Role of Internal Audit in Corporate Governance

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Abstract: **The paper tries to analyze the role of Internal Auditors in the corporate governance of modern era. The method used is in-depth and critical review of the literature. Also, the recent happenings in the corporate world and the role played by the internal audit as a method of control haves been kept on focus. The results of our analysis show that the role of internal audit in corporate governance is to assess the fairness of financial statements, to compliance with applicable standards and rules, and to provide creative advice for the effectiveness and operational efficiency of the company. So, it can be concluded that the internal audit function has a very important role in corporate governance. Moreover, a quality internal audit function can affect the effectiveness and efficiency of the organization as a whole and Corporate Governance framework in particular.**

Keywords: **Internal Audit, Corporate Governance, Auditor, Transparency, Finance, Control**

Introduction:

Internal audits evaluate a company's internal controls, including its corporate governance and accounting processes. They ensure compliance with laws and regulations and help to maintain accurate and timely financial reporting and data collection. Internal audits also provide management with the tools necessary to attain operational efficiency by identifying problems and correcting lapses before they are discovered in an external audit.

Corporate Governance refers to the way a corporation is governed. It is the technique by which companies are directed and managed. It means carrying the business as per the stakeholders' desires. It is actually conducted by the board of Directors and the concerned committees for the company's stakeholder's benefit. It is all about balancing individual and societal goals, as well as, economic and social goals.

Corporate Governance ensures transparency which ensures strong and balanced economic development. This also ensures that the interests of all shareholders (majority as well as minority shareholders) are safeguarded. It ensures that all shareholders fully exercise their rights and that the organization fully recognizes their rights.

Hence from the above definition, it is clear that the basis of existence if internal audit is to have good corporate governance.

Role of Internal Audit in an Organization:

Internal audit provides assurance by assessing and reporting on the effectiveness of governance, risk management, and control processes designed to help the organization achieve strategic, operational, financial, and compliance objectives. It is best positioned to provide assurance when its resource level, competence, and structure are aligned with organizational strategies and when it follows IIA standards. It can do this best when it is free from undue influence. By maintaining its independence, internal audit can perform its assessments objectively, providing management and the board an informed and unbiased critique of governance processes, risk management, and internal control. Based on its findings, internal audit recommends changes to improve processes and follows up on their implementation. Functioning independently within the organization, internal auditing is performed by professionals who have a deep appreciation of the importance of strong governance, an in-depth understanding of business systems and processes, and a fundamental drive to help their organizations succeed.

Internal audit provides insight by acting as a catalyst for management and the board of have a deeper understanding of governance processes and structures. The IIA believes internal audit insights on governance, risk and control provoke positive change and innovation within the organization. It inspires organizational confidence and enables competent and informed decision making. What's more, successful internal auditing can mature to provide foresight to the organization by identifying trends and bringing attention to emerging challenges before they become crises. Internal audit can add value by providing advisory and consulting services, intended to improve governance, risk management, and control processes, so long as internal audit assumes no management responsibility. This is vital to maintaining internal audit's objectivity and avoiding conflicts of interest. Selection of the type of audits or services to be performed should be based on the audit activity's authority, maturity, and purpose, as well as the organization's needs and issues.

These include detecting and preventing fraud, testing internal control, and monitoring compliance with company policy and government regulation.

According to a survey conducted by Ernst & Young, 75% of respondents believe that their internal audit function has a positive impact on their overall risk management efforts.

It is also stated that internal audit top 5 priorities are:

- Improving the risk assessment process
- Enhancing the ability to monitor emerging risks
- Becoming more relevant to achieving the organization's business objectives
- Reducing overall internal audit function costs without compromising risk coverage
- Identifying opportunities for cost savings in our business

With stakeholders' expectations rising and the focus of internal audit shifting from compliance and financial controls to risk coverage and business relevance, the skills required for internal auditors have changed.

It is no longer sufficient for internal auditors to have traditional technical skills. Now, they are required to have both competencies and technical skills. Apart from internal audit knowledge, stakeholders expect internal auditors to have the ability to team with management and business units on relevant business issues. They also expect internal auditors to have deep sector knowledge and business acumen.

Internal Audit and Corporate Governance

Long back internal audit objective was to prevent and detect financial frauds in locations away from the central operating location of the firm. Subsequently, internal audit was used to achieve another objective, which was to reduce the cost of mandatory financial audit by an external auditor. In order to achieve both those objectives, the internal audit's focus was on internal check and internal controls relating to financial transactions. It used to apply the same audit procedures and techniques that are used by the external financial auditor. Even today, as a service to the management, internal audit pursues the above two objectives.

The external financial auditor designs his audit strategy and formulates audit plan and programme only after evaluating the adequacy and effectiveness of the internal audit. Much later, the concept of operational audit emerged. Now, almost every firm includes operational audit in the scope of internal audit. However, internal audit continues to allocate major part of its resources in financial audit. Therefore, till recently, in most firms, the Chief Internal Auditor (CIA) used to report to the CFO. Contemporary internal audit is 'eyes and ears' of the Board, which is responsible for governing the firm. Whenever there is governance failure, the Board is held responsible for the same. The Board sets the 'tone at the top'. It provides strategic direction to the management. It is responsible for ensuring that the firm complies with applicable laws and regulations and that external reporting is correct and not misleading.

The Audit Committee of the Board, among other things, is responsible for:

• Ensuring that the risk management system is adequate and operating effectively;

• Ensuring that internal controls are adequate and operating effectively;

• Ensuring that financial statements provide true and fair view;

• Approving 'related party transactions'; and

• Evaluating the enterprise performance.

The Board sets the ethical policy and approves the 'code of conduct'. It depends on the internal audit for providing an assurance that every employee in the firm has understood the ethical policy and implements the same. The management owns the strategy of the firm. The Board approves the same. It critically evaluates proposed strategies when the management presents a new strategy before it for approval. In some occasions, particularly when the firm is passing through a crisis, the Board and the management co-creates new strategy. Board periodically reviews the current strategy. The Board also oversees the strategy execution, including allocation of resources to different activities. In order to carry out this task effectively, Board needs deep insights into the business and its internal and external environment and this requires analysis of internal and external data. The internal audit provides assurance to the Board that the data and reports presented before it are reliable. The Board expects the internal audit to provide an assurance that feed back mechanism to help managers to evaluate outcome of tactical decisions, for example decisions on debt, investment, product portfolio and target markets, which are based on certain assumptions, is adequate and effective. An effective mechanism helps managers to take corrective actions, if required, well in time and help them in reviewing assumptions.

The Audit Committee cannot perform its tasks effectively without the support of the internal audit. Independent monitoring by the internal audit is necessary for the Audit Committee to get an assurance that the risk management systems and internal controls are adequate and effective. The internal audit provides the assurance that all decision-makers understand the risk-appetite and risk management is embedded in the decision model. The Audit Committee depends on the internal audit to get an assurance that accounting estimates, particularly, judgement-based estimates are reliable and that financial statements provide a true and fair view. It depends on internal audit for initial evaluation of related party transactions. It also relies on internal audit for the integrity of data that it uses to evaluate the performance of the firm and the CEO.

It is high time that the internal audit should be considered as a service to the Board. Management audit should be included in the scope of internal audit. Internal audit should be made independent of the top management. Therefore, it should report to the chairman of the Audit Committee.

One of the non-mandatory requirements of clause 49 of the Listing Agreement (SEBI Code of Corporate Governance) is "The Internal auditor may report directly to the Audit Committee." Ineffective internal audit exposes the shareholders and other stakeholders of the firm to the risk of corporate governance failure and exposes the directors to the risk of being held guilty for negligence.

Conclusion:

From the above, it is clear that the Internal Audit is the backbone of good corporate governance. It is in the favour of Indian Corporate sector that it strengthens its Internal Audit for the business to flourish.

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