

CHALLENGES OF INTERNAL AUDIT IN THE CURRENT CRISIS

Popa Adriana Florina, Breban Ludovica, Bochiș Leonica

¹ Accounting, Audit and Economic Analysis Department, University of Economic Studies, Bucharest, Romania

² CECCAR Salaj territorial branch, Zalău Romania, PhD

³ CECCAR Bihor territorial branch, Oradea, Romania

adriana.fp@gmail.com

ludovicabreban@yahoo.com

bochisleonica@yahoo.com

Abstract: *Modern economic theories reject the generalization of theories concerning the economic and financial crises. Each financial crisis is unique, a historic accident, generated by specific factors in a certain socio-economic and political set-up. According to these theories, crises cannot be anticipated so as to minimize their negative effects. In spite of the fact that economic and financial crises are not identical and do not produce identical effects, history teaches us that they are strongly correlated with the cyclic nature of economic processes. The current economic recession, which shows in all fields of activity, is determining auditors to make evaluations which are a lot more precise, based on extensive procedures, as long as the presumption of activity continuity into the future is accurate. In this context, internal audit is individualized as an managerial assistance function, which allows a correct perception of the reality of the business as a whole and/or as predefined processes. The purpose of this paper is to create an overall picture of internal audit by collecting data and information from literature and showing the dimensions and the internal audit practices internationally. Therefore, we conducted a research based on the analysis of national and international publications, various articles and studies in the financial press, on the emergence and development of the internal audit function both internationally and nationally. Later we analyzed the position of internal audit in terms of global financial crisis, all these leading to the usage of a comparative study of twelve international companies in order to highlight the specific features of the internal audit function in each organization. Our intention is to emphasize aspects of internal audit departments, relations between them and the management, their role in companies based on studies provided by Protiviti, a global consulting and internal audit services company, having experts specializing in risk, consultancy and transactions.*

Keywords: *audit; internal audit; audit practices; multinational corporations*

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1. Introduction

From a territorial, durational and economical and political effects' standpoint, the 1929 crisis, also known as the Great Depression, can be considered, up to this moment in time, the most severe. The Great economic Depression, which started in the United States of America, was preceded by a period of 9 years (between 1920 and 1929) of economic development, which was supported by the increase in circulation of the monetary mass by the Central Bank of America – Federal Reserve (FED), as well as the relaxation of the credit standards and reduction in interest rates.

As a consequence of FED's monetary and financial policy, the population bought stock massively, which registered a constant increase in the Stock Exchange, up until September 1929, when the great Wall Street Crash happened. FED intervened by reducing the monetary mass and by restricting credits, the follow up being a massive bankruptcy in all sectors of the economy: agriculture, industry and banking. National production decreased to half its previous values and the unemployment increased.

The current financial crisis was triggered in the USA in 2007, ten years after the last extended financial crisis from South-East Asia. The first signs of what was to come were experienced in the summer of 2007, when financial institutions started acknowledging that they are dealing with significant losses on sub prime mortgage backed securities (CAFR 2009). The crash of the Federal Housing Administration (USA) is often considered responsible for the generation of the crisis, but the vulnerability of the financial system was caused by complicated contracts and financial operations, subjected to leverage ratios. The USA's monetary policy priced credits at ultra-low rates, thereby encouraging very high leverage ratios and, according to American Professor of Sociology John Bellamy Foster (who wrote extensively on the subjects of financial crisis), a "hypertrophy of the financial sector". A report on the crisis published by the Association of Chartered Certified Accountants identifies as the main factors that generated the crisis the following elements (CAFR, 2009:442):

- The failure of corporate governance
- The failure of institutions to assess and manage the existing links between business risks and the remuneration and incentive systems, which were not at all designed to favor stockholders
- Errors in the process of identifying and managing risk
- The weak influence or even a minimal manifested power of banks' risk management departments
- Weaknesses in the financial reporting systems and regulations.

The relevant economic theories, which established efficiency as an essential instrument of economic growth, are being called to question. Globalization, as a mass phenomenon, combined with the exacerbation of commercial policy the financial markets in order to gain profit by any means necessary, constitute the apotheosis of the economic crisis. The appetite for considerable profits with minima efforts was instilled in generations of managers, who were trained to step up to manage big corporations, and fostered, in the beginning of the 80's, economic policies which permitted the complete deregulation of all economic markets, but especially the banking and stock exchange markets, concomitantly with an unprecedented reduction of the state in the economy (CAFR, 2009:383-446).

As a result of the crisis, it was considered necessary the reports handed in by auditors in the preceding periods were submitted to analysis, which highlighted the fact that, in numerous situations, shortly after an auditor emitted an unqualified opinion regarding the financial statements of a company, they were no longer capable to continue their activities and they collapsed. The attention was focused on auditors who gave the green light on these financial statements, signing their consent that the accounting practices and regulations were kept. In many cases the auditors also provided their clients with other services, besides financial audit, which inevitably raised into question the delicate subject of the auditors' independence. When internal control and internal audit is efficient, the time allocated by the financial

auditor is diminished. This fact means fees reduced for the auditing activity according to Dobre F., Vilsanoiu D., Turlea E. (2012).

One of the reproaches of the audit activity would be precisely the non-compliance with the auditor's independence criteria, necessary for the financial audit to be efficient. The following elements also have a negative impact on the audit activity and can be taken into account in the context of economic crisis:

- Using an audit model which had become obsolete, when considering the complexity of the transaction subjected to said audit
- Not granting due importance to audits based on risk-aware methodologies

According to the International Internal Audit Standard 2110, even though it is not very explicitly mentioned, the internal audit should convey to management and the audit committee from within the company, the results of the efficiency monitoring and evaluation activity, with which the risk management systems functions. The internal auditors will have to check and evaluate the efficiency of the risk management system, which needs to be approached as an integral part of the assurance activities for companies' management. Thus, the internal audit is not responsible for the implementation of the risk response actions, but is responsible for providing management with reports which convey the significant information regarding key risks and their efficient management. Thereby, the internal audit offers insurance as to the efficient functioning of risk management, without being responsible for making any decisions as regards response actions to mitigate the identified negative risks. Therefore, one of the major effects of the crisis is the drastic decrease of the users' confidence in the accuracy and completion of financial statements, financial auditors being the ones to offer a reasonable level of assurance regarding the faithful image reflected by financial statements.

2. Case study concerning the analysis of internal audit practices in multinational corporations

2.1. The objectives of the case study and stating the used material

The actual case study is based on research conducted by the company Protiviti, which is a global business consulting and internal audit firm, composed of experts specializing in risk, advisory and transaction services. Protiviti has offices in 61 major markets, out of which 33 are in the US and 28 in two Americas, Asia and Europe. The firm also has risk consulting partnerships with firms from Abu Dhabi, Caracas, Dubai, Jakarta, Kuwait and Lima.

The company was founded in 2002, when Robert Half International, reached an employment agreement with Arthur Andersen LLP to hire approximately 800 professionals. These were familiarized with Andersen's internal audit, business and risk consulting practices. The employees were the basis from which Protiviti started. The name of the company was chosen based on a branding study conducted by the founding company. It is an invented term which communicates the key attributes - professionalism and pro activity, as well as independence and integrity. The presence of the three „i” in the word represents „independence”, which is, probably, the most important concept. Beyond the linguistic aspects, the name proved to be unique, becoming a world brand.

Protiviti services respond to challenges related to: managing operational and financial risk, the technology to manage risks and effectiveness; litigations and investigations.

The studies conducted by this company are focused on describing the internal audit activities of several multinational companies. Based on information from these studies, verified with information from the companies' websites, a comparative study of several relevant characteristics related to internal audit was conducted. The first two subchapters of the study familiarize the reader with general information about the organizations, their scopes of activity and describe their internal audit department. The next two subchapters cover aspects related to the setting of objectives for the twelve companies and the manner in which they are to be reached. The last subchapter describes the relationship between the internal audit and the corporate governance of the entities.

The aims of the present study are identifying the main characteristics specific to the internal audit function of multinational corporations, emphasizing the internal audit's role in identifying and managing risk and, also, its relationship with the audit committee.

2.2. General description of the companies

Table 1. The activity domains of the companies

Financial services	Pharmaceuticals	Energy	Other fields of activity (Electronics, software)
Accenture Commonwealth Bank Deutsche Bank SPB Bank Mandiri	Dentsply Talecris	Enel Shell	Royal Phillips Electronics SAP

Source: Authors' projection based on data collected from each company's website

The entities analyzed within the scope of this project come from various, distinct activity fields, as it can be observed in Table no. 3. Thus, half of these entities are part of the financial sector, namely: Commonwealth Bank, Deutsche Bank, Bank Mandiri are highly developed banking institutions in the area in which they come from;

- *Deutsche Bank*, with their headquarters in Germany, is an investment bank based on a strong private franchise system. A banking leader in Germany and in Europe, Deutsche Bank offers financial services all around the globe and continues to extend its services in Asia, North America and the important world markets.

- *Commonwealth Bank* from Australia is one of the largest companies listed on the Stock exchange, offering complete financial services to its clients. This bank has more than 1.000 branches, 3.500 ATMs and 3.800 postal agencies, having the largest distribution network in the financial services market from Australia. Internationally, the bank has branches in Indonesia, New Zealand, China, Great Britain, USA, Singapore and Japan.

- *Bank Mandiri* is the largest bank in Indonesia. It was formed by the merger of four state banks. In 2008 the bank had approximately 960 subsidiaries, some of

which were in Singapore, Hong Kong, the Cayman Islands, Shanghai and Dilly. Some of the most important branches of the bank are Bank Syariah Mandiri, Mandiri Sekuritas, AXA Mandiri, and Bank Mandiri Europe Ltd. in London.

- *Accenture* (Ireland) offers management consulting, as well as other technology and externalization services, its activities being spread over 52 countries. In the last fiscal year, the company, which is listed on the New York Stock Exchange, had a net turnover of over 21 billion dollars.

5.1 *Prudential Plc.* (Great Britain) is an international company that offers financial services such as: insurance, pensions, investments and others. Structurally, Prudential PLC, is made up of four entities, namely: Prudential UK, Prudential Corporation Asia, Jackson National Life Insurance Company, and M&G. Prudential PLC has a reputed number of over 21 de millions clients.

5.1 *SPB* is an insurance specialized company originating in France and which operates in over 11 countries and has more than 822 employees. It was focused mainly on the banking sector, but currently offers not only banking products insurance policies, like insurance policies for banking cards, but also insurance policies for consumer products, such as insurance policies for mobile phones or other technological goods, insurance policies for sport equipment and insurance policies which cover everyday life events (like marriage, retirement).

The two companies from the medical field, *DENTSPLY International* and *Talecris*, have their headquarters in the United States of America.

DENTSPLY is a dental instruments and equipment producer, present in more than 120 countries. It is predominantly active on the USA and Canadian markets, but it also penetrated the European market (particularly France, Germany, Italy, Switzerland and England). *DENTSPLY* is also present in Central and South America, the Pacific Rim and South Africa. At the same time, the company holds marketing activities in Moscow in order to serve former Soviet Union countries.

Talecris worked in partnership with Bayer Pharmaceuticals until 2005 when the two companies separated. *Talecris* commenced its activity with revenues reaching 1 billion dollars, but then the company meant a series of products without having a real organizational structure. Presently, *Talecris* is a global entity which discovers, develops and produces essential treatments for humans whose health is in danger, by offering different therapeutic methods.

Enel and *Shell* are two of the energy sector giants, on a worldwide scale, being the main energy suppliers.

Shell is a Dutch company with revenues of 278 billion dollars in 2009 and over 101.000 employees in 100 countries from the globe.

Enel Italia is the largest energy corporation, and in Europe, Latin and North America is the second in terms of installed capacity, production and sales of electricity and gas. After acquiring Spanish utilities' company *Endessa*, together with its partner *Acciona*, *Enel* serves consumers with more than 50 million in power and gas. The company operates a varied array of hydroelectric, thermoelectric, nuclear, geothermal, windmill and solar energy stations.

SAP is one of the world's largest suppliers of enterprise software and software-related services, which help accelerate business innovation for its clients. The company has locations in over 120 countries. It was founded in 1972 and presently employs 47.500 specialists, out of which 13.000 work in Waldorf, Germany, where the headquarters of the company are. *SAP* has sales points in over 50 countries

worldwide and is listed at the Stock Exchange in several countries. The company had revenues of 10,7 billion dollars in the previous year.

Philips is a company originally from the Netherlands and presently employs over 116.000 in more than 60 countries and in 2009 had sales in value of 23 billion dollars. The company is the world's largest producer of lighting equipment, one of the first three producers of medical equipment and the largest producer of consumer goods in Europe (December 2007).

2.3. GENERAL INFORMATION REGARDING THE INTERNAL AUDIT DEPARTMENT

Table 2. Comparative data referring to audit budget, number of years since the functioning of the internal audit department and the number of internal auditors

Company	Internal audit Budget	No. of years of functioning for the Internal Audit	Number of internal auditors
<i>Accenture</i>	unknown	9	45
<i>Commonwealth Bank</i>	15 mill \$ US	21	90
<i>Deutsche Bank</i>	15 mil. \$ US	50	400
<i>SPB</i>	< 1 mil. \$ US	2	3
<i>Philips</i>	unknown	>70	75
<i>SAP</i>	1-5 mil. \$	14	34
<i>Shell</i>	> 90 mil. \$	>50	250
<i>DENTSPLY</i>	< 1 mil. \$ US	15	5 (full-time) + 10-15 (guest auditors)
<i>Talecris</i>	1-5 mil. \$ US	3	3 interns + 3-4 in partnership
<i>Bank Mandiri</i>	65,4 mil \$	10	117
<i>Prudential Plc.</i>	£16 mil.	not certain	~ 130
<i>Enel</i>	€ 1 mil.	>10	~ 100

Source: Authors' projection based on data collected from each company's website

The comparative analysis is based on three variables, namely:

- The budget apportioned by the company to the internal audit department
- The number of internal auditors
- Number of years of functioning of the internal audit department

The following aspects can be highlighted:

- In companies which have an internal audit department for more than 50 years, such as: Deutsche Bank, Phillips, Shell, the number of internal auditors within the department as well as the budget is higher.
- There are also entities, for which even though the budget is quite high, as well as the number of internal auditors, not the same can be said about the number of yours the internal audit department is in function. This is the case for Mandiri Bank, for which the internal audit department is in function for 10 years, with an apportioned budget of 65,4 million dollars and with 117 internal auditors.
- The case of a relatively low budget for internal audit, but with a large number of internal auditors, is exemplified by Enel that has approximately 100 internal auditors.

Table 3. Companies' objectives and the strategies to achieve them

Analyzed criteria	DENTSPLY	Talecris	SAP	Philips	Shell	Enel
<i>Planned objectives</i>	<ul style="list-style-type: none"> -the reduction of risk exposure -the development of cost reduction programs 	<ul style="list-style-type: none"> - the surveillance of the financial sector 	<ul style="list-style-type: none"> - internal control, the covering of risk management - to increase the efficiency of control processes - to develop the reputation of internal auditors 	<ul style="list-style-type: none"> - the inclusion of management risk in the audit process -to assure financial reporting conformity 	<ul style="list-style-type: none"> - risk management - internal control 	<ul style="list-style-type: none"> - the creation of an international audit department – to follow the ethics' code
<i>Strategies to achieve objectives</i>	<ul style="list-style-type: none"> - the use of the program ACL; (the use of technology reduces the auditor's travel expenditure) 	<ul style="list-style-type: none"> - Through the use of ACL program 	<ul style="list-style-type: none"> - through the SAP application 	<ul style="list-style-type: none"> - the implementation of ETR 	<ul style="list-style-type: none"> - the compound effect of auditors working with technology (the basis of this company lies on these two elements) - personnel training 	<ul style="list-style-type: none"> - the ERM model (concentrating on the processes and the risks)

Source: Authors' projection based on data collected from each company's website

3. CONCLUSIONS AND SUGGESTIONS

The aim of this paper was to stress some aspects of the internal audit function within international companies, based upon information provided by Protiviti, a global consultancy and internal audit company made of risk, consultancy and transaction experts.

In our research, we took into account several criteria:

- The companies' field of activity
- General data about the audit department (age of the audit department within the organization, its budget, the number of internal auditors)
- The objectives of the internal audit department
- The strategies used to accomplish these objectives
- Corporate governance

The companies that we analyzed have different fields of activity, mainly within the financial sector. Half of the twelve companies in discussion act on the financial market, and the rest belong to the pharmaceutical, energetic, software and electronics fields. The correlation between this analysis' criterion and the other variables was not taken into account mainly because of the lack of a representative sample of firms from the same field of activity that could have highlighted the particularities of belonging to the above-mentioned field. However, there might be cases in which a certain feature is specific to a field of activity.

According to information supplied by Protiviti, companies which grant a high budget to the internal audit function, are the following: Commonwealth Bank, Deutsche Bank, Shell, Mandiri Bank, Prudential Plc.; the budgets vary from 15 to 65,4 million dollars, the highest value of 65,4 million \$ is allocated to the internal audit department of Mandiri Bank.

As a general conclusion, it can be said that the internal audit function differs from one organization to another, because the organizational culture has a major influence. However, for all companies, the attention to risk management, internal control and continuous surveillance can be distinguished as joint interests. These common desiderates can be reached with the use of technology or applications, such as: ACL, PGP, SAP, MAPS, AWARE, CAATs etc., which combined with the knowledge and skills of the auditors, contribute to the increased efficiency and performance of internal audit. The role of internal audit is paramount within a company, as the reports and information that it supplies is the basis for managerial decisions.

Several of the companies in discussion decided to constitute an audit committee or a risk committee in order to accomplish their risk management and internal controlling responsibilities.

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