Study on the Positioning of Internal Audit Function Under Corporate Governance

Yushen Ma

Department of Accounting, Business School, Shandong University of Technology, Zibo, China

Email address: sdutmys@163.com


1. Introduction

Internal audit develops with the rapid development of economy. The traditional internal audit is generally positioned to serve the management, which determines the audit function, audit content and audit scope are greatly limited. With the continuous strengthening of corporate governance by modern enterprises, the goal of internal audit is gradually consistent with that of corporate governance: to increase the value of the organization [1]. This has led to changes in the internal audit function, audit content and audit scope, which need to be continually and reasonably expanded on the basis of the traditional audit function, audit content and audit objectives. The transformation of the internal audit function from a traditional oversight function to a service function of evaluation, advice and support for decision-making [2]. The expansion of the scope of internal audit is manifested in the comprehensive coverage of audit content. The tentacles of internal audit must extend to all aspects within the enterprise and the scope of internal audit should cover all aspects of the enterprise's economic activities [3].

The international operation of enterprises makes more and more enterprises, especially many listed companies, begin to participate in international economic cooperation and competition on a larger scale and in a deeper degree. Risk management has gradually become the focus of corporate governance and corporate governance has changed from a static control mode to a dynamic mode of constantly preventing various risks. An effective internal audit system is conducive to the improvement of corporate governance. Internal audit plays a very important role in internal control,
risk management and corporate governance [4-5].

Corporate governance mechanism is the core of a modern enterprise system. The effective operation of a modern enterprise system requires standardised corporate governance as a prerequisite, and an effective internal audit system is conducive to the improvement of corporate governance in enterprises. With the continuous development of corporate governance theories and practices, internal audit theories and practices have also undergone significant changes. The functional scope of internal audit has expanded from purely financial audit at the beginning to a series of activities such as review and evaluation, control and risk management throughout all aspects of corporate governance, showing a trend of value-adding. How internal audit can enhance the value-creation capability and serve the value-added of enterprises has become an issue worthy of study. More and more scholars have begun to rethink the positioning of the internal audit function at both the theoretical and practical levels and have attempted to conduct many useful explorations. In order for enterprises to develop steadily and healthily in the long term, company managers should stand in the perspective of achieving corporate governance objectives and give full play to the strategic advisory function, governance control function, risk prevention function and value-adding function of internal audit in the areas of corporate governance, corporate risk management and corporate internal control.

Therefore, to strengthen the study of internal audit theory, promote the development of internal audit, strengthen the internal audit of the company, fully and effectively perform the role of internal audit, prevent risks, improve governance and then add value to the organization is an important subject in front of us, but also has important practical significance. Based on this background and significance, this paper attempts to fully analyse the internal and external dynamics that determine the internal audit function from the perspective of corporate governance and conducts a more in-depth study on the positioning of the modern internal audit function.

2. The Relationship Between Internal Audit and Corporate Governance

Corporate governance is generally defined as a mechanism of supervision and checks and balances between the former and the latter under the separation of ownership and management. The core is to deal with the distribution of rights and interests among various stakeholders, such as large and small shareholders, creditors and the general manager, so as to form an effective multi-party check and balance relationship, thereby creating a harmonious and stable internal environment for the company to achieve smooth operation and overall value appreciation. In fact, corporate governance is a set of procedures for managing and controlling a company, through which a corporate governance framework is organised with the aim of maximising the benefits to the company.

The root cause of corporate governance problems lies in the conflicting interests of the various stakeholders in an enterprise, while good corporate governance provides a channel for the integration of the interests of all parties. An effective corporate governance mechanism is a basic guarantee for the sustainable development of an enterprise. Corporate governance is the separation of ownership and operation. Corporate governance is a system of governance built on ownership, through which the business activities of the company are monitored to ensure that the company's production and operation activities are scientific and effective. Corporate governance requires a balance between all parties, ensuring that the powers enjoyed by each party are fair, while also regulating the obligations that each party needs to fulfill with strict rules for key positions and the need for separation of powers and checks and balances in core positions.

Internal audit and corporate governance are one and the same and internal audit is an important part of successful corporate governance [6-7]. On the one hand, a reasonably effective internal audit is a fundamental requirement of good corporate governance and can maintain checks and balances between shareholders, the board of directors, the supervisory board and corporate governance management. By facilitating the formation of upward and downward communication as well as left-right coordination within the company, the truthfulness and accuracy of corporate disclosure can be ensured and the rights of various stakeholders can be protected to the greatest extent possible. On the other hand, corporate governance is an important guarantee for the implementation of internal audit and for the smooth performance of internal audit [8-10].

From the perspective of organizational structure, the internal audit department is a department existing in the organizational structure of the company but its own independence is relatively obvious. The functions of internal audit include assisting company managers to find out a series of potential problems that may exist in the setting of internal control processes; Identify and control all kinds of risks that may be faced in the internal and external environment of the company based on the whole market level, so as to help the organization minimize losses as much as possible. The functions and responsibilities of internal audit are positioned to promote the achievement of organizational goals, with increasing emphasis on increasing organizational value and improving organizational governance. This means that the functional scope of internal audit has changed from simple financial audit at the beginning to a series of activities such as review and evaluation, control and risk management that run through all aspects of corporate governance, further reveals the new positioning of the value-added functions mentioned therein [11].

The internal audit function enhances the efficiency of the company's operations [12-13] and can help the governance to identify possible problems in the internal control system and to identify and assess the various risks faced by the company,
both internally and externally, from a macro perspective. The function of internal audit can help the governance layer identify the possible problems in the internal control system, and identify and evaluate various risks faced by the internal and external enterprises from a macro perspective. Company managers often make plans and make decisions at the level of overall strategic layout. In these management activities, the internal audit department plays the function of lubricant and adhesive between relevant departments, which can avoid or reduce information asymmetry in the process of departmental collaboration to the maximum extent. Comparatively objective and fair opinions and suggestions are given when enterprise managers make goal decisions, so as to reduce the probability of decision-making errors in work. In addition, internal audit can also help employees form a good professional ethics and quality and promote the company to create a high spirited organizational culture and harmonious working atmosphere, so as to stimulate employees' enthusiasm for work and create more benefits for the company.

Internal audit procedure is an indispensable part of corporate governance. Internal audit is not only a part of corporate governance, but also evaluates and improves the effectiveness of corporate governance procedures. The benign interaction between the two is conducive to the improvement of governance procedures and the increase of organizational value. As corporate governance has become more sophisticated, the function of internal audit has evolved from the initial checking of financial errors and fraud to monitoring and evaluating corporate management, becoming one of the cornerstones of effective corporate governance. For internal audit to better achieve its governance objectives on all fronts, it needs to be involved in the management and arrangement of the company's operations and activities, promoting the transformation of internal audit from a supervisory to a management function. The existence of an internal audit department is conducive to complementing the internal control function of the organisation, improving the internal control activities of the company, providing effective management of risks and improving the corporate governance mechanism.

Internal audit can make use of its unique independency to control the risk of the company, improve the efficiency of corporate governance and improve the process of corporate governance by performing a comprehensive evaluation function, so as to enhance the comprehensive quality and economic benefits of the company and realize the overall value of the company.

3. The Traditional Functions of Internal Audit

Traditional internal auditing is mainly focused on legal compliance auditing, performing compliance checking and effectiveness evaluation functions in corporate governance. Compliance checks are mainly in the area of financial management, while effectiveness evaluations are in the area of operational management.

3.1. Compliance Check Function

Compliance checks include auditing and checking the authenticity and legal compliance of audit objects, etc. Specific reviews include the authenticity of accounting information and legal compliance of financial activities. The compliance checking function, which is the starting point and foundation of internal auditing, is mainly achieved by conducting financial audits, which is still an effective and fundamental audit model. But too much focus on compliance checks can limit the value-added function of internal audit [14].

3.2. Validity Evaluation Function

Effectiveness evaluation includes evaluating the economy, efficiency and effectiveness of the auditee, specifically the effectiveness of operating operations, the effectiveness of management responsibilities, the effectiveness of internal controls, the effectiveness of risk management and the effectiveness of corporate governance. Internal audit is primarily an effectiveness evaluation function through performance audits.

4. Expansion of the Internal Audit Function

4.1. Strategic Advisory Function

On the one hand, Internal audit can act as an advisor in the development of a company's development strategy. On the other hand, carry out direct audits of the implementation of the company's strategy. Internal audit can play an important role in the development and implementation of a company's strategy by taking advantage of its unique independence and supremacy.

4.2. Governance Control Functions

Internal audit is a fundamental synergistic unit of corporate governance and plays a unique role in the corporate governance process, becoming one of the cornerstones of effective corporate governance. Internal audit is both a part of corporate governance and at the same time evaluates and improves the effectiveness of the corporate governance process, providing independent and objective evaluation, advice, services and recommendations on the design and operational effectiveness of the whole process of corporate governance. Internal audit fulfils the governance control function primarily by conducting corporate governance audits.

4.3. System Evaluation Function

The system evaluation function mainly includes business system evaluation, control system evaluation, governance system evaluation and information system evaluation.
Internal audit is uniquely placed to examine and evaluate the performance of a system to determine whether it is operating safely and completely and using the organisation's resources efficiently and effectively to achieve its objectives.

4.4. Risk Prevention Function

Internal audit treats risk management as an audit object. It examines, evaluates and reports on the adequacy and effectiveness of the risk management process. Internal audit provides a systematic and disciplined approach to conducting a series of audits to test risk management information systems, business cycles and related departments, and to evaluate risk management, control and monitoring processes to improve organisational effectiveness and help the organisation achieve its objectives.

5. Analysis of the Drivers That Determine the Internal Audit Function

Internal audit is an important part of the corporate governance system and its determinants are also determined by the needs of the board of directors, supervisory board and senior managers in the corporate governance system. Internal audit is at the service of the enterprise and should be analysed from the perspective of corporate governance to determine what internal audit functions are required by the corporate governance of modern enterprises.

5.1. Intrinsic Determinants of the Internal Audit Function

The essence of internal audit is a special management control in the service of business management. Although internal audit is independent of the business, its objective is to serve the business and add value to the business. Its independence and authority can help the business achieve its objectives by preventing fraud, improving efficiency and adding value to the business.

In the modern society where the trend of economic globalization is becoming more and more obvious, the survival and development of enterprises are facing a more severe market situation. In such a fierce market competition and under the requirements of the corporate governance environment, enterprises need to continuously strengthen their internal management and establish a good internal audit control system to help them achieve their goals. The goal of modern corporate governance is to add value to the company. It is clear that internal auditing must also be aligned with the company's goals. Therefore, the objective of internal audit is to add value to the company, and the core function of internal audit based on corporate governance should undoubtedly be to add value [4].

With the development of the market economy and the advancement of enterprise economic management, the functions of internal audit are constantly expanding. The role of internal audit in business management is mainly to add value to the organisation and improve its operations through independent and objective assurance and consulting activities [2], to provide an objective and comprehensive evaluation of the processes of production and operation, risk management, control and governance, and to take active measures to improve these management activities based on the results of the evaluation, helping the enterprise to achieve various business management objectives.

The Board of Directors and the Supervisory Board are the decision makers and supervisors of the company. Usually they perform the following tasks through internal audit:

Check that the management activities carried out by the company are aimed at adding value to the business and that the work is done with quality and quantity. To examine the financial position, operating performance and cash flows of the company and to review the internal and external financial reports prepared by the company for their truthfulness and reliability. Evaluate the performance evaluation criteria established by the company's Board of Directors and provide the Board with relevant information reflecting management's performance for the purpose of performance evaluation.

Senior management is another component of the corporate governance system and is generally subject only to the direction of the Board of Directors. The core of corporate management is sound design, effective implementation, objective evaluation and the continuous improvement of internal control systems and risk management processes. The company's senior management uses internal audit to effectively implement management controls and to improve economic efficiency with the help of internal audit. This can be broken down into the following sections:

Inspect and evaluate whether the internal control system is sound and reasonable, whether there are matters beyond the scope of control and risk management, and whether fraud has occurred. Emphasis is placed on efficiency and effectiveness in all business activities, improving the efficiency and effectiveness of business activities across departments and the company as a whole, reflecting the value added. Provision of ad hoc and ad hoc consultancy services such as advice on the development and construction of enterprise resource plans to add value to the business at the manager's request [15].

In summary, the needs of the Board, Supervisory Board and senior management for internal audit are focused on the value-adding, evaluation and advisory functions, while its core function is to add value.

5.2. External Determinants of the Internal Audit Function

The external factors that determine the internal audit function lie primarily in the external economic environment. As a result of the dramatic changes in the business environment, various risk factors for the business have increased dramatically. Under the increasing uncertainty of the future business environment, internal audit, as a comprehensive evaluation and monitoring department of enterprise risks, should play a more active role in effectively preventing business risks and improving the sustainable competitiveness of the enterprise [16-17]. Internal audit should continue to maintain its independent organizational...
status in the process of continuous internal restructuring of the enterprise. At the same time, in this context, the senior management of the enterprise urgently needs internal audit to play its independent position and professional competence to work closely on the identification, assessment and prevention of enterprise risks, and effectively address the control risks brought about by the increased span of enterprise operations and the lengthening of the management chain. In the face of these complex and fast-changing risks, the requirements of internal audit are gradually evolving from compliance to management, requiring internal audit not just to "mend the fold" after problems have occurred, but to better prevent and control risks before they occur.

It is easy to see that the internal audit organisation is under unprecedented pressure to survive. To maintain its important position in the ongoing restructuring of the organisation, in addition to doing everything possible to improve the efficiency of internal audit, internal audit must have a significant value of existence. One way to do this is by making "adding value to the business" an objective of the audit.

In the past, internal auditing in enterprises only positioned itself in the role of "supervisor", placing its function in the dual function of supervision and advisory services, with more emphasis on providing advisory services to management based on the performance of its supervisory duties. With the increasing competitive pressure on enterprises, the traditional audit model is no longer suitable for the development of enterprises. For enterprises to grow, the whole enterprise must be run so that all departments aim to add value to the enterprise, and the function of internal audit should be changed from a supervisory one to a value-added one.

Business leaders have recognized the importance of internal auditing, and the function of internal auditing is no longer limited to consulting services, but aims to increase enterprise value and shift the focus of internal auditing work to achieve enterprise value. Internal audit becomes a "partner" of the enterprise, helping the various departments of the enterprise to carry out their work better, auditing the important economic activities of the enterprise, discovering the potential risks of the enterprise in time, helping the enterprise to solve problems, providing reference materials for major decisions of the enterprise and helping the enterprise to find a suitable strategic model for itself. Internal audit can also improve internal controls, help companies improve their risk response capabilities and improve their risk warning systems.

6. Modern Internal Audit Function Orientation

Internal audit is a specific actor in two key governance activities to monitor risks and ensure effective controls. Important areas covered in the internal audit activity include risk management, internal control, corporate governance. In this regard, risk management is the objective, internal control is the means and corporate governance is the content. It is this audit activity with the objective of risk management and effective corporate governance through internal controls that forms the subject of contemporary internal audit. Internal audit, as one of the key subjects of corporate governance, is concerned with governance and has made the evaluation and improvement of the governance process a key function of internal audit.

6.1. The Role of Internal Audit Should Change from a Supervisor to a Controller

Traditionally, internal auditing is considered to be complementary to external auditing, and is usually positioned in the role of "watchdog". The day-to-day oversight by internal audit is an integral part of internal control and the oversight of key controls and procedures by internal audit facilitates the maintenance of the effectiveness of the internal control system. The role of internal audit has essentially changed with the strengthening of corporate governance in modern enterprises, as well as the dramatic changes in the business environment and the sharp increase in various risk factors in enterprises. The primary role of internal audit is to "confirm and recommend" rather than "monitor and review", a shift that gives more substance to internal audit. In the context of the evolution of traditional internal control to risk-based internal control, the internal audit plan is linked to the company's risk management strategy and internal audit uses an analysis of current risks to ensure that its audit plan is aligned with the business plan of the company.

6.2. Internal Audit Should Be Positioned as a Governance Audit

As the requirements for corporate governance in modern enterprises continue to strengthen, the environment for corporate internal control and internal audit is also changing. The requirements of the corporate governance environment have aligned the objectives of internal auditing with the governance objective of adding value, and have led to a new orientation and change in its function, technical approach, content and scope, resulting in the emergence of governance-based internal auditing. Governance internal audit is a risk-based assurance and consulting activity focused on monitoring and evaluating the effectiveness of corporate governance by professionals with a combination of skills to achieve the organisation's value-adding objectives. Internal audit is part of internal control and in turn evaluates the effectiveness of internal control. Internal audit is both part of corporate governance and at the same time involved in auditing the effectiveness of corporate governance. In the corporate governance mechanism, internal audit, through adequate and effective communication with the board of directors, senior management and external audit governance subjects, and through collaboration and interaction with them, to evaluate the basic activities that create direct corporate value, helps to improve operational efficiency and effectiveness, while identifying and improving other
auxiliary activities that create value indirectly, can reduce management costs, improve productivity and enhancing the value of the company while reflecting its own governance effects.

6.3. Internal Audit Should Be Positioned as a Value-added Audit

Internal audit with the objective of adding value is the inevitable orientation of modern internal audit development. Internal audit can add value to an organisation by reviewing internal control systems and risk management processes and by providing recommendations for the establishment and improvement of internal control systems and risk diversification strategies. The objective of corporate governance is to add value to all parties involved in governance. The value-added effect of internal audit at the corporate governance level is to improve the efficiency of corporate governance. The establishment of an internal audit department can bring benefits to a company in improving the efficiency of governance. In measuring the amount of value added by internal audit, we can assess this by considering the combined governance effectiveness of the various internal audit service recipients. This effect is multifaceted, both directly and indirectly; Both short-term and long-term effects; Includes both quantifiable financial metrics and non-quantifiable non-financial impacts.

Internal audit is an important part of the corporate governance system. The value-added function of internal audit has an irreplaceable role in improving corporate governance, helping enterprises to avoid risks, improving their economic efficiency, adding value to enterprises and enabling them to form core competencies.

6.3.1. Increase the Value of Your Business and Improve Your Economic Efficiency

The primary goal of the enterprise is to maximize enterprise value. Internal audit is part of the enterprise, participating in the business management activities of the enterprise. The value-added function of internal audit should also aim to increase the value of the enterprise, which can point out the problems of the enterprise and propose countermeasures to reduce the loss of the enterprise in a timely manner when auditing the business management activities. It is also possible to identify potential risks in business management activities in advance to avoid risks and avoid possible future losses, reducing losses increases the income of the business.

6.3.2. Optimise Risk Management and Improve Risk Control

As enterprises grow larger and their businesses become more diversified and complex, the risks they face become greater, and the value-added function of internal audit, as an important part of enterprise risk management, becomes particularly important. The value-added function of internal audit is based on the interests of the whole enterprise, and can carry out audit activities on various matters of the enterprise to identify the risks in the matters and propose solutions to the risks that exist, so as to nip them in the bud, and can also establish a risk warning system to anticipate the risks and help improve the risk response capability.

6.3.3. Improve Corporate Governance and Increase Efficiency

As part of corporate governance, the value-added function of internal audit requires internal audit to participate in the governance process of the company and to communicate closely with the management of the company. During the execution of the audit, the company's interests are taken as the starting point to assess the possible risks in the operation and management of the enterprise, to check whether the governance of the company is scientific and efficient, and whether the various departments implement the governance objectives of the company. At the same time, the audit results are fed back to the governance level to provide reference for the strategic planning and deployment made by the governance level for the enterprise. At the same time, in the process of auditing the enterprise's operation and management, solutions can be proposed to the problems existing in various departments of the enterprise, strengthening the cooperation between various departments and improving efficiency.

6.3.4. Strengthen the Internal Control of Enterprises and Improve the Internal Control System

Internal audit, as an important part of internal control, has a value-added function that aims to increase the value of the enterprise, from which it participates in the whole process of internal control, evaluates the internal control of the enterprise, participates in the control of the enterprise's business activities, checks whether the control of business activities is scientific and effective and whether it helps to increase the value of the enterprise, proposes corresponding countermeasures to the problems of the enterprise. At the same time it establishes an internal monitoring mechanism and improve the internal control system. Meanwhile, internal auditors can perform audit procedures to complement internal controls, identify problems, improve the internal control system, enhance corporate governance and strengthen risk management capabilities in order to protect company property, increase corporate value and improve corporate competitiveness.

7. Conclusion

With the changing economic environment, in particular the introduction of the concept of corporate governance and the continuous strengthening of fiduciary financial responsibility, the expansion of the internal audit function has been accelerated. Internal audit has gradually expanded from financial audit in a narrow sense to operational audit and management audit including financial and non-financial matters, and internal audit has taken on an active profit-making function. In the new economy of high technology, networks and e-commerce, internal audit will
undergo more significant changes, expanding into an integrated audit that includes risk management and corporate governance, achieving new functions of value addition and better serving corporate governance. While the four traditional functions of internal audit include the supervisory function, the control function, the evaluation function and the advisory function, with the continuous strengthening of corporate governance in modern enterprises, the objectives of internal audit have gradually been aligned with those of corporate governance, i.e. to work towards increasing the value of the company. The main objective of modern corporate governance is to increase the value of the company. For internal audit to be consistent with the company's objectives, its objectives must be set at adding value to the enterprise, so the core function of internal audit based on corporate governance should undoubtedly be to add value.

With the gradual increase in the importance attached to the internal audit function by both the theoretical and practical circles of internal audit, internal audit has gradually risen to the level of corporate governance. To further expand the function of internal audit and develop value-added internal audit, it is important to focus on the positive interactive relationship between internal audit and corporate governance. By sorting out the organisational structure of the company, improving the internal audit management mechanism, forming new ideas on internal audit work and actively expanding the internal audit function, internal audit can play an active role in adding value in corporate governance.

References


