

Audit in terms of Independence, Organizational Characteristics and Internal Relationships

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Abstract

The internal audit function's efficiency is greatly influenced by relationships, organisational characteristics, and internal audit independence. Independence is the capacity of the internal audit function to operate impartially and unbiasedly. By ensuring that the internal audit function has a clear reporting line to the board of directors or audit committee, as well as the resources and independence necessary to carry out its responsibilities, this is achieved. To evaluate the organization's risk management, control, and governance methods fairly, internal audit must be impartial. Organizational aspects include the internal audit function's structure, reporting lines, and resources. These characteristics are essential to guaranteeing the internal audit function can carry out its responsibilities and provide a fair assessment of the organization's risk management, control, and governance systems. The organisational characteristics should support and be consistent with the main objectives and strategy of the company. Internal relationships are interactions and connections between the internal audit function and other organisational entities. The internal audit function's capacity to carry out its responsibilities effectively and provide an unbiased assessment of the company's risk management, control, and governance systems depends on these relationships. These partnerships' essential components include coordination, collaboration, compliance, and efficient communication. To make sure that the organization's overall goals are realised, the internal audit function should closely collaborate with other organisational departments like finance, operations, and risk management. In order for the internal audit function to be able to give an objective and useful review of the organization's risk management, control, and governance procedures, it is crucial that internal audit independence, organisational characteristics, and internal relationships all be present. They all play a vital part in ensuring that the internal audit function can recognise risks, take steps to reduce them, and reassure the management and other stakeholders of the company.

Keywords: *Internal Audit, Independence of Internal Audit, Organizational Characteristics of Internal Audit, Internal Auditor Relationships.*

Introduction

Internal audit is a separate department within a company that offers guidance and assurance services to aid in the achievement of organisational objectives. An audit is a dispassionate examination of financial information, such as financial statements, to assess the accuracy and fairness of the facts presented. Since it ensures the auditor's neutrality and capacity to provide an unbiased opinion on the financial data, independence is crucial for an audit. "The lack of elements that potentially affect the IA activity's ability to carry out IA tasks objectively" is the definition of IA independence (The Institute of Internal Auditors 2017, p. 23). Internal audit's independence is a critical quality since it enables objective analysis of the business's risk management, control, and governance systems. By highlighting the auditee's independence and fostering a neutral atmosphere that helps in communicating the audit results without the auditee's influence, independence is required to better communication with senior management. Additionally, independent thought has already been studied (Mihret and Yismaw 2007). Organizational characteristics that may affect an audit include the company's size and complexity, as well as its industry and regulatory environment. The strategy and scope of the audit may be impacted by several factors. Internal audit is typically a separate division within a company that answers to the audit committee or the board of directors in terms of organisational characteristics. IA organisational features, according to experts, are made up of a variety of components that influence IA effectiveness. According to Mihret and Yismaw (2007), an IA organization's reputation, ethics, and standards affect how relevant audit reports are. For the internal audit department to do its job well, it needs enough personnel, money, and equipment. When internal audit has solid connections throughout an organisation, it is successful. The risk management, operational, and financial departments of the organisation should cooperate well with the internal audit department. Professional collaboration exists between internal audit and external auditors, including regulatory organisations. Since the audit committee's role is to evaluate internal audit and offer support as needed, the interaction between internal audit and the audit committee is crucial. Internal relationships, such as those between management and the audit committee, can also have an impact on an audit. The audit can only be carried out successfully with strong coordination and communication between management and the audit committee. To ensure that both are helping to achieve the audit's objectives, coordination is also necessary between the duties of internal audit and external audit. Through the audit committee, there should be open communication between the board of directors and the internal audit division. The Chief Audit Executive's (CAE) interactions with the audit committee as well as the CEO's dependability and transparency, according to Roussy et al.,(2020) are essential to the accomplishment of internal audits. Overall, the internal audit function must successfully support the goals and objectives of the organisation, which depends on its organisational structure, interactions with other departments within the company, and independence.

Aim of the Study

The purpose of this paper is to present the internal audit in terms of independence, organizational characteristics and relationships.

Methodology

Numerous documents have been reviewed by the researchers. Secondary data and desk-based research method were used to prepare this article.

Internal Audit Independence

Despite the fact that businesses frequently employ internal auditors, professional associations are highlighting the significance of IA independence more and more (Alzeban and Gwilliam 2014). The importance of upholding the organization's reputation and the independence of the IA function was also emphasised in internal auditing standards. This can be done by having the IA report to a level within the organisation that permits it to carry out its duties without interference in establishing the audit's scope of work, conducting the audit, and communicating the audit results (The Institute of Internal Auditors 2017). Because it reports to the CEO, the audit is able to carry out its duties independently and have challenging discussions with other senior officials. Management of the organisation is banned from overseeing and guiding the audit's activity by reporting to the audit committee (The Institute of Internal Auditors 2019).

The ability of the internal audit function to perform its responsibilities objectively and without interference from other corporate components is referred to as internal audit independence. Independence is one of the guiding principles of internal audit since it enables the function to properly assess the company's risk management, control, and governance practices. There are several ways in which internal audit can maintain its independence:

1. Organizational structure: Internal audit should be a separate function within the organization and should report to the board of directors or audit committee.
2. Reporting lines: The internal audit function should have a direct reporting line to the chief executive officer (CEO) or other senior management to ensure that internal audit can communicate its findings and recommendations effectively.
3. Resources: The internal audit function should have its own budget and staff, which ensures that it is not dependent on other parts of the organization for resources.
4. Professional standards: Internal auditors should adhere to professional standards, such as the International Professional Practices Framework (IPPF), which sets guidelines for the internal audit function's independence and objectivity.
5. Ethics: Internal auditors should be committed to maintaining high ethical standards and should avoid conflicts of interest that could compromise their independence.

In order to maintain independence, internal audit must be aware that it is not a different entity from the rest of the organisation. The internal audit department should work closely with the organization's risk management, operations, and finance departments. Furthermore, independence fosters a supportive environment for internal auditors, promotes their objectivity, allows them to work constantly, and communicates to the rest of the organization's workforce that IA results can be trusted (Cohen and Sayag 2010). In a manner similar to this, D'Onza et al. stressed the importance of IA independence in order to guarantee the dependability of IA services (2015). IA's lack of independence affects the audit committee's capacity to offer assurance on compliance with its corporate governance criteria (Christopher et al. 2009; D'Onza et al. 2015). The CEO or CFO's approval of the IA budget is seen as a potent weapon for enforcing budget constraints that might constrict the IA's scope and lessen its efficacy. Senior management contributes significantly to the creation of the IA plan as well. Additionally, IA is paid on a project-by-project basis and engages in advisory activities, all of which pose risks to its independence (Christopher et al. 2009).

Internal Audit Organizational Characteristics

The organisational components of the IA function reveal the IA's workplace and the conditions in which it does its duties. The organization's IA function is a component of it (Roussy et al. 2020). Despite Karagiorgos et al. (2011) emphasising that the IA's position in the organisational hierarchy and its independence are symptomatic of the organisational environment, Turetken et al. believe that it is vital to establish and maintain the IA's segregation of duties (2019). The position of the IA within the organisation and its organisational profile are related to the IA's organisational environment, in addition to the policies and procedures that regulate the audit process. The internal audit function's structure, reporting lines, and resources are examples of organisational characteristics of internal audit. These characteristics are essential to guaranteeing the internal audit function can carry out its responsibilities and provide a fair assessment of the organization's risk management, control, and governance systems.

1. **Separate function:** Internal audit is typically a separate function within the organization, with its own budget and staff. This helps to ensure that the internal audit function can operate independently and objectively.
2. **Reporting lines:** The internal audit function typically reports to the board of directors or audit committee, and has a direct reporting line to the CEO or other senior management. This ensures that the internal audit function has the necessary level of access and communication to effectively carry out its responsibilities.
3. **Charter:** The internal audit function should have a charter, which defines the scope, authority, and responsibilities of the internal audit function. This charter should be approved by the board of directors or audit committee.
4. **Resources:** The internal audit function should have adequate resources, including staff and budget, to effectively carry out its responsibilities.
5. **Professional standards:** The internal audit function should adhere to professional standards, such as the International Professional Practices Framework (IPPF), which sets guidelines for the internal audit function's independence and objectivity.

6. Continuous improvement: The internal audit function should strive for continuous improvement, regularly reviewing and updating its processes and procedures to ensure that it remains effective and efficient.
7. Skilled and Experienced Staff: The internal audit function should employ skilled and experienced staffs who possess the knowledge and technical expertise to perform their roles effectively.
8. Risk-Based Approach: The internal audit function should adopt a risk-based approach, which prioritizes audits based on the level of risk associated with the area being audited, this helps to ensure that the most critical areas are audited first.

Since these dimensions implicitly contain additional dimensions such as norms, processes, and integrity, we used IA independence and size as indicators of IA organisational features in this research. According to the International Standards for the Professional Practice of Internal Auditing, the structure and substance of the policies and procedures depend on the scope, organisation, and complexity of the IA activity. The integrity of the IA function cannot be maintained without independence, and the standards and processes it produces are impacted by both independence and size.

Internal Audit Relationships

Any IA function's success is dependent on relationships. The IIA's IPPF emphasised the importance of having dual reporting relationships with the audit committee and senior management, with the first reporting line functionally reporting to the audit committee and improving IA effectiveness by giving access to sensitive information, guaranteeing IA has sufficient organisational status, preventing organisation management from interfering with IA work, and ensuring the highest level of governance on IA work (The Institute of Internal Auditors 2019). In contrast, the second reporting line is crucial for increasing the IA function's efficacy by providing it with the required authority and resources. It administratively reports to senior management, usually the Chief Executive Officer (CEO). It also makes it simpler for the IA function to do its duties and work with other senior executives to find solutions to challenging challenges (The Institute of Internal Auditors 2019). Additionally, they place focus on the link between relationship quality and the frequency and formality of communication, both of which are essential for fostering openness and trust.

Internal audit relationships are those that exist between the internal audit function and other organisational divisions. The internal audit function needs these links in order to effectively perform its obligations and provide an unbiased assessment of the organization's risk management, control, and governance systems.

1. Reporting lines: The internal audit department should report both directly to the audit committee or board of directors and indirectly to the CEO or other senior management. By doing this, the internal audit function can effectively communicate its conclusions and suggestions.
2. Collaboration: The internal audit function should work closely with other functions within the organization, such as finance, operations, and risk management, to ensure that the organization's overall objectives are met.

3. Coordination: The internal audit function should coordinate its activities with external auditors, such as external financial auditors, to ensure that there is no duplication of effort and that any potential issues are identified and addressed.
4. Compliance: The internal audit function should ensure that the organization complies with all relevant laws, regulations, and industry standards.
5. Communication: The internal audit function should communicate effectively with all stakeholders, including the board of directors, management, employees, and external parties, to ensure that its findings and recommendations are understood and acted upon.
6. Consultancy: The internal audit function should provide consultancy and advice to the management and employees in order to improve the overall performance of the organization.

The internal audit function must be connected to other organisational units in order to carry out its responsibilities and offer an unbiased evaluation of the organization's risk management, control, and governance systems. We considered contacts between the audit committee and top management because they were the main players in the IA function. Without a strong working relationship with the audit committee and the necessary support from top management, the IA function cannot effectively carry out its responsibilities (Soh and MartinovBennie 2011).

Conclusion

Internal relationships, organisational traits, and internal audit independence all have a big impact on how well the internal audit function performs. Independence is the capacity of the internal audit function to act impartially and unbiasedly. By making sure the internal audit function has the resources, objectivity, and channels of communication with the audit committee or board of directors necessary for it to perform its obligations, this can be accomplished. Organizational factors include, but are not limited to, the internal audit department's organisation, reporting lines, and resources. There are a few requirements that must be satisfied in order for the internal audit function to carry out its responsibilities and provide an objective assessment of the organization's risk management, control, and governance systems. Internal relationships are interactions and connections between the internal audit function and other organisational entities. The internal audit function needs these links in order to carry out its responsibilities and provide an unbiased assessment of the organization's risk management, control, and governance systems. These collaborations call for coordination, cooperation, compliance, and effective communication. For the internal audit function to be able to conduct a neutral and beneficial analysis of the organization's risk management, control, and governance systems, it is necessary that internal audit independence, organisational characteristics, and internal relationships exist.

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