

MODALITY OF DETERMINING THE TOTAL SCORE OF RISKS IN INTERNAL AUDIT

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Abstract:

Risk analysis materializes in: applying to the weightings of risk factors the level of risk assessment, on risk factors, based on the assessments made by auditors regarding: the functionality of internal control, the influence of quantitative and qualitative elements; determination of the total risk score, which represents a sum of weights between the appreciation level of each risk and the weightings of risk factors.

Key words: risk, total score, audit, audit mission

JEL Classification: M42

INTRODUCTION

Risk means any event, action, situation or behavior with unfavorable impact on the public entity's capacity to achieve its goals. Risk is the threat that an event or an action negatively affects the ability of an organization to achieve its established objectives.

Possible risks are identified on each objective of the entity/ function/ activity/ program/ process/ operation, followed by continuous monitoring of their evolution in order to determine the most likely ones. From the moment of the commencement of activities prior to conducting the audit missions and until their completion, the internal auditor will address risks.

RESEARCH METHODOLOGY

Identification and risk analysis is perhaps the most important preparation procedure of internal audit missions and is performed in order to develop the audit program. The proper conduct of this procedure, in accordance with the methodological rules, will contribute greatly to achieving the objectives of the internal audit mission.

The general rules for the application of the public internal audit establish a risk assessment methodology which presumes the following phases:

- a) identifying the auditable operations;
- b) identifying the threats and inherent risks associated with operations;
- c) establishing the criteria (factors) for the analysis of risks and their levels of appreciation;
- d) developing the Making Aware Questionnaire - MAQ;
- e) determining the risks' total score;
- f) establishing the level of risk on assessment criteria;
- g) ranking the objects that can be audited based on risk analysis;
- h) developing the detailed thematic of the selected objects that can be audited.

a) Identifying the auditable operations

✓ detailing each activity in consecutive operations, by describing the process, from initiation until its achievement. In audit practice, the auditable operations

are also called auditable objects and they are the elementary components of an audited field;

- ✓ identifying, for each operation, the specific internal controls and related risks;

- ✓ determining the functioning procedures of the controls necessary to ensure that the entity eliminates the risk to achieve the goal.

Establishing the operations skilful in practice is achieved by analyzing the legislative framework, the organizational structure, RFO, methodological rules for applying the regulatory framework governing the activities, job descriptions, procedures, documents flows (audit tracks), decisions, instructions, in order to identify all structural operations that are components of activities.

This phase is materialized through the development of the **centralized list of auditable operations**, which includes consecutive operations for carrying out the activity.

b) Identifying the threats and inherent risks associated with operations by determining their financial impact

Impact represents the effects of risk, if it occurs, and its level can be expressed in a value scale, for example, with three levels: low, moderate and high. Measuring the level of a risk's impact represents the most relevant expression patterns its consequences, materialized in terms of cost, whose possible change shows the impact level of a risk, low, moderate or high.

The identification of inherent risks is achieved by analyzing the operations listed in the centralized list of auditable operations, in order to determine the internal controls related to operations and their functionality.

Several possibilities resulted from practice, namely:

- *Operations in which there are no risks identified* – are usually the operations in which internal controls are not identified.

- *Operations in which several risks are identified* – are usually the operations in which several internal controls were identified.

Groups of operation that in addition to the risks identified on operations can generate together other risks.

In the sub-stage of identifying risks, many situations may occur, depending whether the risks are included or not in the analysis, as follows:

- ✓ operations where internal controls are established and operating, in this case risks are minimum, it may even be possible that they were not considered in the analysis;

- ✓ operations where internal controls are established, but not operating, in which case risks are important and should be analyzed;

- ✓ operations where internal controls are not established, but operating, where it is recommended their formalization through working procedures;

- ✓ operations where internal controls are nor established or operating, where risks are major and will be mandatory considered in risk analysis.

Operations may be encountered in which we can identify several internal controls and operations that do not identify any internal control, for example:

1. operation of exercising the preventive financial control visa, requires the existence of several internal controls, in order to correct the recordings in accounting and annual accounts of these operations it is mandatory:

- to be recorded in the corresponding period, verifying the compliance with the independence of the financial exercises (correct period criteria);

- to be properly evaluated, meaning the sums to be well determined arithmetically, accurate, in observance of all accounting rules and principles as well as the assessment methods (correctly assessment criteria);

- to be recorded in the appropriate accounts, according to the chart of accounts for public institutions (correct imputation principle);
- be correctly totaled, centralized, so they are provided with a presentation of annual accounts according to the rules in force.

2. operations where internal controls are inexistent, usually for updating a procedure, where from the its preparation up to the accomplishment of the internal audit mission there were no changes in legislation of the internal regulations.

Risks can be identified both within the organization, through its policy, as well as the level of processes and strategic or operational activities, through successive analyzes.

For achieving this approach you can start from the highest level, or from the basic level, process or executants, to the general management level.

The most used techniques in identifying risks are:

- ✓ interviewing strategic and operational officers;
- ✓ surveys and questionnaires;
- ✓ brainstorming on activities or departments;
- ✓ organizing focus groups - debate groups coordinated by a moderator specialized to achieve the objectives set in advance;
- ✓ comparisons, groups, verifications.

Internal auditors finalize this stage by developing the list **Risk identification**.

To identify fully the risks associated to operations the internal control questionnaire – ICQ can be used, of which the internal auditor, through the questions raised and the answers received ensures the existence and functionality of internal controls.

c) Establishing the criteria (factors) for the analysis of risks and their levels of appreciation is achieved by taking into account the minimum procedures from regulations, where it is recommended to use the criteria for assessing internal controls, quantitative and qualitative assessment, to which specific criteria for the audited activity can be added.

A risk criterion is the element used to identify the likelihood that events have a negative effect on an auditable operation.

Establishing the criteria (factors) for risk analysis includes in columns the criteria or factors of risk analysis and in rows their levels of appreciation.

For establishing the risk weight it should be taken into consideration the importance and weight of the risk factor in that activity and also the fact that the sum of weights on risk factors must be 100.

Depending on the elements presented, the following weights for risk factors were established:

F1 Internal control assessment	55%
F2 Quantitative assessment.....	25%
<u>F3 Qualitative assessment.....</u>	<u>20%</u>
TOTAL	100%

The weights assigned to risk factors are established based on their importance for the audited activity and their sum must be 100.

We mention that the three factors are determined by the general rules and are coverings for the audited entity, but if we want to highlight other factors, we can add them, but their sum must remain 100.

The risk concept and risk categories associated with audited operations

There are several types of risks classified according to certain criteria, namely:

A. In terms of their possibility of occurring risks are:

- potential risks, which are most likely to occur unless an effective control is established to prevent and / or correct them;
- possible risks are that part of potential risks to which the management did not take the most effective measures to eliminate or reduce their impact. As a result, there is a high probability that errors occur without being detected and corrected.

B. In terms of the audited entity's specificity, the nature of the operations performed, the functioning of systems and processes and significant areas established by the auditors, the risks are: strategic risks related to the development of wrong actions, regarding organization, resources, environment, IT equipment, etc.; informational risks relating to the adoption of unsafe or inefficient systems for information processing and reporting; financial risks relating to the loss of financial resources or the accumulation of unacceptable liabilities; general risks, concerning the economic situation, organization and attitude of the management and others; risks related to the nature of specific activities / processes / operations; risks relating to design and functioning of systems; risks relating to procedures' design and maintenance; legislative risks; financial risks; operational risks; commercial risks; legal risks; social risks; image risks; environmental risks; risks regarding information security.

According to the General Rules on the internal audit activity performance, risks are classified as follows:

- **organizational risks**, such as: procedures that are not formalized, lack of clear responsibilities, insufficient organization of human resources, insufficient and outdated documentation.
- **operational risks**, such as: failure to register in the accounting records; improper archiving of supporting documents; lack of control over high-risk operations.
- **financial risks**, such as unsecured payments, undetected financial risk operations.
- **other risks**, such as those arising from legislative, structural and managerial changes.

To the objective entitled: PREPARATION IN APPLYING THE CALL FOR PROPOSALS PROCEDURE FOR ASSIGNING THE PUBLIC PROCUREMENT CONTRACT, the auditor identified the following three auditable objects:

1. Market research, creating own databases;
2. Creation and transmission of the documentation for the elaboration and presentation of the offer (DEPO);
3. Establishing the evaluation committees.

Regarding the auditable object entitled "*Market research, creating own databases*", the auditor has identified as significant risk the Insufficient information system, which does not allow access to representative offers.

In the analysis of the auditable object entitled "*Creation and transmission of the documentation for the elaboration and presentation of the offer (DEPO)*", the auditor identified the following significant risks: DEPO does not meet the compliance conditions; DEPO includes specifications written in favor of a particular economic operator.

Regarding the auditable object entitled "*Establishing the evaluation committees*", the auditor has identified the following significant risks: the decision to appoint the evaluation committee does not meet the compliance conditions; the evaluation committee's members don't have professional training and relevant experience in the field; incompatibility between members of the evaluation committee and bidders (not all confidentiality and impartiality statements have the signature from the members of the evaluation committee); establishing a single evaluation committee for assigning various acquisition contracts; keeping files in locations and / or adverse

conditions.

The risk's total score, which is the sum of weights between the assessment level of each risk and the weights of risk factors, can be determined according to the formula:

$$P_t = \sum P_i \times N_i, \text{ where:}$$

P_t – total score;

P_i – the weight of risks for each factor;

N_i – risk assessment level for each factor used.

ESTABLISHING THE LEVEL OF RISK AND THE TOTAL SCORE OF RISK

Internal audit mission: The examination of procedures regarding the preparation in applying the call for proposals procedure for assigning the public procurement contract

Audited period: 01.01.2011-31.12.2011

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No.	Objectives	Auditable objects	Significant risks	Risk analysis criteria						Total score
				Internal control assessment F1		Quantitative assessment F2		Qualitative assessment F3		
				P1 55%	Ni	P2 25%	Ni	P3 20%	Ni	
I.	PREPARATION IN APPLYING THE CALL FOR PROPOSALS PROCEDURE FOR ASSIGNING THE PUBLIC PROCUREMENT CONTRACT	Market research, creating own databases	Insufficient information system, which does not allows access to representative offers	0,55	2	0,25	1	0,20	2	1,75
		Creation and transmission of the documentation for the elaboration and presentation of the offer (DEPO)	DEPO does not meet the compliance conditions	0,55	2	0,25	1	0,20	1	1,55
			DEPO includes specifications written in favor of a particular economic operator	0,55	3	0,25	1	0,20	2	2,05
		Establishing the evaluation committees	The decision to appoint the evaluation committee does not meet the compliance conditions	0,55	2	0,25	1	0,20	1	1,55
			The evaluation committee's members don't have professional training and relevant experience in the field	0,55	1	0,25	1	0,20	1	1,00
			Incompatibility between members of the evaluation committee and bidders (not all confidentiality and impartiality statements have the signature from the members of the evaluation committee)	0,55	1	0,25	1	0,20	3	1,40
			Establishing a single evaluation committee for assigning various acquisition contracts	0,55	1	0,25	1	0,20	2	1,20
			Keeping files in locations and / or adverse conditions	0,55	1	0,25	1	0,20	1	1,00

CONCLUSIONS

The internal audit team based on the tests and analyzes performed, assesses the objective "Preparation in applying the call for proposals procedure for assigning the

public procurement contract" according to the scale:

No.	OBJECTIVE	ASSESSMENT CRITERIA		
		FUNCTIONAL	TO IMPROVE	CRITICAL
1.	Preparation in applying the call for proposals procedure for assigning the public procurement contract		X	

The assessment is based on discussions that took place on the recommendations of the internal auditors in the closing and conciliation meetings of the mission, appreciated by participants as being realistic and feasible. I also believe that the results of the internal auditor's assessment regarding the Preparation in applying the call for proposals procedure for assigning the public procurement contract enroll in normal parameters.

Therefore, we consider that by implementing the recommendations of the internal audit team the procurement activity will register a significant improvement.

The audited structure has the obligation to establish the Action program to implement the recommendations and to report to the internal audit team, periodically, their implementation stage.

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