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INTERNAL AUDITING AND ITS ANALYSIS FROM PERSPECTIVE OF A CORPORATE SETUP (APPLICATION OF CASE STUDY METHOD)

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ABSTRACT- The internal auditing function is a critical and significant for private and public institutions as this will monitor and then increase the processes within these institutions and moreover, the functions are also instrumental in designing, growth and expansion of internal control systems, thus supporting the idea of corporate governance. It also helps in gauging and assessing the risks in work environments.

Besides supporting the corporate governance, and simultaneously evaluates efficiency and performance, the role of internal auditing function is to maximize the capacity of company for employing innovative methodologies, which brings quality at workplace and fulfills the ultimate performance goals.

The purpose of this study is to estimate role of the internal audit to control financial and managerial performance, while taking into consideration all the aspects and factors that would otherwise control internal auditing.

Such factors comprise business setting, the prerequisite of the auditor, the laws and regulation, the degree to which the companies are bound and committed apart from discussing as well as highlighting present situation and changes required thereof. Such amendments are required for the future development with purpose that internal audit functions would lend effectiveness to managerial and financial aspects.

Keywords: auditing, corporate governance, work environments

I. INTRODUCTION

Management cannot sit inside their comfy boardrooms or conference rooms and make the decisions. Similarly, a CEO cannot make precise assessment of what really goes out in business world, especially when something as serious as corporate scandals, or privacy invasions, frauds, or serious levels of lapses in governance happen. Even at times when ethics are compromised within an institution, situation becomes chaotic in nature.

The erratic laws and regulations of commerce coupled with all kinds of mergers or acquisition process taking place around along with the forms of restructuring in organization- all of them create imbalance within the structure of an organization.

Business thinkers have also highlighted those stern legislations and regulations may likely cause problems in implication of the compliance. In addition, the information and security management systems practiced in corporate set ups relating to the telecommunications, financial services or the transportation or fuel and energy sector requires a kind of cooperative obligation, or you may call it an assurance.

The idea here is to have a rigid type of strategy in place in the form of planning. Adding to the complexities is the process of continuous globalization that bring several inter-disciplinary problems with respect to execution of righteous regulations, principles as well as the propensity of cultures under which the organizations manage and run themselves.
With increasing competition there is higher pressure on the organizations, and this affects the level of productivity. Furthermore, in the world sustained by means of deregulation, re-engineering besides various types of de-regulation process, there will be a time reached when the traditional hierarchy would break down, and this is going to modify the administrative reporting associations and management tasks.

Each of these processes results in fresh challenges and strains, and these are alternated by occasions for the management. In such diversifications, it becomes pertinent to have an efficient internal auditing system. In the current scenario, internal auditing is perilous to robust corporate governance, hazard management, effective internal control, and a well-organized operation within companies.

II. Defining the Internal Auditing

Internal Auditing is an autonomous, neutral, declarative and consultative activity, which gives quality governance and increases functioning of a company in several ways. Institutionalizing the process of internal auditing in proper manner, helps in realizing the objectives of a company as well as ensure a systematic procedure. Further, when internal auditing is carried out in right way like following a controlled approach, it ensures more effective risk management, better control and streamlined governance.

2.1 Role of Internal Auditors Indispensable to Good Governance

Corporate governance is a serious matter, and the seriousness can be discussed with respect to the role of Internal Auditors, who with their inherent capabilities and knowledge add significant value to the activities of the board as well as the committee involved with auditing. In this respect, the role of senior management and the audit committee is also instrumental as these have to understand their shared responsibilities, which are pivotal in controlling risk management.

Audit committees in today's scenario are taking more objective responsibilities on critical issues and this has happened primarily due to the presentation of actionable laws like the Sarbanes-Oxley Act of 2002, where audit committees were given the order for monitoring the company's managerial machinery to evaluate in detail on the manner in which financial reporting is conducted. It is serious issue for internal auditors to put on risk-based audit methods within the framework of company's financial control structure and deliver a detailed report on the manner in which the committees constituted for internal auditing function.

2.2 Internal Auditing – Risk Based Method

The risk-based methodology applied in the internal auditing process is considered as the primal means by which necessary priorities could be established to carry out the internal auditing activities inside a company. With these types of methodologies set in, the advantage lies with internal auditors, and they become increasingly knowledgeable over the company's critical issues like tolerance besides the risk appetite.

In this manner, the auditors become ready to focus on sensitive financial concerns, allow judicious distribution of the resources and above all are in right position to guide higher management in righteous manner where corrective actions can be instituted in right time.

III. Internal Auditors and Supporting the Management

If the company reaches a level where internal auditing becomes acceptable and accounted for by the management, internal auditors become quite clear of their fundamental responsibilities, when they start aiding the management and the company's board to realize the objectives of that company.

This is where highly qualified internal audit professionals work out a realistic methodology considered integral and objective. The qualified internal auditors have strong control on communication and study the perpetual risks besides innovative skills assessment techniques for judging value of the controls used by management for reducing the risks.

In a dynamic business environment where we work and grow, the effectiveness and value of internal auditing in respect of management needs discussion. The businesses can only beat the competition and increase their returns on investment if internal auditors are sincerely following the business protocols and delivering the results in time.

One of the major concerns that management of any company finds itself is the risk associated with use or overuse of computers and other information technology systems. The regulation and auditability stipulations of new systems also becomes evident. Internal auditors are of the view that adding a comprehensive IT system in company set up will bring in value to the company functions, and on the flipside of it, from the perspective of the management, this will add to the costing.

3.1 Steps Involved in the Internal Auditing

Internal auditing involves several steps, and each of these steps aim at providing right governance and better functioning over a period. The steps include: Collecting Audit Evidence; Collating the Evidence; Assessing its Reliability and the Acceptability, Drawing Conclusion and Stating the Judgement.

For the purpose of driving logical conclusions and in-depth analysis, the internal auditor should have access to right audit evidence on account as well as transaction levels. The evidence should be analyzed for its adequacy in respect of quantity as well as the quality. A fair conclusion is required by auditor after analysis of financial records after examining the transactions. Once the conclusion is made, formulation of opinion on the basis of financial statements is divulged in the reporting. The inclusions in reporting should be just and fair.

Collecting the Evidence – There are several types of procedures involved when collecting the evidence, and these include making an enquiry, collecting information, confirming the evidence and then observing it and later on going out for the observation, compilation, verification and doing the estimation. All these procedures applied on various transactions forms the platform for writing the conclusion for specific head of account. In this manner, the role of auditor is to make everything sure that the company or a firm has strictly adhered to the legal norms and accounting policies completely.

Assessment of audit evidence- Once the audit evidence is collected, the auditor begins to assess the evidence by following a fine-toothed comb and in the process looks into the critical aspects, establishes the reliability before a conclusion is given. The internal auditor is required to give in writing the reasons for accepting or rejecting the reports etc.

Study of Evidence- The auditor incorporates many types of analytical procedures viz-a-viz accounting ratios, analyses, besides looking into the intercompany comparisons for analysis and detailed study.

Audit Conclusions- After analysis of accounting statements, the internal auditor is in right position to frame the conclusions of those statements. The internal auditor has to be confident that conclusions are not biased around company policies and share the facts. Conclusions should not be based on vague assumptions.

Agreeing with Code of Conduct- If the internal auditor does not comply with the professional ethics and does not have sufficient amount of evidence to support his finding, he is liable for actions from competent authority. Therefore, drawing conclusion is important and a critical aspect of internal auditing.

Opinion and Its Expression- The audit will carry forward his analysis and holds discussions with audit committee instituted by the company before the report is finalized. The auditor has to show firmness in statements and keep everything logical and independent. An audit report is a legitimate public text, and therefore drafted by a qualified professional. The code of conduct forbids an auditor from revealing any sensitive information while he is within professional assignment, except when legally bounded.

IV. LIMITATIONS OF THE INTERNAL AUDITS

The management and execution of internal audits is restrictive and disorganized as the internal auditor does not have seamlessly easy accessibility to audit committee. There are no case plans prepared before the internal auditing takes place. The internal auditors do not follow any kind of legitimate practice or the policy, which will help in selecting the cases. Audit manuals are not managed, and they are out of date, and these have not been consistently used by internal auditors. Interestingly, the ideology of best practice case management techniques has not been utilized.

V. LITERATURE REVIEW

Internal auditing has experienced several changes, which led to the increased scope helping the organizations to motivate themselves and give better services to the society for which they serve the purpose.

The internal audit as function of management audit helps in increasing the efficiency of organization. Internal auditing helps in building better corporate resolutions, and this indeed brings efficiency, Aftab Ahmad Khan. Management audit is the service offered to the public enterprise management and this helps in giving increased autonomy with greater effectiveness., G.S. Batra. The reason of Standards for the Professional Practice of Internal Auditing (SPPIA) is to underline essential principles for providing the required framework that will help in promoting internal audit activities, which are essential for measuring the internal audit performance and aid in the improving organizational processes as well as operations (IIA,2000). Internal auditors have to stand as the vanguard that help in taking the business units to the levels of internal control system besides giving the focus around the objectives of strategic business requirements. Role of internal auditors is also to be seen as active participants instead of observers, (Sawyers, 1996).

The internal control system has a pertinent emphasis to leverage internal auditing methodologies for a plain purpose that auditors executing the regular internal audit procedures are among the principle runners within management function. (Chambers, Selim & Vinten, 1987).

Internal auditing methods implemented to evaluate efficacy of internal control systems that defines the framework of internal auditing, and comprises the actions like - assessment of activities undertaken in supervision of management for matching the correct situations, alterations alongside the intentional reasoning. The audit control policies as defined find there has been no fundamental difference between internal control systems and the management control (Chambers et al., 1987).

VI. RESEARCH OBJECTIVE

Auditing, especially the one that refers internal audits, takes a distinction among the partners within the business, besides the presence of strong client-side management as well as self-governing assessor. All such kinds of double roles like to show the factual concerns where internal auditors work both as the business partner as well as a policeman.

Being one of the partners in the business, the auditor executing internal auditing tasks, is a professional who uses his professional expertise to meet the organizational objective, whereas, in the role of a policeman, the same internal auditor searches for the flaws inside the corporate set up. The intent and purpose of detailed internal auditing practices are crucial with respect to both these roles.

The principal research objectives in this context are defined as:

- To identify the extent of compliance that public listed companies adhere to in India
- To analyse whether the sound internal audit practices are effective against the internal control systems practiced within the companies.
- To look inside the sensitive relationship that exists between the internal control system as well as the outcome of internal audit department.

VII. RESEARCH METHODOLOGY

This paper is conceptual in nature as secondary data source was used during the entire research. The research was executed after an elaborate case analysis was done, taking the Indian corporate sector into consideration from perspective of internal control system, of which internal auditing is an influential part.

7.1. Type of Research

The case study is a Type II one, executed by utilizing secondary sources of information, which presents the copyrighted and non-copyrighted material. The type II case studies develop conceptual framework taken either from website sources, industry reports, as well as the annual reports. Various corporate sector has been discussed within Indian context.

7.2 Reason for Selecting the Cases

The sole purpose behind selecting the case studies of following companies and representing it in this research paper is to bring out a strong point of view that shows good governance is only the result of effective internal control functions, which results from genuine internal auditing skills.

VIII. ANALYSIS OF THE CASES

8 (a) Case Study – Toshiba

About Toshiba:

It is 140 years old Japanese MNC, and a leader in the world with superior innovation in pioneering advanced digital technology. The company has diversified its operation into four key business groupings viz-a-viz – Social Infrastructure, Home Appliances, Electronic Devices etc.

Problem:

The president of Toshiba Corp - Hisao Tanaka and two of his forerunners quit after auditors and financial agents doubted that Toshiba Corp x

Corporate Governance in Toshiba:

Toshiba was among the league of first companies, which integrated reforms in their corporate governance that were initiated in Japan. As the result of these reforms, the company structured its corporate governance in accordance with the acceptable standards. Several incidents in the past have clearly highlighted failures in corporate governance, even when it is fully structured.

The practicality and full implementation of corporate governance, where it gives the results, is based on internal culture of the organization.

Observations:

Toshiba Corp had a distinctively unique duties and rule book, which made the corporate audit division as the key responsible taker for auditing not only the principal company, but also the branch as well as the affiliated companies.

The reality was that corporate audit division was only engaged in consultation services to the higher management, instead of executing accounts auditing, which is necessary to establish the validity of accounting treatment.

The observations conducted by committee upheld that internal audit executed only consultation functions and reported to top management.

Inferences:

One of the major faults of auditing practices conducted inside the company had a prime focus over the financial services nurtured as consultants, instead of the working diligently on the assurance services. In overall perspective, the internal audit team was not completely at fault by providing consultation services, but it missed out the seriousness of accounting audit, which was more serious as a function.

In Toshiba, it always was the top management that had the responsibility of setting the targets, which often were quite unrealistic, and as the result, the pressure delegated to the lower management and those who worked under the lower management framework.

The adjustable pay is an important part of the gross pay, and compensation of executive officers consisted of the base compensation achieved on the basis of title besides the role compensation that was achieved on the basis of work. Nearly around 40 to 45% of the role compensation came from the actual performance of entire company and its business department. Achieving those unrealistic targets alongside the performance-based pay motivated the people in Toshiba to manage their earnings accordingly, which is why the accounting audit need to be a focus area for conducting internal audit.

Internal audit can function autonomously in the situation where the appropriate conditions, having committee has the skills, autonomous, operative; besides the power of financial auditor is always there to present its findings to committee constituted for auditing practice.

Within the company, the problem with commission constituting the auditing role happened to be that it neither had those skills and nor was it completely independent. More interestingly, the executive members enrolled within the commission had absolutely no knowledge of the financial principles.

8 (b) Case Study – The Enron

About Enron:

Enron was the biggest and most widespread company dealing in energy sector, commodities and providing a league of internet-based services. The company was known to market electricity, natural gas, transported energy besides other kinds of physical commodities, and gave out financial and risk management services to its potential customers across the globe.

In the beginning, Enron was projected as natural gas pipeline company, but later it transferred itself from just delivering energy to brokering energy futures for the reasons that the energy markets had begun to deregulate themselves.

The company gradually began to market the electricity in 1994 before serving the European energy market in 1995. And in the year 1999, Enron launched a unique and innovative plan for sale and purchase of fast bandwidth lines and addition to new internet business titled as Enron Online, which exclusively formed the community trading that helped in further establishing Enron as premium e-commerce company.

The Problem:

The real trouble was noticed after the Enron CEO reigned from its executive role in the year 2001. The company showed loss registered in the 4 years, for the non-performing assets. Again, there were reports of third quarter loss that substantiated to $618 million. Consequently, Enron claimed in a SEC filing that will restate the earnings from 1997 onwards by giving a reduction of $586 million. This announcement created a disaster in share price of the company.

Enron adopted fraudulent accounting practices as the result of which the internal auditing company AA was provided with excessively high audit and non-audit fees, and all of it was completely unaccountable.

Enron had been taking into practice quite questionable accounting and reporting practices for years, and its firm AA, was not able to get through the Enron's frauds.

The Powers Committee, instituted by Enron's Board found that the accounting firm Andersen was not able to accomplish its obligations with respect to checking the pecuniary statements, and make it visible to the executive board members.

Observations:

There were five types of failures, the first one was that Enron botched to understand and reveal investments, which were specifically suctioned into special purpose entities, SPEs; Second, Enron was not able to correctly recognize the revenue, and this enhanced reported net income; third, it was observed that Enron restated the merchant investments with fair-value accounting that was due to the unreliable information where overstatements were made with respect to company's possessions and total of commercial funds; while the fourth failure noticed, The company shadowed improper accounting for its personal shares, which were with SPEs; and finally the fifth failure seems to become evident, when inadequate revelation of fraudulent transactions, contentious moments, before the final costing, eventually delivered to stockholders.

Inferences:

Enron had conclusively projected profits directly after it had made astronomical asset, which included the power plant, and did not even wait for any realization.

The financial reports of Enron had not presented any money earned through the company operations in the financial accounting, rather it was the money of investors.

In addition, large portion of financial reporting delineated that revenue shown was the result of accounting manipulations carried out by chief finance officer of Enron.

Enron and its internal and external auditor Arthur Andersen were executing the regular procedures for many years and in return, it was collecting good money as professional fee.

There was a tie up between top management of Enron and the Anderson, and the auditing company sidelined financial problems. Enron had not instated any independent and responsible auditing committee within the company.

8 (c) Case Study – IL&FS

About IL&FS:

IL&FS is an India operated and India based infrastructure development and finance company, operating in form of over 250 subsidiaries, which also includes IL & FS Investment managers, IL & FS financial services and IL & FS Transportation networks India Limited (ITNL). The company is also involved in various infrastructural development projects such as construction of longest tunnel in India.

IL&FS came into existence in the year 1987 as means of "RBI registered Core Investment Company" through the unification of three financial institutions- namely, Central Bank of India, Housing Development Finance Corporation (HDFC) and Unit Trust of India (UTI), with the purpose of financing through means of loans in the infrastructure projects.

The Problem:

The total fraud of IL&FS was of 9900 crore rupees. IL&FS had granted the loans in violation of RBI guidelines, and that the auditors misled the shareholders.

IL&FS and its group companies had different auditors and loans were being disbursed by routing money from one group company to another through an unrelated party, but for the auditor of any individual group company it was just impossible to understand what really happened to the loan after it was disbursed

Deloitte Haskins & Sells and KPMG's audit partner BSR & Co, allegedly failed to highlight shortcomings while reviewing the books of subsidiary IL&FS Financial Services (IFIN).

BSR and DHS together audited the books of IFIN for FY18, pertaining to the period before the IL&FS crisis were first highlighted on the month of July in the year 2018, as it stuck into the problem of repaying the debts that matured on the money bonds. The company had defaulted on many occasions.

The defaults also put direct threat on investors, banks and mutual funds, which were directly or indirectly had association with IL&FS. It flashed panic among equity investors and many non-banking financial companies felt the default scare.

IL&FS was under huge debts with the assets not balancing together, and all of this happened because of problems in land acquisition. The land acquisition law resulted the projects being null and void. Furthermore, lack of timely action worsened the problems.

The Observation:

It was found that the auditors fail to perform the audit with due care and professional skepticism. Investigations revealed that Quid Pro Quo (something in exchange for something) relation between the two bodies and mutual benefits were given the advantage.

The Inferences:

Audit firms Deloitte and KPMG, BSR failed to let the financial irregularities made public. Auditors are responsible for frauds detection after an audit and they were failed to prove that audit was performed with due diligence and all the SAs have been followed.

8 (d) Case Study – Satyam

About Satyam:

Satyam was Hyderabad based information technology (IT) that offered key services like the software development, system maintenance, packaged software integration as well as many types of engineering design services. Satyam Computer Services had listing in the Pink Sheets, the National Stock Exchange and Bombay Stock Exchange, besides providing direct services to Fortune 500 companies.

The Problem:

Satyam fraud was known to be one of the largest frauds in India's accounting. Auditors working inside the Price Waterhouse "intentionally" did not fairly and squarely investigated the standardized practices involved within the auditing principles. The problems seen in financial statements, were the result of highly projected profits. The assessment concluded last many years of Satyam's financial perfprmance. However, its subsidiaries did not show any misappropriations.

The company had put on bogus purposes of executive members for gaining the approval of funds. It is here that gains of Satyam were shown up, and the forged customers and invoices of all such customers were benefitted for increasing revenues, and there was falsification of accounts.

The Observation:

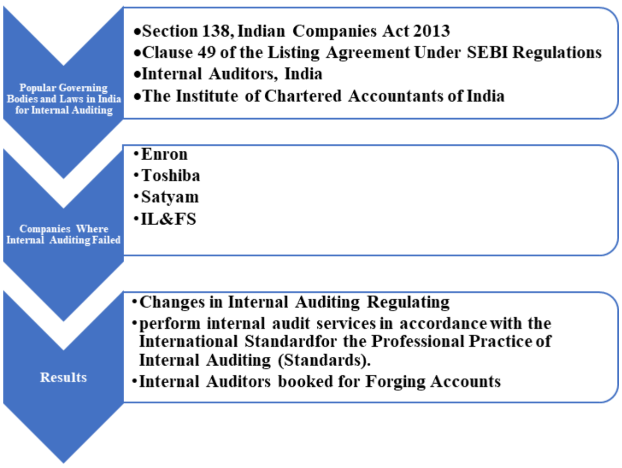
India's corporate sector had a well-organized auditing system along with rules, guidelines, besides the strategies. Satyam had the option to take a huge amount of money through adulteration of records that included revealing non-existent bank adjusts, premium receipts that were rarely gotten, phony client billings, borrowings on created board goals with earth-shattering announcing of non-existent resources of equivalent sizes.

Companies Act, 1956 authorizing the creation of 'audit committees' having powers similar to the auditors and had the knowledge of examining various types of documents, vouchers related to the enterprise. However, in case of the Satyam, internal auditors and the auditing committees were nothing more of failures and collusions.

The Inferences:

The way of functioning of the fraud clearly indicates the culpable intentions of the auditors. The objective as well as the role of the statutory auditors could not described as the one that showed responsibility. Along with the faltering of internal auditors, there was also complete failure of the internal control machinery.

IX. THEORETICAL FRAMEWORK



X. RESEARCH LIMITATIONS:

There were a few limitations while conducting the research, and one was the inaccessibility to the organizations. The conductance of research required free accessibility into the functioning of the internal audit staff and the procedures followed by them. One of the other limitations found during the research was non-availability of real time facts and figures, which are essential in driving home the opinion.

Besides, there may be many undetected errors, which will be in the accounts books as these errors were never elaborately discussed.

XI. RESEARCH FINDINGS:

The research findings aim that the internal control functions in internal auditing are not organized in

Case Study	Objectives	Strategy Used	Platform/ Dimensions	Outcome
IL&FS	• To understand the reasoning behind the laxity and collusion in frauds committed by Internal and External Auditors. • Reason for Financial Frauds • Why financial reports are inflated **Problems Faced:** Limited availability of the financial reports where internal auditors did not find any flaw.	• Formulation of Research Committee • Analysis of Financial Reports **Target Audience:** • Corporate Companies • Higher Management • Corporate Owners	• **IIA** • **ICAI** • **Google Research Reports** • **PwC**	• Frauds are committed by Internal Auditors as the result of ignorance or collusion with the higher management and the owners. • Financial books are not checked. • Absence of internal audit committee.
Enron	• To understand the reasoning behind the laxity and collusion in frauds committed by Internal and External Auditors. • Reason for Financial Frauds • Why financial reports are inflated **Problems Faced:** • Limited availability of the financial reports where internal auditors did not find any flaw.	• Formulation of Research Committee • Analysis of Financial Reports **Target Audience:** • Corporate Companies • Higher Management • Corporate Owners	• **IIA** • **ICAI** • **Google Research Reports** • **PwC**	• Frauds are committed by Internal Auditors as the result of ignorance or collusion with the higher management and the owners. • Financial books are not checked. • Absence of internal audit committee.
Satyam	• To understand the reasoning behind the laxity and collusion in frauds committed by Internal and External Auditors. • Reason for Financial Frauds • Why financial reports are inflated **Problems Faced:** Limited availability of the financial reports where internal auditors did not find any flaw.	• Formulation of Research Committee • Analysis of Financial Reports **Target Audience:** • Corporate Companies • Higher Management • Corporate Owners	• **IIA** • **ICAI** • **Google Research Reports** • **PwC**	• Frauds are committed by Internal Auditors as the result of ignorance or collusion with the higher management and the owners. • Financial books are not checked. • Absence of internal audit committee.
Toshiba Corp	• To understand the reasoning behind the laxity and collusion in frauds committed by Internal and External Auditors. • Reason for Financial Frauds • Why financial reports are inflated **Problems Faced:** Limited availability of the financial reports where internal auditors did not find any flaw.	• Formulation of Research Committee • Analysis of Financial Reports **Target Audience:** • Corporate Companies • Higher Management • Corporate Owners	• **IIA** • **ICAI** • **Google Research Reports** • **PwC**	• Frauds are committed by Internal Auditors as the result of ignorance or collusion with the higher management and the owners. • Financial books are not checked. Absence of internal audit committee.

corporate sector. Moreover, the higher management of the companies collude with the internal and external auditors and commit corporate frauds of very grave nature.

XII. CONCLUSION:

The comprehensive process of auditing is elucidated as an integral component within the company, which is managing a business organization, where there is an independent scrutiny of the financial reports of the company in order to ensure that the financial information inside the business organization is followed under the strict legal procedures and legitimate policies written within the company.

Audit opinion has significant relevancy within the purview of the audit reporting as provided to the external auditor. The study finds that there are variety of aspects like the company size, referrals and advice from familial resources that hinder the independency of external auditor. The research paper concludes that the business risks comprising the legal risks, financial risks, controlled risks, audit risks etc. causes problems in transparent assessment of internal audit functions of a company's business behaviour and profit assessments.

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