



INTERNAL AUDIT: A TOOL OF MANAGEMENT

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ABSTRACT :

Internal audit is an evaluation and analysis of the business operation conducted by the internal audit staff. It is the part of overall system of internal control established in an organization. Internal audit is the independent appraisal activity within an organization for the review of accounting, financial and other business practices as protective and constructive arms of management. It is a type of control which functions by measuring and evaluating the effectiveness of other type of controls. According to Professor Walter B. Meigs, Internal Auditing means "Internal auditing consist of a continuous, critical review of financial and operating activities by a staff of auditors functioning as fulltime salaried employees." This paper is a modest attempt to study the internal audit role as a tool to the management.



KEY WORDS: Compliance Audit, Environmental Audit, Internal Audit, Operational Audit, Performance Audit, SIA.

INTRODUCTION

In big organization, an internal audit is carried out by the team of professionals in the organization. The internal audit is not mandatory but organization gets the internal audit done with a view to evaluate the effectiveness of internal control, the soundness of financial system, effectiveness of business processes etc. This provides management an assurance about the control process in the organization and it aids in early detection of inefficiencies/fraud etc. it helps the statutory auditors too in getting the statutory audit done effectively. As per company audit report order, 2003, statutory auditor also requires to comment whether the company is having sound internal audit system or not. Internal audit is a dynamic profession involved in helping organisations achieve their objectives. It is concerned with evaluating and improving the effectiveness of risk management, control and governance processes in an organisation. Now there is more pressure than ever on executive management and internal auditors to mitigate corporate fraud and misconduct. Job security can be at risk for internal audit directors when they don't develop an antifraud action plan and fail to address stakeholders' expectations. Management can be liable for two types of misconduct – failing to have sufficient internal controls and the offense itself. The increased concern for fraud prevention is easily understood in light of the billions at stake due to fraud. Companies have changed their management of fraud from a compliance driven approach to proactive prevention.

Need and Scope for Standards on Internal Audit

The Standards on Internal Audit (SIAs) establish uniform evaluation criteria, methods, processes and practices. The Standards are pronouncements which form the basis for conducting all internal audit activity. These pronouncements are designed to help the internal auditor to discharge his responsibilities. The following internal audit related pronouncements have been issued:

- Preface to the Framework and Standards on Internal Audit
- Framework Governing Internal Audits
- Basic Principles of Internal Audit
- Standard on Internal Audit (SIA) 210, Managing the Internal Audit Function
- Standard on Internal Audit (SIA) 220, Conducting Overall Internal Audit Planning
- Standard on Internal Audit (SIA) 310, Planning the Internal Audit Assignment
- Standard on Internal Audit (SIA) 320, Internal Audit Evidence
- Standard on Internal Audit (SIA) 330,

Internal Audit Documentation As per Framework Governing Internal Audits issued by ICAI, Internal Audit is defined as follows: “Internal Audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives”

1. Basic Principles of Internal Audit- Standard on Internal Audit (SIA) 2, Basic Principles Governing Internal Audit was, originally, issued by the Board in August, 2007 which was recommendatory in nature. The revised Basic Principles of Internal Audit is being issued as overarching document for all the Standards on Internal Audit, and shall become mandatory from such date as notified by the Council.

The Basic Principles of Internal Audit are a set of core principles fundamental to the function and activity of internal audit. The Basic Principles are critical to achieve the desired objectives as set out in the Definition of the Internal Audit, and therefore, apply to all internal audits.

All internal audits shall be performed based on these basic principles, and departures from these principles shall be appropriately disclosed in internal audit report or other similar communication. The principles can be in a nutshell: If internal auditors or the internal audit activity is prohibited by law or regulation from conformance with certain parts of the Standards, conformance with all other parts of the Standards and appropriate disclosures are needed. If the Standards are used in conjunction with standards issued by other authoritative bodies, internal audit communications may also cite the use of other standards, as appropriate. In such a case, if inconsistencies exist between the Standards and other standards, internal auditors and the internal audit activity must conform with the Standards, and may conform with the other standards if they are more restrictive. Implementation Standards are also provided to expand upon the Attribute and Performance standards, by providing the requirements applicable to assurance (A) or consulting (C) activities. Assurance services involve the internal auditor’s objective assessment of evidence to provide an independent opinion or conclusions regarding an entity, operation, function, process, system, or other subject matter. The nature and scope of the assurance engagement are determined by the internal auditor. There are generally three parties involved in assurance services:

- (1) the person or group directly involved with the entity, operation, function, process, system, or other subject matter — the process owner,
- (2) the person or group making the assessment — the internal auditor, and
- (3) the person or group using the assessment — the user. Consulting services are advisory in nature, and are generally performed at the specific request of an engagement client. The nature and scope of the consulting engagement are subject to agreement with the engagement client.

Consulting services generally involve two parties:

(1) the person or group offering the advice — the internal auditor, and
(2) the person or group seeking and receiving the advice — the engagement client. When performing consulting services the internal auditor should maintain objectivity and not assume management responsibility. Work performed by others, documentation, planning, evidence, internal control & risk management systems and reporting, which governs the internal auditor's professional responsibilities. The internal auditor should not disclose any information acquired during his course of work, to any outside party including the entity's employees without obtaining permission from the entity. The internal auditor is expected to either have such skills and competence or obtain them with the help of technical knowledge obtained through study and formal courses, as are necessary for the purpose of discharging his responsibilities. The internal auditor should carefully direct, supervise and review the work delegated to assistants. The internal auditor may also have to rely on the work of other auditors or experts. He should be satisfied that he has no reasons to believe that he should not have relied on the work of the expert. The internal auditor should, based on his professional judgment, obtain sufficient appropriate evidence to enable him to draw reasonable conclusions therefrom to support his opinion or findings.

Types of Internal Audit**Compliance Audit**

A company may be required to adhere to local laws, compliance needs, government regulations, external policies, or other restrictions. To demonstrate compliance with these rules, a company may task an internal audit committee to review, compile appropriate information, and provide an overall opinion on the status of the compliance requirement.

Internal Financial Audit

Public companies are required to perform certain levels of external financial auditing where a completely independent third party provides an opinion on the company's financial records. Companies may want to dive further into audit findings or perform an internal financial audit in preparation for an external audit. Many of the tests between an internal or external auditor may be similar; the nature of independence separates the two types of audits for financial audits.

Environmental Audit

As companies become continually more environmentally conscious, some take the steps of reviewing the business' impact on the planet. This results in an internal audit covering how a company safely sources raw materials, minimizes greenhouse gases during production, utilizes eco-friendly distribution methods, and reduces energy consumption. Companies leveraging triple bottom line reporting may perform internal environmental audits as part of annual reporting.

Technology/IT Audit

An IT audit may have different objectives. The internal audit may be the result of an external lawsuit, a company complaint, or a target to become more efficient. An internal audit focused on technology reviews the controls, hardware, software, security, documentation, and backup/recovery of systems. The goal is likely to assess general IT accuracy and processing capabilities.

Performance Audit

An internal audit focused on performance pays less attention to the processes and more on the final result. The company will likely have set performance objectives or metrics that may be tied to performance bonuses or other incentives. As a result, an internal auditor assesses the outcome of an objective that may not be easily quantifiable.

For example, a company may wish to have expanded its use of diverse suppliers; the internal auditor, independent of any purchasing process, will be tasked with analyzing how the company's spending patterns have changed since this goal was set.

Operational Audit

An operational audit is most likely to occur when key personnel leaves or when new management takes over an entity. The company may want to assess how things are done and whether resources are being used more efficiently. During an operational internal audit, the auditor will review whether current staff and processes fulfil the mission statement, value, and objectives of a company.

Construction Audit

Development, operating, real estate, or construction companies may perform construction audits to ensure not only appropriate physical development of a building but appropriate project billing along the life of the project. This mostly includes adherence to contract terms with the general contractor, sub-contractors, or standalone vendors as necessary.

This may also include ensuring the company has remit the appropriate payments, collected the appropriate payments, and internal project reports regarding project completion are correct.

Special Investigations

Many of the audits above may be recurring and performed each year. In some cases, it might make sense for an internal audit committee to evaluate a special circumstance that will occur only once. This may entail gathering a report on the efficiency on a recent merger, the hiring of a key employee, or a complaint from staff. When selecting the individuals for the special investigation audit, a company must be especially mindful to select members with appropriate expertise and independence.

CONCLUSION

As Internal Audit as the review of financial, managerial and systems aspect of an undertaking to ensure that there is optimum utilisation of human and physical resources in carrying out operations and that performances is in conformity with management plans.

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