INTERNAL AUDIT IN FINANCIAL INSTITUTIONS

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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*

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 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 business itself and to bring permanent increase of efficiency in their business area.

Each unit of the internal audit should build its activities on the "International Framework of Internal Audit Professional Practice", which was 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 and effective internal audit function is an important source of information for the bank Management and the Board of Directors, the Supervisory Board as well as the relevant supervisory bodies, regarding the efficiency and effectiveness of the internal control system. The internal audit acts as an internal assurance and advisory service for representatives of the owners and the company management.

The internal audit position depends mainly on the following facts: how the customers (namely the Supervisory Boards, Boards of Directors and relevant Managements) use the services and recommendations, what prerequisites they prepare for the function activities, and on the grade of professional and ethical level of the internal audit employees. Correctly working internal audit fulfils the unique mission, which it has and helps the organisation to reach the set targets with introduction of unified systematic attitude towards evaluation and improvement of efficiency in the areas of risk management, internal control systems and the company governance processes. Despite the fact that the methods and focusses of the internal auditors in an organisation vary, the internal auditors managed to create a profession recognized as necessary component of an efficient and effective management; a profession, which continuously builds its reputation by offering professional and valuable services for the company managing bodies and other managing employees.

1. Internal Audit Development

The internal audit profession is rather old. There exists presumption that the name of the person performing the internal audit profession "auditor" comes from the practice of the Roman questors (the ones who lead the investigation), who were hired by the government for supporting oral reports on the status of the exchequer. These "audiences" (the word comes from Latin) resulted in the name of an "auditor"- (the one, who states all the facts). Ancient Rome applied so called "audition on accounts", where one clerk compared his records with another clerk. This kind of oral verification should prevent the clerks administrating the funds from committing frauds or deceits. And it is possible to say that the expression "audition on accounts" was the background for the name "audit". The questors then went through the accounts of small-town governors and tried to disclose frauds, deceits or abusing of the financial means.

From the half of the nineteenth century independent public accountants started to create a specialised profession of accounting. Nevertheless the role of internal auditors remained virtually unchanged till the first years of the twenties century, the main task of the auditors was to disclose frauds or deceits and to prevent them. At the time, mentioned above, there appeared the techniques of "professional" or "scientific" management and there also appeared the new focus on the effectiveness and efficiency of business operations. Managements used the services of internal auditors for evaluating various operations, for reviewing of proposals and processes regarding the costs and for other studies contributing to the management task to fulfil the business (company) targets.

The internal audit focus has changed a little after the approval of a Law on Securities in the USA (in the year1933) and the Law on Securities and Stock Exchange (in the year 1934). These laws increased managements responsibilities for submitting of precise financial and accounting information, which led to the change of priorities of internal auditors shifting from fraud and deficiency prevention and disclosing, and improving of financial operations to the reviews of management and control tools regulating the financial and accounting information. In the year 1941 the internal audit was declared an independent branch to such extend that a small group of practice performing auditors founded an "Institute of Internal Auditors" in New York (hereinafter also IIA). Its domicile is currently in Altamonte Springs, Florida.

IIA has been developing and nowadays it is the profession association with global scope promoting and supporting development of the internal audit profession. The Institute focuses its attention on professional trainings of internal auditors, on the profiling and development of internal audit function and preparation of the norms and regulations, which could ensure correct performance of these activities with parallel granting of efficiency guarantees and following of the rules set for the ethics. This starts significant changes regarding the requirements for professional qualities of internal auditors, and at the same time also shift from accounting and financial management of a company, which start to dominate in the scopes of the external audit activities. IIA contributes to the performance of internal audit activities mainly in the form of well-prepared professional standards, granting of professional certifications to internal auditors, performing of research in the area of internal audit, organising of professional education (conferences, seminars, workshops, courses, and issuing of professional literature) and keeping of the (global) contacts with related associations (societies), institutions, clubs, university institutes and universities.

Since these days the significance as well as the positon of internal audit within the organisational structure of a company has been growing. It gradually becomes more frequent that the internal audit activities find the place in the highest management levels (Board of Directors, Company Management or Supervisory Board), and it provides the relevant information either directly or through the Audit Committee. It is exactly this position, which grants the required independence to the internal audit.

The efforts for unification of the attitude towards internal audit issues led several internal auditors to foundation of European Confederation of Institutes of Internal Auditing – ECIIA in 1982. The confederation keeps entire autonomy of the individual national institutes and they see their mission in "putting forward and developing of the professional practice in the area of internal auditing within Europe via the member organisations to the benefit of the profession in all member countries."

To fulfil the stated mission the ECIIA laid out the following main targets:

- Share knowledge and experience with other ECIIA members via permanent analysis exceeding a state borders, educational projects, conferences, seminars and public tribunes to serve and develop professional internal audit in Europe;
- Share knowledge and experience with other ECIIA members to gain the relevant support for the acceptance of International Standards of Internal Audit Professional Practice and to support the certification of internal audit professionals in Europe;
- Ensure unified relations among the ECIIA members and European Union regarding all the matters in the interest of the Confederation;
- Support the internal audit profession generally and its specific development in Europe especially, via the development of close cooperation with other professional organisations;
- Make an effort in creation of global organisation, which will include all professional organisations, which deal with the internal audit profession.

2. International Standards for Professional Practice

Internal audits are carried out in various legal and cultural environments; within the organisations varying in the focus, size and structure by internal employees as well as the external specialists. These variances can influence the internal audit practice in the set environment but should the internal audit fulfil its mission, its activities must always build on following of the Standards for Internal Audit Professional Practice. Their purpose is to set the basic principles, representing the best practice of internal audit and grant a framework for performance and support of all activities performed by internal audit and create a platform for internal audit performance evaluation. The standards contain the basic standards as well as the standards for the internal audit performance.

The basic standards characterise the fundamental requirements and qualities concerning the units and persons dealing with the internal audit. These are namely:

- 1000 – Purpose, Competence and Responsibility – The purpose, competencies and responsibilities of internal audit must be officially defined according to the Standards in the internal audit status and must be approved by the company bodies.
- 1100 – Independence and Objectivity – Internal audit activities must be independent and the internal auditors must proceed objectively during their work performance.
- 1200 – Professionalism and Adequate Professional Care – Internal audit tasks must be carried out professionally with relevant professional care.
- 1300 – Programme for Ensuring and Increasing of Internal Audit Quality. – The internal audit manager prepares and regularly updates the programme for ensuring and increasing of the internal audit quality, which includes all aspects of internal audit and will continuously perform the monitoring of its efficiency. This programme includes periodical internal and external evaluation of quality and continuous internal monitoring. Each part of the program is created to help the internal audit in adding value and improving of the company processes and grant assurance that the internal audit follows the Standards and the Code of Ethics.

Standards for internal audit performance describe the core principles of internal audit activities and offer qualitative criteria for internal audit activities evaluation. These standards concern:

- Internal Audit Management – The manager of internal audit unit performs an efficient and effective management of internal audit performance to ensure that its activities add value to the company.
- Nature of Audit Work – Internal audit systematically and methodically assess the risk management, the management and control processes and corporate governance of the company and contributes to their enhancement and improvement.
- Audit Planning – Internal auditors prepare and file an audit plan for each engagement, including setting of the scope, the targets, the timing and sources.
- Audit Process – To fulfil the audit engagement targets the internal auditors must identify, analyse, assess and document sufficient amount of information.
- Results Handover – Internal auditors immediately present the audit engagement outputs and results.
- Monitoring – Internal audit manager creates and keeps a monitoring system to see how the outputs and the results presented to the management are dealt with.
- Risk Acceptance by Company Management – If the internal audit manager things that the company management has accepted such amount of risk, which could be unbearable for the company, he/ she should discuss such eventuality with the management. If they cannot reach a common conclusion in the matter of the outstanding risk the issue is to be handed over to the company bodies.

The Statements (Position Papers) help the wide range of the involved parties, including the parties outside the internal audit profession, to understand the significant matters connected with corporate governance, risks and internal control system. They further help to determine connected roles and responsibilities of internal audit.

Practice Advisories are detailed procedures determined for the performance of internal audit activities. They include detail procedures and processes e.g. tools, advisories, plans and step-by-step solutions.

Practice Recommendations are approved guidelines. Their function is to help with the interpretation of the Standards for Professional Practice of Internal Audit or applying of the Standards in the specific environment of internal audit. From the beginning of this year the Internal Audit Professional Practice Framework contains already 94 recommendations for the practice.

3. Position and Independence of Internal Audit

Position of internal audit respectively an internal auditor must build on its current role, which can be briefly described as a role of an advisory with informal authority, with the knowledge and experience at relevant level and with the ability to form recommendations to the audited issues. To all these stated qualities it is necessary to add another significant fact and that is the internal audit independence from all activities, which are being audited.

To reach such independence in the full scope it is necessary for the internal audit unit employees to be subordinated to the head of this unit and the head of this unit should be functionally subordinated to the Audit Committee and within the bank organisational structure the internal audit manager should by also subordinated to the company CEO. Independence is for internal auditors an important part of their everyday practice, as it is the prerequisite for stating unbiased and unprejudiced verdicts and statements from the performance of their activities.

Internal audit independence in a bank is among other things achieved via the authority, which is given with the decision of the bank top managing bodies and implemented in the bank articles and regulations as well as in the internal audit status. There should not be areas in the bank, which would be excluded from the internal audit attention. When assessing the internal audit independence it is

necessary to evaluate how the internal auditors follow the Code of Ethics and the Standards for Professional Practice during their activities performance.

4. Internal Audit Role within a Bank

4.1 Regulatory Requirements for Internal Audit

One of the main targets of the Czech National Bank and its Supervision of banks set in the medium term concept of banking supervision development is finalisation of complex regulatory framework for banks and consolidations. On the basis of this concept in agreement with own findings and external recommendations, the Czech National Bank has published a set of regulations, stipulating the requirements for quality of management and control processes in banks and requirements for IA activities. Internal audit activities in financial institutions in the Czech Republic are influenced mainly by the following legislation acts:

- Act 21/1992 Coll.,
- Decree 123/2007 Coll. on Prudential Rules for Banks, Saving and Credit Unions and Brokers,
- Act 346/ 2008 Coll. on Financial Market Trading.

On the basis of the Act No. 21/1992 Coll. on Banks, amendment of Act and Decree 123/2007 Coll. promulgated on June 1 2007, the bank is obliged to ensure permanent and efficient internal audit performance, which is reviewing and evaluating mainly the functionality and effectivity of the bank management and control system, the risk management system and following of prudential business of the bank.

Internal audit unit manager can be neither a member of the bank Statutory Body nor a member of the bank Supervisory Board. After announcement to the Statutory Body of the bank, the internal audit manager is obliged to inform about relevant findings the Supervisory Board and in case of findings, which can negatively influence the bank economy, IA manager has to initiate extra meeting of the Supervisory Board. According to the § 9 of the Act on Banks a bank is obliged to set in its articles the structure and organisation of the bank, authority and responsibility of managing employees, authority and responsibility of other employees of the headquarters and branches, or other organisational units of the bank with authority to perform banking transactions and organisational covering of the management and control system.

In comparison with other bank units the internal audit plays specific role, which results from the services they grant, the client of the services, and the procedures used by internal audit for their work. Specific role of internal audit is given also by the fact that it is not managing and controlling activity but in principle it plays a service function within the bank. Internal audit has its client for who it performs assurance and advisory services, discloses insufficiencies, identifies risks and gives recommendations for improvements of processes in agreement with the International Guidelines for Internal Audit Professional Practice.

The basic tasks of internal audit include the performance of continuous analysis of the bank and its organisation, evaluation of efficiency of management and control system, and at the same time propose relevant recommendations and measures to the bank management. Last but not least the internal audit should keep close relationship with the bank management targeting in better understanding of the bank environment and better awareness of risks, the bank is exposed to, for better identification of risks for management purposes and setting of efficient controls and so contribute to increase in risk management quality and improvement of managing and control mechanisms.

4.2 Subjects of Internal Audit Activities

Internal audit must be able to grant services in an independent and objective way, identify and review risk activities and risk factors, elaborate analysis and evaluations, prepare statements, information and recommendations, resulting from the bank activities. Within these activities perform continuous

evaluation and assessment focusing on following of the legal requirements, norms and regulation, reaching of the bank strategy, evaluation of functionality and efficiency of management and control system of the bank, efficient utilisation of sources in the bank activities, codes of ethics, fulfilment of Board decisions, review of applying and efficiency of risk management processes and the methods of risk evaluation following of prudential business principles, reviews of information systems security, including the electronic information systems and electronic banking services, accuracy and reliability of accounting, statistical and operational information, testing of transactions and functionality of specific internal controls and others.

Nevertheless the internal audit activities in a bank further include also compounding of risk analysis, preparing of internal audit plans, implementing and keeping of a system for regular checking of taken measures and regular evaluation of their efficiency, monitoring of riskiness of processes, projects and other bank activities, regular submitting of information to the bank Board and Audit Committee regarding audit activities, preparation of methodology and information system of internal audit and fulfilment of internal auditors educational concept.

Subject of internal audit unit work is also deciding if the structures of risk management processes, management and control processes and corporate governance, as applied in the bank by the top management according to the long-term strategic aims and targets, if all the mentioned structures are adequate and viable and if they correspond with the principles for corporate governance.

4.3 Relations between External and Internal Audits

In the previous years there was paid rather intensive attention to limit the positions of internal audit linked to the external audit in various companies. These positions specifications concerned mainly understanding of different functions of these audits mainly with regard to determination of their roles. Internal audit often felt the jeopardy of the external audit, and the topic of internal audit outsourcing in companies was often discussed. The external audit on the other hand saw different possibilities and limits of cooperation. I presume, that within the last years the roles were clearly set and limited and the development showed undoubtedly that good function of internal audit is crucial partner for cooperation with the external auditor and the other way round.

In this context it is necessary to mention, that the financial sector and mainly the banking sector have been exceeding the other branches regarding the significance and social recognition of internal audit. This statement does not build only on the facts that the bank owners' structure brought the views from foreign countries and stressed the importance of internal audit function as an inseparable part of Corporate Governance but it builds also on the view of significance, which was introduced by the regulator – the Czech National Bank.

The basic task of the internal as well as the external audit is granting of an independent and objective view of company activities. Nevertheless there is fundamental difference in the scope of their work and the users of the outputs. Primary task of the external audit is to submit their professional opinion regarding the financial statements and their true and correct reflection of the company economy according to the defined standards for financial reports. This opinion is expressed by the external auditor in the form of audit opinion to the accounts, which is usually freely available together with the financial statements of the audited company.

This means that while the external audit work focuses on rather narrower scope than the work of the internal audit there is, on the other hand, much wider scope of the output users. This scope does not include only the audited company and its managing and supervisory bodies as it is in the case of the internal audit, but also the bank shareholders, the community of investors, the public and other groups, which can have investment intentions with the company or think about them. The external audit work seems to be focussed only on the company accounting and its financial statements. Nevertheless to be able to perform all its roles the external auditor must penetrate into and assess the company activities and its transactions including the company information system its setting and the functionality of the management and control system. So in the practice there can often appear the overlap of activities with the internal audit and it is likely, that there is some space for cooperation and synergy. This general result can be further supported by the standards of the external as well as internal audit, which not only

allow the cooperation and synergy but also, in some cases they really request such cooperation and synergy.

For reaching the maximum efficiency in their activities the internal audit cooperates with the external audit in their activities during the whole planning period. This cooperation builds mainly on mutual trust regarding both sides work and mutual respect to the work quality performed by both sides within their activities performance, and last but not least on the quality and objectivity of the set communication rules. One of the pillars of this mutual cooperation is the fact that each party knows the position and the role of the other and both are aware of separated missions. Internal audit manager in the bank should also ensure that the work performed by the internal audit does not duplicate the work of the external audit. Coordination of audit efforts includes regular meetings for discussing of common matters, exchange of audit reports and management letters and for common understanding of audit techniques, methods and terminology.

Contribution of mutual cooperation of internal and external audits:

- Increased mutual communication brings better understanding of the internal audit and the external audit roles and consequently better specification of the work scope;
- Coordination of audits performance and continuous sharing of information can lead to elimination of duplicities and reducing of audited subjects load and consequently to a reduction of costs for the internal audit and the external audit;
- Qualitatively better dialogue about risk expositions leads to more efficient audit focus and consequently to higher added value for the company management resulting from the internal as well as the external audit,
- Cooperation on realization of concrete audit tasks (e.g. common testing) mean saving of sources, which can be utilised alternatively.

1. Differences between External and Internal Audits

Area of difference	**External Audit**	**Internal Audit**
Reporting to	Management, Owners and Investors. CNB on review of accounts and management and control system.	Management / Statutory Bodies
Periodicity	annual	continual (permanent)
Standardisation	obligatory	obligatory and recommended
Qualification	obligatory	recommended
Work scope	given by legislation and standards	approved by Audit Committee and Board of Directors and given by international standards
Position	outside the organisation	company employees

Source: Author

4.4 Organisational Structure of Internal Audit Unit in a Bank

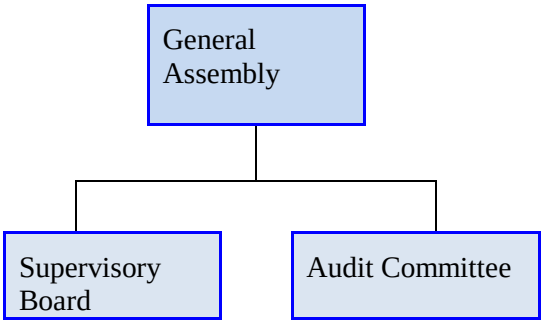
According to the existing experience it is obvious that quality work results can be expected only from such an internal audit unit, which is and an inseparable and organic part of the bank, and which activities create an integral component of management efforts as a complex. Basil Committee for

supervision of the central banks recommends functional subordination of the internal audit unit and its manager to the Audit Committee. In the year 2009 there was issued new act on auditors, which imposed on the banks to establish an independent body of the company – Audit Committee, which reports directly to General Assembly and performs supervision over internal audit activities. This strengthens the independence of internal audit units in banks. The internal audit position within a bank must be so significant that the bank Top Management applies permanent support to the audit activities, respects its independence and ensurs for enough capacities for smooth performance of its activities and authorities at any level in the bank. That is way the internal audit unit should in organisational subordination to the bank CEO. (Basil Committee for Central Banks Supervision, Internal audit in banking organisations and relation to supervisory bodies for the internal and external auditors)

In the Czech Republic a bank management usually follows the Germen model; it means that the Board of Directors is, at the same time, the Top Executive Management. The Supervisory Board and the Audit Committee consist of the representatives of owners and professional theoretical community - stakeholders (1/3 members of the Supervisory Board are elected by employees) and has mainly controlling function. One of the Audit Committee members must be independent from the bank and must have 3 years of professional and practice experience in the area of auditing or accounting.

Picture No. 1 demonstrates the most frequent position of internal audit unit in the bank organisational structure.

1. Organisational Incorporation of Internal Audit Unit



Source: Author

What facts influence the organisation of the internal audit unit in a bank? They are the size and the kind of the bank, its strategic targets and the tasks of the bank, and bank management ideas about internal audit.

According to some opinions, when creating its organisational structure, the internal audit unit in a bank should consider specifics of the individual audit activities, they perform in the bank. This considers mainly the methodical activities, planning activities, realisation of the activities and focus of the internal audits on the central activities, the activities of subsidiaries, activities in the bank network – branches, and the information technologies.

5. Internal Audit Process

5.1 Internal Audit Activities Planning

Audit activities in a bank should be performed on the basis of risk analysis, where the internal audit is to identify the risks. The identification of the existing risks and mainly the material risks should be the starting step for setting of the areas and banking activities, which should undergo the internal audit review.

Among other tasks the internal audit management in the bank has to prepare a plan for all internal audit activities, which are to be carried out. Internal audit plan should contain timing and frequency of internal audit work and should build on methodical and control assessment of risks. Control risk assessment proves how the internal auditor understood significant activities of the institution and connected risks. Internal audit unit management should set the methodology principles for risk assessment and should perform regular update, so the changes in management and control systems or work procedures were reflected and they should include new business subjects or new bank products. The risk identification and the risk analysis represent the starting phase of internal audit unit activities, the activity planning concerns mainly - the management and control system quality, management competency (skills), management integrity (complexity), unit size (overall turnover, assets), recent changes in accounting system, perplexity of operations, recent changes in key personnel, liquidity of assets, deteriorating economic environment of the unit, fast growth, scope of computerised elaboration of data, time from the last audit and pressure on the management to reach the set targets.

Risk analysis studies all activities and subjects of the bank and the entire system of internal control. On the basis of the risk analysis there is created an audit plan regarding the risk size connected with the processes. The plan also includes the expected development and innovations of banking products. All these interests will decide on the scope, the nature and frequency of tasks, which should be performed. After the performed evaluation of all stated factors and identified bank risks, which should be performed at least once a year, there are set the priorities of internal audit activities. When preparing the activity plan we start mainly from the bank strategy and targets, from the risk analysis of bank activities, from the requirements of Supervisory Board or the Audit Committee, from the ideas of the bank managing employees and from the analysis of other, especially external information sources.

The main targets and priorities of the internal audit unit activities are stated in the middle term strategic plan, which is usually prepared for the period of three years and the periodical plan, which is usually elaborated for the scope of one year, in case of need it is prepared for individual terms of the relevant year and it builds on the strategic plan.

Strategic plan is generally determining the focus and periodicity of internal audit activities in the medium-term perspective. It builds on legislation and regulatory requirements and its annual update takes accounts of the risk analysis, assessment of the bank strategic targets, internal and external changes in the business environment, evaluation of the performed audits and other information sources.

Periodical plan of internal audit activities starts from the strategic plan intentions and it focuses on ensuring the internal audit duties, which result from the valid legislation and from the requirements of regulatory bodies and further it focuses on audit activities according to the risk analysis. When compounding both of the activity plans, the strategic as well as the periodical one, it is necessary to take into account the internal audit unit capacity.

An inseparable part of work connected with creation of the periodical plan is defining of its structure. One of the possible structures of the periodical plan of internal audit activities is its separation according to its function namely to the assurance services of internal audit (which means the audits based on the regulatory and legislation requirements, audits of banking activities bases on the risk analysis, review of the taken measures, review of efficiency and effectivity of the management and control system) and advisory services of internal audit (which are the audits based on the management requirements, monitoring of risks from the bank activities and the system of their identification and

analysis, methodical activities, complex reporting on internal audit units, cooperation with the external auditor).

In practice the internal audit activity planning process consists of three phases namely preparation, creation and discussion of the plan proposals. Within the plan preparation phase relevant employees of internal audit unit continuously collect all available information, which has adequate value for elaboration of periodical plan proposal and update of the strategic plan of activities. After organizing of all the gathered information there is performed the relevant analysis targeting in an identification of the most significant risks in the commercial and the non-commercial activities of the bank. Further, within the preparation phase, there are addressed the managing employees of the bank to gain their views concerning the bank risks. Last but not least in the preparation phase, there is prepared a time-scheme of all the planning process steps.

On the basis of the preparation results, within the phase of the plan creation there is specified the working version of the internal audit periodical plan proposal regarding the subjects and capacities mainly the part of priorities in the internal tasks realisation and the split to assuring and advisory services. At the same time, within this part of the planning process there is finalised the internal audit unit capacity available for the planned period including the split of capacities for the individual internal audits.

This way prepared first proposal of the periodical plan is subject of several circles of commentary processes within the internal audit unit. The purposes of the comments are mainly organising of the capacity space regarding the individual professional teams of the internal audit unit and also mutual approval for aims and targets of the individual audit activities stated in the periodical plan proposal. Also there is assessed the possibility of outsourcing according to the audit targets and specialisations. After elaborating of the precise proposal of periodical plan of internal audit activities there should be updated the strategic plan.

The proposal of the strategic plan, its update and the proposal of relevant periodical plan of internal audit activities, including eventual changes are submitted for approval by the Supervisory Board or the Audit Committee by the internal audit unit manager. Prior the submitting of the plans for approval, these plans proposals are submitted to the Board of Directors, so that the top management of the bank was aware of the internal audit unit intentions for the following planned period.

5.1.1 Internal Audit Process

After the approval of the periodical plan of internal audit, the internal audit unit manager nominates the managers of the individual planned audits, who are responsible for following of individual parts of the relevant audit process. The audit manager sets the relevant audit team and its leader for each audit. When proposing the audit team the audit manager considers the professional skills and relevancy of the individual auditors related to the audited issues. At the same time he/she considers the possible conflict of interest regarding the individual internal auditors. Professional adequacy of each individual auditor as well as his/ her motivation and continuous increasing of qualification are necessary presumptions for efficient activities of the internal audit team and it should be continuously evaluated, and there should be considered the audit nature and the ability of each auditor to collect all necessary information, to review, to evaluate and to communicate. In this regard it is necessary to take into account the increasing technical complexity of banking activities.

5.1.2 Audit Preparation

After the approval of the audit team composition and its leader the next step of the audit preparation is the issuance of “delegation for the internal audit performance”. This is a document for all audit team members to prove their authorisation for the audit performance in the audited unit of the bank and imposing the competences to require the necessary documents and information. The “delegation for the internal audit performance” usually includes the audit name, the name of the audited unit, the audit performance term, the audit team leader, the audit team members, date of issuance and the person responsible for the delegation approval.

Within the audit preparation the audit team has to study the audit target, term and its performance and personal covering. The presumption for reaching the audit target is detail studying of the relevant issues of the audited unit and other facts necessary for the fulfilment of the set target. The concrete preparation of the audit team members builds mainly on the following source information: valid legal regulations, the bank internal regulations of the audited units, information systems (bank databases), data from the accounting and reporting, organisational scheme with description of the audited unit activities, organisational structure of the audited unit, personnel list and description of functions, the samples of used blank forms, and forms, documentation and risks from the already performed audits, and the International Regulations for the Internal Audit Professional Practice.

An inseparable part of the audit preparation should be preliminary examination at the spot of the audit, with the target to get acquainted with the audited unit environment, where the audit targets should be reached, gaining of eventual ideas from the audited unit, which could be included in the audit programme and which could help with reaching of the audit targets. At the same time, within the audit preparation the audit team decides on the audit techniques and procedures they are going to choose to obtain the relevant information within the audit including the time scope and there is also formed the basic scope and focus of the audit tests.

5.2 Audit Programme

Within the entire process of preparation and prior the audit commencing, there is elaborated the audit programme, which describes the targets and detail work processes of the auditors necessary for reaching the targets. All the audit team should participate in the audit programme elaboration under the audit leader management. The programme should contain the individual acts/steps, procedures, techniques and methods, used for the relevant area review. For the purposes of maximal consistency of the view regarding the programme and the possibility of using the standardised programmes (benchmarks) or pre-prepared programmes.

Relevant audit manager should be responsible for the audit programme quality and it is he/she who approves the audit programme. The programme should contain also the ideas and results gained by the audit team within the audit unit monitoring activities in the relevant audited unit, after their consideration and assessment, as well as the ideas obtained from the manager of the audited unit.

For reaching the set target the programme describes procedures and tests. The scope of these procedures and tests builds on the audit team assessment, which always considers the risk of the audited areas, complexity and time adequacy. The audit scope should cover all necessary issues for reaching the audit targets. The audit programme usually contains the following data: the identification data on the audit, the audited unit title, the audit kind, the performance term, the audit team leader and the entire audit tem, the programme approval, the audit target, the capacity and the time limits, the procedures, the techniques and the methods including the time schedule.

5.3 Selection of Samples

For reaching of the audit targets, the internal auditors have to gain sufficient, reliable, relevant and necessary information. Also well performed selections of samples, which are a part of the audit preparation phase and should be specified in the audit programme, ensure the basic presumptions for fluent and smooth audit process. The selection of samples means application of tests of material correctness on less than the basic set (100% of items). The process of the samples selection is given in the audit programme according to the relevant audit focus. The generally used methods of the sample selection are the selection based on a judgement (non-statistic method – it represents a subjective attitude to the setting of the selection scope and the sample selection; it is advisable for the internal auditor to test the most significant and most risk bearing transactions) and statistical selection (based on probability):

- it represents an objective method of setting the scope of selection and the selection of items, which are being audited,

- it grants a tool for quality assessment of the sample selection for specifying of accuracy or risk tolerance in the selection (how well does the sample represent the basic set) and reliability or level of significance (probability that the sample will represent the basic set).

For selection of the sample it is possible to recommend the following procedures: selection from the largest or the widest group of monitored items or activities; selection from a typical group; selection from the entire accounting period; selection including the events from the relevant audited unit activities and selection of items according to their materiality.

An important step at the end of the preparation phase is the official information for the audited unit manager on the prepared audit. One of the forms of such information can be the announcement letter, which sufficiently describes the audit focus to the manager of the audited unit, further the audit performance term and the audit team, which is to perform the audit. A part of the letter should be also an official request for creating of necessary working conditions for the audit team and assigning of a contact employee and last, but not least the list of background materials requested by the audit team to be prepared at the date of the audit start. From the description of the preparation phase it is obvious, that it is very important phase of the entire audit process. Perfect and quality preparation is a presumption of successful realisation of further phases of the internal audit process.

5.4 Audit Performance

After the finalisation of the preparation phase of the audit process there comes the audit performance phase. The audit opening is performed by the audit manager, eventually by the audit team leader, with the audited team manager (the managers of all audited units) or as the case might be with an employee assigned by the relevant manager(s) usually in the form of a personal meeting. The personal meeting serves for introducing the audit target, the audit subject and its scope to the audited unit(s) together with the planned procedures and last but not least it helps entering into the contact with the relevant employee(s).

If needed the audit team leader should have the possibility to ask for the statement, where the audited unit manager confirms, that he/she submitted to the audit team all information and data necessary for the audit performance. Asking for such a document is not obligatory for all audits, so it is necessary to deeply consider such eventuality. The use of such a statement should be decided by the audit team leader.

During the audit performance the internal auditors identify, analyse, assess and record sufficient amount of information for reaching the audit target. When setting the process and methods of gaining information the auditor follows the principle of significance of the individual findings. Deciding on the significance depends on the auditor's professional assessment. The used procedures and methods of gaining and elaborating information can be: observation and inspection – obtaining of physical information (e.g. video, photography, and maps), interview – gaining of evidence oral as well as written (e.g. reaction to the request for explanation, use of test questions), calculations (revision of calculations), verification – it means a search for evident exceptions in large amounts of data, confirmation (oral as well as written, positive and negative confirmations) – confirmation of an agreement or disagreement of facts by external subjects (mainly clients) and analysis assessment, comparing and evaluating of information, form the findings, with the presumptions (expectations) created by the internal auditor.

Analytic audit procedures are very suitable for finding of unexpected differences, absence of expected differences (varieties), potential mistakes, discrepancies or acts contradicting the valid legal regulations and other unusual or non-repeating transactions or events.

Analytic audit procedures include comparing of information for common period with similar information for the previous period, comparing of information for common period with budget or prognosis, considering of relations between or among the individual piece of information (e.g. moves in accounted credit interests compared to the changes in relevant credit balances), research in the relations between the financial information and the relevant information of non-financial matter (e.g. accounted costs for salaries and the average number of employees), comparing of information with

similar information from other organisational units of the company and comparing of information with similar information from the field (branch, industry), where the company performs its business.

If the analytic audit procedures identify risks, unexpected results of relations, the internal auditors review such eventualities, and assess them. Analytic audit procedures are used for the audit preparation as well as for the audit process itself. The auditor keep a file of records where they chronologically note all steps performed within the audit activities. This file contains all significant facts, found during these activities, mainly the gained, reviewed and analysed information. The file contains also the materials, which are available for the auditor after the audit termination and which were prepared or gained for the audit purposes, eventually the forms elaborated for internal audit evaluation. This auditor's file is a part of the audit documentation.

The internal auditor continuously discusses the findings with relevant employees of the audited workplace. He/she also informs the head of the relevant organisational unit about the findings in the pre-agreed terms. The audit performance is continuously monitored by the internal audit unit management.

5.5 Audit Finalisation

After the assessment of all gained information, necessary for formation of audit conclusions and recommendations and after finalisation of documentation it is possible to close the audit. On the basis of all gained information, analysis, consultations and documentation, the audit team prepares a report on the performed audit, which includes the target, the subject and the scope of the audit, the relevant conclusions and recommendations. The report further includes the identified risks and at the same time it signalises the risks, which can occur in the reviewed area. The report also includes the auditors' opinion on the size of the stated risks. The purpose of the report is not only to communicate the findings, the risks and the recommendations but also to initiate a reaction of the audited unit to take relevant measures for decreasing of the risks to an acceptable level.

Prior the start of work on the internal audit report elaboration, it is always necessary to consider all the possible potential recipients of the audit report. These recipients are from various levels of the bank management and use the report for various purposes at various times. According to the current practice, the audit report readers are split into primary readers (the audited unit management, the executive employees responsible for the audited unit and the bearers and implementers of processes) and secondary readers (internal audit unit management, other employees of the internal audit unit, Audit Committee, Board of Directors, External Auditors, Regulatory Bodies).

The above stated facts are important for conceiving of the internal audit report, so it satisfied all groups of readers with its content. The authors of the report should be able to deduce the main and the partial information, which should the report contain on the basis of inquiries in the field of needs and requests of the readers – the clients and the end users of the internal audit, and the recommendations of the report should be used for accepting relevant measures targeting in amendment of the insufficient status in the reviewed processes of the audited unit. The findings and recommendation, formed in the report, represent description of the findings and should build on the following attributes:

- Criteria – norms, standards, benchmarks, measures or expected results used for the evaluation – what should be.
- Status – proves, found by the internal auditors within the reviews – what really exists.
- Causes – reasons for differences between the expected and the real status – why are there the differences – varieties.
- Impacts
    - risk exposure or threat in the audited unit and/or other parts of the bank - the found status does not correspond with the criteria – impact of the differences,

- when setting the risk level or the size of jeopardy the internal auditors take into account the possible impacts of their findings and recommendations to the operations of the audited unit and operational results.

The Report Should Be:

- Objective and balanced – the report builds on undistorted, unbiased findings,
- Brief, material and accurate – precise elaboration of the report observes sufficient predicative ability regarding the findings including risks and unambiguous formation of conclusions and recommendations,
- Correctly stylised
  - clarity of the report can be increased by giving clear reasons of the sated data and by avoiding of unusual abbreviations,
  - carefully edited and without grammatical mistakes.

The basic plot of the audit report can be summed into three basic items: introduction and summary of audit results, review results and conclusion. To confirm all data, stated in the report and correctness of the data, all the audit them members sign the report. The final version of the audit report is forwarded to the manager of the audited team together with an invitation for discussing the report.

6. Discussing of the Internal Audit Report

An audit is usually concluded with discussions over the internal audit report with the manager(s) of audited unit(s). The audit manager should be responsible for organising the time and date and for the presence of relevant employees of internal audit. Prior the internal audit results discussion there are prepared items for the agenda of the Discussion Minutes, and the Minutes are specified and enlarged during the discussion, so it included all eventual objections and comments of the audited unit representatives. Discussion Minutes should contain the relevant date, statement that all participants are aware of the report and statements of the participants regarding the findings and recommendations of the audit team.

In case that the manager of the audited unit decides to take measures on the basis of the findings already during the audit discussion this fact is noted in the Minutes including the date regarding the submission of the information on the taken measures. This information must be concrete, unambiguous, and documentable with time deadlines, terms and responsibilities for fulfilment. If there appear a clash of opinions between the manager of the audited unit and the audit team, regarding the audit results, it is solved by the internal audit unit manager. At the end of discussion the correctness of the Minutes is confirmed by signatures of all participants with their eventual statements.

6.1 Internal Audit Documentation

The audit documentation is compounding all documents and data, unambiguously proving the audit preparation, reviews, information assessments and handing over of the findings, including the recommendations. The internal auditors always work in such a manner to be able to prove the findings in relevant documentation. For keeping records and evidence of the internal audit documentation, there should apply general principles: transparency (all documents are well and logically arranged including the documents numbers connected to the findings), suitability (the documentation includes only those materials, proving negative findings or the ones prepared consequently to the performed audit activities), topicality (for the background materials prepared by the audited subject, e.g. analysis, reviews, charts – the auditor reviews, if these were prepared adequately and within the set term/deadline), completeness and sufficient details (documents proving the performance of audit work necessary for forming the audit opinion to prove the performed audit with regard to the set targets and final results) and comprehensibility (the documentation should allow understanding of the performed

audit and reasoning of the outputs, recommendations even for the auditors who were not participating in the performed audit).

Documentation of each audit records the audit work at each individual phase of its process. The documentation scope varies according to the kind and complexity of the performed audit. The audit documentation includes the contents of submitted documents. The audit documentation should chronologically include the following: the authorisation for the audit performance, the report from on-the-spot inspection, the audit programme, the announcement letter of the IA unit manager (director) regarding the audit start, the written records of the auditors from the audit process, the written copies, the photocopies of documents, exceptionally the originals for supporting the findings, the statements, the written explanations of the audited unit employees regarding the findings, which can have the form of responds to pre-prepared questions or the form of a partial record written by an auditor, etc. the results from pre-prepared test questions, professional assessments, information analyses, which serve as the auditors prove for their findings, formation of conclusions and recommendations resulting from the audit, the evaluation of the found risks, the statement of the organisational unit management – if it was issued, IA report, minutes (record) from discussion and written information of audited team manager on the taken measures. The check of audit documentation by the audit manager and its filing into the IA unit documentation files closes the audit process.

6.1.1 Information for the Bank Management Regarding the Performed Audits

To ensure the basic mission of the internal audit in the bank the internal audit unit manager should inform the bank Board of Directors, eventually its individual members, about the overall results of each performed audit (including the audits on management requirement) and this should be done in an appropriately chosen form. The target of such information is brief and summary report on the audit name, reasoning for its performance (audit target), the audit performance term, the areas and the scope of the audit focus, the crucial findings, the risks and recommendations and the audit assessment by the audited units. The audit results are presented to the Audit Committee or the Supervisory Board of the bank.

6.1.2 Programme for Ensuring and Increasing of Internal Audit Quality

Together with the development of organisations their internal activities specialise and their processes change and develop. For ensuring permanent quality in such dynamic environment, consistent effort for development and improvement has crucial significance. Each unit of the internal audit must keep pace with this development.

It is rare that the requirements for professionalism, knowledge, incorruptness, management and control are stricter than the one imposed on the internal auditors. Internal auditors play the role of the company conscience and protect the operational efficiency, the internal control and the risk management. It also trains the Company Management and the Board of Directors (and/or other supervisory bodies for the corporate governance) and forwards them recommendations supporting the organisation in the fulfilment of its task and targets.

How does the current internal auditor find out what is necessary to be performed for ensuring the top quality results and what should be done for reaching of long-lasting efficiency and professionalism? Internal audit practitioner follows the instructions given in the Code of Ethic, the International Standards for Internal Audit Professional Practice and strives for reaching the highest professional education – CIA Certificate, performs internal assessment of quality and undergoes the independent external quality assessments for reviewing the compliance. When the above mentioned procedures are followed automatically, it can lead to the success of the auditors as well as the organisation, they serve. So it is a duty of each internal audit unit manager to elaborate complex programme of internal audit unit quality, namely the programme for ensuring and increasing of internal audit quality, which includes all aspects of internal audit and which is regularly updated including continuous monitoring of its efficiency.

7. Conclusion

In conclusion it would be possible to say, that the current banks, the large and medium-size companies cannot do without a regular internal audit unit. Market economy operators often deal with very competitive environment and apply an effort to be the best. To be successful in such environment it is the internal audit unit, which can help. It is necessary to say that the internal audit quality builds on the grade of each individual auditor. Despite the fact that internal auditors undergo demanding tests and they must fulfil certain personal criteria, it is possible that some errors or mistakes appear on their side, too. Nevertheless such errors or mistakes are rather rare.

8. Literature

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