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Original scientific paper

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THE ROLE OF INTERNAL AUDIT IN RISK MANAGEMENT SYSTEM OF THE COMPANIES

Abstract

Taking into consideration the need and the requirements of the management, as well as the structure and the size of the company and its business, there are differences in the internal audit as well. Except the analysis of the accounting data, the verification for compliance with the law, detecting errors and illegal operations, the internal audit is increasingly directed towards the process of risk management to meet the demands of the business uncertainty and to enable the management for appropriate business decision making.

The subject of the research is the role of the internal audit in the risk management of a company, while **the purpose** of the research is to examine and evaluate the contribution of the internal audit in the management of risks in the Macedonian enterprises. For these purposes, a research was conducted in 30 Macedonian enterprises during which their managers / heads were surveyed as well as 48 internal auditors on the territory the Republic of Macedonia. The research has led to the conclusion that internal audit has a significant impact on improving the quality in the process of risk management.

Key words: risk management, internal audit, contribution, operation scope, responsibility.

JEL classification: M4, M41, M42, M48

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Introduction

The need for organizing internal audit in the enterprise is designed for unstable operating environment, growth and development of the enterprise, business risks that the company faces with and many other factors. The task of the internal audit is an examination of the business transactions and evaluation of the realization of the set plans and objectives i.e. an evaluation of the system for internal control and management in order to improve the operation of the enterprise. The internal audit must be conducted in an independent and objective manner. Depending on the organizational positioning in the enterprise, the quality of work of internal audit is different. According to the International Standards of the Professional Practice on the Institute of Internal Auditors, the internal audit should be organized independently, out of the business functions in order to ensure full independence of the internal audit in determining the scope of activities, work performance and result announcement. The internal audit has a particularly important role in the risk management of enterprises with which this work is going to continue to deal with and for which purpose an empirical research in Macedonian companies was conducted.

1. Approach and operation scope of internal audit in enterprises

Managing in the process of internal audit contributes to more efficient decision-making and because of that the areas of operation should be as broad as possible despite the examination of the accounting data which include checking the compliance with the law, evaluation of financial risks, detection of criminal activities and mistakes etc. However, depending on the needs and the requirements of management, as well as the structure and size of the enterprise, the scope of the internal audit is different. The internal audit usually performs one or more of the following activities: a review of the accounting system and the systems of the internal controls; examination of the financial and business information (identification, estimation, classification and reporting on those information); examination of the efficiency, effectiveness and economy of the business decisions; examination of the compliance with the law and professional regulations, as well as the policy management. In order to respond effectively to the demands of the management, the internal audit uses different approaches in the implementation of the

activities. To impose the pace of work, the uncertainty and the size of the business operations, the internal audit leads to selecting a suitable approach for a certain area of operation. The internal audit can use the following approaches:

- The approach overcorrections refers to the reviewed documentation based on which the business events are recorded and financial statements are compiled, overcorrections by the internal audit (eg. overcorrections of the inventory in the enterprise).
- The approach verification requires a review of the financial statements and all the business activities as well as determining the compliance with the established standards and procedures.
- The system approach is based on the synthesis and the upgrade of the previous two approaches, and can be applied to all the activities of the internal audit. It implies assessing of the officially established system based on the remarks of the internal audit or the examination of the employees. After that the system approach determines whether the established system is functioning correctly by conducting various tests, questionnaires and similar. Finally, based on the reports of the internal audit a comparison with the previously performed internal control is carried out, with which the function of the internal controls themselves is also examined, as well as the disadvantages and weaknesses of the established systems.
- The cyclic approach refers to the classification of transactions within a certain cycle and requires knowledge of the flow of transactions and the ways of controlling.
- The approach for risk assessment is an approach which is increasingly used as a consequence of the turbulent operation full with uncertainties and dangers. Adapting to the modern way of working, the internal audit evaluates all the risks of the operation in the enterprise and provides an advisory role in managing and reducing the risks for a smooth operation of the enterprise.
- The matrix approach uses a tabular view of the important decisions, solutions and possibilities for choice which ensure visibility and comparability.

The application of the above given approaches provides the internal audit a proper assessment of the business activities, as well as a guidance for further action in order to increase the additional value and to improve the operation of the enterprise.

2. Internal audit in the process of risk management in enterprises

The complex environment in which the enterprise operates requires an analysis of the previous and current condition as well as a prediction of the future movements. Whether the enterprise will successfully realize the set goals in the changed operating environment, will seize new opportunities for achieving additional value and will avoid potential hazards that are present on the markets depends on the risk management of the company. The internal audit directs more towards the risk management process in order to ensure that the management brings appropriate business decisions. In fact, it is necessary to understand the risk as a potential danger that could endanger the implementation of the set plans. However, if it is identified on time, except that it can be removed or at least mitigate the negative effect, sometimes the potential danger can turn into a competitive advantage which leads to additional profits. Risk management has become essential in modern business. The existence of a process for risk management is separated from the establishment of the internal audit in the enterprise, which means that enterprises that do not have organized internal audit can manage risk. The internal audit is present in risk management through examining the process used for risk management in order to reduce risk at a level acceptable for the company.

After the goals set by the management, the internal audit identifies all risks that are a threat to the operation of the enterprise. Determining the level of risk that is acceptable for the enterprise is an obligation and responsibility of the management, while internal audit provides useful information and suggestions which help the management in decision making. The main role of the internal audit in the risk management of the enterprise refers to the following activities: "providing assurance for the processes of risk management, providing assurance for the regularity of the risk assessment, evaluation of the process for risk management, evaluation of the reports on key risks and evaluation of the method for managing key risks." If the established processes for risk management do not identify, evaluate and manage risk in an appropriate and efficient manner, the secondary role of the internal audit is found in providing advice and recommendations to the management regarding the identification and evaluation of risks, improvement of the process for risk management, proposing a strategy for risk management and similar. Under no circumstances the internal

audit should make decisions on risk management independently, or take responsibility for it. The enterprise management is the one that determines which strategy the company will use to defend against potential risks for which it bears responsibility.

3. Stages of the process for risk management in enterprises

The process of risk management starts with identification of the risk. During the identification of the risk, the internal audit includes an analysis of the risks that can affect the value of the enterprise, no matter whether it is from a physical, financial, human or non-material value. Then, the internal audit needs to analyze the environment which can affect the fulfillment of the given operations and assess the risk of fraud or accident, with which also contributes to the creation of plans to prevent crime. The conditions for the second and the third step of the process for risk management is the identification of the risk, after which it is necessary to measure the risk. In order the internal audit and the management to know what the defined risk specifically means for the enterprise, a measurement of the risk of certain methods is conducted (direct evaluation of probability, risk factors, weighted matrix, etc.). The measured risk needs to be ranked in order the management to plan business activities on whose realization the defined risk impacts. The systematization of the risk can be done in three ways: absolute systematization which involves classifying risks according to the size; relative systematization which groups risks in low, medium and high risks, and the matrix systematization which places the greatest risk at the top and the components of the control unit at the sides. Although there is no universal solution for effective risk management, it is required a knowledge in a phase of the process of risk management, methods and techniques of risk management, communication skills, interviewing and objective analysis from the internal audit. Thus it is contributed to reducing the risk on a level acceptable to the enterprise through an appropriate set process for risk management.

4. Results

In 2014 a research was conducted on a total of 30 companies and 48 internal auditors in the Republic of Macedonia. The following table

gives an overview of the activities of the internal audit on the enterprises which were analyzed.

Table 1: Activities of internal audit

Activities of internal audit	Percent	Rank
Assessment of the performance (operation) of the enterprise	88.9%	1
Assessment of the compliance with the law	75.1%	2
Assessment of the financial risks	71.6%	3
Detection of errors and illegal activities	71.2%	4
Assessment of the effectiveness of the internal control system	68.8%	5
Contributions to Corporate Governance	44.5%	13

Source: Author's research.

According to results of the survey, a total of 88.9% of enterprises think that the most important activity of internal audit is the assessment of the enterprise operation. According to the importance the following activities are given: activities for assessment of the compliance with the law (75.1%), assessment of the financial risk (71.6%), detection of errors and illegal activities (71.2%) and assessment of the effectiveness of the system for internal control (68.8%).

To test the existence of differences in views of the respondents from the Macedonian enterprises, average scores for each category of respondents are calculated (managers of enterprises and internal auditors) in terms of contribution of the internal audit to the quality of the process for managing the risks of the enterprise. In this survey the Likert scale was applied.

Table 2: Average assessment of the respondents for the contribution of the internal audit in the quality of the process for risks management.

Group of respondents		F	As	Sd
Contribution of the internal audit in the quality of the process for risks management	Internal auditor	48	3,81	0,842
	Manager	30	3,93	0,907

Source: Author's research.

The arithmetic mean, or the average assessment of the internal auditors is 3.81 with a value of a standard deviation $sd = 0.842$, and the arithmetic value of the managers is 3.93, with a value of a standard

deviation of 0.907. In order to test the differences of the average estimations of the respondents a t-test for independent samples is applied.

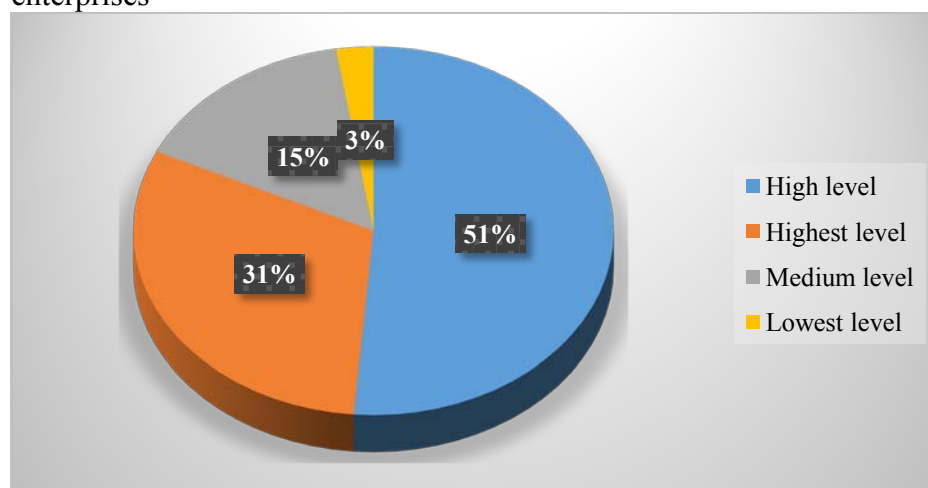
Table 3: Testing differences in average assessments of the respondents for the contribution of the internal audit on the quality of the process for risk management - t-test for independent samples

	Levand test for equality of variance		T-test for equality of arithmetic means						
	f	Sig	t	df	Sig (2-way)	Difference of AS	Standard error of differences	95% interval of confidence of differences	
								Up	Down
Assumption for equal variances	0,032	0,858	-0,599	76	0,551	-0,121	0,202	-0,523	0,281
Assumption for unequal variances			-0,588	58,215	0,559	-0,121	0,205	-0,532	0,290

Source: Author's research.

According to the given results (see Table 3), with an assumption for an equal variance, the value of the empirical $t = -0.559$, for an empirical difference of significance of 0.551 (bigger than 0.05). Hence, we can conclude that the average assessment of the respondents has no statistically significant difference. So considering that, it can be pointed out that all of the respondents from the research sample believe that internal audit significantly contributes to the quality in the process of risk management in enterprises.

Chart 1: Involvement of the internal audit in the activities for risk assessment as a phase of the process for risk management and internal audit contribution to the quality of the process for risk management in enterprises



Source: Author's research.

Aimed at respondents' attitudes about the involvement of the internal audit in the activities for risk assessment as a phase of a process for risk management and an internal audit contribution to the quality of the process of risk management in the enterprises, the following conclusions have been drawn: respondents in whose enterprises there is an active involvement of the Internal Audit Department in the risks assessment, as a phase of an overall process of risk management, consider that the internal audit significantly contributes to the quality of risk management taking also into account that more than half (51.3%) consider that internal audit contributes on a high level to the quality in the process, 30.8% believe that the contribution is on the maximum level. Smaller proportion of respondents (15.4%) believe that the internal audit

contributes to this process of a medium level, while only 2.5% believe that the impact of internal audit is insignificant.

Conclusion

In every day operations the Macedonian enterprises are exposed to numerous risks. The objectivity and the independence of the work of the internal audit among other things, depends on the organizational positioning of the internal audit in the enterprise. The risk management in the enterprises is considered as a necessary "tool" in the process of their survival. The research of the role of internal audit in the risk management in the enterprises occurs as a result of the involvement of internal audit in the activities for risk management in the enterprises, i.e. on the process of internal audit itself. The responsibility of the internal audit refers only to express the opinion on the effectiveness of the applied method for risk management, while the establishment of a process for managing risks as well as making decisions regarding the elimination of the disadvantages and improvement of the process of risk management, is a responsibility for the management. The survey included a total of 78 respondents, internal auditors and managers. According to the conducted survey it can be pointed out that internal audit can significantly contribute to improving the quality in the process for risk management of companies, and therefore its role has greatly influenced the overall operation of the Macedonian enterprises.

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