – International Accounting Standards Board
- IAPC** – Comitetul Internațional pentru Direcția de Audit
- IFAC** – Federația Internațională a Contabililor
- IFRS** – Standarde Internaționale de Raportare Financiară
- ISAs** – International Standards on Auditing
- IFACI** – Institutul Francez al Auditorilor Interni
- IIA** – Institutul Auditorilor Interni USA
- MFP** – Ministerul Finanțelor Publice
- UCAAPI** – Unitatea Centrală de Armonizare pentru Auditul Public Intern
- UE** – Uniunea Europeană
- US GAAP** – United States Generally Accepted Accounting Principles