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FINANCE**

THESIS:

THE ROLE OF INTERNAL AUDIT IN ORGANIZATIONS

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ABSTRACT

Audit as a meaning was developed in recent years, although the need of control existed from the ancient times. The audit was always connected with humans through accounting operations throughout the ages of history. Audit may be grouped into two main categories: internal and external. The external audit is a periodic or specific purpose audit conducted by external qualified accountants. The internal audit is the audit which is organized within the economic unit and conducted by employees. In particular, internal audit is considered to encompass the audit of both operational activities as well as financial activities. It has a major role in designing and developing the internal control system and support the corporate governance. Internal audit contributes in measuring and evaluating the risks surrounding the work environments. In addition, it creates a climate of certainty and prevents from irregularities and thefts. Alongside, over the last few years the role of the internal auditor has been recognized as a special role within organizations. Internal auditors provide important support to organizations. The purpose of this thesis is to examine the usefulness of internal audit. It aims to identify the role of the internal audit in controlling the financial and managerial performance in organizations.

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INTRODUCTION

An essential condition for the survival of an organization lies on the ability of its members to act reliably and efficiently to achieve the objectives of the organization. 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 behavior of its performers. In a common interest, ways to measure the impact of moral decisions have been found and the company must be able to justify and control its activities. This control may be performed by the internal audit.

In the recent years a lot of improvements have appeared on the function of the internal audit with respect to the extent of the work or the independency of the internal auditor, especially after the emerging of the auditing committee and its responsibility in front of the board of directors and the shareholders that make this function worth investigating and researching. Within the framework of modern business world, the role of internal audit is important since it is regarded as a source from which core abilities are given or drawn and are transformed into competitive advantages. In this study we want to contribute in the field of internal audit.

Internal audit is an independent, objective assurance and 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. Internal audit is a catalyst for improving an organization's governance, risk management and management controls by providing insight and recommendations based on analyses and assessments of data and business processes. 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 audit activity.

CHAPTER 1

1 INTRODUCTION TO AUDIT SCIENCE

1.1 HISTORICAL DEVELOPMENT OF AUDIT

The presence of auditing has been inferred from records of a Mesopotamian civilization going back as early as 3500 BC. These records, involving financial transactions displayed various markings, which may be construed as a system of verification. Internal controls and separation of duties arose at the same time. Records of other civilizations, including early Egyptian, Greek, Chinese and Persian, display similar systems. Ancient Rome employed the "hearing of accounts", where one official would compare his records with those of another, an application of both separation of duties and verification. It is this practice, of hearing of accounts, which probably gave rise to the term "audit", from the Latin word "auditus".

In the 16th century auditing and accounting were merely concerned with governmental and family issues to keep independent records of transactions. Another objective of auditing was to periodically record inventories and to ensure accuracy in the accounting records and reporting. During the Industrial Revolution it was usual for the owner to disengage from the capital investment and management of the business. Further, the first change in attitude was realized due to a general apprehension that there was a need for standardized system of accounting to accomplish both fraud prevention and accurate reporting. The second change in attitude was realized due to the need of an independent accounts review of the business.

A thorough inspection of the financial records was the guideline and the generally accepted approach. In the middle of 19th century the proprietor of the company frequently used to check the production areas in order to verify the financial data of the company. Those days' audits were expensive and incompetent, because of complete assessment of all the transactions and financial statements. 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.

1.2 AUDIT ACTIVITY

An audit is a systematic, objective and independent examination and evaluation of books, accounts, statutory records, documents and vouchers of an organization to ascertain how far the financial statements and non-financial disclosures present a true and fair view of the concern. It also attempts to ensure that the books of accounts are properly maintained by the concern as required by law. It can be done internally by employees of the organization, or externally by an outside firm. The auditor perceives and recognizes the propositions before them for examination, obtains evidence, evaluates the same and formulates an opinion on the basis of his judgement which is communicated through their audit report. Audits performed by outside parties on private companies can be extremely helpful in removing any bias when it comes to the state of a company's financials.

Any subject matter may be audited. Audits provide third party assurance to various stakeholders that the subject matter is free from material misstatement. The term is most frequently applied to audits of the financial information relating to a legal person. Other areas which are commonly audited include: secretarial and compliance audit, internal controls, quality management, project management, and energy conservation. As a result of an audit, stakeholders may effectively evaluate and improve the effectiveness of risk management, control, and the governance process over the subject matter.

Companies receive an audit once/twice a year, or monthly. For some companies, audits are a legal requirement due to the compelling incentives to intentionally misstate financial information in an attempt to commit fraud. For some publicly traded companies, auditors are used as a resource to evaluate the effectiveness of internal controls on financial reports.

1.3 TYPES OF AUDITORS

1.3.1 EXTERNAL AUDITORS

When it comes to external auditing, there are two different categories of auditors. First, there is an external or statutory auditor who works independently to evaluate financial reporting, and then there are external cost auditors who evaluate cost statements and sheets to see if they're free of misstatements or fraud. Both of these types of auditors follow a set of standards different from that of the company or organization hiring them to do the work. They only announce relevant reports to the

company's shareholders. External auditors are qualified accountants and report on an annual basis. The external audit report shows if the accounts are in true and fair value. The scope of their work is to check the accounts, the balance sheet and the annual financial reports.

1.3.2 INTERNAL AUDITORS

Internal auditors, as the name implies, are employed by the company or organization for which they are performing the audit. To the best of their ability, internal auditors provide information to the company's audit committee, board of directors, managers, and other stakeholders on the accuracy of their books and the efficacy of their internal systems. Also, internal auditors play an advisory role since they reassure that the company's organizing systems and that the risk management policies are smoothly operated. Furthermore, internal auditors are qualified persons that are trained in the field of internal auditing and they are not independent since they work in the organization.

1.3.3 CONSULTANT AUDITORS

Consultant auditors, while not working internally, use the standards of the company they are auditing as opposed to a separate set of standards. These types of auditors are used when an organization doesn't have the resources to audit certain parts of their own operations.

CHAPTER 2

2 CONCEPTUAL FRAMEWORK OF INTERNAL AUDIT

2.1 HISTORY OF INTERNAL AUDIT

The birth of modern day internal auditing is perceived by many to happen with the formation of The Institute of Internal Auditors (IIA). It was established in 1941 in the United States, with first 24 members. IIA's fast growth, worldwide expansion, continuous research, and development fueled growth in internal audit profession.

The Internal Auditing profession evolved steadily with the progress of management science after World War II. It is conceptually similar in many ways to financial auditing by public accounting firms, quality assurance and banking compliance activities. While some of the audit technique underlying internal auditing is derived from management consulting and public accounting professions, the theory of internal auditing was conceived primarily by Lawrence Sawyer (1911-2002), often referred to as "the father of modern internal auditing".

Internal audit function started mainly as protection against fraud and asset loss. Organizations grew in size and complexity which led to their decentralization. Management needed to internally evaluate accounting information that was used for making decisions. They also needed to control efficiency of work and to ensure that no deceitful actions took place.

First companies that realized the potential of internal auditing beyond audit of financial statements were railroad, defense, and retail industries. Quickly, internal auditing became a mean to verify all transactions and to summarize business and its activities. In this way internal audit provided further insights and ensured integrity and objectivity. Therefore internal audit's role changed from typical clerical function to a management practice.

Even though, in the early years after the establishment of IIA, internal auditing was still connected with external audit. Internal auditors have still been assisting in the review of the financial statements, but the profession was developing. It can be said that it was finally established as serious and fully equipped profession in 70's. In 1974 first Certified Internal Auditor exam was held.

Since 1978 all American listed companies are required to have auditing boards with three to five independent members. Additionally, internal audit's importance in organizational hierarchy rose as its success was depending on the relationship between the audit committee and those in charge of the organization. By 1990's internal auditors have been performing financial, operational, management and

compliance audit with risk and control based approach. Moreover, internal auditing function has become “industry based” with internal auditors working within the industry that they specialize in. In 1999, to include all these changes and expanding roles and obligations, The Institute of Internal Auditors implemented a definition of internal auditing in the form that is known.

With the implementation in the United States of the Sarbanes-Oxley Act of 2002, the profession's exposure and value was enhanced, as many internal auditors possessed the skills required to help companies meet the requirements of the law. However, the focus by internal audit departments of publicly traded companies on SOX related financial policy and procedures derailed progress made by the profession in the late 20th century toward Larry Sawyer's vision for internal audit. Through 2000's and the beginning of 2010's internal auditing evolved around tightened regulations and increased need for regulatory compliance. It was focusing more on risk management, improvement of business operations and information technology (IT) and battle with corruption. This was mainly due to global economic downturn and many corporate scandals that resulted in new laws and regulations. In about 2010, The Institute of Internal Auditors (IIA) began advocating for the broader role internal auditing should play in the corporate arena.

Continuous and rapid development of internal auditing over the years has been fueled by globalization, technological development, e-commerce and growing complexity of organizational structures. In the same time, The Institute of Internal Auditors expanded into 170 countries and territories with over 180 000 members world-wide. It continuously conducts research and develops practices that allow internal audit to adjust and respond to ever-changing needs of organizations.

2.2 INTERNAL AUDIT

Internal audit is an independent, objective assurance and 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. The Internal Audit is performed in all the operations of an organization, such as management, financial statements and the protection of the organization's assets. All the operations can be performed by internal audit except the ones that do not present an interest in audit function. In this way, internal audit controls all the parts of an organization and ensures if any deficiencies exist. The measure that the organization should take into account is the protection of the assets, the reliability and the accuracy of the accounting records. According to the Professional Association of Internal Auditors of the US, the Internal Audit Service, includes the actions that are adopted by the administration to plan, organize

and direct. These actions provide assurance in order that the following objectives will be achieved:

- a) Economic and adequate use of resources,
- b) Protection of its assets,
- c) Reliability and information integrity,
- d) Compliance with policies, procedures, laws and regulations.

In addition, the internal audit function is a component of corporate governance, and also, it is an important factor to the process of governing an organization while it evaluates and improves some assets.

The Internal Audit shall inform all departments and all members of an enterprise that control procedures are in line with the decisions taken by the administration in order to exempt them from responsibility. As it was stated by the principles of Corporate Governance, Internal Audit protects the interests of the shareholders and the employees while it evaluates : the Internal Control System and subsystems, the risk assessment and effective management, the existence of the organization and effectiveness of internal processes, the education and compliance agreements with employee management decisions, the comparison of operating costs, the reliability of financial statements, the evaluation of cooperation and communication between employees, the use of means of production, the prevention of fraud, damage and loss.

The purpose of the audit is the accurate examination of accounting books, records and financial statements of the enterprise. During the audit process the verification of the report is based on the accounting system organization unit and thus the initial measurement and report of any problem that concerns the company is achieved.

The audit performed by the auditor who follows some certain rules - standards of professional conduct. These rules are called audit work standards and their purpose is to achieve the audit procedures. Moreover, the auditing standards are divided into four categories:

- a) The basic standards are referred to the purpose of checks and the conditions needed to become an auditor.
- b) The performance of labor standards which contain principles of technical control.
- c) The reporting standards, referred to a draft report by the auditor
- d) Professional qualification standards, referred to the professional conduct of the controller.

2.3 AUDIT CONTROLS

Internal Audit controls can be divided into five categories:

- a) Financial Control, checks the reliability and the efficiency of the accounting system of the enterprise as well as it measures and presents the financial figures of the results which are carried out by auditors.
- b) Operational Control, examines and monitors whether an enterprise is operated in accordance with the operational and administrative authorities of industry and it is usually performed by internal auditors.
- c) Efficiency control in which there are internal auditors who are interested in the functions and procedures and positively contribute to the proper functioning of the business.
- d) Compliance Audit aims at finding compliance with already agreed terms such as invoice payment check.
- e) Special Control is a control that does not coincide with the above categories, but as long as the controller can handle the instance judicial review it can be performed.

2.4 INTERNAL AUDITORS

Internal auditors are explorers, analysts, problem-solvers, reporters, and trusted advisors. They have to be independent people who are willing to stand up and be counted. Their employers value them because they provide an independent, objective and constructive view. Internal auditors need to have integrity, objectivity, confidentiality and sufficiency. To do this, they need a remarkably varied mix of skills and knowledge. They come from diverse areas such as finance, operations, IT, and engineering. The internal audit activity must have qualified, skilled and experienced people who can work in accordance with the Code of Ethics and the International Standards. An internal auditor preferably needs an accounting background and understanding of internal control, because of his or her involvement in appraising financial reports.

Internal auditors are, to a great extent, key to an organization's success. They review the organization's processes, operations, and goals. They provide objective, professional advice to all levels of management and pave the path toward continuous improvement. They identify the organization's greatest risks and plan audit coverage accordingly. To demonstrate their professionalism and competence, some internal audit practitioners choose to obtain professional certifications such as the globally recognized Certified Internal Auditor or Certification in Risk Management Assurance. They might be advising the project team running a difficult change program one day, or investigating a complex overseas fraud the next. From very early on in their

careers, they talk to executives at the very top of the organization about complex, strategic issues, which is one of the most challenging and rewarding parts of their role.

Depending on the structure, maturity, and resources of the function, internal auditors are responsible for the following tasks:

- a) Offer insight advice
- b) Evaluate risks
- c) Assess controls
- d) Ensure accuracy
- e) Analyze/Improve operations
- f) Promote ethics
- g) Review processes and procedures
- h) Monitor compliance
- i) Assure safeguards
- j) Investigate fraud
- k) Communicate results

2.5 ORGANIZATIONAL INDEPENDENCE

While internal auditors are not independent of the companies that employ them, independence and objectivity is the cornerstone of the IIA professional standards. Professional internal auditors are mandated by the IIA standards to be independent of the business activities they audit. This independence and objectivity are achieved through the organizational placement and reporting lines of the internal audit department. Internal auditors of publicly traded companies are required to report functionally to the board of directors directly, or a sub-committee of the board of directors, and not to management except for administrative purposes.

The required organizational independence from management enables unrestricted evaluation of management activities and personnel and allows internal auditors to perform their role effectively. Although internal auditors are part of company management and paid by the company, the primary customer of internal audit activity is the entity charged with oversight of management's activities. This is typically the Audit Committee, a sub-committee of the Board of Directors. Organizational independence is effectively achieved when the chief audit executive reports functionally to the board.

2.6 ROLE IN INTERNAL CONTROL

Internal auditing activity is primarily directed at evaluating internal control. Under the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Framework, internal control is broadly defined as a process, affected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of the following core objectives for which all businesses strive:

- a) Effectiveness and efficiency of operations
- b) Reliability of financial and management reporting.
- c) Compliance with laws and regulations.
- d) Safeguarding of Assets

Management is responsible for internal control, which comprises five critical components: the control environment, risk assessment, risk focused control activities, information and communication, and monitoring activities. Managers establish policies, processes, and practices in these five components of management control to help the organization achieve the four specific objectives listed above. Internal auditors perform audits to evaluate whether the five components of management control are present and operating effectively, and if not, provide recommendations for improvement. In the United States, internal auditors may assist management with compliance with the Sarbanes-Oxley Act (SOX).

The internal control system indicates an organized pattern of functions and procedures in an integrated control system which establishes the management and it highlights the organizations' effective function. The internal control systems in order to be effective and to introduce to the auditors all the significant matters to take into consideration, must follow some certain principles.

2.7 ROLE IN RISK MANAGEMENT

Internal auditing professional standards require the function to evaluate the effectiveness of the organization's risk management activities. Risk management is the process by which an organization identifies, analyzes, responds, gathers information about, and monitors strategic risks that could actually or potentially impact the organization's ability to achieve its mission and objectives.

Under the COSO enterprise risk management (ERM) Framework, an organization's strategy, operations, reporting, and compliance objectives all have associated strategic business risks - the negative outcomes resulting from internal and external events that inhibit the organization's ability to achieve its objectives. Management assesses risk as part of the ordinary course of business activities such as strategic planning, marketing planning, capital planning, budgeting, hedging, incentive payout structure, credit/lending practices, mergers and acquisitions, strategic partnerships, etc. Sarbanes-Oxley regulations require extensive risk assessment of financial reporting processes. Corporate legal counsel often prepares comprehensive assessments of the current and potential litigation a company faces. Internal auditors may evaluate each of these activities, or focus on the overarching process used to manage risks entity-wide. For example, internal auditors can advise management regarding the reporting of forward-looking operating measures to the Board, to help identify emerging risks; or internal auditors can evaluate and report on whether the board and other stakeholders can have reasonable assurance the organization's management team has implemented an effective enterprise risk management program.

In larger organizations, major strategic initiatives are implemented to achieve objectives and drive changes. As a member of senior management, the Chief Audit Executive (CAE) may participate in status updates on these major initiatives. This places the CAE in the position to report on many of the major risks the organization faces to the Audit Committee, or ensure management's reporting is effective for that purpose.

The internal audit function may help the organization address its risk of fraud via a fraud risk assessment, using principles of fraud deterrence. Internal auditors may help companies establish and maintain Enterprise Risk Management processes. This process is highly valued by many businesses for establishing and implementing effective management systems and ensuring quality is maintained and professional standards are met. Internal auditors also play an important role in helping companies execute a SOX 404 top-down risk assessment. In these latter two areas, internal auditors typically are part of the risk assessment team in an advisory role.

2.8 ROLE IN CORPORATE GOVERNANCE

Corporate governance refers to a number of principles adopted by a company, aiming to uphold its performance and the interests of its shareholders and all stakeholders. Internal auditing activity as it relates to corporate governance has in the past been generally informal, accomplished primarily through participation in meetings and discussions with members of the Board of Directors. According to COSO's enterprise risk management (ERM) framework, governance is the policies, processes and structures used by the organization's leadership to direct activities,

achieve objectives, and protect the interests of diverse stakeholder groups in a manner consistent with ethical standards. The internal auditor is often considered one of the "four pillars" of corporate governance, the other pillars being the Board of Directors, management, and the external auditor.

A primary focus area of internal auditing as it relates to corporate governance is helping the Audit Committee of the Board of Directors perform its responsibilities effectively. This may include reporting critical management control issues, suggesting questions or topics for the Audit Committee's meeting agendas, and coordinating with the external auditor and management to ensure the Committee receives effective information. In recent years, the IIA has advocated more formal evaluation of corporate governance, particularly in the areas of board oversight of enterprise risk, corporate ethics, and fraud.

2.9 INTERNAL AUDIT EXECUTION

A typical internal audit assignment involves the following steps:

- a) Establish and communicate the scope and objectives for the audit to appropriate management.
- b) Develop an understanding of the business area under review. This includes objectives, measurements, and key transaction types. This involves review of documents and interviews. Flowcharts and narratives may be created if necessary.
- c) Describe the key risks facing the business activities within the scope of the audit.
- d) Identify management practices in the five components of control used to ensure each key risk is properly controlled and monitored. Internal Audit Checklist can be a helpful tool to identify common risks and desired controls in the specific process or industry being audited.
- e) Develop and execute a risk-based sampling and testing approach to determine whether the most important management controls are operating as intended.
- f) Report issues and challenges identified and negotiate action plans with management to address the problems.
- g) Follow-up on reported findings at appropriate intervals. Internal audit departments maintain a follow-up database for this purpose.

Audit assignment length varies based on the complexity of the activity being audited and Internal Audit resources available. Many of the above steps are iterative and may not all occur in the sequence indicated. In addition to assessing business

processes, specialists called Information Technology Auditors review Information technology controls.

2.10 INTERNAL AUDIT REPORTS

Internal auditors typically issue reports at the end of each audit that summarize their findings, recommendations, and any responses or action plans from management. An audit report may have an executive summary; a body that includes the specific issues or findings identified and related recommendations or action plans, and appendix information such as detailed graphs and charts or process information. Each audit finding within the body of the report may contain five elements, sometimes called the "5 C's":

- a) Condition: What is the particular problem identified?
- b) Criteria: What is the standard that was not met? The standard may be a company policy or other benchmark.
- c) Cause: Why did the problem occur?
- d) Consequence: What is the risk/negative outcome (or opportunity foregone) because of the finding?
- e) Corrective action: What should management do about the finding? What have they agreed to do and by when?

The recommendations in an internal audit report are designed to help the organization achieve effective and efficient governance, risk and control processes associated with operations objectives, financial and management reporting objectives; and legal/regulatory compliance objectives.

Audit findings and recommendations may also relate to particular assertions about transactions, such as whether the transactions audited were valid or authorized, completely processed, accurately valued, processed in the correct time period, and properly disclosed in financial or operational reporting, among other elements.

Under the IIA standards, a critical component of the audit process is the preparation of a balanced report that provides executives and the board with the opportunity to evaluate and weigh the issues being reported in the proper context and perspective. In providing perspective, analysis and workable recommendations for business improvements in critical areas, auditors help the organization meet its objectives.

2.10.1 QUALITY OF INTERNAL AUDIT REPORT

The qualities of internal audit report are the following:

- a) Objectivity - The comments and opinions expressed in the report should be objective and unbiased.
- b) Clarity - The language used should be simple and straightforward.
- c) Accuracy - The information contained in the report should be accurate.
- d) Brevity - The report should be concise.
- e) Timeliness - The report should be released promptly immediately after the audit is concluded, within a month.

2.11 THE EFFECTIVENESS OF INTERNAL AUDIT

Every business is different from others both in size and in management. The implementation of an effective internal control system is very challenging since each business has its own needs. Nevertheless, we can mention some features which are necessary for the effectiveness of an internal control system. Independence is an indispensable element for the effectiveness of an internal control system, as it allows auditors to act unaffected and free of interference. The Director of Internal Control shall transmit the reports to the Board of Directors. This direct connection gives prestige to the work of the internal auditors. Furthermore, each enterprise in order to achieve its own purpose needs an organizational plan which will ensure the proper functioning, as it will allocate the responsibilities among the members of the internal auditors. Since the current management of an organization does not have its own direct and reliable information to establish the safeguards for managing the business risks, the internal audit covers this gap with its advisory and repressive role. Internal audit aims at implementing the corporate Governance principles as a transparency calibration method and thus gives value to it, while it shields the interests of employees, customers, shareholders within the business. Disclosure and control are essential information that are related to the company and they are fundamentals in ensuring transparency, protection of investors and consequently the proper functioning of the capital.

Furthermore, the design of an efficient internal control system should guarantee the transactions done by the firm. In particular, the procedure of transactions must be checked and conducted according to the principles and policies of the administration,

in order that it could control the registration of transactions, which must be preceded by authorization of principles and rules of accounting. The access to the financial data of the company should be done with the required documents. For a better control of the transactions there are four steps to be followed:

- a) Authorization,
- b) Approval,
- c) Implementation,
- d) Inventory.

Moreover, another important factor that makes internal audit more effective is the labor inspection. It is vital to control all the methods and the processes and make suggestions where needed, in order to improve and ensure quality. In addition, all information from reports, councils and conferences should be taken to be distributed throughout the administration to streamline the functioning of the financial unit. Also, each Internal Control System should correspond to the size and needs of each enterprise.

CHAPTER 3

3 INTERNAL AUDIT IN ORGANIZATIONS

3.1 INTRODUCTION TO ORGANIZATIONAL CULTURE

Since time out of mind, mankind has organized for collective advantage. At the micro-level such organizing has today lead to the firm or corporate entity. So today, when we talk of organizations we generally talk in terms of business entities. It is with that concept in mind that organizational behavior has come to be associated with the social or group behavior of individuals who see themselves as members of a particular corporate organization. These simple economic organizations vary in size from a small group to many thousands of people, who may simultaneously be members of several different organizations, each of which will influence the attitudes and values of the group. Generally, this type of social interaction is considered to be organizational culture and has been the province of anthropologists and sociologists.

Today, however, accountants have started to consider the influence that these attitudes and values have on the production and use of accounting information. Thus, accountants have expressed growing interest in the influence of the culture of an organization on its behavior and the effect that this behavior has on the financial accounting operations of the organization. Accountants are recognizing that any activity of the organization will have an effect on the accounts. For example, the ability of an organization to maintain higher quality standards than its competitors will affect how well that organization is accepted within its market and therefore how successful it is within its chosen industry.

3.2 INTERNAL AUDIT AND ITS ROLE IN AN ORGANIZATION

Internal audit is designed to help the organization to reach its objectives. Fulfillment of organizational objectives defines the company's achieved success. Business objectives are organizational goals and what the company wants to achieve. If they are coherent and can be measured, they are in fact evaluation criteria of the organization's success. The organization states its objectives in a mission and vision statements. Mission statement conveys what the organization is and what it wants to achieve today. Vision statement communicates aspirations to what it intends to achieve in the future. Business objectives' categorization is a matter of discussion and believes. COSO (Committee of Sponsoring Organizations of the Treadway Commission) categorizes them as follows:

- a) Strategic objectives are about what managements do and plan (strategy) in order to create value for the organization's stakeholders
- b) Operations objectives focus on organization's operations in order to increase effectiveness and efficiency
- c) Reporting objectives are about reporting internal and external information and the level of its reliability
- d) Compliance objectives concentrate on existing laws and regulations and their implementation in the organization

Business objectives are measures of success for the organization, but for an internal auditor, they provide foundations for engagement objectives. Engagement objectives are goals of an internal auditor that are to be achieved within the organization. Internal auditor's mission is to help the organization to achieve its objectives. Therefore, the proper and thorough definition of engagement objectives within given organization is vital. Another vital point for the fulfillment of organizational objectives and sustainable success is effective risk management, control and governance process. The role of the internal auditor is to evaluate and improve those processes:

- a) Governance process is an achievement of the organization's objectives by authorization, directions and overseeing management by the board of directors
- b) Risk management is a process of understanding and dealing with uncertainties by the management of the organization. Uncertainties are all risks and opportunities that could affect (negatively or positively) organization's ability to achieve its objectives
- c) Control is a process of mitigating risk to the level that can be accepted by the management of the organization

Overall, the board of directors conducts the governance process, while management conducts risk management and control processes. The board of directors and management's cooperation is essential to efficient implementation of all processes. Internal auditor's role is to evaluate, improve and guide through those processes. Therefore, internal auditing is also a vital point of the equation. Internal auditors are able to assist top management with the following:

- a) Monitoring activities that top management cannot monitor itself
- b) Identifying opportunities and minimizing risks of failure
- c) Validating reports to senior management
- d) Protecting senior management in technical analysis that is beyond their knowledge
- e) Providing information for the decision-making process

f) Reviewing for the future as well as for the past

g) Helping line managers manage by pointing to violation of procedures and management principles

The main role of internal auditing is to add value to the organization by performing assurance and consulting activities. They need to be operational, tactical, and strategic and improve operations. However, the interpretation of this role is wide. Primary duties of assistance with risk management, control, and governance processes will add a different value to the organization. In reality, it is depending on the specific needs of organizations and the sector they are operating. Examples may be following: for organizations in the scandal-ridden industry value adding auditing service will be compliance reviews. For organizations in quickly growing sectors, value adding will be consulting advice on programs and projects. For organizations in developing countries it may be building controls and preventing fraud or corruption. For global organizations it may be management of the risks and logistics of coordinating information with the head office and so on.

Another categorization of internal audit's role based on the type of organization (public or corporate sector) rather than organization's environment is: For public sector, internal audit's role will be focused on efficient and effective expenditure of public money. In the corporate setting, internal audit's role will be measured by and will be focused on his ability to satisfy stake-holders and ensure profit.

To decide the scope and to interpret the role of auditing needed, the auditor will refer to audit charter. The internal auditor will also need professional standards, mission, and vision and success criteria. They should be based on the sector in which the company is operating.

Additionally, it is suggested that understanding strategic priorities will give insight to the internal auditor of where value can be added. Moreover, the internal auditor should strive to meet stakeholder expectations by embedding performance measurement processes focused on the most efficient and effective use of limited resources. As Guidance Task Force points out, most audits provide value to the organization already when they facilitate communication with management about control structure and its effectiveness. However, the most important function of internal audit is to be independent.

The subservient internal audit is a source of significant risk to the company. It may result in fraud, monetary loss, devastate reputation and brand or result in the company's collapse. Therefore, it is essential for the internal audit function to have independent authority and reporting lines and have adequate access to the audit committee. Internal audit functions should be well funded, staffed, and trained, with appropriate specialized skills depending on the nature, size, and complexity of the operating environment of an organization. Internal auditing services provide value

altogether if they are maintained in the high quality. Compliance with professional standards of internal auditing is a way to provide it.

3.3 THE IMPORTANCE OF INTERNAL AUDIT IN ORGANIZATIONS

By reporting to executive management that important risks have been evaluated and highlighting where improvements are necessary, the internal auditor helps executive management and boards to demonstrate that they are managing the organization effectively on behalf of their stakeholders. Internal audit's role is to enhance and protect organizational value by providing risk based and objective assurance, advice and insight.

Hence, internal auditors, along with executive management, non-executive management and the external auditors are a critical part of the top level governance of any organization. Assessing the management of risk, the profession of internal audit is fundamentally concerned with evaluating an organization's management of risk. All organizations face risks. For example, risks to the organization's reputation if it treats customers incorrectly, health and safety risks, risks of supplier failure, risks associated with market failure, cybersecurity and financial risks to name some key areas. The key to an organization's success is to manage those risks effectively – more effectively than competitors and as effectively as stakeholders demand.

To evaluate how well risks are being managed the internal auditor will assess the quality of risk management processes, systems of internal control and corporate governance processes, across all parts of an organization and report this directly and independently to the most senior level of executive management and to the board's audit committee.

3.4 THE VALUE OF INTERNAL AUDIT IN ORGANIZATIONS

Internal auditors deal with issues that are fundamentally important to the survival and prosperity of any organization. Unlike external auditors, they look beyond financial risks and statements to consider wider issues such as the organization's reputation, growth, its impact on the environment and the way it treats its employees.

In sum, internal auditors help organizations to succeed. They do this through a combination of assurance and consulting. The assurance part of their work involves telling managers and governors how well the systems and processes designed to keep the organization on track are working. Then, they offer consulting help to improve those systems and processes where necessary.

CONCLUSION

This thesis has focused on the role and importance of internal audit in organizations. The main purpose of this thesis is to show off the internal audit contribution to the organization goals. Internal audit influences company's operations on an everyday basis. It influences an organization positively by service assurance and supervision of internal control processes. Properly developed internal audit can positively influence business operations, risk management, and decision making on all levels of the organization. Internal audit makes sure that internal controls are developed well so that through internal control, processes are effective. Company's attention to the development process and its careful implementation are the best indications of its importance to the whole organization. The role and benefit of the internal audit is to secure more effective and risk respondent operations of the company. It also increases the assurance of fulfillment of the business' objectives and goals. Internal audit must be developed to respond to the company's needs and to fit its culture. Consequently, it provides the satisfaction of shareholders. Alongside, internal auditors play a crucial role to the organizations. Internal auditors are employees of a company charged with providing independent and objective evaluations of the company's financial and operational business activities, including its corporate governance. Internal auditors provide evaluations of operational efficiencies and will usually report to the highest levels of management on how to improve the overall structure and practices of the company. Therefore we lead to the conclusion that internal audit is positively influencing company's operations. So, internal audit is important in an organization.

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