

INTERNATIONAL FRAMEWORK OF INTERNAL AUDIT PROFESSIONAL PRACTICE

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Abstract

This article deals with the significance of internal audit and explains that implementation of an internal audit unit into a company organisational structures is going to significantly influence the company business success in the future. Further, it focuses on the strategies, procedures and all organisational processes but also on the methods for reaching the intention on the individual operational levels. Nevertheless the internal audit position depends mainly on the utilisation of the unit services and recommendations. It plays an unreplaceable role in the help to the company reaching its targets as it introduces systematic approach to assessment and improvement of risks and efficiency of management and control systems including the company corporate governance. The profession of an internal auditor is necessary part of efficient management as it grants professional and valuable services to managing employees. The text goes into details regarding the individual parts of an audit and all complementary documentation.

Keywords: *internal audit, auditor's duties, audit in a bank*

The concept of internal audit is defined in the "International Framework of Internal Audit Professional Practice", which was first approved by the Board of the Institute of Internal Auditors (IIA) based in the USA in the year 1999. Internal audit practice can be influenced by the differences in the legal and cultural environments. Should the internal audit fulfil its mission, than the activities of internal audit must follow the "International Framework of Internal Audit Professional Practice", which was last updated in the year 2011. The framework contains two basic types of obligatory guidelines, which are reflected in the Internal Audit Definition, in the Code of Ethics and the Standards. The agreement with the attitude formed in the obligatory guidelines/ regulations is necessary for effective performance of internal auditor duties and the internal audit function in general. The obligatory guidelines were formed to be used by individuals as well as audit companies.

The currently recommended guidelines contain Practice Guides, Practice Advisories and Position Papers. These guidelines are not obligatory. The target of these recommended guidelines is granting of wide range of useful solutions determined for successful fulfilment of the obligatory requirements. The overview of basic internal audit Documents and Regulations in the Czech republic is given in the appendix No.1.

1. Internal Audit Definition

The content of internal audit was defined by internal auditors themselves. Obsolescence of the original internal audit definition was reflected in the narrow view of the internal audit activities, which were only the reviews and evaluation of the internal controls of a company, and it was not clear if it concentrates on the checking solely or all the control and management mechanisms. Internal audit was usually defined as the activity, which is performed by specialised staff in their own company, where the activities of such audit relate to all kinds of operations, which are performed within the company so to ensure the internal control (checking) and this was independent from the function and responsibilities of managing employees of the relevant company. That is why there was carried out a different, wider search, which would adequately reflect the conditions connected with such professional activities. These are objectivity, verity, independence and utilisation of relevant methods for audit activities.

The currently valid definition is as follows: “Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes“. A possible version of Independence of Internal Audit in a company is shown in the appendix No.2.

2. Internal Auditor

Internal auditor is a professional. He/she submits the opinion on general or specific part of the management system to the company management. On the basis of such opinions they assure that the company management is aware and understand the risk threats, the relevance of the performed risk management, adequacy of risk balancing and controls – checks (the strategy of controls is proportional to the risk management strategy) and effective adaptation to changes. Assurance services contain an objective reviewing and assessment of information, which target is to grant an independent evaluation of risk management, management and control mechanisms and corporate governance. The character and scope of an assurance engagement is set by the auditor. The participants of such an assurance service are usually three parties:

- 1) the audited person, namely the person or group (audited person or the process owner), who are directly involved in the process, system or any other subject matter,
- 2) the auditor, namely the person or the group performing the assessment, and
- 3) the recipient, namely the person or group benefiting from the assessment (the recipients could be the audited subject, the Board of Directors, the Audit Committee)

The consultancy services are the advisory and similar client services, which nature and scope are pre-agreed with the client, and which are intended to add the value and improve the company corporate governance, risk management and control processes of the organisation. The consultancy services in general involve two parties, namely the person or group offering the advice - internal auditor and the person or the group requiring and receiving the advice – the engagement client. During granting of the advisory services the internal auditor should keep the objectivity and should not overtake the responsibility of the management.

Organisations and companies exist to create value or use for their owners, the relevant stakeholders, the customers and clients. This concept or approach creates base or their existence. Within the process of gathering information for understanding and evaluating of risks the internal auditors significantly penetrate into the principles and keystones of operations and see possibilities of improvements, which can be beneficial to the relevant company. This useful information can be provided to the relevant management or operational management in the form of consultancy, recommendation, audit report or other relevant product and it is this way the internal auditors add the value to the processes within the organisation.

The internal audit focusses on strategy, processes and all organisational intentions and the means for reaching these intentions at operational levels. The processes of risk management are implemented by management for identification and assessment of potential risks and their reaction to the potential risks, which could influence reaching of the organisation targets. Management control processes are the principles, processes and activities the parts of the internal control system, which should ensure that the risks are within the tolerance of the risk management process. The processes of governance concern the procedures used by the representatives of the involved parties of the organisation (shareholders, stakeholders etc.), which should allow supervision over the risk, management and control processes. The target of the Code of Ethics is an improvement of the ethical culture in the internal audit profession.

3. The code of Ethics

The Code of Ethics is necessary and important for the internal audit profession, as it builds on trust input into all internal audit activities. The auditors are expected to follow and apply the following principles and rules. [4]. Integrity of internal auditors creates trust, which is the basic attribute of reliability into their judgements. Internal auditors:

- Must carry out their work honestly, appropriately and responsibly;
- Must follow the rules and disclose information, required by law or profession;
- Must not intentionally involve in any legal activities or participate in such activities, which could discredit internal audit profession or organisation;
- Must respect legal and ethical targets of the organisation and contribute to their fulfilment.

Objectivity – in gathering, evaluating and providing information on activities and processes, which are being reviewed, the internal auditors apply the highest possible level of objectivity. Internal auditors perform objective evaluation of all significant circumstances and do not allow the influence of their own or other people's interests. Internal auditors:

- Do not participate in any activities or relations, which could affect or dislocate their objective assessment. This participation concerns any activities or relations, which could be in the conflict of the company interests;
- Do not accept anything which could be understood as a breach of their professional assessment;
- State all significant facts (they are aware about), which could - in case of their omitting - distort the report on the activities which were subject of the audit.
- Confidentiality – internal auditors respect ownership and value of information, their gain within their activities and do not forward the information without relevant agreement, if there does not exist the legal or professional duty to do so. Internal auditors:
- Must be prudent in use and protection of information, they gain within their duty fulfilment;
- Do not use the gained information for any kind of personal profit or anything in conflict with the law or the company legal or ethics targets.

Competency – during granting of internal audit services the internal auditors apply necessary knowledge, skills and experience. [4]. Internal auditors:

- Grant only the services, which are based on the necessary knowledge, skills and experience;
- Grant all their services in agreement with the Standards for Internal Audit Professional Practice;
- Permanently improve their qualification, efficiency and quality of granted services.
- Introducing of the Programme for Quality Ensuring and Increasing

Internal audit manager is personally responsible for introducing and implementing such processes, which are proposed to grant sufficient assurance to various involved parties (stakeholders) that the internal audit unit:

- performs their activities in agreement with its Status, which should correspond with the International Standards and the Code of Ethic,
- works efficiently and effectively,
- is understood by all the parties as the unit adding value and improving the organisation operations.

The processes should include relevant supervision, regular internal assessment and continuous monitoring of quality and periodical external evaluation. The scope quality should be significant to

include all aspects of activities and management of internal audit unit, as stated in the International Standards and in the profession Best Practice.

Programme for ensuring and increasing of quality should be structured so it reached optimum level of professional abilities and the reviews should be managed in supposed scope, independently from the units and the activities they review. The key points of the complex programme of internal audit quality increase include:

- helping to the internal audit unit manager and to the audit management setting the budget and helping with financial management of the internal audit unit,
- keeping and updating the overall process of internal audit, including data collecting and elaboration of new information, influencing the oversight regarding the split of responsibilities among the internal and the external audits and other assessing units,
- managing of general operations of the system for evaluation of audit risks and long-term planning – help granted to the internal audit unit manager and to audit management for this area,
- helping with the entire process of audit schedules elaboration and advisory engagements and connected monitoring of time fulfilment,
- helping to the internal audit unit management with gaining, keeping and applying of audit tools and with utilisation of technologies,
- managing of external employees recruitment and participating of internal audit unit in the programmes of employees rotation within the organisation and in the management programmes,
- supervising over the employees development, e.g. selection or elaboration of training courses and managing of connected processes of career planning, supervising the evaluation of efficiency including the system for monitoring the professional development of individual audit employees,
- supervising the systems of statistics/measurements of internal audit performance and the researches carried after audits finalisation (e.g. from the audit clients or other stakeholders),
- monitoring of activities for ensuring quality and improvements of processes including the formal internal as well as external quality evaluations,
- managing of data collection and preparation of regular summary reports of internal audit for the company Top Management and the Audit Committee (including the reports on internal and external evaluation of quality),
- keeping of summary database for consequent monitoring of recommendations and time schedules for the measures fulfilment resulting from the internal audit engagements and from the work of external auditors and other internal evaluating units,
- helping to the internal audit unit manager, to the audit management and other internal audit employees with keeping the agreement with current International Standards, other changes and the Best Practice for internal audit profession, in regulatory matters and other rising issues for directing by the internal audit management.

The complex programme for ensuring and increasing of internal audit quality builds on the International Standards for Internal Audit Professional Practice, as stated above, but for banks it follows also the requirements of the regulator – the Czech National Bank.

4. Internal audit quality programme

Internal audit quality programme includes continuous internal evaluation of the internal audit quality, periodical internal assessment of the internal audit quality and external assessment of the internal audit quality. These assessments should evaluate the internal audit activities and reach conclusion regarding its quality and suggest recommendations for improvement. Quality programmes evaluation should include the following assessments:

- agreement with the Standards and the Code of Ethic including early steps for improvements of any significant case of disagreement,
- sufficiency of internal audit status, its targets, tasks, principles and procedures,
- contribution to risk management, corporate governance, and management and control processes,
- correspondence with the valid laws, the regulatory norms, and the government and industry standards,
- efficiency of continuous monitoring of activities and accepting the Best Practice,
- the scope of IA contribution to increasing the value and improving the company processes by internal audit activities.

For ensuring responsibility and transparency, the internal audit manager should share the internal as well as external results of the quality programme with various persons interested in the company activities, e.g. the Top Management of the company, company bodies and external auditors. At least once a year the internal audit manager reports about the quality programme and its outputs to the company bodies.

5. Continuous Internal Assessment of Internal Audit Quality

Continuous IA quality assessment is performed in regular evaluation of finalised audits by the management of the audited units. After the discussions over the audit report, the manager of the audited unit prepares co called “Audit Assessment” and forwards it in an electronic form to the internal audit unit manager, at the latest - the following working day after the audit report discussion. The system of continuous internal assessment of internal audit quality focuses mainly on gaining the feedback regarding IA unit efficiency, improving of work quality, efficiency and organisation, increasing of professionalism, specialisations and flexibility of internal auditors, supporting of professional development and motivation of internal auditors, improving of the customer services and adding value to the bank processes as well as following of the Standards and the IA Codes of Ethics.

A subject of such assessment is also the organisational and contentual side of each relevant audit, the contribution to the audited unit and the audit team activities in each audit. The assessment concerns the performed audit as well as the audit team.

6. Audit assessment practice in the in the Czech Republic

Despite its relative youth the internal audit function, which is an inseparable part of the banking sector, is often discussed in the industrial environment and even in the area of public services, where we can currently see its enormous expansion. More and more public as well as private entrepreneurial subjects come to the conclusion that introduction of an internal audit function into their organisational structures is going to influence the success of the company governance and the business itself and it is to bring permanent increase of efficiency in the relevant business area.

Each unit of the internal audit should build its activities on the “International Framework of Internal Audit Professional Practice”, which is updated and approved by the Institute of Internal Auditors. This framework includes Internal Audit Definition, Code of Ethics, International Standards for the Professional Practice of Internal Auditing, Practice guides, Practice Advisories and Position Papers. Efficient internal audit function is an important source of information for the organisation Top Management and the Supervisory Board, regarding the efficiency and effectiveness of the company management and control system. So the internal audit acts as an internal assurance and advisory service for representatives of the owners, the company management as well as the state organisations.

The recent proof of internal audit unit necessity can be seen in the June purge in six Ministries under the Movement ANO management. The Ministry of the Exchequer published the audit report on the six

Offices. The review regarded the years from 2011 to 2013.

All together the auditors found 1207 invoices without relevant public orders, which represent approximately about 5% of the total amount. Their total amount is approximately 16 milliard Czech crowns. The Ministry informed about the results on their web-pages. The analysis regarded 650 thousand invoices for app 318 milliard Czech crowns, the public orders for 213 milliard Czech crowns or 86 reports of the General Auditing Office.

The Minister of Finance deputy Mr. Lukáš Wagenknecht stated that despite the fact that there were spent milliards of the Czech crowns on various IT systems for the Civil Services, it appeared to be a serious problem to obtain quality and comparable data on the ministries management and economy. The area of IT purchase for the needs of the Civil Services turned up to be the most problematic. As an example he stated the amount of 357 million Czech crowns, which were paid by the Ministry of Justice to the firm CCA Group, the supplier of IT services, within the years 2011 and 2013. The relevant documents were found only to the amount of 69 million Czech crowns, where most of the orders were performed without relevant selection procedures. The remaining 288 million Czech crowns were in the contracts from the years 1995 to 1997, where Public Procurement Code was completely omitted.

The Ministry for Regional Development, which invested the largest amounts into IT, advisory and audits, paid the largest sums to the software company Tesco SW, which invoiced the Ministry for app 345 million Czech crowns. Over hundred million Czech crowns were also paid to the firms S&T CZ (103 million Czech crowns) and Datasys (101 million Czech crowns). Regarding the audit and advisory companies the Office paid largest amounts to their favourite company EY (former Ernst & Young), which obtained 68,6 million Czech crowns, and the CS – Project, which got 66 million Czech crowns from the state.

Mr. Wagenknecht further stated that thanks to the internal audit review the resorts finally obtained clear view of what is necessary to be amended or improved, they see the need for introduction of central purchases and improvement of National Treasury function, but the main task will be in the focus of the ministries internal audit work, which is to concentrated more on the area of IT. This fact again pointed out the indispensableness of functional and independent internal audit unit in the state organisations and not only in them.

The in-depth audits coordinated by the Ministry of Exchequer were started in six Ministry Offices led by the Movement ANO ministers after the impulse of the Movement ANO Chairmen and the Vice-Minister Mr. Andrej Babiš at the end of February. Apart from the Ministry of Exchequer the Movement ANO chairs also the following ministries: the Ministry of Transport, the Ministry for Regional Development, the Ministry of Defence, the Ministry of Environment and the Ministry of Justice.

7. Conclusion

On the basis of the above mentioned facts and in conclusion it would be possible to say, that the current state organisations, the large and medium-size companies and the banks cannot do without an internal audit unit any further. To be successful in such environment it is the internal audit unit, which can help. Still it is necessary to say that the internal audit quality builds on the quality of each individual auditor. Despite the fact that internal auditors must undergo demanding tests and they must fulfil certain personal criteria, it is possible that some errors or mistakes appear on their side. The fact is that it includes the human factor, which has always been the most risky one and with regard to the political interests the risk dramatically increases. Nevertheless such errors or mistakes are rather rare.

8. Literature

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Appendix No. 1

Regulation of internal audit

IIA - International Internal Auditing Professional Practices

COSO - „Internal Control – Integrated Framework“

OECD - Principles of Corporate Governance

BIS - „The internal audit function in banks“, June 2012

EU - Regulation No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms

Zákon č. 21/1992 Sb., on Banks

ČNB - Decree No. 163/2014 Sb., on the performance of the activity of banks, credit unions and investment firms (“Prudential Decree”)



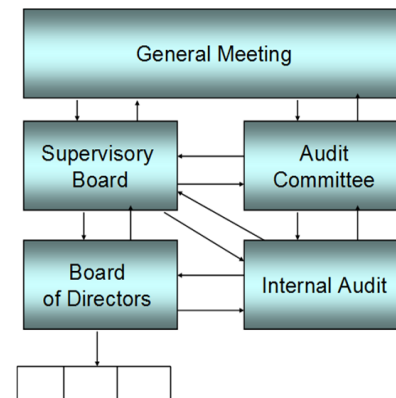
Appendix No. 2

Independence of internal audit

The internal audit activity must be independent, and internal auditors must be objective in performing their work.

Audit Committee as a body of the company

- Act No. 93/2009 Sb., on auditors,
§ 44



The purpose, authority, responsibility and the position of internal audit within the company is defined by basic formal document called [The internal audit charter](#).