

## **ROLE OF INTERNAL AUDITING IN RISK MANAGEMENT IN THE PUBLIC SECTOR AND LOCAL ENTITIES – CASE STUDY BIHOR COUNTY**

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**Abstract:** *This exploratory study of the internal audit in the public sector in function, points out the need for the involvement of public sector entities, showing that in its role has traditionally focused mainly on evaluating internal control and not on the process of risk management and corporate governance. The objective of this study is to analyze the role of the internal auditing in risk management in public institutions from Bihor County. The method chosen is the research is based on questionnaire and the analysis of the institutions has been divided into two categories, so that, when the sample was taken in consideration, the likelihood that local public institutions of Bihor County have organized the public internal audit activity. Based on responses from 49 entities from public sector, the result of the study show us that the public internal auditors know they can play an important role in the risk management, but there is a number of other activities which must be conducted within the organization. So, they tend to understand the concept of risk management and risk management process, where it is carried out, and of the role they can play in improving and activity, however, issues of disposable incomes allocated to activity, and enough personnel specializing in the field, as well as a lack of interest of management to increase the efficiency and profit of the public internal audit activity, are issues that impede performance and risk management.*

**Keywords:** Auditing, Public entities, Internal Auditing;

**JEL classification:** M40, M42

### **1. Introduction and motivation of the study**

Internal audit provide constant review and appraisal of the systems and procedures introduced by the management with the intention to enable the management to control and utilise their resources properly and effectively (Mu'azu Saidu Badara and Siti Zabedah Saidin, 2012:404). In recent years, enterprise risk management has received a wider attention (Beasley, Clune & Hermanson, 2006) and become an agenda in both public and private sectors (Wood, 2009). Economic recession Romania is facing at the moment generates imbalance in public entities, progress in limiting public resources, low quality of service, the multiplication of risks and uncertainties, as well as the lack of performance. All these reasons take us to the study of the internal audit in the public sector, because the public entities have to change the traditional role of the audit (Deloitte, 2011), from evaluating internal control to the process of risk management and corporate governance.

It used to be that internal auditing in the public sector served as a simple administrative procedure comprised mainly of checking accuracy of transactions, pre-payment verification and control, counting assets and reporting on past events to various types of management, but in recent times, governments moving toward higher levels of transparency must demonstrate accountability in the use of public money and efficiency in the delivery of services. Larger and more complex operations demand greater competency and professionalism from internal auditors to minimize and manage risk (Deloitte, 2011).

In Belgia, Sarens G. et al (2010) makes an analysis that provides an in-depth analysis of risk management and internal control practices within Belgian social security public institutions (sspi). The findings show that: risk management and internal control are not highly developed; internal control is more developed than risk management; and risk management concepts like risk identification and evaluation are part of internal control, rather than internal control being part of risk management. Also concluded the fact that the traditional internal control philosophy (focusing on conformance) is more wide-spread than the recent risk management philosophy (focusing on performance) could be a reason why the performance requirements of the SSPI are not met.

With respect to internal audit's involvement in the identification and assessment of risks in the local public sector and public institutions, Ernst& Young (2008) has achieved a relevant study on a sample of 400 local authorities and 125 public institutions. The study was based on the questionnaire which was sent to these entities and had questions about the governance of the public sector, the trends of organizations with regard to the risks and identify significant areas, the stage of implementation of internal control. The answers about the responsibilities of the internal audit were the following:

**Table 1 The activities of the internal audit function in the public sector entities and public global institutions.**

Types of activities	Public institutions		Local public sector	
	Systematically %	Often %	Systematically %	Often %
Evaluation of internal control	47	32	20	44
Testing the effectiveness of procedures	40	30	17	44
Risk identification	32	16	6	27
The audit of the financial statements	26	42	15	43
Audit of information systems	25	38	8	22
Audit of subordinate entities	13	31	41	38
Formulating procedures	5	26	25	43

Types of activities	Public institutions		Local public sector	
	Systematically %	Often %	Systematically %	Often %
Evaluation of public policies	-	6	21	36
The consistency of internal control	-	21	6	26

Source: Ernst & Young (2008)

The survey shows that the identification and assessment of weak points in terms of risks is subject to regular internal audit assignments in a percentage of 32% in public institutions and local entities, 6% in the public sector. Also testing the effectiveness of auditing procedures, information systems, and financial information are rarely subject to public internal audit missions, and missions with an indirect internal audit (writing manuals of procedures, internal consistency checks) are often subject to choice. The assessment of the internal control and audit of subordinated entities about the systematic and common responsibilities of the internal audit in most of public entities (79%, 64%, 42%, 79%), demonstrates that the internal audit assignments are still traditional.

Another poll conducted by Deloitte (2009) shows improper risk management in the public sector. The survey was conducted in 200 government departments in 28 States, according to officials, 48 percent of the public believes that the world of risk management is one of many challenges met by the financial departments of public entities.

The implementation of relatively recent internal audit in the public sector in Romania and financial resources will decline in economic conditions, leading to the premise to conduct an empirical study to identify to what extent public audit, there are participating, improves and helps to smooth risk management in public entities in Romania.

Therefore, regarding the previous researches (Rudasingwa Justin, 2006; Mu'azu Saidu Badara and Siti Zabedah Saidin, 2012) we proposed as objective the analysis of the role of internal audit in risk management of the local public institutions in Bihor County.

The analysis was conducted in order to obtain information regarding:

- The internal auditor's role in risk management (Anuntaakalakul A., 2010);
- The activities undertaken with regard to risk management and the internal audit risk management (IIA, 2011);
- The role of public audit on the identification and assessment of risks (Ahmad N. et al, 2009);
- Internal audit skills to cope with the development of risk management (Matthew Leitch, 2004);
- Lack of motivation activities relating to internal audit and risk management (IIA, 2011).

We believe that all replies to questionnaires being released, would help us to form an opinion on the role of internal audit in public institutions and risk management, and to determine the reasons for these processes are not carried out.

The study undertaken focused on public institutions that operate locally and use of public financial resources. Local government institutions are taken into account in our analysis are those in the Bihor County, the County Council and town councils of municipalities, towns and communes, that the law derives income and use budgetary appropriations.

## **2. Research methodology**

The objective of our study is to analyze the role of the internal auditing in risk management in public institutions, at local level. As the current research, there has been a positive-type research, and in doing so (Ionașcu I., 2003:76) the positive approach in accounting assumes that any theoretical formulation cannot be valid unless it is verified empirically, by confronting the hypothesis with the facts.

The method chosen in the research is based on questionnaire, and Francois de Singly (1998:21) states that the survey-based questionnaire serves the explanatory data, and as a form of research we opted for the statistical survey.

## **3. The construction and presentation of sample review**

The analysis of the institutions has been divided into two categories, so that, when the sample was taken in consideration, the likelihood that local public institutions of Bihor County have organized the public internal audit activity.

From the analysis of the sites linked to the Mayor's and the Board of Auditors 'Bihor report on 2010, we found that public internal audit activity at the level of municipalities is not organized in the form of individual departments, it unfolds as an outsourced. So, using a single questionnaire for both categories of institutions that do not provide relevant answers and would have hindered the process of gathering information, which we consider relevant to their classification depending on the organization of public internal audit division.

As a result, the sample is comprised of two categories of institutions:

- class I, consisting of the County Council and town councils of municipalities in Bihor: Oradea, Beiuș, Salonta and Marghita; and the mayoralties of cities in Bihor County, namely: Aleșd, Nucet, Săcueni, Stei, Valea lui Mihai and Vașcău; a total of 11 entities;

- class II, consisting of the municipalities of the 91 municipalities found in the County. The data are recorded and reported by the Directorate General of public finances Bihor, and the sample chose a representative geographical distribution. For the two categories of institutions we have realized 2 questionnaire containing questions relevant to the work of risk management in the context of public internal audit division and the respondents are internal auditors of public employees in selected public institutions (where there is organized the public internal audit office) and unemployed people in the management of institutions (where the public external audit service is outsourced). The questionnaires were sent electronically and listed.

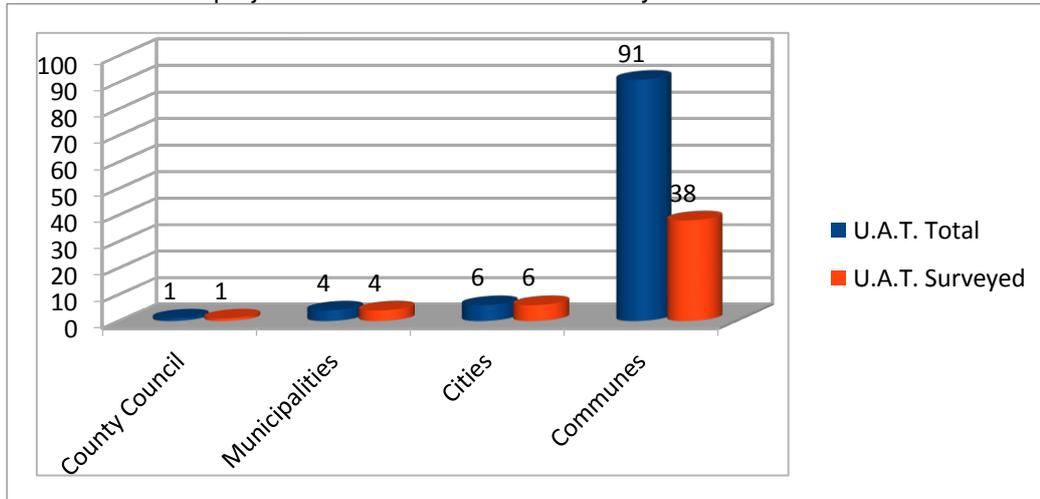
As a result of the questionnaire, we obtained a total number of 49 responses, representing a response rate of 48.03 %. By clicking on the two distribution categories, the response rate for the first category is 100%, and for category II the response rate is of 41.75 %.The non-response rate is higher than that of the responses and we think the reasons are the lack of system of public internal audit, including outsourced, or negative perceptions, distrust, on opinion polls.

## **4. Analysis of the collected data**

The sample size is 102 territorial and administrative units and their distribution are presented as evidenced by the following graph:

**Graph 1.** Distribution of administrative territorial units

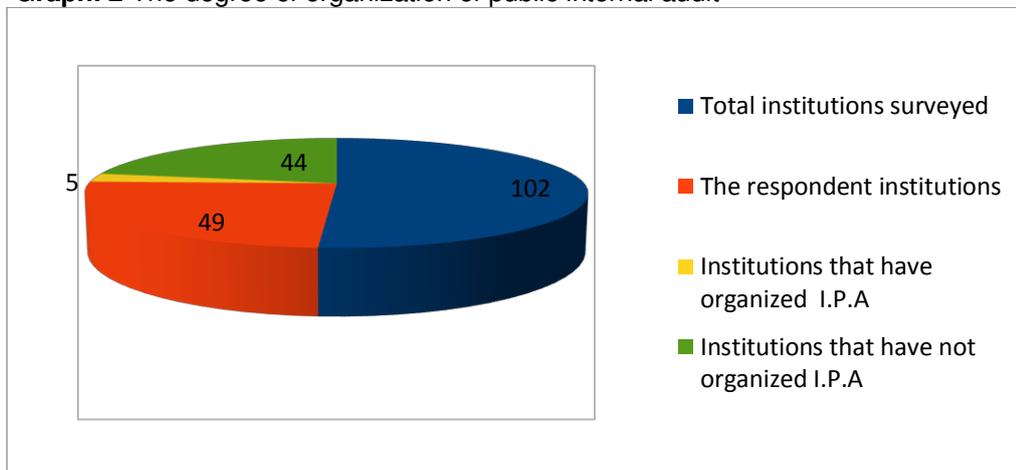
Source: projection made by the author



Source: projection made by the author

From the point of view of the internal audit division, common question for both categories of respondents, of total institutions surveyed 10.2% declare that organized public internal audit and its activities that include the control, the control environment, risk assessment and monitoring. The rest of 89.79% institutions performing public internal audit as outsourced service.

**Graph. 2** The degree of organization of public internal audit

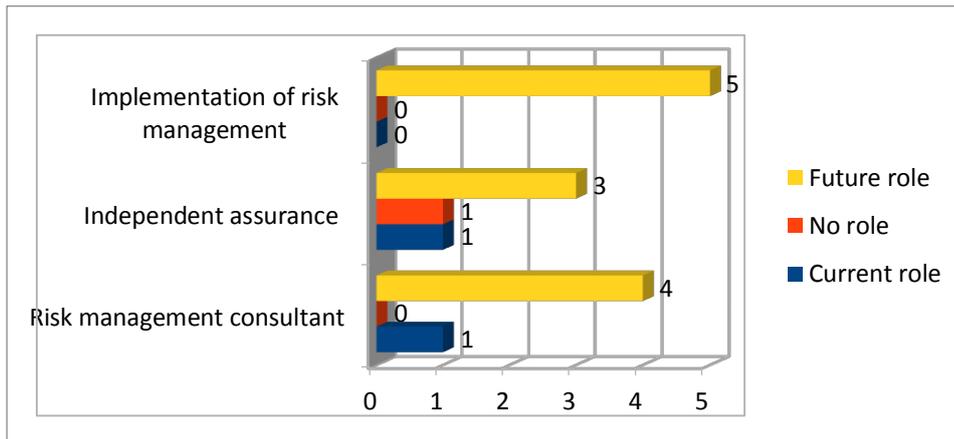


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For the first category of respondents, the questions were focused on the role of internal audit in public in current business practices and activities for the process of risk management, counseling and support granted by the audit reports on the implementation of the process improvement and performance increase.

As a result of the questionnaire, all 5 of the first entity category indicated that the internal audit activity, the public has had responsibility for implementing risk management, reflecting an active role in the learning process of the management to respond to existing risks (80%) and for the identification and assessment of risks (80%). However, only 66.6% offering independent on the process of risk management, and on the advisory role, it seems that the public internal auditors tend to understand well enough to see the risk management implementation process.

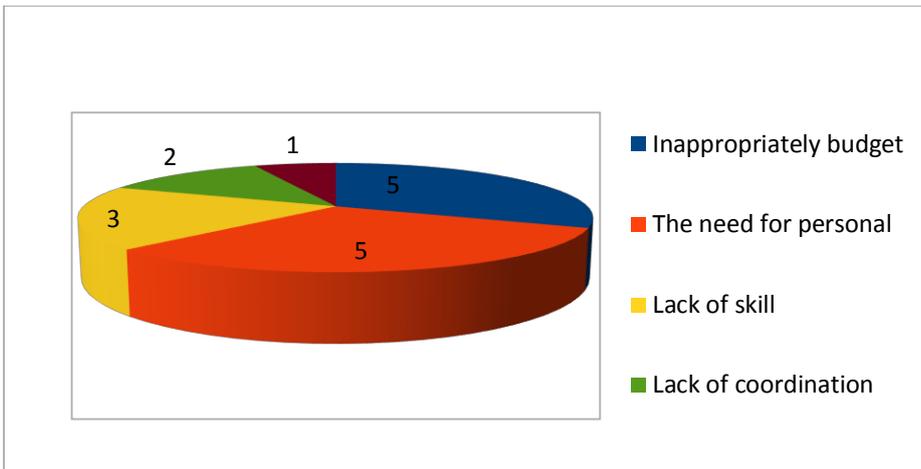
**Graph. 3** Description of the role of public internal audit risk management



Source: projection made by the author

Among the shortcomings identified in the analysis, they could identify the sufficient revenue or funds available and the specialist personnel. In all entities, public internal audit work was carried out with 1-2 auditors, which according to the questionnaire applied requires knowledge of the practices and techniques of management of risk management. The problem of the lack of personnel in the field of public internal audit at the national level is reflected in the local plan generated by the current economic situation of our country and blocking positions in the public domain as well.

**Graph 4.** Problems encountered by the public internal auditors:



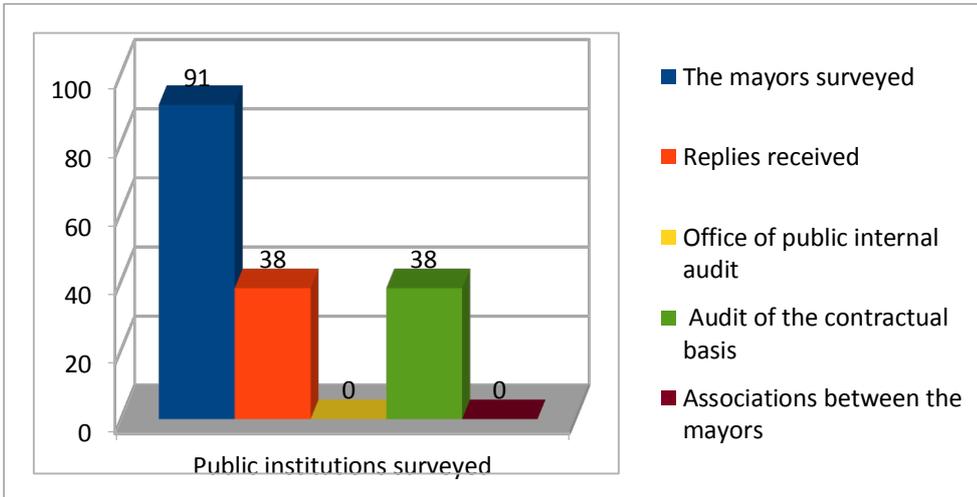
Source: projection made by the author

As for the second category of entities considered for the analysis undertaken, out of 91 from mayoralities in records, we achieved a number of 38 replies. The response rate is of 41.75% and respondents are persons or institutions in the Finance Department, so the answers can be considered relevant to the analysis.

The municipalities surveyed all declared that the work of the public internal audit in the form of outsourced service, or under contractual form. Excluding non-response rate, an increase in the level of activity of internal audit in public administration, in one form or another, and as the regulations require, the local public entities which have not set up their own internal audit department or have not been in cooperation to ensure that the internal audit activity it may be provided by the internal auditors qualified individuals on the basis of contracts for the provision of services, in accordance with the provisions of the law of 2002 on the audit of 672/public, republished in 2011.

At the same time, however, it can be seen that public institutions were not considered appropriate to amend the article 24 in the law 273/2006 on local public finances on the formalization of possibility of association of local public institutions, for the organization and conduct of internal audit, through the county structures with legal personality of associative structures of local public administration authorities, recognised as being of public utility or development associations established in accordance with the law of intercommunity, existed at the level of the institutions surveyed no association of its kind.

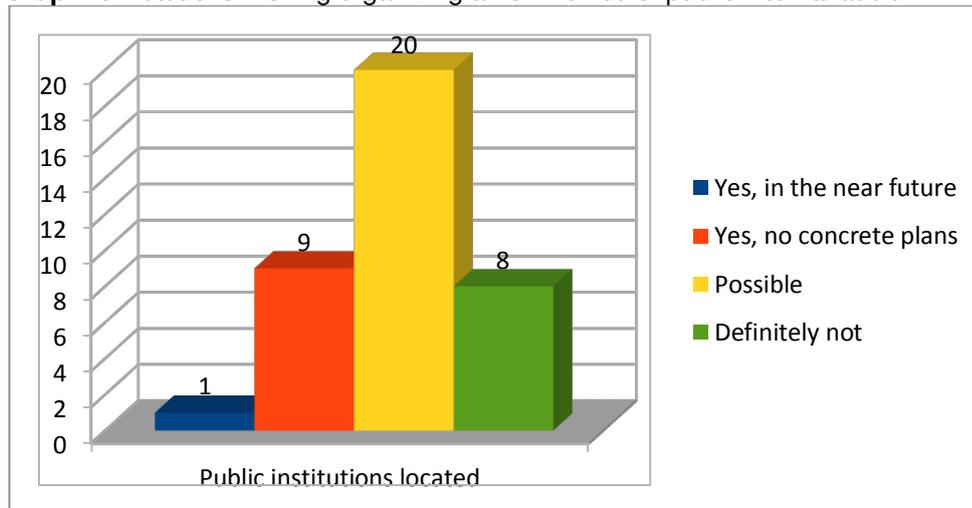
**Graph. 5** Form of organisation of public internal audit



Source: projection made by the author

With regard to the organization of a future office of public internal audit, only one institution has expressed the willingness to hold a certain office, while only possible 52.63% consider this opportunity, arguing the lack of staff and a budget.

**Graph. 6** Institutions wishing organizing an own office of public internal audit



Source: projection made by the author

Taking into consideration the risk management, over 13% of the analysed institutions argue that it is in an advanced stage of development, 37% are in the process of implementing or has been recently adopted, and the rest do not carry out activities specific to the risk management process.

Of the interviewed institutions, in 60% of cases, the liability risk management belongs to a risk officer and the remainder belongs to a person who has other duties.

## Conclusions

We examine the role of internal auditing in risk management in the public sector from the local entities of Bihor county and we find that the activities of the public sector, as well as in the private sector are becoming increasingly more complex due to the news that appear and the risks they face. Organizations providing risk management increasing attention, but implementing an effective risk management requires time and knowledge.

We also document that the public internal auditors know they can play an important role in the management of risk, but there is a number of other activities which must be conducted within the organization. So, they tend to understand the concept of risk management and risk management process, where it is carried out, and of the role they can play in improving and activity, however, issues of disposable incomes allocated to activity, and enough personnel specializing in the field, as well as a lack of interest of management to increase the efficiency and profit of the public internal audit activity, are issues that impede performance and risk management.

The limitation of the paper concerns the analysis of a single county, and the rate of respondents. For future research we should validate our findings by extending the review in other counties of Romania. Likewise, future research should look at the possibility of inserting institutions that use internal audit from private sector, making a comparison between the two sectors.

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