THE NATURE OF INTERNAL AUDIT AND ITS RELATIONSHIP WITH THE INTERNAL CONTROL SYSTEM

Isroilov I.
NamTSU PhD student
https://doi.org/10.5281/zenodo.15298381

Abstract

In this article, the essence of internal audit, its role in the implementation of economic activities and the interrelationship of internal audit with the internal control system are discussed.

Keywords: internal audit, internal control, economic entities, financial condition, stability, income, strategy, costs.

Introduction. Currently, the direction of internal audit is actively developing all over the world. In many countries, internal audit is widespread in various areas of economic activity. Instead of using consulting services or outsourcing the same tasks, companies prefer to have their own structural units whose main task is to conduct internal audits.

A number of advantages of internal audit allow to focus the attention of entrepreneurs and public sector employees of Uzbekistan on this type of activity. Interest in this field is growing. Because internal audit is a cheap and effective resource that allows to increase the efficiency of the enterprise with minimal risks. Nevertheless, the field of internal audit is still not paid enough attention, as a result of which its distribution in Uzbekistan is not at the required level.

However, modern economic conditions lead to the active development of internal audit, proving once again that it is one of the crucial tasks of any organization. Uzbek companies are not only becoming a part of the world market and economic processes, but also establishing new international relations. Accordingly, the activities of companies focused on integration into global processes must comply with certain requirements and standards, with a strong focus on internal audit.

Analysis of literature on the topic.

In the COSO model, internal control and internal audit are distinguished. "Internal control is a process carried out by the highest policy-making body of the enterprise, senior management and all other employees, which adequately and reasonably ensures that the enterprise achieves the following goals:

1. Expediency and financial efficiency of activity (including preservation of assets).
2. Reliability of financial statements.
3. Compliance with legal and regulatory requirements"[1].

Internal control is "a process aimed at achieving the company's goals and is the result of the management's efforts to plan, organize, and monitor the activities of the entire company and its individual units"[1].

Internal control "includes" all the operational activities of the organization, helps to achieve the goals of the business entity as much as possible. Internal control in the enterprise constitutes a specific system.

Internal control is a process organized and carried out by the owners, management, as well as other employees of the audited object to ensure sufficient confidence in the achievement of goals in terms of the effectiveness and efficiency of business operations and the compliance with regulatory legal documents of the audited entity's activities in terms of the reliability of financial (accounting) reports. This means that the organization and operation of the internal control system is aimed at eliminating any risks of economic activity that threaten the achievement of one of these goals.

If we turn our attention to the analysis of economic literature, we can see that there are different views on internal audit.

According to american scientists E.A. Arens and J.K. Lobbeck, internal audit is an audit that provides management with valuable information to make decisions about the effective operation of the "business". [2].

K. B. Akhmedyanov, one of the economists of our country, says that "Internal audit is an independent system that helps economic entities to achieve the goals set on the basis of risk management, control and an acceptable approach to the corporate governance system, and provides objective guarantees and advice aimed at increasing the efficiency of financial economic activity." [3]

One of our economists, S.U. Mehmonov, paying special attention to the characteristics of budget organizations, defined the internal audit as follows, i.e. "Internal audit is an activity aimed at verifying compliance with legislation and monitoring the preparation and implementation of estimates by the organization, ensuring the reliability of financial reporting data, compliance with budget-estimate discipline, targeted and rational spending of funds".[4]

The analysis of the above definitions allows us to emphasize that internal audit contains a certain dualism, which, on the one hand, internal audit should be a mechanism for evaluating and analyzing the internal control system, and on the other hand, it should serve the purposes of improving the effectiveness of the internal control system. On the other hand, internal audit is a part of the internal control system.

Based on the conducted research, the author's definition of internal audit was developed, in which *three main principles of internal audit are taken into account: corporate governance, business process efficiency and risk management.*

Internal audit is an activity conducted within an organization to serve the interests of the owners and management. It is regulated by internal documents and involves monitoring and analyzing all aspects of business activities for compliance with current legislation. The purpose is to improve the internal control system, assess effectiveness, and develop recommendations aimed at reducing risks to an acceptable level based on audit results. Additionally, it includes consulting with employees on business matters within the scope of the auditor's authority.

Research methodology.

Our study was conducted with the aim of improving the internal audit, and tasks for the organization and improvement of the internal audit were determined. In the course of research, conclusions and proposals were developed using methods such as comparison of practical materials and statistics.

Analysis and results

Audit is closely related to internal control. Initially, internal control appeared in North America and Europe. The rapid development and spread of internal audit and internal control around the world also happened due to the unscrupulous approach of some external audit professionals to their profession. We all know the scandals that have taken place in the matter of submitting false audit reports or concluding dubious contracts for the provision of auditing services. For example,in 2011, tenders were held for the provision of audit services to Vneshekonombank, Rosselkhozbank, and " Yaku ts k e nergo " JSC.

Audit organizations that offered 13-16% of the initial price won each of them"[7]. In this case, it can be considered that audit services were provided in low quality due to the fact that the service price was deliberately lowered. The goals of such an audit will not be clear from the point of view of objectivity and efficiency, as it is carried out in the interests of the audited entity.

As another confirmation of the fact that the external audit does not carry out its activities in good faith, the following analytical research of the Bloomberg agency can be cited:

"Since 1996, there have been 673 major bankruptcies in the West, and in 54% of cases, auditors gave positive conclusions about the condition of insolvent companies before the bankruptcy" [8].

This research data proves that even the "Big Four" international audit firms have provided a biased opinion for large sums of money without adhering to the principle of impartiality in the audit of large companies.

Undoubtedly, the development of internal control and audit was motivated by the loss of assets of business entities. Therefore, they must be objective and independent in assessing the financial condition of the economic entity, especially large business representatives. The regulation that had a significant impact on the development of internal control is the "Integrated Internal Control Concept". This concept is also referred to as the COSO model for short, or the COSO model, which was developed in 1992 by the Committee of Sponsoring Organizations of the Treadway Commission.

According to the COSO framework, internal control is a process carried out by the board of directors (i.e., the company owners), management (senior executives), and other employees of the company. Its purpose is to ensure the reliability of financial reporting, compliance with legal requirements and regulatory bodies, and, in addition, to ensure the rationality and efficiency of the company's business activities.

The main aspect of the COSO model is that the implementation of internal control is the responsibility of the management of the business entity. The COSO model assumes that the internal control system is not an end in itself and is a mechanism that helps the economic entity achieve its goals . Any employee of the company is a part of the internal control system, so its effectiveness directly depends not only on internal rules and methods, but also on employees working at all levels of the team.

It would be a mistake to think that the creation and implementation of an effective internal control system in the company is an absolute guarantee that protects the business entity from various risks. Owners and management of an economic entity should remember that internal control can provide sufficient assurance, but never achieve absolute results .

It should be noted that internal control and audit ensure the achievement of a specified goal or several goals in the relevant areas of activity. But this type of activity cannot cover the entire spectrum of business processes in large companies. The COSO model later served as a basis for revising new international auditing standards. Because many new requirements have been imposed on auditors working in the field of external audit . One of the ways out of this situation is to strengthen the interaction between the internal control system and the external audit . External auditors are assigned the task of evaluating the quality of internal control in the enterprise. In addition, external auditors should find an answer to the question whether the internal control system in the enterprise prevents serious errors in accounting (financial) reports.

Today, COSO strives to develop a variety of rules, recommendations, and guidelines to manage risks, improve internal controls, and eliminate various forms of fraud and theft. Based on the set goals, the COSO model is being developed in the following directions:

1. Management of operational activities.
2. Internal control.
3. Enterprise risk management.
4. Prevention of various frauds in the preparation of financial reports.

In addition, special attention should be paid to the Sarbanes-Oxley law, which is widely used in the assessment of legislation regulating the field of internal control and auditing in the West. This legislation was adopted in the United States of America on July 30, 2002 and applies to public limited liability companies. This piece of legislation resonated for America because it significantly changed and tightened federal securities laws for the first time in sixty years.

Another important aspect to consider is the introduction of the term "Audit Committee." This refers to a committee (or equivalent body) established by the board of directors of the issuer from among its members to oversee the rules and procedures for maintaining accounting records and preparing financial statements of the issuer. Additionally, the committee is responsible for conducting an audit of the issuer's financial statements or the full board of directors of the issuer (if no such committee exists within the issuer's structure).

The main task of the committee is to supervise the preparation of financial statements, to check compliance with accounting principles and internal control processes. In addition, the selection of the auditing company and monitoring of their activities is also the task of the committee.

The activity of the committee is directly related to the internal audit department, because in order to achieve the set goals, a part of the authority should be transferred to an independent and objective structural unit of the organization.

One of the main provisions of the Sarbanes-Oxley Act regarding internal control and auditing is Section 404, Management's Evaluation of Internal Control.

The main issue in this section is the obligation to include internal reports of the enterprise in the annual report of the joint-stock company. According to him, the managers of the economic entity are maximally responsible for the implementation of internal control procedures, which, in turn, serves to improve the effective management system.

This section sets out the necessary provisions for the annual report on internal control prepared for the company's management. These provisions include "management's responsibility for establishing and maintaining appropriate internal control systems and procedures over financial reporting" and "assessing the effectiveness of the issuer's internal control systems and procedures over the most recent fiscal year-end financial statements issued by the issuer."[9]

At the initial stage, companies want to solve the following problems with the help of the internal audit department:

1. Increasing the efficiency of the enterprise.
2. Optimization of business processes.
3. Formation of objective information about the state of the legal entity for the owners.
4. Increasing the investment attractiveness of legal entities .
5. Identification of risks in the activity of a legal entity and formation of methods of reducing these risks.

The next step is to clarify the relationship between internal audit and internal control. The concept of internal control is widely covered in current regulatory documents. Therefore, it is important to address the following questions: Is audit considered part of the internal control system, or is it a separate form of control within the enterprise? Are the concepts of internal control and internal audit synonymous? Finding answers to these questions is of significant importance.

Analysis.

The internal control system is represented by organizational structures, methods and various procedures used by all employees. Thus, each employee can affect the effectiveness of the entity .

Creating a reasonable and effective internal control system in the enterprise depends on the following factors:

1. Organizational-legal form of the enterprise.
2. Network affiliation.
3. Form of ownership.
4. Enterprise size.
5. Specific features of the legal entity structure.

Organization of the internal control system in the enterprise is a very complex and interesting process. It is necessary to take into account the factors that make it possible to create a rational, reliable and efficient system. The creation and organization of the internal control system is part of the authority of management of economic entities.

In order to achieve the economic stability of the company, it is necessary to pay attention to the fact that the internal control system should be organized in such a way as to respond to deviations and errors in a timely manner and allow them to be eliminated as much as possible. Otherwise, widespread continuous control over the activity of each employee, each process will not give a positive result, but will lead to the consumption of additional resources and will lead to the deterioration of the psychological environment in the team.

The feasibility of creating and implementing internal control in the enterprise should be compared with the costs of its organization and implementation.

The creation of an internal control system implies that the control function in the enterprise is performed not only by a specific structural unit or a responsible person (depending on the criteria listed above), but by each employee in accordance with his powers and work duties.

The internal control system consists of the following elements :

1. Management environment.
2. The process of risk assessment by the person conducting the audit.
3. Information system (including the preparation of financial (accounting) reports);
4. Control flows.
5. Monitoring of management tools.

Based on the above, the internal control system can be viewed as a system that allows the employees of the economic entity to achieve their goals using the necessary methods and procedures.

The interaction of internal audit and internal control system is shown in Figure 1.

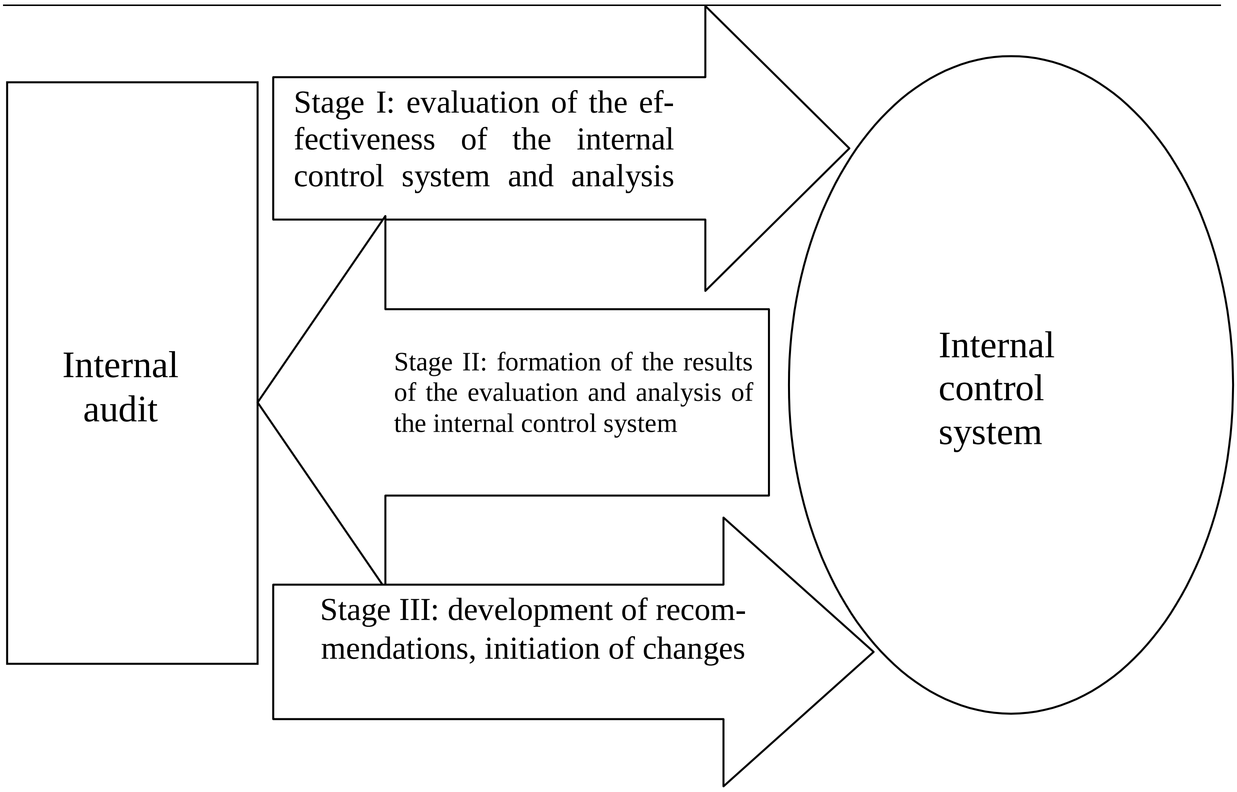

***Figure 1** . The interaction of internal audit and internal control system in assessing the reliability and effectiveness of the internal control system (compiled by the author).*

Conclusions and suggestions.

The need for an internal audit system is related to the fact that this activity allows you to identify risks and initiate various changes aimed at improving efficiency within the organization. The need for such changes may be related to the results of an internal audit or an assessment of the internal control system.

The second important task of the internal audit system, which is directly related to the internal control system in the enterprise, is to organize control in order to prevent the loss of the organization's assets. As mentioned above, every employee participates in the internal control system in one way or another. In this regard, there is a risk of bias in conducting control measures. Therefore, the presence of an independent department or employee in the organizational structure that evaluates the internal control system and conducts audits according to the instructions of the management or owners allows to reduce this risk to an acceptable and acceptable value.

The internal audit system also serves to form the investment attractiveness of a legal entity. Carrying out control activities aimed at identifying various inconsistencies with the current legislation, reducing risks to an acceptable level on the eve of external audits and other inspections, providing advice to employees of other structural units are activities that allow indirect investment attraction.

In addition to control and analytical functions, the internal audit system can also perform information and advisory functions. This means giving advice to employees of all structural units and heads of organizations on issues within the competence of internal auditors. For example, finance, economics, tax, etc. advice is given in the field.

Conducting an internal audit is an activity directly related to the functions of the internal control system. Its purpose is to confirm the reliability of financial reports, to identify violations in the financial and economic activity of a legal entity, to identify the guilty persons and the reasons that led to errors, and to formulate relevant recommendations and various proposals that allow to eliminate the identified violations or minimize the risks .

It is worth noting that the involvement of organizations whose main activity is related to external audit in the assessment of the effectiveness and reliability of the internal control system may lead to conflicts in the future.

By performing this function, internal audit indirectly solves the problem of establishing the most reasonable and optimal system of internal control in the enterprise. It should be noted that the creation of an internal control system is the task of managers of a legal entity. If there is an existing system in place, the internal audit service should focus on evaluating efficiency and reliability. When errors and malfunctions are detected in the system, it is necessary to optimize its operation as much as possible by identifying the causes. Duties include developing recommendations and making proposals for various system changes.

In this way, the relationship between internal audit and internal control system was established. It was found that depending on the functions and tasks performed, the internal audit may have different proportions with the internal control system of the business entity.

References:

1. Internal audit/ Zminko S.I., Shvyryova O.I., Safonova M.F. - Rostov n/D: Phoenix, 2008. - 316, [2] p.: il. – (Vysshee obrazovanie).

2. Arens A., Lobbeck Dj. Audit: Per s Engl.-M.: Finansy i statistika 1995g., p.212.

3. Akhmedyanov K.B. Improvement of internal audit methodology in economic entities. Dissertation written for obtaining the scientific degree of Doctor of Economic Sciences. - Tashkent 2016. - 32 pages.

4. Mehmanov S.U. Improvement of accounting and internal audit methodology in budget organizations. Dissertation written for the degree of Doctor of Economics. - Tashkent 2018. - 55 pages.

5.https www theiia.org The Institute of Internal Auditors.

6.https www aasb.com International Auditing and Assurance FirmThe Standards Board.

7. Chernenko A.F., Sumkin A.S. Formirovanie stoimosti uslug audita// Mejdunarodnyy bukhgalterskiy uchet. - 2012. - No. 8. - S. 41-51.

8. Aganina R.N. Pravovoe regulirovanie auditorskoy deyatelnosti v RF: dissertation kand. walk Nauk: 12.00.03 /Aganina Renata Nadimovna.- M., 2009.- 184 p.

9. Sarbanes-Oxley Act of 2002. Corporate responsibility. [Electronic resource] – URL: http://www.sec.gov/about/laws/soa2002.pdf