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Role of Auditing in Advanced Accounting

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I. Introduction

Audit is an evaluation of a person, organization, system, process, enterprise, project or product. Audits are performed to ensure the validity and reliability of information and also to provide an assessment of a systems in internal control. Demand for audit comes from relation between owner and manager as an exact measure of state in finances according to available information. Quality audits are essential to verify the existence of objective evidence shoving conformance to required processes, to assess how successfully processes have been implemented, for judging the effectiveness of achieving any defined target levels, providing evidence concerning reduction and elimination of problem areas and are a hands-on management tool for achieving continual improvement in an organization. New look on Audit, as a crucial process in finding, avoiding and preventing possible frauds, initiated evolving changes in process itself. Modern Audit carries responsibilities in adequate risk management in doing business and protection of business units from inside.

II. Internal Auditing Process

Traditionally, audits were mainly associated with gaining information about financial systems and the financial records of a company or a business. However, recent auditing has begun to include non-financial subject areas, such as safety, security, information systems performance, and environmental concerns. There are now audit professionals who specialize in security audits, information systems audits, and environmental audits. An audit must adhere to generally accepted standards established by governing bodies. These standards assure third parties or external users that they can rely upon the auditor's opinion on the fairness of financial statements, or other subjects on which the auditor expresses an opinion. Audit is by the law defined as ”examination of accounting statements in the purpose of provision of an opinion if state of property, capital and obligation, and business results of legal entity are given objectively and authentic”. A person performing Audit and responsible for its authenticity and objectivity is an Auditor. Obligations of Auditors are:

- Making reports of an audit,
- Giving an opinion about authenticity and objectivity of statements,
- Informing managing board about identified weaknesses and providing suggestions for overcoming,
- Emphasize all special demands, etc.

Obligations of clients are to create accounting statements according to law, to perform adequate conduction of accounting records, to make accessible all records and data’s to auditor.

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. With commitment to integrity and accountability internal auditing provides value to governing bodies and senior management as an objective source of independent advice. Professionals called internal auditors are employed by organizations to perform the internal auditing activity.

Internal auditing frequently involves measuring compliance with the entity's policies and procedures. However, internal auditors are not responsible for the execution of company activities; they advise management and the Board of Directors (or similar oversight body) regarding how to better execute their responsibilities. As a result of their broad scope of involvement, internal auditors may have a variety of higher educational and professional backgrounds.

Publicly-traded corporations typically have an internal auditing department, led by a Chief Audit Executive ("CAE") who generally reports to the Audit Committee of the Board of Directors, with administrative reporting to the Chief Executive Officer.

Internal audit is a complement of external audit, because in those organizations where internal audit function is implemented external audit is more determined to appreciate in a different manner the regularity, sincerity and fair view of the results and financial statements.

External audit is a complement of internal audit, starting from the idea that where an external specialist made his job, it is certain that there is a better control. In additional, internal auditor could have significant benefits because of external audit activity, in order to express his opinion or to argue his recommendations? Internal auditing activity is primarily directed at improving internal control.

A) The Main Differences

There are many key differences between internal and external audit and these are matters of basic principle that should be recognized are:

-The external auditor is an external contractor and not an employee of the organization as is the internal auditor. However, that there is an increasing number of contracted-out internal audit functions where the internal audit service is provided by an external body.

-The external auditor seeks to provide an opinion on whether the accounts show a true and fair view, whereas internal audit forms an opinion on the adequacy and effectiveness of systems of risk management and internal control, many of which fall outside the main accounting systems.

B) The Main Similarities

The main similarities between internal and external audit are as follows:

- Both the external and internal auditor carry out testing routines and this may involve examining and analyzing many transactions.
- Both the internal auditor and external auditor will be worried if procedures were very poor and/or there was a basic ignorance of the importance of adhering to them.
- Both tend to be deeply involved in information systems since this is a major element of managerial control as well as being fundamental to the financial reporting process.
- Both are based in a professional discipline and operate to professional standards.
- Both seek active co-operation between the two functions.
- Both are intimately tied up with organization's systems of internal control.
- Both are concerned with the occurrence and effects of errors and misstatement that affect the final accounts.
- Both produce formal audit reports on their activities.

It should be clear that the external audit role is really much removed from the considerations of the internal auditor both in terms of objectives and from scope of work. External audit is a legal requirement for limited companies and most public bodies, while internal audit is not essential for private companies and is only legally required in parts of public sector.

Internal audit may be charged with investigating frauds and, although the external auditors will want to see them resolved, they are mainly concerned with those that materially affect the final accounts. Internal auditors cover all the organization's operations whereas external auditors work primarily with those financial systems that have a bearing on the final accounts.

External auditors have a great influence on the audit activities, including conferring with management and their recommendations for improvement to internal controls. They provide important feedback on the efficiency of the internal control system. The most important being independence the auditor must have in relation to the organizations he/she is auditing, and attaining the adequate training and proficiency to perform an audit.

Internal auditors, on the other hand, evaluate and provide reasonable assurance of risk management and decide if internal control systems are implemented as intended to allow the organization's goals to be met. They report on deficiencies in the internal controls, issues involving risk management, and provide recommendations on how to improve these areas.

Security is also an area of expertise an internal auditor may have when employed by an organization. An internal auditor examines the security involving sensitive information that must be kept inside the organization.

The major difference between internal and external auditors is amounting of experience and expertise each hold. Internal auditors seem to obtain knowledge specifically have about the organizations to which they are employed. External auditors have specific guidelines and laws to abide by, which requires them to obtain vast amounts of knowledge, of many different types of accounting methods, controls, and more importantly, uncommon entities and environments.

III. The Internal Audit Function in Banks

Effective internal audits function independently and objectively evaluate the quality and effectiveness of a bank's internal control, risk management and governance processes, which assists senior management and the Board of Directors in protecting their organization and its reputation**.**

The internal audit function plays a crucial role in the ongoing maintenance and assessment of a bank's internal control, risk management and governance – areas in which supervisory authorities have a keen interest. Furthermore, both internal auditors and supervisors use risk based approaches to determine their respective work plans and actions.

While internal auditors and supervisors each have a different mandate and are responsible for their own judgments and assessments, they may identify the same or similar/related risks. Providing consulting services to senior management on the assessment or development of internal controls is often a cost-effective way of ensuring that management makes informed decisions. This role as a trusted advisor to senior management, while valuable, should be performed in a way that does not compromise the independence and objectivity of the internal audit function. This requires that internal auditors should not assume management responsibility when providing consulting services or design and/or implement internal controls.

Although the need for objectivity and impartiality is of particular importance for the internal audit department in a banking institution, this does not exclude the possibility that this department, too, may contribute to advisory and consultancy activity, if the independence of analyses and evaluations is ensured.

Some banks have also introduced a system of evaluating their activities, which does not replace, but supplements the function of the bank's internal audit. This is a formal and documented process whereby management and employees analyze their activities and evaluate the effectiveness of the related internal control procedures. Internal audit has several aims and principles which it is necessary to adhere to.

It is the board of directors of the bank, however which bears final responsibility that the bank's management applies an appropriate and effective system of internal control, a system of evaluating banking activity risk and risks concerning bank capital, appropriate methods of monitoring compliance with laws, measures and internal procedures.

The management must ensure an organizational structure that clearly defines powers and responsibility. It is responsible for risk management, proposing suitable internal control mechanisms and monitoring their adequacy and efficiency. Internal audit is a part of the repetitive monitoring of the internal control systems of the bank and its procedures for evaluating internal capital. As such, it assists management and the board of directors in the effective performance of their responsibility as outlined above.

Every bank should have an internal audit department on which – with regard to the volume and nature of its activities – it can rely. In smaller banks internal audit is often provided externally. The internal audit department in a banking institution must be independent from the activities which it controls and must likewise be independent from the day-to-day internal control processes. In this way it is guaranteed that this department performs its activities objectively and impartially.

Internal audit must be objective and impartial, meaning that it should perform its activity free of doubts and interference. Members of the internal audit team may not participate in the bank's operations or in the selection and implementation of internal control systems. The professional competence, as well as internal motivation and systematic professional development of each internal auditor are essential factors for the correct functioning of the whole internal audit department of the bank. The professional competence of the department's employees must always be ensured, as must their regular
training.

Each activity and each of the bank's subjects (i.e. its subsidiaries or branches) should fall within the scope of the internal audit. None of the bank's activities or any of its subjects may be excluded from an internal audit examination. The internal audit department should have access to the bank's records including and information and minutes from meetings of the advisory or decision-making bodies of the bank, where this is relevant would regard to the performance of the internal auditors' activity.

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Banking supervisory authorities should evaluate the work of a bank's internal audit department and, where satisfied with their work, may rely on the internal audits findings in identifying areas of potential risk. Bank audit bodies issue various measures concerning banking internal control systems. However, the scope of these measures varies from country to country, though in general covers the basic principles of a suitable control system in the fields of bank capital, credit risk management, and other risk.

IV. Improvement of the Risk Management Process

Internal audit risk assessments, regulatory requirements and enterprise risk assessments are the top three drivers of the audit plan, and internal audit is playing a more prominent role in organizational issues, such as major capital projects IT systems implementations, mergers and acquisitions and material contracts . Technology also remains a key area of focus for internal audit functions, comprising the big part of current audit plan.

Improving the risk assessment process is the number one priority of CAEs and stakeholders alike. Identifying risks that are truly significant to the business is the first step to effective risk management and monitoring. Today's internal audit functions are focused on enterprise-wide risk coverage, leadership engagement and direct linkage to strategy to increase the relevance of the risk assessment. As well, most leading organizations are incorporating a quantitative component

Nearly half of global respondents indicated that their internal audit functions perform annual updates, or none at all, leaving themselves unprepared for events that could crop up throughout the year including transactions, new product launch or retirement, new market entry, patent expiry and litigation. The key risks should then be incorporated into the internal audit plan, which must be risk-focused and relevant to operations. The results of such an internal audit plan provide the Audit Committee with a pertinent assessment on the strength of the internal control environment, which facilitates them in providing an opinion on the adequacy of internal controls.

As the role of the internal auditor evolves and stakeholder expectations rise, internal audit functions increasingly require competencies that exceed the more traditional technical skills, such as the ability to team with management and business units on relevant business issues. Two main approaches that internal audit functions can take to attract the right capabilities include an auditor rotation program across business units or functions in other parts of the organization and a guest auditor program for high-performing employees from other parts of the business to gain internal audit experience.

If the bank's supervisory authority is satisfied with the internal audit department's work, it may use the internal auditors' reports as the primary mechanism for identifying the bank's potential problems or fields of potential risks that the auditors have not yet controlled. Banking supervisory authorities should organize regular meetings of the managers of the internal audit departments of various banks. Individual department managers may at these meetings exchange knowledge and opinions on topics of common interest in their banking sector.

In general it is recommended that banks, in particular those with complex activities have a standing audit committee. Also the subsidiaries of a bank may then consider the suitability of such a committee in the framework of their boards of directors. In setting up such a committee the bank's board of directors should set out, in writing, the powers, responsibility and duties of the audit committee, as well as the form of reporting, for the committee who is to prepare for the board of directors. The board of directors should regularly update this written document.

V. Changing Role of Internal Audit in Modern Times

Because of higher and more frequent frauds the managements and senior executives are increasingly concerned about the vulnerability and exposure of their businesses/ organizations to frauds and whether or not they are adequately protected. It has come to clear that more than half the frauds were detected by internal audit reviews. This brings into focus the role of internal audit in fraud risk management.

As the mandate and role of internal audit continue to evolve, managements are increasingly counting on internal audit functions in their efforts for managing fraud risks and keeping organizations protected. Increasingly, the internal audit function is not to monitor and detect but also to investigate fraud incidences when they arise. The role of internal audit in fraud risk management by way of preventing, detecting and investigating fraud has amplified as a result of economic uncertainty and increased focus of certain organization's management on fraud risks. As fraud has a number of negative impacts on organizations – financial and reputational – it is important for the organizations to have a strong fraud prevention program. Internal auditors are expected to have sufficient knowledge to evaluate the risk of fraud in their organizations, and are required to report to the board any fraud risks found during their investigations. The expectation is that internal auditing should provide objective assurance to the board and management that fraud controls are sufficient for identified fraud risks and ensure that the controls are functioning effectively.

Practically, while planning their annual audit plan, internal auditors should consider the assessment of fraud risk and review management's fraud management capabilities periodically. They should regularly and closely communicate with those responsible for risk assessments in the organization and also others in key roles throughout the organization, to ensure timely fraud risk management. Internal auditors, during their assignments, should spend an adequate time and attention to evaluating the framework and internal controls related to fraud risk management. Because of that big responsibility of internal audit their function may vary in scope and authority in different organizations, there is a clear trend that internal audit in banks is taking on a more strategic and central role. With these changes, the increased interaction between the evolving internal audit function and its major stakeholders is an important area for banks to focus on and develop. This could include roles in relation to fraud risk management, initial or full investigation of suspected fraud, root cause analysis and control improvement recommendations, monitoring of a reporting/whistleblower hotline, and providing ethics training sessions. If the internal audit activity is responsible for the investigation, it may conduct an investigation using in-house staff, outsourcing, or a combination of both. For that reason it is expectably important to have adequate funds for appropriately trained staff with special skills, if necessary, depending upon the nature, size, and complexity of the operating environment of an organization.

VI. Conclusion

Co-operation between banking supervisory authorities, external auditors and their internal auditors with the aim of improving the effectiveness of their work is very important, where each of the parties concentrates on its own field of responsibility. Such co-operation may, for example, be founded on regular meetings, where each of the parties presents information on areas of common interest, the recommendations of internal and external auditors are discussed and each of the parties gives its opinion on them. The cooperation of banking supervisory authorities, internal auditors and external auditors requires a relationship founded on trust. Auditing is now necessary part of legislature in every country. Each company that is serious in business and exploration of standards would make obligation of auditing even without national legislation. Auditing provides to interested party (bank, company, managers, state) to have certainty in statements from depending companies and to be sure in decisions they are making regarding such statements.

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