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## THE INTERNAL AUDIT AS COGNITIVE PROCESS

*The term AUDIT generally comes from the Latin word "audire" to listen and to inform others, from today's Anglo-Saxon countries, this term has the meaning of a revision of the accounting information and of those of a different nature, realized by an independent professional, in view of expressing an opinion regarding the regularity and honesty of the audited information (1 Ştefan Crăciun, Audit financiar şi audit intern, The Economic Publishing House, Bucharest, 2004, page 22). In a general register, an audit has the purpose to grant an entity added value by a systematic and methodic approach, evaluating the risk management processes, the control processes and the governing processes, all of which are materialized within an objective and professional report.*

**Key words:** audit, auditor, risk management, value

### Introduction. Brief history of the audit

In its current meaning, the term "audit" has been used since the XIXth century, when the commercial companies were developed. Thus, a new profession appears- the auditor one.

Within the norm of accounting revision elaborated by the Order of Chartered Accountants (Ordre des Experts Comptables et Comptables Agréés-OECCA), it is given the following definition of the financial audit: "The examination at which a competent professional proceeds in view of expressing a motivated opinion about the regularity and honesty of the balance sheet and of the enterprise's accounts of results" [2].

Subsequently, the French National Association of Auditors (Compagnie Nationale des Commissaires aux Comptes-CNCC) after having accepted the term "audit" within their report models, gave the following definition to the audit: "An audit consists of the examination via poll, of the evidentiary elements which justify the data contained within the accounts. It also consists of the appreciation of the accounting principles followed and of the significant estimates retained for the preparation of the accounts and the appreciation of their general presentation." [2].

In the USA, each professional organization has elaborated a definition for the audit. Thus, The American Accounting Association-AAA considers that "the audit is a systematic and objective process of attaining and assessing the evidence about the information referring to economic phenomena and processes with the goal to establish the degree of correspondence between these pieces of information and the prerequisite criteria, and to communicate the obtained results to the interested users". Robertson, Davis [8]. Another professional organization, the American Institute of Certified Public Accountants- AICPA considers that the audit represents the examination of a company's financial statements by an independent auditor, having as objective "the expression of an opinion concerning the accurate image given by the annual accounts in relation to the financial statement, the results and amendments within the financial statement in accordance with the generally accepted accounting principles [8].

The Body of Licensed Accountants and Expert Accountants in Romania (CECCAR [12]), within the Norms for the Financial Audit, the verification and certification of the balance sheets considers that the financial audit represents "the examination performed by a competent and independent professional (censor, chartered accountant or licensed accountant with higher education) in view of expressing a motivated opinion about: the validity and the correct application of the internal procedures established by the management of the company (internal control); the accurate, clear and complete image of the patrimony, of the financial statement and

of the results obtained by the company (the legal audit required by law and carried out by censors or the contractual audit performed at the request of the company by the chartered accountants, licensed accountants with higher education or by accounting expertise companies)." [10].

Additionally, besides these points of view, it is appropriate to mention the approaches of certain authors, also, in what regards the concept of audit.

Thus, the audit can be defined as being "the issue of a motivated opinion about the correspondence between the existing (factual) and the reference criterion (the referential)" [8].

On the other hand, audit is "a critical exam which allows the information given by the company to be checked, as well as the consideration of the applied systems and operations for its presentation" [8].

In order to conclude the cycle of the conceptions related to the audit (but without having the pretense for comprehensiveness), we stop at the definition given by Robert Obert [4]: "the audit represents an opinion mission, entrusted to an independent professional (internal/external auditor), who uses a specific methodology and justifies an acceptable level of diligence by reporting to the norms".

As a synthesis, with regard to accounting, "the audit is the control procedure of the accounting and management of a company"[5].

### Internal audit as cognitive process

A team lead by Benjamin Bloom (1956) created a categorization which may help at the formulation of professional objectives. Bloom's team identified 3 fields of competence:

Cognitive: mental abilities (Knowledge)

Affective: emotional "growth" (Attitudes)

Psychomotor: manual, physical abilities (Abilities)

These are also known as: to know, to be able to, to want (levels which are also used in the construction of job descriptions- human resources). For each professional field certain competencies are defined (knowledge, abilities and attitudes). Thus, before all, one must know the concept, then one must understand it, in order to be able to apply it, to be able to analyze it, to be able to synthesize and, in the end, to evaluate..... IS THIS ALSO THE CASE WITH THE INTERNAL AUDIT!?

Cognitive process (Benjamin Bloom, 1956)

- Data recognition (KNOWLEDGE= to identify, to name, to recognize, to memorize, to reproduce, to tell, to highlight)

- Explaining the data (UNDERSTAND= to define, to discuss, to describe, to translate, to explain, to provide arguments, to express, to localize, to report)

- Solving clearly defined problems (APPLICATION= to use, to utilize, to demonstrate, to practice, to interpret, to program, to illustrate, to operate)

- Solving the weakly defined problems (ANALYSIS= to compare, to relate, to analyze, to distinguish, to differentiate, to categorize, to appreciate, to experiment, to test, to calculate, to inspect, to question, to examine, to solve, to resolve)

- Formulating creative 'unique' solutions (SYNTHESIS= to propose, to formulate, to conceive, to compose, to design, to plan, to prepare, to assemble, to build, to develop, to organize, to lead, to manage)

- The elaboration of critical reasoning based on the comprehension of the situation's complexity (CRITICAL-CONSTRUCTIVE EVALUATION) = to appreciate, to evaluate, to reason, to estimate, to compare, to situate, to hierarchize, to revise)

- In 2001, Lorin Anderson and David Krathwohl revised these competences and they expressed them as verbs (unlike Bloom, who expressed them as nouns).

The cognitive process (Lorin Anderson and David Krathwohl, 2001)

- In 2001, these competences were revised and formulated as verbs (unlike Bloom, who formulated them as nouns)

- Remembering – to recognize, to list, to describe, to identify, to name, to localize, to find.

- Understanding – to interpret, to paraphrase, to classify, to compare, to explain, to exemplify

- Applying – to implement, to use, to execute

- Analyzing – to compare, to organize, to deconstruct, to attribute, to highlight, to structure, to integrate

- Evaluating – to verify, to issue hypotheses, to criticize, to experiment, to judge, to detect, to test, to monitor.

- Creating – to build, to plan, to produce, to invent, to make.

Principles concerning the professional practice of the internal audit – The Chamber of Financial Auditors of Romania (CAFR) R Bilius Course

- She demonstrates integrity.

- She demonstrates professional competence and scrupulosity

- She is objective and it is not subject to certain inappropriate influences (it is independent).

- She is aligned with the organization's strategies, objectives and risks.

- She is positioned adequately within the organization and I disposes of the adequate resources

- She demonstrates continuous improvement and quality.

- She communicates efficiently

- She provides assurance based on risk evaluation.

- She has an in-detail knowledge, it is proactive and future-oriented!

- She promotes the improvement of organizational processes.

- BUT, all these would not be applicable if we do not have a cognitive approach towards the process of audit!

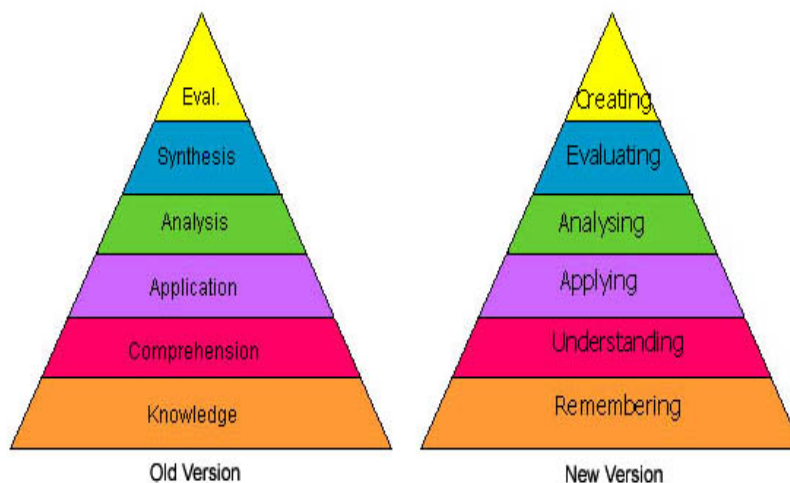


Fig. 1. The internal audit and the internal/managerial control system.

Source: Bloom Taxonomy [www.bloomstaxonomy.org](http://www.bloomstaxonomy.org)



Fig. 2. Mandatory Guidance

Source: [https://www.ianz.org.nz/Category?Action=View&Category\\_id=40](https://www.ianz.org.nz/Category?Action=View&Category_id=40)

Improved agenda

- The presentation of the concept of internal audit
- Planning the activity of the internal audit
- The performance of the internal audit mission: the preparation of the audit mission

- In situ intervention

- The internal audit report

- Following the recommendations

The definition of the internal audit

- Independent activity of objective assurance and counselling, destined to add value and to improve the organization's activity

• It helps the organization in fulfilling its objective by a systematic and methodic approach that evaluates and improves the efficacy of the risk management processes, control and governing

• (The methodical and systematic approach= COGNITIVE PROCESS!)

Adds value to the entity

- All the functions from the organization to bring value

- The added value to be measurable

- Oriented to the needs of the organization

- Auditors should not be:

- Critical at all costs

- Simple persons who note the deficiencies

- They do not make the inventory of the dysfunctions

within a structure

- Emphasis is put on the proposal of recommendations/feasible solutions, on improvement (COGNITIVE PROCESS!)

- Sensing opportunities (COGNITIVE PROCESS!)

Approach from a systemic perspective and that of value

- Based on standards (COGNITIVE PROCESS!)

- Planned on the basis of risk assessment (COGNITIVE PROCESS!)

- Documented and rigorous methodology (COGNITIVE PROCESS!)

It evaluates control, governing and risk management

- Growth of the probability of achieving established objective (the purpose of the organization)

- Function of evaluation (comparison)

- Raw material: internal control, risk management and governance

So, EVALUATION= a stage of a COGNITIVE PROCESS! [14]

The auditor's code of ethics (deontological code)

The deontological code represents a statement regarding the values and principles that must lead the daily practice and activity of internal auditors. The deontological code comprises the principles and manner of application that the internal auditor must respect in order not to move away from the provisions of the standards, when accomplishing the auditing missions.

The deontological code enunciates four fundamental principles, namely:

- Integrity, which constitutes the basis of the trust granted to the internal auditors;

- Objectivity, which is related to the independence;

- Confidentiality, which is absolutely necessary, excepting the situations provided by law;

- Competence, which involves the continuous update of the theoretical and practical knowledge.

The integrity principle implies honesty and correctness in carrying out the professional services. Integrity implies not only honor, but also equity and sincerity [6]. In order to realize an honest and sincere internal audit, there must be developed an environment that should offer the basis for general trust within all the activities carried out by the internal audit team, which must carry them out in a professional manner.

Rules of conduct in relation to the integrity principle:

- He/she carries out the activity with honesty, professionalism and responsibility;

- He/she respects the law and makes public the necessary communications according to law and to the profession;

- They are not knowingly part of illegal activities and they are not involved in actions which may compromise the internal audit profession or the organization;

- They respect and contribute to the achievement of legitimate and ethical objectives of the organization;

Rules of conduct in relation to the objectivity principle:

- They do not take part in activities and they do not establish personal relationships that may affect or it can be assumed that they may affect the expression of an independent opinion. These include activities or personal relationships which may being conflict with the interest of the organization;

- They do not accept anything that may affect or that it is assumed that it affects their professional judgment;

- They communicate all the significant elements they have knowledge of and which, if not made known, might prejudice the quality of the reports concerning the activities under observation [7].

Professional standard 36, concerning this norm provides that: "Upon the occasion of performing an internal audit mission, the chartered accountant must not take part in activities or to establish relationships that might compromise their professional judgment". Internal auditors have the obligation to abstain from any activity in which they have a personal interest and which, otherwise, may affect their objectivity [12].

Competence implies that the internal auditor will apply the necessary knowledge, standards, abilities and experience in the provision of the audit services. The internal auditors must know the professional standards and norms and they must not accept missions for which they do not have the necessary competence.

Rules of conduct in relation with the principle of competence:

- They get involved only in those missions for which they have the necessary knowledge, competencies and experience;

- They provide internal audit services according to the standards of internal auditing;

- They continually improve their competences, the efficiency and quality of their services;

The confidentiality principle implies the fact that the internal auditors respect the value and the right of property for the information they receive and they do not provide information without the proper approval, lest in the event in which there are legal or professional obligations in this respect.

Rules of conduct in relation to the confidentiality principle:

- They manifest prudence in the use of the information obtained during the exercise of the service tasks;

- They do not use information with the purpose of obtaining personal benefits or in any other way which might be contrary to the law or to the ethical and legitimate objectives of the organization;

The professional standard 36, concerning the norm, provides that: "Upon the occasion of realizing a contractual internal audit mission, the chartered accountants must respect the value and the property of the information they receive: they do not reveal this information, lest on the basis of the necessary authorization, except when a legal or professional obligation forces them to act otherwise" [12].

THE ORGANISATION OF THE IIA STANDARDS

These comprise:

- Enunciations concerning the basic requirements for:
- The professional practice of the internal audit

- The evaluation of the efficacy of the missions
- Interpretations by which the terms and the concepts from the enunciations are clarified
- So, THE STANDARDS indicate a COGNITIVE PROCESS!
- The qualification standards (series 1XXX): the characteristics of the organizations and participants that carry out internal auditing activities
- Performance standards (series 2XXX): they describe the type of internal auditing activities and they offer qualitative criteria for the potential results
- Implementation standards:
- Putting in practice the Performance and Qualification Standards
- Applicable requirements for the assurance activities (I) and those of counselling (C)

Assurance implies- the responsible for the process (the person or group involved directly in the audited entity, operation, function, process, system or subject); the person or the group that performs the evaluation, the person or group that uses the result of the evaluation.

Counselling. The difference between assurance and counselling/consultancy: Assurance: "audited"

- Counselling: "client"

The characteristics of the counselling service:

- The consulting character
- Generally, upon the express request of the beneficiary
- A relationship of partnership between audit and clients
- Involvement only if the necessary knowledge and competencies are held (e.g.: actuarial calculations)
- The client is the operational management (usually!)

**Table 1. COMBINED MODEL of the IA ASSURANCE service- 3 interdependent lines of defense**

	<b>I line of defense</b>	<b>II line of defense</b>	<b>III line of defense</b>
<b>Name</b>	Internal/managerial control	Risk management	The internal audit
<b>Operation</b>	Permanent	Permanent	Periodic.
<b>Instruments</b>	The internal/managerial system of control	They evaluate and counsel the first line of defense	They evaluate the first two lines of defense
<b>Role</b>	Provides assurance concerning the fulfillment of the objectives by the entity	The risk management process	Independent evaluation
<b>Results</b>	Implementation of improvements The correction of deficiencies and deflections	Identifies the threats that may appear with regard to the provision of the objectives  Recommends the improvement of internal control system, management, (internal checks for threats/risk management)	Confirms independently the operation of the first two lines of defense Recommends improvements of the internal control system, risk management, governance.

Source: Ruxandra Bilius – Adaption according to the source: National Australia Bank/Andrew Cox/How Can Internal Audit Report Effectively to Its Stakeholders?

#### Standard 2010-Planning

The CAE (Chief Audit Executive) must establish a plan based on risks in order to determine the priorities of the internal audit activities, in compliance with the objectives of the organization (does PLANNING indicate a COGNITIVE PROCESS?)

Interpretation: the CAE is responsible for the elaboration of a plan based on risks. The CAE takes into consideration the framework concerning the management of risk from the organization, including the level of appetite for risk established by the management for various activities or structures from the organization. If such framework does not exist, the CAE uses his/her own appreciation with regard to the risks pursuant to the consultation with the superior management and council. The CAE must revise and adjust the plan, if necessary, in the event of the occurrence of certain modifications of the activities, risks, operations, programs, systems and controls of the organization.

#### General stages:

- Identification of the objectives of the organization
- Establishing the auditing universe
- Identification of the associated risks (correlation between the objectives of the organization- risks- auditing universe) (audits/auditable areas)
- Risk evaluation
- Prioritizing the audits/auditable areas BASED ON RISK ANALYSIS
- Establishing the frequency of the audit
- Allocation of a reserve for the unpredicted activities or for other activities (ad-hoc missions, verification of the implementation of recommendation)
- Establishing the necessary resources

- Approval of the plan (PLANNING indicates a COGNITIVE PROCESS?)

#### Standard 16 –Internal audit

- Description= The public entity establishes or it has access to a competent auditing capacity, which has in its structure competent auditors, whose activity is typically performed in accordance with certain programs based on risk evaluation.

Legal references: Law 672/2002, on public internal audit, republished, with subsequent amendments; Government Decision 235/2003 concerning the public internal auditing committee; The Order of the Ministry of Finances 252/2004 concerning the code of ethical conduct of the internal auditor; Government Decision 1086/2013 concerning the approval of the General Norms regarding the exercise of the internal public auditing activity; Government Decision 1183/2012 concerning the cooperation system regarding the assurance of the public auditing functions; Government Decision 1259/2012 concerning national certification and that of the continuous professional education of the internal public auditors from the public sector and of the natural persons; The Order of the Ministry of Public Finances 659/22.VI.2015 concerning the approval of the General Framework for the equivalence of the professional competences in order to obtain the certification certificate by UCAAPI within the framework of the Ministry of Public Finances.

#### Conclusions

Internal audit as cognitive process

General requirements: The internal audit assures the independent and objective evaluation of the internal control/managerial system in order to allow the attainment of an assurance in what regards the process of

management, control and leadership (governance). The public internal auditors must improve their knowledge, abilities and values within the continuous professional formation and to assure the compatibility of their preparedness with the type and nature of the internal auditing missions that must be accomplished. The internal auditor completes his/her actions through the auditing reports, where he/she enunciates the weaknesses identified within the system and formulates recommendations to remove them. The leader of the public entity disposes the necessary measures having in view the recommendations from the auditing reports, with the purpose of removing the noted weaknesses during the auditing missions.

As a conclusion, do the LEGAL REQUIREMENTS reflect and claim a COGNITIVE PROCESS?!

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### ВНУТРІШНІЙ АУДИТ ЯК КОГНІТИВНИЙ ПРОЦЕС

*Термін АУДИТ походить від латинського слова "audire" слухати і інформувати інших. В сучасних англосаксонських країнах, цей термін має сенс перегляду бухгалтерської інформації, здійснюваний незалежним професіоналом, з урахуванням виразу думки щодо правильності і чесності перевіряємої інформації. У загальному рахунку, аудит має на меті надати додану вартість компанії шляхом систематичного та методичного підходу, оцінки процесів управління ризиками, процесів контролю і регулювання, що матеріалізується в рамках об'єктивного і професійного звіту.*

*Ключові слова: аудит, аудитор, управління ризиками, вартість.*

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### ВНУТРЕННИЙ АУДИТ КАК КОГНИТИВНЫЙ ПРОЦЕСС

*Термин АУДИТ происходит от латинского слова "audire" слушать и информировать других. В современных англосаксонских странах, этот срок имеет смысл просмотра бухгалтерской информации, осуществляемый независимым профессионалом, с учетом выражения мнения относительно правильности и честности проверяемой информации. В общем счете, аудит имеет целью предоставить добавленную стоимость компании путем систематического и методического подхода, оценки процессов управления рисками, процессов контроля и регулировок, что материализуется в рамках объективного и профессионального отчета.*

*Ключевые слова: аудит, аудитор, управление рисками, стоимость.*

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## THE PERFORMANCE OF MUTUAL FUNDS IN SLOVAKIA

*A good indicator for the financial markets performance in different countries is the evolution of mutual funds in terms of their inflows and outflows. The goal of the present paper is to analyse the performance of the mutual funds in Slovakia. The research objectives are twofold: to study the flows of funds into and out of mutual funds from Slovakia during the period 2007-2014 and to analyse how investors in Slovakian mutual funds behave in terms of their investment choice. The analysis focuses on identifying patterns in investors' decision making process and on examining the similarity of their behavioural patterns with the ones identified at international level.*

*Key words. Mutual funds, Slovakia, financial portfolio performance, emerging markets.*

**Introduction.** A good indicator for the financial markets performance in different countries might be considered the evolution of mutual funds in terms of their inflows and outflows. Most mutual funds studies so far have focused on

developed markets, especially the US market, and there are very few studies investigating emerging markets, in spite of the fact that in recent years the mutual funds industry recorded growth in those markets, especially in the