

The Role of Internal Audit in Organization Goals Achievements: A Security of Exchange Commission of Pakistan (SECP) Perspective

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Abstract

There is currently considerable interest in the topic of internal audit and its contribution to the organization goals. Internal auditing could be used as mechanisms of risk management, corporate governance and internal control. The paper aims at examining the relation between internal audit and organization goals. In this paper, at first, the conceptual approach of internal audit, which could be used as a mechanism of risk management, corporate governance and internal control, is analyzed. Then, integrated categorization of the responses received from the SECP internal audit staff is depicted in three different tables (i.e. Coded in Common Pattern (Table 1), Word Frequencies (Table 2), and Linked Table (Table 3)). After that the role of internal audit in organization's goals explanatory model presented. Finally, I suggest these areas for further research. The results point out that internal audit is not only vital in the efficient risk management, internal control and corporate governance but also play a crucial role in the business survival and success.

Keywords: The Institute of Internal Auditors (IIA), Internal Auditing (IA), Security of Exchange Commission (SEC), Committee of Sponsoring Organizations of the Treadway Commission (COSO), Corporate Goals.

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1. Introduction and aim

Internal auditing has undergone dramatic changes and has expanded its scope to make greater contribution to the organization goals. Internal auditing is also performing its role in diverse cultural and legal environments within different organizations; which varies in size, structure, purpose and also in persons.

We must continually broaden our vision and look for barriers that may stand in the way of universal application of the IIA Standards. We must not feel we have reached the ultimate and that development is not needed [Å]¹

Internal auditors are often called as both a policeman and a business partner. An internal auditor is called as a business partner during his/her dealing with client management, and a policeman because of his/her acts an independent reviewer of management of an organization. Internal auditor as a business partner expected to provide expertise to assist an organization to meet its goals; and as a policeman, internal auditor is looking for weakness and flaws in the internal control system. The empirical portion of this study will provide evidence whether compliance with the internal auditing practices and standards will lead the organization towards its effective internal control system to achieve organization goal or not. Review and evaluation of an internal control system and the quality of performance carries to assigned responsibilities are the basic activities of internal audit. The purpose of the appraisal of the adequacy of the internal auditing is to find out whether the recognized system provides reasonable assurance that the organization's objectives and goals will be met efficiently and reasonably. An ample control is considered to be present if the internal control planned and organized by the administrative management in a manner, which provides reasonable assurance that the organization's goals and objectives will be achieved efficiently and reasonably.

The role of internal auditing in the review of effectiveness of the internal control system is to find out whether the internal control system is functioning well as it is intended to do. The internal control system is called to be effective, if the administrative management direct the system in such a way which provides reasonable assurance that the organization's goals and objectives will be achieved. Because the basic aim of internal control system of an organization is to provide management with reasonable assurance that the financial information of the organization is reliable and accurate; the organization comply with the stated policies,

¹ [Å]: This article won the International Chapter Research Contest Award (First Place) at the International Meeting of the Institute of Internal Auditors held in Toronto, Canada, 19-23 June 1994.

procedure and planes; assets of the organization is safeguarded and protected from theft and loss; resources are used efficiently and effectively; and finally recognized goals and objectives for operation. Thus, the internal auditing focuses on this internal control framework.

2. Theoretical points of departure

2.1 Internal audit and its role:

The fundamental role of internal audit is to assist management to attain organization's goals. It also provides assurance that the management has implemented a satisfactory internal control system for risk prevention. In accumulating, internal audit provide internal consulting services to the whole organization in terms of facilitation, advices, training and counsels (IIA, 2011).

According to IIA (1999); "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".

According to the IIA (2009) definition, internal auditing can well be classified into three diverse areas; risk management, corporate governance and internal control. Internal auditors play a basic role not only in risk management but also providing consultants and assurance services to the executives. Previously, the IIA issued "The Role of Internal Auditing in Enterprise Wide Risk Management (ERM)" as a track to the internal auditors that they supposed to play their role in the enterprise risk management procedure. Lately, related to consulting services the IIA report portrays four essential activities for internal auditor to be accountable, which are; coordinating Enterprise-Wide Risk Management activities, facilitating the identification and evaluation of risks, maintaining and developing the Enterprise-Wide Risk Management framework, and for the management support developing of risk management strategy.

2.2 Internal audit as a mechanism:

2.2.1 Internal audit as a risk management mechanism:

Internal audit plays a role of risk management mechanism in organizations. Internal audit play a critical role in monitoring the risk profile of an organization. Further, it should classify areas in order to provide better risk management procedures (Lindow and Race, 2002). An internal audit can be obliging for corporation in identifying and evaluating risks and lay the profession at the front line of the risk management (Walker et al., 2003, p.52). Besides, Kwan (1999) explains that inside a company, development of a risk based culture is essential in order to construct a strong organizational commitment for risk management i.e. the development of an integrated risk management framework.

2.2.2 Internal audit as an internal control mechanism:

Internal audit also plays a vital role in internal control mechanism in organizations. The directors and management of an organization adopt internal control process, which provides assurance about the attainment of the organization's objectives regarding operations, financial reporting and compliance with the regulations (COSO Report, 1992). External auditing standards (for example: AUS, 402 and ISA, 400) shows that the control environment can be reinforce by using effective internal audit function by: a). Assessing of the internal control structure of a firm; and b). On behalf of the executive; monitoring different operations regarding the control procedure and information system (AUS 402 19-d). The asymmetry of information between division and senior manager's result in weakling the ability of the senior managers to firmly control operations (San.M and Govindarajan, 1984). The reason for this problem is the presence of internal agency costs (Ettredge et al., 2000), which occurs between the upper management and the lower level staff because of the incentive's differences. An internal audit includes a strong internal controls system for reviewing and monitoring mechanism. The senior management can delegate their responsibilities in accordance with the internal control to the internal audit function (San.M and Govindarajan, 1984).

2.2.3 Internal audit as a governance mechanism:

Internal audit also plays a role of internal governance mechanism in organizations. From the agency point of view, the role of strong governance within a firm lays by aligning the management interests with the stakeholders in order to minimize agency costs (Cohen et al., 2002). An independent board chair, independent directors on the board, internal audit, external audit and effective audit committee are different corporate governance mechanisms used to monitor behavior of the management (Cohen et al., 2004). According to The complex interactions within these governance mechanisms are like a "corporate governance mosaic" (Cohen et al., 2004, p.88). But the problems between independent and executive directors due to asymmetry information shows internal audit more likely as a complementary mechanism. This is supported by determining evidences from the researches examining the relationship between audit committees and internal audit (Scarborough et al., 1998). This is in accordance with the IIA view about internal auditing; which helps organizations to improve and evaluate governance processes (IIA, 1999). Thus, positive relation between the internal audit function and a

stronger audit committee can be expected because of their closely intertwined goals (Scarborough et al., 1998, p. 53). An effective audit committee can strengthen the internal audit function position (Braiotta, 1999), whereas a powerful internal audit function can result in enhancing the audit committee's effectiveness (NYSE and NASD, 1999).

2.3 Organisation goals:

On the basis of economic theory most of the organizations are looking towards achieve their goals i.e. profit (maximization), but this view is not accepted in today's business world. According to Lilien and Kotler (1983), "Although profit in some firms is an overriding goal of the business, it is not the only factor that an organization considers when trying to decide among alternative plans of actions. An organization is a complex hierarchal social system pursuing a variety of organizational and personal goals." Further, Kotler (1980) describes that the common objectives of most of the companies are; to increase sale growth, profitability, innovation and diversification of risks. Stagner (1969) visited 125 huge firms and 125 vice-presents and he pointed that the goals of a firm is other than maximization of profit, i.e. cohesiveness of the management. His study showed that managerial cohesiveness is playing a key role in business decision making. A proper set of goals can be used as a first point for a firm's study which describes design (Gouldner 1959). This is an important approach, because a proper set of goals represents efforts of a firm's to deal with; dynamic, multidimensional, an uncertain environment and to properly state managerial activities (Baily and Boe 1976). Additionally, Osteryoung (1977) notes this approach that for the development of a realistic theory of firm, goal training is an important link. Though, some complex firms normally follow more set of goals rather than single, among these most must be incidental (i.e. politically oriented statements) at different organizational levels (Connor and Bloomfield 1977). Further Lilien and Kotler (1983) stated that, "Generally the announced or published objectives of a company are of little operational help in choosing among alternative plans." So, currently a firm set of goals are connected to the firm's philosophy.

Dittenhofer (2001) prescribed that an internal audit is to assist organization in achieving their goals and objectives. Further, Institute of Internal Auditors stated about internal audit that it, "helps an organization accomplish its objectives" (IIA, 2004). In the same way other literature has documented the internal audits role in the achievement of corporate goals (see example as; Hass et al., 2006).

3. A Case of SECP

The Security and Exchange Commission of Pakistan (SECP), internal audit department (IA) is an independent appraisal function within the Commission. The work of IA is governed under internal audit charter and internal audit manual which covers the role to review the adequacy and effectiveness of the Commission's governance, processes, controls and risk management in implementing agreed strategies across the organization.

Internal Audit in fact is an activity which is designed to add value and improve company's operations. It ensures reliability and integrity of financial and other operating information and the means used to identify measure, classify and report such information. It helping an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. Internal audit assists the management of an organization by giving valuable recommendations on weak areas in order to enhance overall effectiveness and efficiency of company's operations. Internal auditors generally know where the control weaknesses are and which individuals or operations bear closer scrutiny.

The audit department enjoys an independent status in SECP, if an auditor is not free then he/she will not be able to audit properly. No matter how well internal controls are designed, they can only provide reasonable assurance that objectives have been achieved, whether; some limitations are mostly inherent in all internal control systems. Furthermore, the internal audit techniques do not affect the efficiency of the company, but sometimes internal auditing fails to check planned frauds by the management of organization. The management of an organization can play many tricks in order to manipulate accounts to conceal inefficiencies. These types of frauds are not disclosed and the audited accounts will not always show a true and fair view. If the information from management is false, then there is room for fraud and internal audits can sometimes yield undesirable results.

A number of questions were posed to the SECP internal audit department professionals and their answers are arranged in three different tables, i.e. *Coded in Common Pattern (Table 1)*, *Word Frequencies (Table 2)*, and *Linked Table (Table 3)*.

Table 1
Coding Table (Common Patterns)

Respondents	IA & Corporate Goals-(Q1)	IA Mechanism-(Q2)	IA & CG Expectations gap-(Q3)
Director Internal Auditor	Review and control	Risk management and internal control	Compliance and goals
Joint Director Internal Auditor	Add value and operation	Risk management, control and governance	Accomplishment of goals
Assistant Director	Add value and operation	Risk management, control and governance	Accomplishment of goals
Internal Auditor	Deterrent to fraud	Internal operations, RM and control	Reducing losses and achieve goals

Table 2
Word Frequencies Table

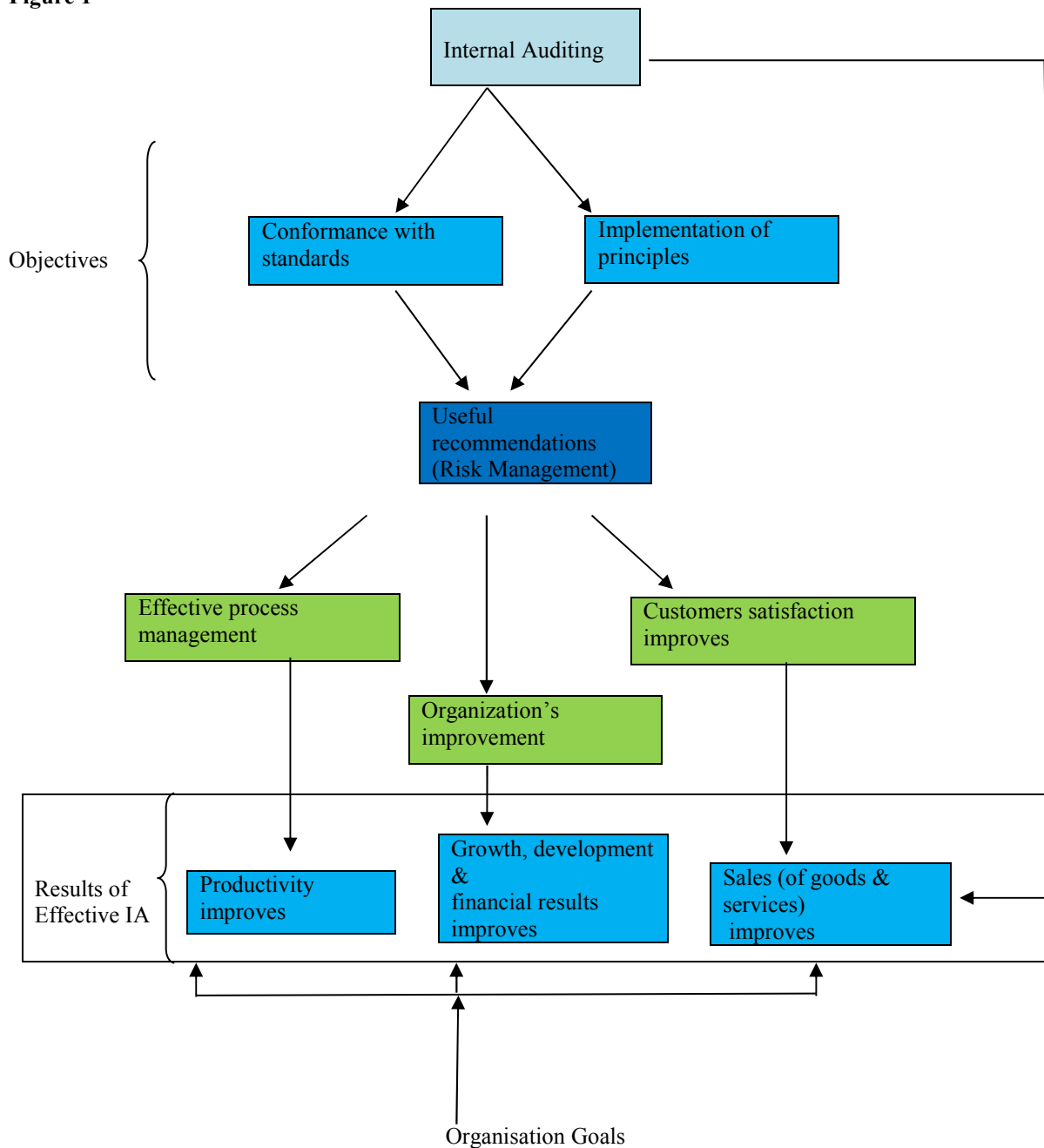
Q1- Factors	Words Frequencies			
	Director Internal Auditor	Joint Director Internal Auditor	Assistant Director	Internal Auditor
Review & control	2 time	1 time	1 time	1 time
Add value and operation	1 times	2 time	2 time	1 time
Reduce losses and achieve goals	1 times	1 times	1 times	2 times
Q2- Factors				
Risk management and internal control	2 time	2 time	2 time	2 time
Q3 - Factors				
Corporate goals	1 time	1 time	1 time	2 time
Fraud detection	1 time	0 time	0 time	2 time

Table 3
Link Table

Respondents	Q1 (source-to-end)	Q2 (source-to-end)	Q3 (source-to-end)
Director Internal Auditor	Control-transparency	Reliability-useful information and reporting	Laws and regulation-effectiveness and efficiency
Joint Director Internal Auditor	Adding value-improve operations	Risk management-control and governance	Operations-achieve goals
Assistant Director	Adding value-improve operations	Risk management-control and governance	Operations-achieve goals
Internal Auditor	Review-fraud detection	Internal operation-control weaknesses	Losses prevention-goals achievement

Internal auditing determined the organization's procedures and improved organization's processes. Good internal audits not only decrease external auditing involvement, improve effective processes and also increase the productivity of an organization's. Internal audit not only play role in income increasing and decreasing product cost but also improve the profitability and satisfaction of owner or shareholders.

Figure 1



(Explanatory Model)

4. Discussion and Analysis

An organization compliance with the internal auditing standards not only makes an effective internal control system but also lead the organization to achieve its ultimate objectives. An internal audit basic activity is to review and evaluate the internal control system and the quality of performance carries for assigning responsibilities. It also review effectiveness of the internal control system is to find out whether the internal control system is functioning well as it is intended to do or not. The system is called to be effective, if the system provides reasonable assurance that the organization's goals and objectives will be achieved. Internal auditing plays their role in risk management, corporate governance and internal control not only but also providing consultancy and insurance services to the executives.

Previously internal auditors were responsible for enterprise risk management and later on it is broaden. Internal audit classify areas to enhance risk management procedures. Internal control process adopted by directors and management of organization in order to provide assurance about attainment of organization's objectives, financial reporting, compliance with the stated rules and regulations; and provides strong internal

controls system for reviewing and monitoring mechanism. Most of the organizations are looking towards maximization of their profit. But some organizations in today's business world are focusing on other factors along with profit maximization i.e. to improve organization's sale growth, innovations, and diversification of risks. Some of the organizations are focusing on the management cohesiveness, rather than profit maximizations and thus it helps in effective decisions making. Most of the complex firms normally follow set of goals rather than a single goal, like profit maximization and thus it is connected to the firm philosophy.

Internal audit improve organization's operations and ensures reliability and integrity of financial and other operating information to the management and shareholders. During internal auditing, internal auditors provide valuable recommendations on weak areas to improve organization's operations, because they have better understanding of the internal control weaknesses. Almost all internal controls inherent weaknesses, no matter how well they are designed. Auditor's independence is one of the most important factors for good internal audit and without auditor's independence they can't provide a true and fair report. The internal auditor is directly reportable to the board of directors and is hence the true representative of the shareholders and his recommendations give an independent opinion about the state of affairs of the company. In internal audit organization's methods and procedures are more determined, which not only improves organization's processes but also decreased scrap and rework processes. Furthermore, it improves profitability and satisfaction of shareholders.

5 Conclusion

The purpose of my paper was to investigate that how the internal audit plays their role in organization goals achievement. The theoretical model shows the role of internal audit in organization's goals. The paper demonstrates that for an organization to achieve its goals, efficient performance of the management and internal audit department is required. Because the management objectives are connected to the organization objectives and the internal audit objective can also be connected to the organization's objectives.

Based on the theoretical explained relationship of internal audit and organization's goals, I developed an explanatory model (diagram 1), which shows the role of internal audit in organization's goals achievement in the case of Security of Exchange Commission of Pakistan (SECP). The effective internal audit shows the positive results (i.e. productivity improves; growth, development and financial results improves; and sales improves) which are the ultimate goals of organizations. Internal auditing could be used as a mechanism of internal control, risk management and internal governance. No gap existing between organisation goals and internal audit. Finally, it is concluded that internal auditing not only plays positive role in organization's goals but also improve organization's efficiencies.

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