The Effective Function of the Audit in the Organization

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Abstract: Audit is a process of verification of contentions of management over financial statements. The role of audit has an impact in increase of quality of financial reports and influences the improvement of performance of the company and the modern and essential understanding of determining the quality, from the viewpoint of diversity and characteristics and multitude of claims made by users of financial reports. The growth and globalization of businesses, pressure of the market for improvement of operations, rapid change of business conditions created the need for control, but it should be made sure that the control is as effective as possible and that it properly unveiling the risks. In order to meet this need, internal auditors are using continuous audit in order to maximize the effectiveness of their work. The auditor preserves the independence of internal audit and the objectivity in assessing the effectiveness of controls, risk management and governing processes. Constant monitoring is a process that should be assessed by the internal auditor in order to observe whether the management is acting according to business policies, procedures and processes, namely whether it is acting effectively. However, continuous audit usually enables auditors to assess the adequacy of manager’s function and conduct monitoring with the view of identifying and assessing the fields of risk.

Key words: financial statements; audit; internal audit; monitoring; control

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1. Introduction

Within current managerial environment of economic unit (which changes constantly) management cadre which are usually vested with many competencies, should take the necessary time and decisions aiming to determine the future flow of their economic units. These important decisions make a preliminary and fair assumption of all objective data of the economic unit, at the right time. Thus from the viewpoint of calculation of internal options of the economic unit, audit is of great importance. This can shed light to the strategy and enlargement of the economic unit. Audit can especially avoid anomalies or possible administrative or other such violations before being published, what could have serious consequences in the reputation that is enjoyed by the economic unit.

2. The Role of Auditing in Governance and Accountability

It is usually stated that the market is a very objective instrument that does not forgive wrong decisions made

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by economic units. In fact every wrong decision has its “cost” which should be paid in the market.

This is exactly why wrong decisions by economic units should be avoided; the governance should be based in realistic and objective information. In the context of that information it is worth emphasizing that the accountancy information are a very important part, namely financial information that are contained in financial statements. In order for the information to be realistic and objective it is implicitly supported by the audit issues.

The question that arises in this context is, what is the real role of auditing in the market economy and who are the users of financial reports and information provided by the auditor? For this reason, the role of auditing is expressed in ensuring credibility of information bases for decisions taken by economic units. Obtaining of credible information for the users and interested parties, indicated that there is a need to use services of information professionals (auditors). Through services that are offered by these professionals they provide security of information provided and reported. The security is obtained not only by knowing that the accounts were audited, but by knowing that every group of accounts has been audited based on common standards.

This puts forwards the need that audits be regulated in order for auditors to follow the same standards. These rules are compiled by different bodies. Some obligations are imposed by governments through laws and statutes. Some obligations are imposed by professional bodies, in which auditors are required to be affiliated. The practical standards serve as guidelines for conducting audits and other security arrangements. The profession of accountant and auditor are linked to a range of groups and standards that govern the quality of professional work for both internal and external auditors.

Audit has become a systematic way that follows four steps: planning, collection of evidence, assessment of evidence, and issuance of a report. The purpose of an internal audit is to scrutinize the policies, procedures and data of a company, as well as assess the plans of a company and achievement of its objectives. The internal audit provides an assessment for providing a certainty the governance processes and structures are built in a suitable manner and function effectively. It provides advice on the possible improvements for governing processes and structures.

Whereas the external auditors assess the reality of financial statements of the company and issue a written report which contains an opinion that they have formed in relation to financial statements of the company. Certified auditors work in a systematic and planned manner in order to assess the exact financial situation of the company. The work that they perform offers useful information for the possible shareholders, managers, and even external users of information such as moneylenders, because auditing allows for potential internal and external clients to assess the financial stability of the company by opening the way for investments and by assisting the management to take decisions.

A company needs auditing in order to ensure that the organization is moving towards achieving the objectives and that it does not move away from the rules established by the government and the company itself. Thus, it is important to have independent auditors in order to check the compliance of these objectives. External auditors are important for creating credibility of the business and to ensure compliance with tax regulations. The external auditor serves the private interests of shareholders of a company. The objective of auditing financial statements is to enable the auditor to express an opinion as to whether the financial statements have been prepared in the entire respective material, in compliance with an applicable financial reporting structure. External audit gives independent certainty over the preparation of financial statements and reporting activities, in line with applicable standards, accountancy regulations and principle.

Financial audit remains an important aspect of corporate governance which makes the management
accountable towards the shareholders regarding its administration of a company. The debate regarding the role of external auditors is especially focused in the independence of an auditor. There is a concern that the interests of an auditor to protect shareholders of a certain company and his/her commercial interests are not in conflict with one another. There should be sufficient measures in place for ensuring that the independence of an external auditor remains untouched.

External auditors assist in determining as to whether a business is in compliance with all applicable rules of the country. The external auditor shall not be a company employee and in this manner we can follow the compliance of the company. An external auditor can depict small problems before they become serious and help the business return to the right track.

Financial statements shall be more credible if they are assessed by an external auditor and certified as accurate. Credibility is important for businesses, especially during their first years of operation, while they are trying to build up a positive reputation. The internal auditors cannot effectively be a part of internal processes of the company because they are a part of the company. External auditors can nevertheless observe operations from outside and determine the business of the company. They can recommend actions of the company in order to reduce mistakes and this increases efficiency in general, and strengthens accountancy practices.

Internal auditors could be close to the business due to their positions within the company. Some internal auditors also lack sufficient experience on accurate accountancy and checking financial statements of their company.

The audit program determines the necessary procedures for conducting an efficient and effective control. It includes a detailed work plan which is to be executed, as well as steps that are required in order to achieve the audit objectives. Auditors during an audit program execute steps in a routine manner and make their judgments. A well drafted audit plan provides a scheme of the work that is to be conducted in general in the audited unit. It acts as guideline for setting the pace of work and in this manner the scrutiny of the project from the beginning to the end. It produces documentation and evidence that the work has been performed. It assists in reviewing management in order to ensure quality. This ensures that all fields of risk management have been addressed adequately.

The fields that are to be covered by the audit program include audit objectives, testing procedures, the quantity of sample, selection of sample, deadline, reports for selection of a sample, reports and documents subject to review, and testing attributes. The program should be prepared before initiation of the field work and should be approved Audit Committee. Any change in the audit program or procedures should be reviewed and approved by the Audit Committee.

Internal audits serve for different purposes. Some audits assess the compliance with laws and regulations, other compliance with internal policies and procedures of the organization. A strategic audit helps the business, owners in assessing whether the internal processes are moving towards their strategic goals. Based on an audit results, the management regulates its operations in order to maximize the progress towards its goals. A business needs a strategic plan that includes short term and long term objectives. Long term objectives represent intentions for a business that can dominate the market for a certain category of product. Establishment of the strategic plan gives the auditor a good basis for his/her work. Through strategic plan auditors review the functions of business and assess every function in order to see the future projections. Auditor prepares a written report that assesses whether every functional unit of the business is in compliance with the data and policies of the company. Strategic audit is a constant activity. A business owner implements changes based on an audit report, and the audit team
conducted periodical checks in order to reassess the work of every unit. Once its business objectives have been achieved, the management updates its strategic plan and the audit cycle starts again.

Audit is a tool for assessing the effectiveness of internal controls of a company. Having an effective internal control system is of vital importance for achieving the objectives of the company's business, generating credible financial reporting in its operations, preventing fraud and illegal acquisition of its assets, and minimizing the costs of capital. Internal and independent auditors contribute to a system of an audit company in different but important ways.

Having an effective audit system is important for a company because it enables it to follow and achieve its different corporate objectives. The business processes should have internal control in order to facilitate supervision, monitoring, prevent and disclose irregular transactions, maintain adequate records for the business and motivate operational productivity. Internal auditors should review the design of internal controls and suggest improvements, by documenting any material irregularity in order to enable further investigations.

Audit report enables the auditor to express his/her opinion as to whether financial statements are in compliance with all aspects and settings determined by the financial reporting standards. Auditors assess the risk of material errors in financial reports of a company. Without an internal control system or an audit system, a company will not be able to generate credible financial reports for both internal and external purposes. Thus, it will not be able to determine how to allocate its sources and it will not be able to know which segment or production line of the company are profitable and which not. Moreover, it cannot manage its own affairs, as it will not have the capacity to show and verify its status of assets and liabilities and it will not be able to get into the market because of its incapacity to continuously produce goods and services in a credible manner. Thus an audit system is crucial for preventing mistakes and huge negative impacts in the records of a company and its reports.

Internal audit serves an important role for companies in preventing fraud. By repeating analyses of company operations and maintenance of rigorous internal control systems it can prevent and detect different forms of fraud and other irregularities in accounting. Auditing professionals should assist in drafting and modification of control systems which inter alia aim at prevention of fraud. An important part of prevention can be deterrence, and if a company has an active and effective audit system it can prevent frauds.

Strong control systems can reduce different types of risks in an enterprise, including the risk of information (the risk of material anomalies in the financial reporting), the risk of fraud and misuse of assets, as well as the risk of optimal management due to insufficient information.

Internal audits offer a number of important services for company management. These include disclosure and prevention of frauds, testing of internal control, and monitoring of compliance with company policies and government regulations. Smaller companies may require these functions even more than the big companies. A small business can simply not afford a fraud. Creation of the function of internal audit provides for a vital step for growth of a small business.

Small businesses lose millions of dollars every year to staff theft. Types of fraud committed by employees include skimming payments from customers; check tampering, cash theft and misuse of company credit cards, and improper payroll transactions. Many small-business owners may believe they lack the staff to create an internal audit policy or carry out audits to combat these problems. However, even with a small staff, a small business may create a program for monitoring employees and their behavior. An announced policy of internally auditing financial transactions for fraud may inhibit an employee from misusing company resources. Examining policies
and procedures on a regular basis ensures that the company minimizes its exposure to fraud and other losses.

Operational audits examine the practices of a company, rather than its finances. Is your business operating at maximum efficiency? An operational audit may reveal these inefficiencies. A rapidly expanding business needs to monitor compliance with human resource laws as new employees join the company. Internal audit performs a vital service in reviewing these functions.

Small businesses likely cannot afford to create an internal audit department; however bigger businesses should carefully plan the audit department which they should create a system for controlling the company and its employees. In this system, a professional staff should be used, which are capable of providing information you need to improve financial operations and control. It also provides an opportunity for the team members to discuss results and prepare an objective report.

3. Efficiency, Role of Audit and the Main Components of an Efficient Audit Activity of Governing in State Institutions

The function of internal and external audit undoubtedly plays an indisputable role in economic units and corporations, but does it play the same role in state institutions (public sector)?

The manner of spending public funds and the quality of services that are offered from public sector organizations is very important for all citizens, whether be it as service users or taxpayers. For this purpose, it is required that the governance of public services be at the highest standards. Good governance leads to good management, good performance, good administration of public money, good public engagement and ultimately, good results.

Internal auditors, having an objective view from within the organization, may play an important role in the governance process by informing the management, the management body/officials and external audits on the risk and control problems, and by evaluating the efficiency of risk management. The effective governance of organizations requires a system of checks and balances, in order to ensure that the appropriate issues are addressed to the right persons.

An effective system of governance of organization establishes a connection between the management, decision-makers, external audits and internal audits in such a manner as to establish a framework that not only meets their interests and needs, but also established a sufficient level of trust amongst each other or amongst the entire organization in general. The audit of governance is a basic element for good public governance. By offering an objective and fair evaluation on whether the public funds were managed effectively and responsibly to accomplish the intended results, the auditors assist the governmental organizations (public sector entities) to maintain accountability and integrity, to improve the operations and to promote trust amongst organizations, citizens and all groups of interest. As a basic component for a strong governing structure in the public sector, the audit supports the responsibilities of governance as a supervisor, internal evaluator and predictor.

Based on the fact that the success of governance is generally measured by its ability to offer successful services and implement its programs in an appropriate and fair manner, the activities of governance audit must have the authority and competencies (abilities) to assess the financial integrity and the effectiveness and efficiency of the program. Furthermore, it should protect and preserve the main values of the organization, while it serves all the citizens as a public sector organization.

The auditors assist the decision-makers in performing the supervision by assessing if the public organizations
are accomplishing what is expected of them and what they are tasked to accomplish, by using the funds for the intended purposes, and in compliance with the legal framework. The audit supports the government structure by verifying agency and program reports of financial and program performance by testing and trying the adaptability and the compliance with the rules and the purposes of the organization. Furthermore, the supervisory audits contribute to the public accountability by ensuring access to such information for the relevant groups of interest within and outside of the organization. In addition, the managers have the duty to assess the risks and to establish effective control systems for the accomplishment of the objectives and the identification of risks.

In the supervisory role, the auditors asses and report on the success of these efforts. Supervision also includes the role that the auditors have in the discovery and prevention of corruption, including fraud, inappropriate or abusive actions, and other abuses of power/duty and other resources that were made available to the officials and employees of the public sector. Auditors monitor the efficiency of the internal control structure established by the management in order to identify and reduce the conditions that could provide the basis for potential corruptive activities.

Audits provide assessments from within the organization to support the decision-makers by evaluating which programs or policies are functioning and which are not, by promoting good practices and standardized information, and by looking horizontally in all public organizations and vertically amongst various levels of government for possibilities to borrow, adopt or reorganize management practices. The audit activities also assist in institutionalizing new organizational changes by offering ongoing information on the improvement of policies. The audits perform their duties in a systematic and objective manner by establishing a detailed concept of operations and reaching conclusions based on the gathered evidence.

In addition, by offering an exact description of the problems, sources, roles and responsibilities, combined with valuable recommendations, the audits assist the stakeholders to reconsider the problems and the programs. At the same time, through the accountability role, the audits contribute in the improvement of the functioning of the organization and its governance. The audits also assist the organization to look forward in the long-term by identifying the tendencies and by bringing to attention the urgent problems and the expected critical challenges before they become crisis. The audit activity may highlight the changes or the expectations regarding the changes that may happen, such as demographic tendencies and economical or political situations, and it may identify risks and the opportunities that arise from the growth of technology, the complexity of modern society and the changes in the nature of the economy. These problems generally represent long-term risks that are not considered or that are simply considered a low priority when there are more urgent problems or lack of resources.

Besides this, a common method of audit, the Risk Based Audit, is focused on the general framework of risk management in the organization that may help to identify and discover unacceptable risks. Through risk based audit, the audit activity gives useful and appropriate information to the organization regarding the management of its risks. In public sector audits focus on the tendencies and on the future, they help in the decision-making by playing a key role in assisting the managers in identifying and assessing the risks.

The risk assessment by the auditors ensures that the audit sources are used efficiently by focusing on the fields that are more vulnerable to such risks. The mere audit of governance forces the public sector governance to ensure accountability and the protection of the main values of the governance by assessing whether the managers and the officials are conducting their activities in a transparent, honest and fair manner.

The audits play an important role in the effective governance of public sector. The term “governance” refers to the manner in which an organization takes and implements the decisions based on which that organization is
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managed, controlled and implements the responsibilities. While the governances are structured in various manners, there is no single model of governance that is implemented in public sector organizations. The general principles of governance indicate the policies, processes and structures used by an organization to manage and control its activities, in order to accomplish its objectives and protect the interests of groups within an ethical framework. At the same time, the public sector organizations serve the public, therefore for this reason they must ensure accountability in offering these services.

The accountability is the process according to which the public sector organizations and its employees are responsible for their actions and their decisions, including the managing of funds and all aspects of performance, and at the same time it is important how they present (subject) themselves to appropriate supervisions/assessments from the outside. This is accomplished if all parties have a clear concept of these responsibilities and if they have a clearly defined role in a sustainable structure. The audit serves as an accountability instrument.

The audit is an independent and objective assessment of the integrity of the management over the performance, or an assessment of the system and management practices, reported to the managing body or to the others that have similar responsibilities.

Continuously and increasingly, the managers of the organizations expect the auditors to play a more strategic role, and not only a technical role in the organizational governance. Monitoring is one of the areas where audit may add an important value and still remain faithful to its mission, objectives and standards. At a higher level, the organizational governance is thought to be comprised of seven intertwined elements: managing bodies of public entities/officials; provision of explanatory information and transparency; practices and ethics of the organization, legality and order; risk and performance management; monitoring and communication. The roles of the parties are divided, individual, and the responsibilities for each role are different. The effective governance is weakened if the boundaries of the roles are not respected.

Good governance results exactly from effective relations amongst the activities of these various roles, whereas in the meantime the division of these roles is preserved. What are the main duties and responsibilities of audit related to governance? These duties and responsibilities include:

- To ensure the compliance with the mandatory statutory requirements and to report to the Audit Committee, Managing Board or other entities.
- To ensure the Board that the business of the organization is conducted in an effective, efficient and economical manner.
- To confirm that the systems and procedures for internal control and risk management are appropriate and effective, and also to assist in the identification of risks through evaluation and treatment of most important risks of the organization.
- To verify that there is a compliance with the laws and the practices of organizational governance.
- To assess if the values and the ethics are preserved, applied and implemented in the organization by the entire staff of the organization, its personnel and all the others related to it.
- To evaluate the appropriateness, credibility and integrity of the management and financial information.
- To advise, using its role or capacity as an advisor, on the appropriateness of the control systems and other accounting and operational issues
- To draw attention to every shortfall or failure and to undertake remedial actions.
- To conduct assessments, inspections, investigations, examinations and reviews when required by senior management, decision-maker.
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- To recommend improvements in procedures and systems in order to prevent loss, theft or fraud.
- To ensure the implementation of social policies of responsibilities adopted by the board and the senior management.

Undoubtedly, there are initiatives and activities that support governance. Based on the organization and the methods used to follow these initiatives, within an organization there are often major clashes between various activities and initiatives. There is nothing extraordinary in these clashes or overlaps, but the audit must understand these clashes and overlaps, explain how they impact in the governance processes, and understand the assessment and advisory work that it conducts before the full exercise of its organizational governance activities.

The audit profession could possibly become a strategic element in the governance of the organization as a response to the growing requests of governance and management directives to strengthen the controls and risk management. The International Audit Standards require the auditors to evaluate and provide recommendations on the improvement of governance processes and to confirm their importance in risk management activities.

4. Conclusions

There is no doubt that the implementation of standards leads to a stronger corporate governance and increases the ability of the unit to monitor internal processes and controls. The boards are requesting security in critical areas of risk and audit, in particular internal audit, which is an important source for such security. Fraud, internal and external, is an ongoing challenge for the organizations and it is even more so during difficult economic climates.

By increasing the efficiency and the abilities to identify main risks, especially those that stem from economic decline, the Audit is seen as an important component in the fight against negative effects towards entities. This allows internal and external audits to perfect their role in risk management through a strategic approach that would not only prevent future catastrophes, but it would also make the company operate more efficiently.

The responsibilities of the audit are increasing because of an increase in the careful review of statutes and directives by the organizational executives to enforce the controls and improve risk management.

In an ongoing manner, the managers of organizations expect the audits to play a more strategic role, and not only a technical role in the organizational governance. Good governance is a process that starts with a broader organizational perspective.

In order to make sustainable progress, it is necessary to have the full engagement of senior management, integrated approach, coordinated execution and sustainable monitoring. Monitoring is one of the areas where audit may add an important value and still remain faithful to its mission, objectives and standards.

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