

## RISK ASSESSMENT OF THE INTERNAL MANAGEMENT CONTROL SYSTEM AT THE PLANNING OF THE INTERNAL PUBLIC AUDIT ACTIVITY

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**Abstract:** *Public internal audit is for providing advice and providing objective assurance on the effectiveness of the internal managerial control system by providing recommendations for improving it. The activity of public internal audit is independent and objective and its activities are planned for long, medium and short periods. Planning the public internal audit activity involves a general strategy based on the entity's major risk analysis that may affect the achievement of the entity's planned objectives over a period of time to achieve performance and optimize resource utilization. The planning of the audit activity ensures the efficient and timely accomplishment of its activities within a well-defined time period, through a detailed approach regarding the nature, duration and coverage of the audit and the workload achieved. The topic addressed in this article refers to the way of planning the activity of the internal public audit and models for the risk assessment of internal managerial control.*

**Key words:** *public, internal audit, risk, internal control managerial, entity.*

**JEL Classification:** *H83, G32, M42, C33.*

### 1. Introduction

Appropriate and well-structured audit work planning guides the audit of the areas / objectives of the entity and the risks identified by the entity's managers in internal control and resource management. Thus, the audit may focus on planning its activities on the size of the entity, the complexity of the audit, the auditor's experience and the knowledge of the entity's field of business, which is a very important part of the audit planning.

Any public entity to achieve performance will plan its activities based on national targets. The public internal audit must understand the field of activity, the internal control environment, the control activities, the resources, which is the starting point for the planning of its activities. The value that the public auditor generates is directly proportional to the contribution of his/her work in achieving the strategic and operational objectives. The assurance and counseling missions aimed at seeing the degree of compliance of the internal managerial control system

Thus, by carrying out the planned activities, management and operational managers provided with the degree of achievement of the objectives and recommendations for improving the internal control processes/activities.

The public internal auditor evaluates the managerial internal control system in terms of the degree of compliance with the National Managerial Internal Control Standards and the associated risks in achieving the objectives planned for a period.

### 2. System of planning internal audit activities

Activity planning is a systematic and well-structured process that facilitates the achievement of planned objectives with its actions within the foreseeable timeframe and is an instrument for monitoring progress and promoting both the quality and professionalism of the public internal audit activity (Christmas, 2004, p. 102).

a) a description of the required information, where reference will be made to factors such as: policies, strategies, reforms and internal factors on the efficiency and effectiveness

of operations, the reliability of financial reports, compliance with internal laws and regulations, the use of resources;

- b) description of sources of information;
- c) description of methods of collecting information;
- d) the chart of the activities included in the plan.

Activities are planned on three levels-in three documents:

I. Long-term strategic planning envisages planning the activity of the internal audit function of the subordinated structures that have organized subdivisions / internal public audit unit every five years according to the normative framework of the public internal audit. This process is documented through the Internal Public Audit Strategy and / or Strategic Development Plan; The strategic plan is the means by which the vision and mission of the internal audit activity will be pursued through the statement of (Practice Guide, 2012, p. 4):

- **a vision** will articulate the concept of internal public audit activity and the way it hopes to bring added value to the entity, and on the basis of the analyzes conducted, issues that will not be included in the strategic plan will be communicated to senior management and operational managers to ensure a total opening;
- **mission**, which is formed on the basis of the vision statement, outlines the primary purpose of the activity of the public internal audit, which it plans to carry out in the future and how it is part of the strategic plan of the entity. It is the same for all staff involved in public internal audit, as well as for internal and external stakeholders.

Analyzing the degree of realization of the vision and mission through the limited number of elements and critical factors of realization. These critical factors will identify the key elements that major initiatives need to be chosen to ensure the concentration of resources on the most important activities. Three primary questions will be used to identify the FCS (Practice Guide, 2012, p. 5):

- *Positioning* - Is the public internal audit activity positioned and strategically supported?
- *Processes* - Are the processes of internal public audit activity dynamic and allow for the needs of orientation?
- *Individuals* - Does the internal public audit activity have professional staff in the field to enable it to accomplish its mission?

One of the effective ways to analyze vision, mission and critical success factors is SWOT, which will identify sensitive elements and critical factors.

The purpose of a SWOT analysis is to identify the main internal and external factors that are important in achieving the strategy. This analysis groups the information into two main categories:

*Internal factors* - Unique strengths and weaknesses for internal audit work in the public sector.

*External factors* - Opportunities and threats that the external environment represents for the internal audit activity of the public entity.

**Table 1. Components of SWOT analysis**

<b>STRENGTHS</b>	<b>WEAKNESSES</b>
Internal characteristics of the internal audit activity that can be considered facilitators of the audit strategy.	Internal characteristics of the internal audit activity that, in opposition, can prevent the achievement of the audit strategy, and can place the activity in an unfavorable position.
<b>Opportunities</b>	<b>Threats</b>
External items other than internal audit activity that may increase demand for more and audit and audit consulting services	External elements apart from the internal audit activity that, in opposition, can decrease the demand of assurance and consulting services, prevent the achievement of the audit strategy, and place the activity in an unfavorable position.

Source: *Practice Guide, Developing the Internal Audit Strategic Plan, 2012, p. 6*

The initial step in timing planning will assess the human resources within the department, the skills, aptitudes and knowledge required to achieve those set out in the internal audit strategy. It is important to assess the extent to which it will have to be based on the skills and knowledge identified, as this will influence the selection of the resource allocation model type. The assessment of the necessary skills and knowledge could include (Practice Guide, 2012, p. 8):

- a) the applicability of internal audit responsibilities defined in the charter;
- b) the expected balance of insurance and consultation missions;
- c) the expectations and requirements of the entity's management;
- d) the results of the risk assessment;
- e) level of coordination with other risk management and insurance functions;
- f) the long-term strategic plan of the entity, which is a valuable source in identifying things that internal public auditors need to know in order to operate and adding value to its entities.

Additionally, it is necessary to analyze how best to balance technological resources in the context of establishing the most appropriate resource allocation model. These aspects of resource analysis will support the department's priorities defined by the public internal audit.

Another important aspect in the development of the Strategic Plan is the review of the technology and tools that will help to set the boundaries of audit missions, as the use of electronic work documents could be very useful for increasing productivity and facilitating quality control, especially for managing multiple components missions involving more than one person and multiple locations. Balancing workflow tools in such applications to transmit files and consolidate findings can promote effective information dissemination to allow timely control of the quality of working documents and reports. Additionally, these tools may allow the public internal auditor to better monitor the progress of the audit plan to the level of the mission components of each plan. Such applications also provide a central repository of work documents and reduce the risk of multiple versions of documents, allowing for efficient file dissemination. It may be necessary to analyze the profitability to justify the implementation of these instruments. Some applications are first of all for the benefit of internal audit. However, many applications for electronic work papers can provide study and certification models and accompany workflow technology in managing governance / control initiatives.

**Revision of the Strategic Plan.** The strategic plan for the entity and the internal audit strategic plan should be regularly reviewed and updated accordingly. The frequency of revisions is determined through negotiations between the entity's managers. Factors

influencing the frequency of revisions include (but are not limited to) (Practice Guide, 2012, p. 9):

- The degree of entity growth and the assessment of institutional maturity;
- Changes in entity strategy;
- The level of trust of the organization and senior management in independent assessments of internal audit work or in organizational risk management help;
- Significant change in the availability of resources for internal audit work;
- Considerable changes in legislation or volume of changes in organizational policies and procedures;
- The degree of change in the organization's control environment;
- Essential changes in the management team of the organization and the composition of the board of directors;
- Assessing how internal audit has made its strategic plan from a qualitative or quantitative perspective;
- Results of internal / external evaluations of internal audit work.

<b>STRENGTHS</b>	<b>WEAKNESSES</b>
<ol style="list-style-type: none"> <li>1. Well-defined internal audit vision, mission, values and charter</li> <li>2. Respect and high trust in the public internal audit department from senior management</li> <li>3. Defined and validated audit environment</li> <li>4. The formal planning process based on risk with validation by the management Individual plans for staff training / certification</li> <li>6. Independent and objective perspective across the organization</li> <li>7. Personnel adapting to change; positive attitude</li> <li>8. Skills, environments of provenance and diversified staffing skills, etc</li> </ol>	<ol style="list-style-type: none"> <li>11. Lack of skills and knowledge of fraud,</li> <li>2. Risk assessment is not mapped to the organization's strategy; limited identification of new risks,</li> <li>3. Limited involvement in the strategic decision-making process within the entity,</li> <li>4. Limited concentration on efficiency versus operational effectiveness,</li> <li>5. Limited use of analysis and data collection,</li> <li>6. Performance is evaluated only once a year,</li> <li>7. The audit cycle has a long duration,</li> <li>8. There is no full alignment with IAI Standards,</li> <li>9. The audit methodology does not address all types of services.</li> </ol>
<b>Opportunities</b>	<b>Threats</b>
<ol style="list-style-type: none"> <li>1. Improving the perception of staff skills, knowledge and capabilities</li> <li>2. Informing management on recurring / regular issues</li> <li>3. Co-operation with other risk management / risk management functions during the year and during the risk assessment</li> <li>4. Introduction of self-assessments of risk and controls.</li> </ol>	<ol style="list-style-type: none"> <li>1. The Council's tendency to focus on financial and compliance risks, without paying due attention to operational risks</li> <li>2. The rectification of irregularities is limited by budgets, staffing and governance</li> <li>3. Restriction of management co-operation</li> <li>4. New and changing risks increase gaps in skills</li> </ol>

*II. Strategic planning* in the medium term takes into account that, according to the law, all activities that have a major risk are audited at least every three years. Depending on the importance of an activity within the entity, the internal control system and the degree of risk. The internal public audit documents this process with a multi-annual plan, which will include the main audit areas, the type of missions and the scope of applicability based on assessed risks. The plan updated through periodic risk assessment and achievement of objectives through Internal Control Standards.

*III. Annual planning* includes the work to be carried out over a one-year period, taking into account the time available in the plan and the resources allocated annually. It includes both internal public management activities and planned missions (Practice Guide, 2012, p. 22).

The annual planning aims at establishing the volume of auditable activities for one year, and the time and resources limits will focus on audit engagements on how to achieve and on the priorities of management.

In the planning of auditable activities next year it will also take into account the missions planned in the previous year that have not been carried out and based on risk reassessment priority will be given to activities with high added value. The results of which will be relevant to those audited and to the management of the entity will create a favorable impact for internal public auditors. Annual Internal Audit Plans updated during the year when the type of risk within the entity changes and have a reserve for ad hoc missions that do not exceed at least 10% of auditable days during the year and unforeseen events in the life of a public internal auditor.

With the help of the annual plan, the achievement of the objectives set in the internal audit management and the multi-annual planning modeled. The continuous preparation and improvement of the public internal auditor must planned according to the legislation in force. In order to consider a fair and qualitative planning, the manager of the internal audit subdivision should include internal audit missions per person at 60-80% per year.

In cases where a supplementary/unplanned audit mission is required, the manager of the internal audit department before he/she accepts it will consider to what extent it can add value and contribute to improving the risk management in the entity's operation.

The audit plan will delimit audit engagements such as insurance or counseling. This will focus on how to approach and report on the field to audit.

Each audit mission will include the scope, the implementation period with the date of the Audit Report and the personnel responsible for the audit. Audit planning designed to determine the important areas of the audit. Incorrect or incomplete planning leads to the loss of internal control activities/processes or sites that carry major risks.

Internal Auditing Standards recommend that in order to achieve the planned objectives, we must evaluate the risks annually, to define the priorities of the internal audit activity in accordance with the objectives of the public entity, through this process, the views of the public entity manager and the operational managers other stakeholders on internal audit opinions and other conclusions.

In cases where internal audit activity perceived as a source of talent for the entity, it may be beneficial to consider the opportunity of a rotation-based staffing system. This model provides the organization with people who have a deep understanding of governance, risk management and controls. Rotational models provide benefits for internal audit work by introducing staff (other than audit) from other activities and contributing specialized skills and an independent view of audit engagements and procedures. Disadvantages of models include higher training and supervision of rotation staff, lack of continuity in missions, and a "cooling" period from the audit field they have worked in the nearest past.

### **3. New regulations in risk assessment, in view of planning the annual audit**

Considering that the public entity manager tends to assure that the strategic plan and the annual plan address the risks identified by the operational managers, the head of the public internal audit sub-divisions plans the internal audit activity based on the identification and re-evaluation of the risks. This risk assessment shall carried out at least annually.

Thus, in the strategic and annual planning of the internal audit activity, internal public auditors address the risks in the following way (The Law on Public Internal Financial Control no. 229 from 23.09.2010):

- a) the analysis of the risks related to the objectives of the public entity;

b) assessment of the inherent risks at each level (strategic risks, financial / performance risks, operational risks and compliance risks);

c) establishing priority areas to be covered by future missions.

A particular emphasis in public entities is on the degree of control risk. In terms of internal control, the degree of achievement of objectives addressed. The control risk is the risk that a material error that may occur in a category of operations, individually or together with errors in other categories of operations, cannot be prevented, detected or corrected in due time by internal controls in function.

Therefore, the risk that some errors cannot be detected to correct by the internal control system, but management discovers the deviations of the results from the objectives, analyzes the causes that have determined them and orders the necessary corrective or preventive measures. An entity's internal control system encompasses the control environment and the system of procedures and policies developed and put in place to ensure (Boulescu, Ghiță and Mareș, 2001, p. 103):

- compliance with the regulations under the activity of the audited entity (internal legislation, internal procedures);

- preventing and detecting frauds and errors;

- achieving the managerial objectives in a systematic, economical and efficient manner;

- accomplishment of the attributions at a suitable quality level and the regular implementation of the adopted policies;

- compliance with the legality and management provisions;

- protecting assets;

- protecting information;

- providing timely accurate and complete information to substantiate management decisions.

A favorable control environment implies the imperative need to have an ethics, a policy, an organization that consists of all the concerns of the management of the audited entity about the organization of the internal control system and the importance it attaches to it.

The internal audit of the audited entity designed to ensure rigorous and effective management of the entity's activity, so auditors at the planning and evaluation stage will deepen their understanding of the structure of the internal control system by reviewing and documenting its operation in practice. At the auditor's wishes and reasoning, he can rely on and then it is necessary to test the system and if the auditor decides not to trust the internal control system and the control risk will be assessed at a high level, the auditor should test the internal control system, ensure that it exists and operate properly throughout the year (Munteanu, 1998, p. 62).

The assessment of the control risk requires the use of the auditor's professional judgment, which can be characterized as a subjective process. The evaluation can be expressed either in quantifiable terms (e.g. 80% 50% 20%) or in non-quantifiable terms (e.g. low, medium, and high).

The risk analysis model will be documented and attached to the multiannual and annual plan to provide assurance in the planned activities by uniformly analyzing departments based on risk factors.

Improving the risk quantification model remains a permanent priority of the internal audit function.

The objectives of internal auditors are to allocate audit resources in an optimal manner, to the highest risk audits, to the entity's activities / sub-activities, and resource saving based on risk analysis to remain a priority.

Preserving a general view of processes and internal resources can only ensure by a broader analysis of risk typologies and risk assessment criteria must be effective.

Because major risks usually focus on the management of the entity and it is therefore more appropriate to start top-down planning activity, it will ensure that only to minimize major risks that will not allow the full realization of the objectives planned for a period.

The public internal audit ensures the assessment of the areas involved in the achievement of the objectives and at least every three years the high risk processes in the following areas (Law on Public Internal Financial Control no. 229 from 23.09.2010):

- Financial Accountant;
- public procurement;
- asset management;
- Information technologies.

Internal audit missions are more complex when they planned on processes, so it will in itself include the assessment of several major risks for achieving the entity's objectives.

Various methods and techniques used in the risk assessment, which is consistent with the specificity and scope of the entity. The identified risk assessment is to optimize the allocation of audit resources through a comprehensive understanding of internal control and the risks associated with each element. A risk assessment model described in the International Good Practice, adopted by IAA, which aims to quantify the level of risk of each entity's department through the system of managerial internal control.

The risk analysis model, recommended by IAA in 2003, is based on 6 risk factors, namely (Ghiță, Pereș and Bunget, 2005, p. 105):

- F1 - Previous audit findings;
- F2 - Sensitivity of the system, as perceived;
- F3 - Control environment;
- F4 - Trust in Operational Management;
- F5 - Changes in people or systems;
- F6 - Complexity.

Each element in the audit universe will be quantified using these 6 factors using a numeric scale from 1 to 3 where:

- 1 means "probably no problems";
- 2 means "possible a problem";
- 3 means "probably a problem".

The results of these analyzes totalized and then multiplied by an "age factor" of the audit, such as:

- 100% if a similar audit has been done over the last 24 months;
- 125% if the audit was done 25-36 months ago;
- 150% if the audit was done 37/60 months ago;
- 200% if the audit is older than 60 months.

The levels of the results will be spread over a range of 6-36, which after the completion of this scoring process will be grouped into 4 categories, depending on the risk factor presented, as follows:

- the top 40% layer represents the maximum risk level;
- the 30% layer represents the level of sensitive risk;
- the 20% layer represents the moderate risk level;
- the last layer of 10% represents the low risk level.

The framework for the annual internal audit plan then constructed from 4-layer samples using the following coverage targets:

- High-risk audit entities will be audited 100%;

- The sensitive risk layer will audited at a rate of 50%;
- 25% sample will audited from the moderate risk layer;
- The low risk layer will audited by selecting 10% elements.

Please note that the risk weight determined by the importance and weight of the risk factor in the activity, and that the sum of the risk weights should be 100.

Depending on the chosen criteria, we determine the following weights:

- Internal control appreciation 30%;
- Quantitative 25%;
- Quality assessment 20%;
- Legislative changes 15%;
- Staff age 10%.

In the process of identifying the risks associated with the activities / processes, it will take into account the environment and the managerial internal control activities, respectively the existence and the functionality of the procedures. In assessing processes / working procedures, what controls are in place for monitoring and reporting, if it is lacking, the activity poses potentially greater risks than those for which procedures are being developed.

Evaluating the risk register prepared by the entity's departments, taking into account the recommendations of the General Rules for the use of factors regarding: internal control assessment, quantitative assessment and qualitative assessment, to which we may add other activity-specific factors.

Identifying and accurately and timely assessing risks will help to avoid a negative impact on auditable activity.

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