

Internal Audit: Role, Mechanism and Challenges

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Abstract

During the Industrial Revolution it was usual for the owner to disengage from the capital investment and management of the business; due to this some important changes in the attitude towards auditing were made. The company must maintain control of the implementation process of internal audits. When businesses were so large in size a systematic verification of the recorded transaction may not be used all the times. This led to an upgrade of the accuracy and also to prevent frauds in business and in result the accounting system improved.

Keywords: IIA, Governance, verification, financial scandals, ethical norms, internal audit, internal control

Introduction

An essential condition for the survival of a company or more generally of an organization lies on the ability of its members to act reliably and efficiently to achieve the objectives of the organization. The substantial coordination of behaviour can be achieved in numerous ways. In a very small business, the manager can verify directly that the tasks are performed on the way he thinks which is suitable. But the supervision of the manager and the mutual adjustment among various actors are quickly becomes insufficient when the number of the firms increased. However it may be wished to maintain these ways of controlling but it would only be applied to the part of the organization. Therefore it is necessary that management put in place mechanisms to fill the gap in supervision.

Business performance is a major concern these days due to importance of the global competition. One factor of this performance lies on the ethical and responsible behaviour of its performers. But at the end of the 20th century, the Enron and WorldCom scandals show that there was a lack of control in organizations.

Following these financial scandals, actions were taken. It has become essential to provide an ethical control in the interest of leading to better take into account the content of internal control, in order to overcome the weaknesses of economic and legal support. In a common interest, ways to measure the impact of moral decisions have been found and the company must be able to justify its activities (Ethical norms and values) this control may be performed by the internal audit.

Organizational performance can also be "the ability of an organization to identify and implement appropriate strategies within the framework of the aims it pursues". The objectives are vary; organizations may want to become the largest company in the world or to remain a successful specialized business, or even be best able to achieve the goals it has set. Once the purposes 2 have been defined, success depends on the ability to define appropriate strategies and to implement them. Organizational arrangements must ensure the level of performance in both economic and strategic scopes and we call internal control the combination of such devices. It is necessary to periodically test the effectiveness and suitability of a particular aspect of internal control. Auditing is the process of studying and evaluating internal control and certain of its aspects, as well as its expected performance. The ensuing result may help to determine the effectiveness of the company. It is something important because the challenges of every business day are for the companies to be competitive so as not to be forced out of the market

Objectives

1. To analysis the role of internal auditors in current scenario.
2. To analysis the internal audit mechanism.
3. To analysis the internal audit challenges.

Research Methodology

Research methodology is the way how we execute the research in a proper manner for finding results according to the objectives. This nature of research is pre-empirical, descriptive and evaluation, in which minute analysis of every factors and strategies on the investors objectives. It's the crux of research by which how, when, what, why all these types of questions answer are built in this part of study.

The research paper is theoretical so data are not needed in the analysis of paper.

Internal Auditing

The Institute of Internal Auditing (1999) presented a broad definition of internal auditing as; "Internal auditing is an independent, objective assurance and 11 consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes".

According to the Glossary to the IIA standards differentiate independent and objectivity concepts as; "Independence: The freedom from conditions that threaten objectivity or the appearance of objectivity, such threats to objectivity must be managed at the individual auditor, engagement, functional and organizational levels." And, "Objectivity: An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made. Objectivity requires internal auditors not to subordinate their judgment on audit matters to that of others."

According to the Institute of Internal Auditor Research Foundation (2008) an internal auditor is a forward looking individual, who knows and understands business systems and ensures the management that they operate rightly and achieve firm goals. Today's business world, internal auditors plays key role in businesses. Internal auditors review organizational goals, processes and operations and provide professional advice to the management.

Role and Responsibility of Internal Auditor

The basic role of internal auditing is to help management achieve company goals. It also provides assurance that management has implemented a satisfactory internal control system to prevent risks. In addition, internal auditing should provide internal consulting services to all levels of the organization in terms of training, advices, facilitation and counsels.

The Institute of Internal Auditors issued objective about internal auditing

"The objective of internal auditing is to assist all members of management in the effective discharge of their responsibilities by furnishing them with analyses, appraisals, recommendations and pertinent comments concerning the activities reviewed. The internal auditor is concerned with any phase of business activity where he can be of service to management. This involves going beyond accounting and financial records to obtain a full understanding of the operations under review."

Sawyer and Vinten (1996) described benefits of internal auditing assistance, which provides action and judgment basis to managers by reporting, performance and internal control limitations and recommendations for improvements, for solution of business problems providing counsel to board of directors and managers for its solution and providing useful, timely and reliable information to the management. Furthermore, the statement also mentions the internal auditor services types and activities kind achieving the overall objectives. The internal auditor appraises the firm operations as planned and to determine the outcomes with the established objectives and appraises the internal control system adequacy and effectiveness of company. The basic purpose to check the adequacy of the internal auditing of the company is to determine about the reasonable assurance provision that the company objectives met efficiently.

Institute of Internal Auditing defines, internal auditing can appropriately be classified into three different areas; internal control, corporate governance and risk management. Internal auditors play a key role in risk management and providing consultants and assurance services to the executives. The Role of Internal Auditing in Enterprise Wide Risk Management (ERM) as a direction to the internal auditors that they should play a role in the enterprise risk management procedure. Secondly, related to consulting services the Institute of Internal Auditing report describe four basic activities for internal auditor to be accountable, which are; coordinating Enterprise-Wide Risk Management activities, maintaining and developing the Enterprise-Wide Risk Management framework, facilitating the identification and evaluation of risks, and for the board support developing of risk management strategy.

Internal Audit as Mechanisms

Internal Audit as a Risk Management Mechanism

Value addition to the entity can be given by the internal auditors. It can be done by giving assurance that its exposures regarding risk are properly managed and understood. Internal audit need to play a vital role in monitoring the risk profile of a company. Moreover, it should identify areas in order to better the risk management procedures. An internal audit can be helpful for organizations in identifying and evaluating risks and putting the profession at the front line of the risk management. Further, describes that within a company, development of a risk based culture is required in order to build a strong organizational commitment for risk management. This should result in the development of an integrated risk management framework.

Internal Audit as a Control Mechanism

The management and directors of an entity adopt the process of internal control. This process gives assurance about the achievement of the entity's objectives regarding financial reporting, operations and compliance with the regulations. The control environment can be strengthening by using effective internal audit function by:

Review of the internal control structure of a firm, On behalf of the management; monitoring different operations regarding the information system and control procedures.

The asymmetry of information between division managers and senior managers result in weakling the ability of the senior managers to firmly control operations. The reason for this problem is the presence of internal agency costs which occurs between the upper management and the lower level staff because of the incentive's differences. So the use of strong internal controls system including the internal audit for reviewing and monitoring mechanism. So keeping this in mind, senior management can delegate their

responsibilities in accordance with the internal control to the internal audit function.

Internal Audit as an Internal Governance Mechanism

From the agency point of view, the role of strong governance within a firm lays by aligning the management interests with the stakeholders in order to minimize agency costs. An independent board chair, independent directors on the board, internal audit, external audit and effective audit committee are different corporate governance mechanisms used to monitor behaviour of the management. According to The complex interactions within these governance mechanisms are like a “corporate governance mosaic”. But problems between independent and executive directors due to asymmetry information shows internal audit more likely as a complementary mechanism. This is supported by determining evidences from the researches examining the relationship between audit committees and internal audit. This is in accordance with the IIA view about internal auditing; which helps organizations to improve and evaluate governance processes. So, positive relation between the internal audit function and a stronger audit committee can be expected because of their closely intertwined goals. An effective audit committee can strengthen the internal audit function position whereas a powerful internal audit function can result in enhancing the audit committee's effectiveness

Challenges of Internal Audit

An internal audit should be an objective task and that it can compromise sometimes in the reporting line, where they required to report and review the operational areas. The internal audit should have an independent role and this is a long term confront for the internal auditors. Internal auditors' profession has received a new awareness due to the rise of corporate governance. Internal auditors should not subordinate their decision during an audit to management but they cooperate with them and accept boards of director's judgment about management. The internal auditors required reinforcing their relationship with the board of directors and with audit committee. Internal auditors providing assurance should be the best achievement of objectives as well as independent, i.e. in terms of internal control, corporate governance and risk management. Internal auditor's actions will be used to new legislation, development and requirements. Internal auditor importance is growing due to their activities and their professions still need to be recognized within the firm. The complexity of firms increases due to huge business transactions, advancement in information technology and due to broad dynamic environment.

Conclusion

The main purpose of our study was to explore the internal audit contribution to the organization goals. A theoretical study was conducted to find about internal audit participations in overall objectives of the university or organization. As the management and audit staffs are working as team members, therefore the management and company objectives in the same direction. It simply means that the business objectives and organization objectives can be the same. The result of such audit assures the conformity of the operation standards and effective process implementations in operations areas to contribute in organization efficiency.

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