

OFFENCES AND PENALTIES IN THE INTERNAL AUDIT ACTIVITY

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***Abstract:** The purpose of the paper is to present the offences and penalties that can be instituted as a result of actions performed by the internal audit. On the other hand, we sought to highlight the mechanisms used for the ascertainment of offences and the establishment of the corresponding penalties. For this purpose, we started from the basic concepts related to the offence and penalty problems in the internal audit missions and we continued with their application at practical level in the accomplishment of an actual audit mission. We also tried to highlight the role and place of the offence and of the penalty respectively in the process of exercising the internal audit activity, and also the finality at the level of entities and persons responsible for the improper exercise of the designated actions.*

Key words: internal audit; offence; penalty.

JEL Classification Codes: H83, M42.

1. INTRODUCTION

The origin of the concept audit comes from the Latin *audio, audire, audivi, auditum* which means *to listen*. The current meaning of the word originates in the period of the 1929 economic crisis in the United States of America. In this period, in order to be listed on the stock exchange, companies needed to be audited by external auditors, which service generated a substantial financial effort (Macarie, 2013).

The audit profession has been criticised over the years for failing to deal with issues that have led to some-well known companies collapsing. This was particularly the case with Enron which saw a catastrophic effect brought about by manipulation of the financial statements and the misleading of shareholders (some of whom lost their entire pensions as a result of the company collapse) (Collings, 2014).

The certification of the financial statements and the verification of the annual accounts were made through independent External Audit Offices which also performed a number of preliminary operations:

- assets inventory
- verifying the synthetic and analytic accounts
- verifying the balances and their composition
- random checking of the supporting documents
- verifying the accuracy of the determination of the fiscal obligations, etc. (Macarie, 2013)

In Romania, the notion emerges rather late and it is mistaken for the concept of internal control, especially in practice (at the emergence of Law no. 672/2002 on the internal public audit, the public entities required to integrate internal audit structures “turned” internal control employees into auditors).

In Law no. 672 /2002 on the internal public audit in Romania, the internal public audit is defined as follows: “a functionally independent and objective assurance and advisory activity, meant to add value and to improve the activities of the public entity; it helps the public entity accomplish its objectives, by a systematic and methodical approach, it assesses and improves the efficacy and efficiency of risk management, control, and governance processes”.

The overall objective of the internal audit activity is to improve the management activity and can only be achieved if two categories of activities are executed:

- a) assurance activities, i.e. through the examination of the elements, entities are provided with an independent evaluation of all the existing processes;
- b) advisory activities meant to improve the existing processes, even if the internal auditor is not an actual manager (Țogoe, 2004).

Like any other activity, the internal audit activity is subject to legal constraints that determine the application of penalties and implicitly contraventions. In this paper we sought to synthetize contraventions and penalties for the faulty exercise of the internal audit activity or those following the lack of organization of the internal audit. On the other hand, we sought to highlight the set of mechanisms that allow for ascertaining offences, and consequently, for applying penalties. In order to achieve this purpose, an analysis of the specialised literature and of the laws in force on the concepts of audit, offence and penalty was carried out.

Under Ordinance no. 2/2001 on the legal regime of offences, an offence is an act guiltily committed, ascertained and penalised as such by the law, through Government decision or through a decision of the local commune, town, city or Bucharest sector council, of the county council or of the Bucharest General Council (Ordinance no. 2/2001, art. 1). Offences and corresponding penalties can be set in any field of activity. By defining the general notion of offence, the legislator highlights the aspects that characterise this antisocial act:

- A. material, meaning that it is an exterior manifestation of an individual that breaches a legal norm;
- B. human, because it is a human action or interaction contrary to the law;
- C. social, because the illicit action or infraction affects the social relationships, goods, values or interests protected by the legal norms;
- D. moral, because it represents the moral attitude of the offender towards social values;
- E. juridical, because it is a breach of a juridical norm.

Concretely, the definition of the offence establishes the rule of law according to which any act incriminated as such must meet the characteristic features distinguishing it from other antisocial acts (infractions or misconducts).

A consequence of the offence is the penalty, which is, in its turn, defines as being a measure of constraint applied to a natural person or to a legal entity, following the failure to fulfil an obligation (depending on the nature of the obligation, which can be disciplinary, civil, criminal, administrative, patrimonial, etc.)

2. THE OFFENCE – DEFINING ELEMENTS

In the audit activities, actions are always impartial, with a minimum risk level in order to provide the transparency of information and the efficiency of the horizon of any audit strategy developed. Even so, the recommendations prepared as a result of performing the internal audit mission are not mandatory and are part of the advice that should be provided by the auditor. As we have stated, the poor organization or the lack of organization of the internal audit activity may be an offence and is penalised accordingly.

The normative acts determining offences will include the description of the facts that are offences and the penalty to be applied for each of them; in the case of a penalty by fine, its maximum and minimum limit must be set, as the case may be, percentage rates of certain values, tariffs can also be determined for compensations for damages caused by the offences.

The contravention nature of the act is removed in the case of self-defence, state of necessity, physical or moral coercion, fortuitous case, irresponsibility, full involuntary intoxication, error of fact and infirmity, if they are related to the offense committed.

The offence is ascertained by a report concluded by persons specifically provided in the normative act which ascertains and penalizes the offence, generally known as official examiners (mayors, officers and non-commissioned officers within the Ministry of Interior, with special competences, persons empowered for this purpose by ministries and other heads of central public administration authorities, prefects, presidents of county councils, mayors, the general mayor of Bucharest and other persons provided in special laws) (Government Ordinance no. 2/2001).

3. OFFENCES AND PENALTIES IN THE INTERNAL AUDIT

According to Law no. 672/2002 on the internal public audit, the following acts are offences and are penalized by fines between 3.000 RON and 5.000 RON (Law no. 672/2002 art. 23):

- 1) breach of the obligation to provide the organizational and operational framework required to perform the internal public audit activity - “the head of the public institution or, in the case of other public entities, the collective management body has the obligation to provide the organizational and operational framework required to perform the internal public audit activity”;
- 2) breach of the obligation to develop public internal audit norms specific to the public entity, or not to submit them for endorsement – “develops methodological norms specific to the public entity in which they work, with the UCAAPI endorsement, and in the case of subordinated public entities, respectively coordinated or under the authority of another public entity, with the endorsement of the latter”;
- 3) breach of the obligation to develop the public internal audit draft plan – “develops the multiannual public internal audit draft plan, usually for a 3-year period, and based on it, the annual internal public internal audit draft plan”;
- 4) the refusal of the executive or management staff’s, involved in the audited activity, to present the documents requested on the occasion of carrying out the internal public audit missions – “the executive or management staff’s in the audited structure have the obligation to provide the documents and information requested, within the periods established, and to provide the necessary support for the good performance of the internal public audit”;
- 5) failure to observe the provisions related to the appointment/dismissal of the head of the internal public audit compartment, or to the appointment/dismissal of internal auditors – “The head of the internal public audit compartment is appointed/dismissed by the head of the structure/associative entity, with the UCAAPI endorsement; and for the subordinated public entities, or for those coordinated or under the authority of a another entity, the appointed/dismissed is made with the endorsement of the higher public entity, in compliance with the legal requirements”; “The appointment or dismissal of the internal auditors is made by the head of the public entity in question, or by the collective management body, with the endorsement of the internal public audit compartment head” (Boulescu, Bârnea, Ispir, 2004).

Offences are ascertained and penalised as follows (Law no. 672/2002, art. 24):

- a) by the empowered representatives of the Ministry of Public Finance, for all above-mentioned offences;

- b) by the empowered representatives of the higher body, at subordinated entity level, for all offences provided at items 1, 2, 3;
- c) by the empowered representatives of the head of the public entity, in the case of offences provided at item 4.

4. OFFENCES AND PENALTIES DUE TO THE LACK OF INTERNAL AUDIT

Besides the actual offences and penalties provided by the laws in force on exercising the internal audit missions, there is also another category of offences and penalties due to the lack of organization of the internal audit activity. This category includes all poor operational activities related to the organization of the economic and financial activity and whose exercise as such leads to negative effects, opposed to the established legal standards. The lack of organization of the internal audit activity does not allow for highlighting such standards, makes it impossible to correct them under actual conditions impossible, and thus leads to poor results.

Under Accounting Law no. 82/1991 the following acts are offences, unless they are perpetrated under such circumstances as to be classified as crimes, in compliance with the law (Law no. 82/1991 art. 41 and art.42):

1. owning, by any title, goods, securities, cash, and other rights and obligations, as well as performing economic operations without bookkeeping them (a fine between 1,000 RON and 10,000 RON);
2. failure to observe the provisions issued by the Ministry of Economy and Finance related to:
 - a) using and keeping the accounting records (a fine between 300 RON and 4,000 RON);
 - b) drawing up and using supporting and accounting documents for all operations performed, bookkeeping them in their corresponding period, keeping and archiving them, as well as reconstituting the lost, stolen or destroyed documents (a fine between 300 RON and 4,000 RON);
 - c) inventorying (a fine between 400 RON and 5,000 RON);
 - d) preparing and auditing the annual financial statements (a fine between 400 RON and 5,000 RON);
 - e) submitting the annual financial statements with the territorial units of the Ministry of Economy and Finance (a fine between 400 RON and 5,000 RON);
 - f) preparing and submitting the periodic financial statements or the accounting reports provided by the law with the territorial units of the Ministry of Economy and Finance (a fine between 500 RON and 1,500 RON; a fine between 1,000 RON and 3,000 RON, if the delay period for the preparation and submission the periodic financial statements is between 15 and 30 working days, and between 1,500 RON and 4,500 RON, if the delay period exceeds 30 working days);
 - g) failure to submit the statement specifying that the persons provided by the law did not perform an activity (a fine between 100 RON and 200 RON);
 - h) the publication of the annual financial statements, in compliance with the law (a fine between 2,000 RON and 30,000 RON).
3. submitting financial statements which contain erroneous or inconsistent data, including in compliance with the identification of the reporting person (a fine between 200 RON and 1,000 RON);
4. failure to observe the provisions related to the preparation of the statements provided by the law on the submission of the annual financial statements (a fine between 400 RON and 5,000 RON);

5. failure to observe the provisions related to the obligation of the members of the administration, management and surveillance bodies to prepare and publish the annual financial statements (a fine between 400 RON and 5,000 RON);
6. failure to observe the provisions related to the obligation of the members of the administration, management and surveillance bodies of the parent company to prepare and publish the consolidated annual financial statements (a fine between 10.000 RON and 30,000 RON).

In relation to these aspects pertaining to the indirect negative impact on the economic and financial objectives of the entity, the risk identification and analysis component intervenes from the audit methodology. This is the most important procedure in relation to the preparation of the internal audit mission. It implies:

- the identification of the auditable objectives;
- the identification of threats, and of the associated inherent risks;
- setting the risk analysis criteria and assessment levels;
- determining the total risk score;
- classifying operations depending on the risk analysis;
- ranking operations depending on the analysis performed;
- preparing the detailed themes of the auditable objects set.

The risk problems are assessed through the actual financial impact of the operations to be audited. For example, in what the accounting records of an economic entity are concerned, the problems can be analysed as follows (Table no. 1):

Table no. 1 – Identification of the auditable objectives, of the associated threats and inherent risks

It. No.	Area	Specific operation	Auditable objective	Risks
1.	Preparing and editing the accounting records	Preparing the accounting records	Preparing Record 1	Failure to prepare Record 1
			Preparing Record 2	Failure to prepare Record 2
			Preparing Record 3	Failure to prepare Record 3
		Keeping the accounting records	Analysing the supporting documents	There are no supporting documents. The supporting documents are not prepared in compliance with the legal provisions
			Chronological and systematic data registration	The data are not recorded chronologically and systematically
			Preparing accounting notes	There are no accounting notes. The accounting notes are not prepared in compliance with the legal provisions
			Recording the operations in the standard accounts	The accounting operations are not recorded in compliance with the account plan
			Preparing the trial balance	The trial balance was not prepared

**Source: own work, 2015*

The determination of the risk analysis criteria and assessment levels will take into account the requirements of the norms, i.e. there are three categories of criteria: criteria concerning the assessment of the internal control (C1), quantity assessment criteria (C2), and quality assessment criteria (C3) (table no. 2 and table no. 3). These can be added to others depending on the

practical needs. Through the criterion, the likelihood of the negative impact on a certain event is determined, and its level is in fact the change generated by the risk in question.

Table no. 2 – Setting risk analysis criteria

It. no.	Area	Auditable objective	Risks	Risk analysis criteria						Total score
				C1		C2		C3		
				P1	Ni	P2	Ni	P3	Ni	
1.	Preparing and editing the accounting records	Preparing Record 1	Failure to prepare Record 1	0.5	2	0.3	1	0.2	1	1.5
		Preparing Record 2	Failure to prepare Record 2	0.5	2	0.3	2	0.2	2	2
		Preparing Record 3	Failure to prepare Record 3	0.5	2	0.3	1	0.2	1	1.5
		Analysing the supporting documents	There are no supporting documents. The supporting documents are not prepared in compliance with the legal provisions	0.5	2	0.3	1	0.2	1	1.5
		Chronological and systematic data registration	The data are not recorded chronologically and systematically	0.5	2	0.3	2	0.2	2	2
		Preparing accounting notes	There are no accounting notes. The accounting notes are not prepared in compliance with the legal provisions	0.5	2	0.3	2	0.2	2	2
		Recording the operations in the standard accounts	The accounting operations are not recorded in compliance with the account plan	0.5	2	0.3	2	0.2	2	2
		Preparing the trial balance	The trial balance was not prepared	0.5	1	0.3	1	0.2	1	1

*Source: own work, 2015

Table 3 – Risk assessment level

Assessment criterion (Ci)	Share(Pi)	Risk assessment level (Ni)		
C1	50%	There are procedures and the procedures are applied	There are procedures, but the procedures are not applied	There are no procedures
C2	30%	Low financial impact	Medium financial impact	High financial impact
C3	20%	Low vulnerability	Medium vulnerability	High vulnerability

*Source: own work, 2015

Subsequently the total risk score is determined by multiplying, for each risk determined, the level by their share and finally by adding in compliance with the legal provisions:

$$Pt = \sum Pi * Ni \quad (1) \text{ (for example: } 0.5*2+0.3*1+0.2*1=1.5)$$

Where: Pt – total score, Pi – risk share, Ni – risk assessment level

Depending on the results (scores) obtained, a total score is subsequently determined as well as the importance of the risk in the total number of risks.

For the 3 criteria (C1, C2 and C3) we can determine a general classification grid: up to 1.9 - low risk, between 1.9 and 2.4 - medium risk, and above 2.4 – high risk. Taking into account the results obtained in our case, we can assess the existence of two categories of risk: low risk and medium risk. The classification of the operations depending on the risk analysis is presented in Table no. 4.

Table no. 4 – Classification of the operations depending on the risk analysis

It. no.	Area	Basic operation	Auditable objective	Risks	Total score	Risk level
1	Preparing and editing the accounting records	Preparing the accounting records	Preparing Record 1	Failure to prepare Record 1	1.5	Low
			Preparing Record 2	Failure to prepare Record 2	2	Medium
			Preparing Record 3	Failure to prepare Record 3	1.5	Low
		Keeping the accounting records	Analyzing the supporting documents	There are no supporting documents. The supporting documents are not prepared in compliance with the legal provisions	1.5	Low
			Chronological and systematic data registration	The data are not recorded chronologically and systematically	2	Medium
			Preparing accounting notes	There are no accounting notes. The accounting notes are not prepared in compliance with the legal provisions	2	Medium
			Recording the operations in the standard accounts	The accounting operations are not recorded in compliance with the account plan	2	Medium
			Preparing the trial balance	The trial balance was not prepared	1	Low

**Source: own work, 2015*

In relation to the items presented in this table, only the items implying a medium risk will be retained for the audit, while those implying a low risk are not significant. The items for which a medium risk level was determined will receive, depending on the auditor's opinion, a level of assessment, being of confidence in relation to the impact of the risk on the respective activity which will increase or decrease the level of risk in practice. This operation is referred to as being the ranking of the operations depending in the risk analysis and will be substantiated by drawing up a table of strengths (ST) and weaknesses (WK) (Table no.5).

Table no. 5 – Strengths and weaknesses

It. no.	Area	Basic operation	Auditable objective	Risks	ST/WK	Risk level
1	Preparing and editing the accounting records	Preparing the accounting records	Preparing Record 2	Failure to prepare Record 2	WK	Medium
		Keeping the accounting records	Chronological and systematic data registration	The data are not recorded chronologically and systematically	WK	Medium
			Preparing accounting notes	There are no accounting notes. The accounting notes are not prepared in compliance with the legal provisions	WK	Medium
			Recording the operations in the standard accounts	The accounting operations are not recorded in compliance with the account plan	ST	Medium

**Source: own work, 2015*

As can be seen, out of the 4 objectives subjected to ranking that are presented in Table no.5, 3 are qualified as representing weaknesses that are to be subjected to auditing. Subsequently, for these 3 objectives, the topics of the audit plan will be determined in detail and then the audit will be performed.

5. CONCLUSIONS

As can be seen, the existence and exercise of the internal audit activity represent one of the multiple methods of continuously improving both the information flow and the overall business. The effectiveness of the business carried out by any the entity, the results substantiating such business represent ways of quantifying the involvement of the internal audit in the life of any entity.

Under such circumstances, it is absolutely necessary to organise and perform such activity in an appropriate manner, and implicitly to penalise actions that lead to unfavourable situations, poor functioning, affecting the results of the entity to the extent where the normal business is disturbed, both internally and externally. As shown in this paper, a number of activities are deemed offences and are penalised accordingly.

The risks implied by the exercise of the audit activity or by exercising it in an inappropriate manner are the main element based on which the contravention and implicit penalties are applied.

As shown hereinabove, the assessment of the risk level implies following several inherent steps, and based on the structure of these steps, the structure of an appropriate audit programme is determined. The higher the impact at financial level, the higher the risk threat will be.

The three categories of criteria recommended by the standards constitute, in fact, the basis for the assessment of risks, and, as mentioned in this study, others can also be used depending on actual practical needs.

We can conclude that by means of the risk criterion, we can determine the likelihood of the negative impact of the operations performed from the perspective of all audited activities. The level of any such criterion allows for associating the risk impact on all the audited activity. By calculating the score for each risk according to the category and share, we will subsequently be able to rank them and highlight the risks representing true weaknesses, in order to direct the audit activity judiciously.

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