

DEVELOPMENT TRENDS OF INTERNAL AUDIT IN RUSSIA

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Abstract

The article discusses the main results of the development of internal audit in Russia, taking into account national characteristics of the economy. Particular attention is pay to factors affecting the effectiveness of internal audit in Russian companies. The problems of organization and functional subordination of internal audit are highlighted.

Keywords: functional and administrative subordination of the internal audit service, internal audit, organization of the internal audit service

1 INTRODUCTION

The most important condition for the development of any business is to increase its competitiveness. Competitiveness - consists of two main factors - the ability to attract capital on favorable terms and the ability to effectively use the resources available to the organization.

Initially, internal audit arose as an activity ensuring the accuracy of accounting and financial reporting. But today this is not the only and main task created by the Internal Audit Service (hereinafter - IAS).

Referring to the opinion of Robert Montgomery (1872 - 1953) and his book "Audit: Theory and Practice" (1912), which in subsequent editions was called the "Montgomery Audit" [26], distributed in the 18-19 centuries. A detailed audit of the income and expense accounts of financial managers of large farms ended with an oral report from the auditor to the owner. It is important that, according to the conclusions of [3], this audit became the forerunner of modern internal audit. It is interesting that the auditor himself was an employee on the farm, and sometimes was even introduced into the composition of the owners for services.

The evolution of internal audit has been accelerated with the creation of the International Organization for Standardization ISO in 1946 year. This event should be regarded as the most important from the point of view of the beginning of the formation of common international requirements for solving the problems of quality management not only of products, but also of the business management system itself, where audit has a significant place [5]. It is in the ISO standards that the foundation will be laid for the formation of an internal quality control system with its attributes and requirements, which are still relevant for both internal and external audits. Confirmation of this conclusion, we consider the appearance in 1947 year of the first GAAS standards for external audit [1] and the release of the International Fundamentals of Professional Practice of Internal Auditing (IFPP), developed by the International Institute of Internal Auditors (The IIA), which are used by internal auditors around the world their daily work [2].

In Russia, the Institute of Internal Auditors was established only in 2000 year. Currently, the Russian Association Institute of Internal Auditors (hereinafter - IIA) is a professional association of internal auditors,

internal controllers and auditors of Russian companies and organizations. It was created with the aim of popularizing and developing the profession of internal auditor in Russia, promoting the professional development of internal auditors and playing the role of an expert in the field of internal audit.

The number of the Russian IVA Association by 2015 year increased from 35 to 4,000 members [20]. IVA has 12 regional centers formed on the basis of partner organizations in the cities of Yekaterinburg, Kazan, Krasnodar, Krasnoyarsk, Nizhny Novgorod, Novosibirsk, Perm, Samara, St. Petersburg, Tyumen, Ufa and Khabarovsk.

Due to the success of the Russian Association IVA, the profession of internal auditor in Russia has already passed the formation period and has become one of the most attractive for both business and researchers. Therefore, at present, there are various literature on internal audit, in which one can meet various concepts of internal audit, its definition and interpretation. Someone considers internal audit a process subordinate to internal control, or its element, someone - a control or evaluation activity, someone - an activity to ensure the management of quality information, etc. (Table 1).

Table 1. Retrospective of the conceptual characteristics of “internal audit” and its processes

| Sources | Meaning of Judgments |
|---|---|
| Robertson J. [19] | Internal audit is an independent activity to verify and evaluate the organization's work in its interests. The purpose of an internal audit is to help members of the organization perform their functions effectively. Internal auditors submit to their organization analysis and evaluation data, recommendations and other necessary information resulting from the audit. |
| List of terms used in the PSAD [23] | Internal audit - a control system organized at an economic entity in the interests of its owners and regulated by its internal documents that complies with the established accounting procedure and the reliability of the internal control system. Institutions of internal audit include auditors appointed by the owners of an economic entity, audit commissions, internal auditors or groups of internal auditors. |
| Kochenev Yu.Yu. [12] | Internal audit is an element of the internal control system in an enterprise. Internal audit services are created at large enterprises with an extensive network of branches. The tasks of internal audit services may include the following: <ul style="list-style-type: none"> - confirmation of the accuracy of the information provided to management; - control over the condition and safety of assets; - executive control; - assessment of the effectiveness of management, production, financial investments, etc. Internal audit is not independent, it is subordinate to the organization's management, acts in accordance with its task and reports to it. At the same time, the internal audit is independent of those persons whose activities it verifies. |
| Mironova O.A., Azarskaya M.A. [15] | Internal audit is an integral part of enterprise management control. The main task of internal audit is the solution of individual functional management problems, the development and verification of enterprise information systems. |
| «The Institute of Internal Auditors» [22] | Internal audit is the activity of providing independent and objective guarantees and consultations aimed at improving the organization. Internal audit helps the organization achieve its goals using a systematic and consistent approach to assessing and improving the effectiveness of risk management, control and corporate governance processes. |
| IAS 610 [4, paragraph 2, 14 (a)] | The objectives and scope of work of the internal audit service usually include assurance and counseling activities aimed at evaluating and improving the effectiveness of corporate governance, risk management and internal control processes, such as: <ul style="list-style-type: none"> - events related to corporate governance; - activities related to risk management; - activities related to internal control. |

Source: compiled by the authors

From the array of opinions presented in the table, it is clear that modern internal audit is capable of performing various and ambitious tasks and represents an activity related to assessing the reliability and effectiveness of the internal control system (not only financial, but also operational, as well as compliance with policies and procedures), the process of managing the risks faced by the company (for example, in

connection with the offer of new products on the market, the introduction of new information systems, business restructuring, etc.), in the process of operating management.

The recognition of internal audit in Russia is supported by the introduction of regulations for certain industries and business areas: banks [6], [7], insurance [8], [24] and state-owned companies [9], state-owned corporations [10], [11].

The importance of internal audit for Russian business served as a catalyst for this study in the target vector of determining the specifics of realizing the potential of internal audit in Russian conditions.

2 SOURCES AND METHODS

The research was based on the scientific work of Russian scientists, articles by members of the internal audit institute, KPMG analytical reviews, materials from the Association of Certified Fraud Examiners international organization, and personal observations of the authors. The aspects of the development of internal audit in Russia were drawn to the following aspects: the relevance of the work results of internal auditors, the organization of the internal audit system, the functional subordination of the internal audit system, the main difficulties of the work of internal auditors.

3 RESULTS

If the purpose of the external audit is to express the opinion of the auditor on the reliability of the financial statements, then the internal audit is an ongoing process aimed at the future, the task of which is to assist the management of the company in achieving its goals in the most efficient way.

At the same time, the main customers and consumers of the results of the internal audit service of the company are the owners, senior management (Board of Directors), and managers at various levels, Figure 1.

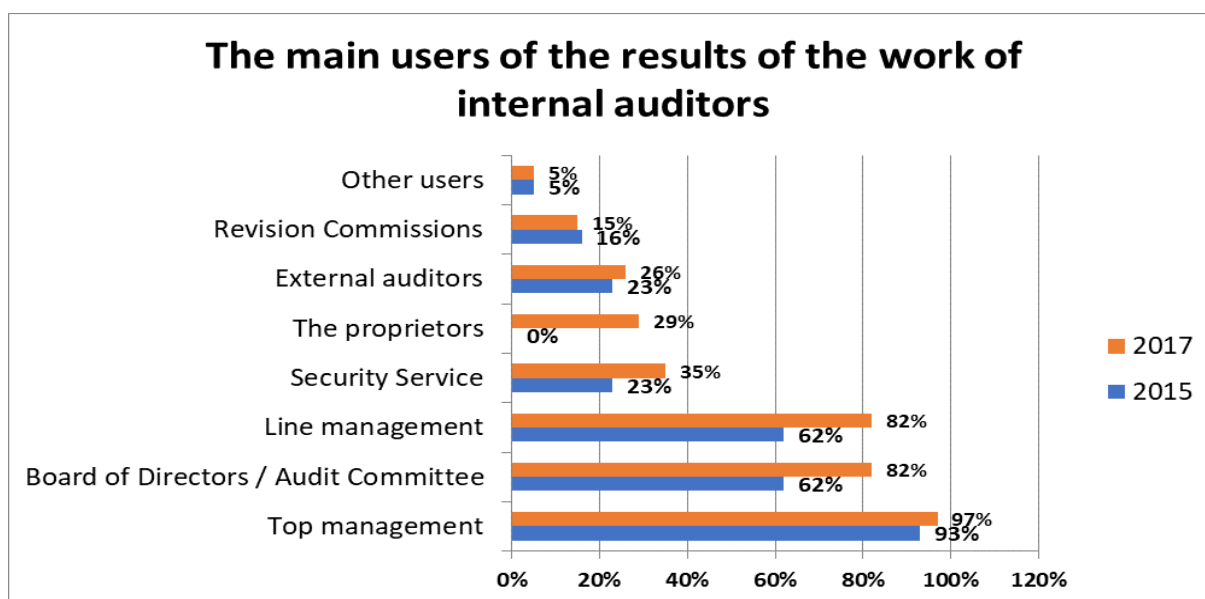


Fig. 1. The main users of the results of the work of internal auditors

Source: compiled by the authors based on [17]

Internal auditors provide protection against errors and abuses, identify “risk areas” and opportunities to eliminate future shortcomings or shortcomings, and help identify and “strengthen” weaknesses in management systems.

All these actions are supplemented by a discussion of problems with company management bodies, the needs and proposals of which determine the internal audit procedures, which are obliged to provide senior managers with wide information regarding the competence of these specialists. The frequency of sending reports of the Internal Audit Service (hereinafter - IAS) of Russian companies [17] to the Board of Directors and other officers varies from 1 time per quarter (47%), more often 1 time per quarter (32%), to 2 times a year (21%).

There are three main approaches to the organization of IAS in a company.

The first approach is to create your own internal audit service.

This option has the following advantages:

- Company employees are well acquainted with its internal culture and features;
- When the audit tasks are performed by full-time employees, the acquired skills and experience remain within the company;
- The company's management can use internal audit as a "platform" for professional growth and career development of future management personnel.

The second approach: organize an internal audit using outsourcing, that is, completely transfer the functions of internal audit to a specialized company or an external consultant.

The third approach is cosourcing, which is to create an internal audit service within the company, but in some cases involve experts from a specialized company or an external consultant.

Potential benefits of using outsourcing and co-sourcing include:

- The ability to use the services of experts in various areas;
- Access to highly professional audit staff;
- Flexibility in the issue of attracting audit resources (for example, when introducing a new system or the need for an unscheduled audit, you will not have to expand the IAS staff or to distract internal audit service resources from other projects);
- Access to advanced technologies and techniques for conducting internal audits.

The main disadvantage of outsourcing and cosourcing is that it is very difficult for an outsider in relation to the organization to become a part of it, to feel the pulse of the pulse and to penetrate its culture. No matter how friendly and open the specialists working in outsourcing (cosourcing) projects are, they will always be treated as "strangers" and they will not be dedicated to all the intricacies of the functioning of the organizational mechanism.

The organization of outsourcing and co-sourcing in the organization of IAS uses both small companies that do not have sufficient financial resources to create their own internal audit service and large companies. The latter, as a rule, require such services to audit a specific area (for example, such as information technology or capital construction). In addition, additional audit resources may be required during peak periods of workload for staff auditors.

There isn't "correct" (template) organization of the internal audit service, its structure, composition and number. In each case, the structure and strength of IAS are determined individually, based on various factors.

The first of these is the role of internal audit in the organization and the tasks that the company's management poses to internal audit. The second factor affecting the structure of IAS is the degree to which the company is exposed to various risks. The third factor is the maturity of the control environment in the company. The fourth factor is the number of structural divisions and the geographical branching of the company.

There are three possible options for building an internal audit service: centralized, decentralized and hierarchical. Each of the options has its own advantages and disadvantages. The advantages of a centralized scheme include the greatest degree of independence from the local leadership and the unity of audit approaches. The disadvantages can be considered less responsiveness and increased travel expenses.

The advantages of a decentralized scheme are the good knowledge of the specifics of their units (branches, subsidiaries) by internal auditors and prompt response to emerging problems. The most significant shortcomings are the lack of independence from the local leadership, as well as the likely differences in the approaches and recommendations of the internal audit services of the company divisions.

Considering the organization of the internal audit service in companies, one cannot stop at various approaches to the design of its functional and administrative subordination. Russian researchers [13], [16] identify four such approaches (Table 2).

Table 2. Options for subordinating the internal audit service in Russian companies

| | Functional submission | Administrative submission |
|-----|-----------------------------------|---------------------------|
| I | Audit Committee | General Director (CEO) |
| II | Company shareholders | CEO |
| III | CEO | |
| IV | Director of Economics and Finance | |

Source: compiled by the authors [13, p. 7]

According to Russian realities, option I is the most common. It ensures the functional independence of internal auditors, both when approving the general array of inspections, and when summarizing and deciding on bonus remuneration. However, as noted by O. Kryshkin [13], this option "overgrown with a number of pitfalls" in the Russian version, partially leveling all these advantages:

- "stardom" of the position of CEO in Russian companies, often ignoring the activities of the audit committee;
- low qualification of members of the audit committee, which fetters, and does not generate, the work of IAS.

In 2013–2015 year 53–55% in Russian companies

IAS was functionally subordinate to the board of directors (audit committee). (Figure 2) In 2017 year, this indicator increased significantly and reached 81%, which means that with respect to this issue, companies are increasingly following the requirements and recommendations of the Standards, the Corporate Governance Code [14], methodological recommendations of the Federal Property Management Agency [25], as well as international best practices [].

Option II - with all its semantic positivity, it is quite rare in Russian business and is inherent in medium-sized companies¹.

Option III - was the most common for the period 2000 – 2012 year. In our opinion, there is no reason to consider it positive. After all, the results of IA audits come to a person who is sometimes not at all interested in eradicating the deficiencies that internal auditors identify. This refers to the well-known facts published by the Association of Certified Fraud Examiners, which show that 46.5% of thefts in Russian companies are committed by top management, and if you add 45.21% of thefts to them, they are initiated and with the participation of senior management [18], then we get a terrifying figure of 91.71% - "authorship" of the activities of senior management in the amount of all theft within Russian companies.

Option IV, in our opinion, has the same risks as option III.

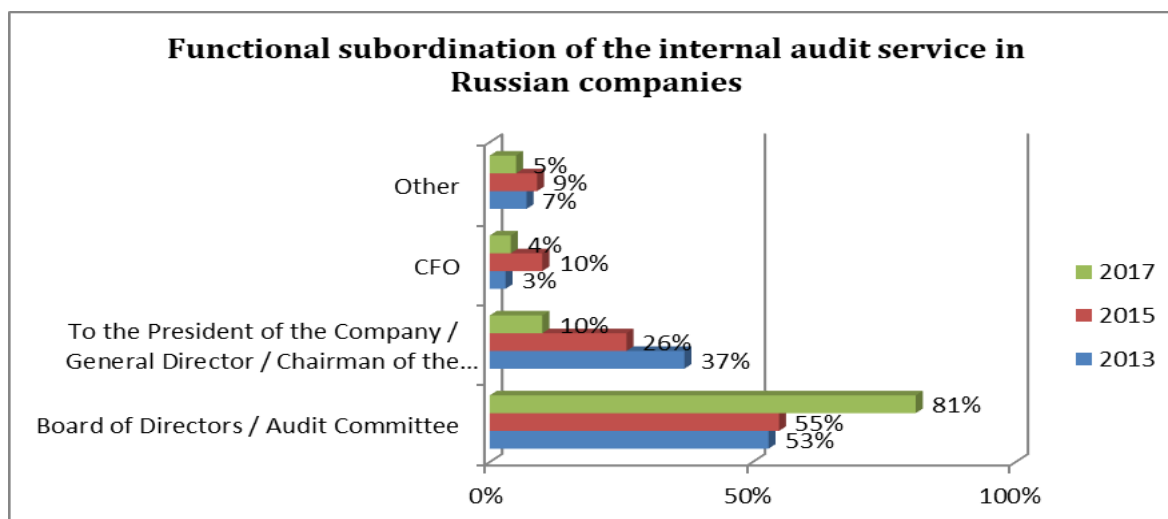


Fig. 2. Functional subordination of the internal audit service in Russian companies

Source: compiled by the authors based on [17]

¹ According to GAIN (Global Audit Information Network - Annual) Benchmarking Study) The Institute of Internal Auditors for 2017, in 86% of responding companies the internal audit unit is functionally accountable to the board of directors (committee on audit).

According to Figure 2, to date, the situation of the functional subordination of IAS of Russian business is steadily changing for the better.

A change in the level of functional accountability of the IAS has accordingly affected the degree of independence of internal auditors from company management.

In 2013, 31% of NEA considered themselves completely independent of management, and in 2015, 40%. According to the data of the Russian Association Institute of Internal Auditors [17], 15% of IAS is at the stage of formation, 52% - at the stage of active growth, and 33% of IAS can be called "mature". The "mature" IAS are those with more than 10 years of experience.

An analysis of the functional responsibilities of the IAS of Russian companies allowed us to identify an extensive array of practices performed by internal auditors (Table 3).

Table 3. Types of work performed by internal audit service in Russian companies

| Rating | Counseling | Audit | Monitoring |
|--|---|--|---|
| reliability and effectiveness of the internal control system (hereinafter - ICS) | executive management on various issues | Prevention / investigation of corruption abuses | the process of eliminating deficiencies ICS |
| Regulatory Compliance (Compliance) | management in building an internal system control | organization costs | failure indicators business processes / abuse |
| risk management system effectiveness | | asset security | |
| management reporting and performance KPI systems | | IT audit | |
| corporate governance system performance | | labor protection, industrial safety and security the environment | |

Source: compiled by the authors

The contents of table 3 indicate that today the internal audit is transforming into a risk assessment tool, while there is a shift in emphasis from the assessment of individual operations to the assessment of risks in the company as a whole. In fact, companies are faced with risks of the widest range - falling demand, loss of liquidity, disruptions in the supply of raw materials and supplies, difficulties with lending, growing internal tension among company employees, etc. Not to mention the risks of various kinds of abuse that multiply increase in the current situation, including theft and falsification of reporting [21].

Under these conditions internal audit service implements its key customers — boards of directors and senior management — to present their assessment of the most serious risks and offers their active participation in the process of managing them. Currently, the practice of planned meetings of the management of internal audit service and key customers is beginning to take shape (Figure 3).

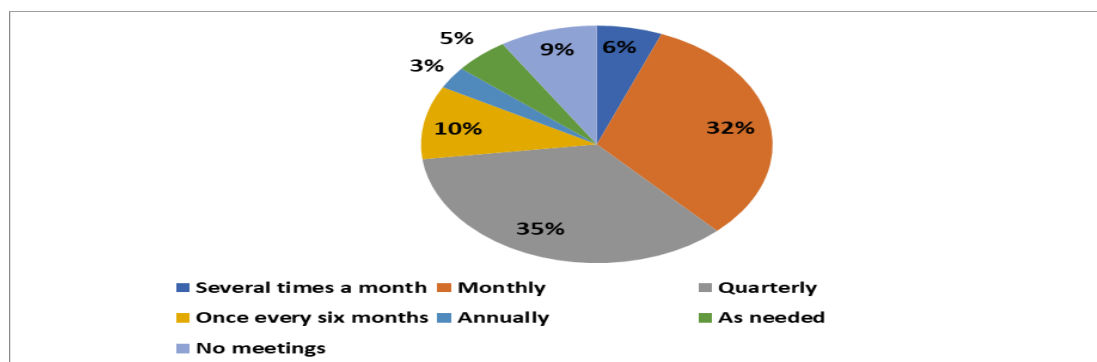


Fig. 3. Frequency of meetings of the head of the internal audit service with company management
Source: compiled by the authors based on [17]

Among the indicators by which effectiveness is evaluated

IAS activities most commonly used are: degree fulfillment of the plan of audit assignments, degree of customer satisfaction with internal audit, results of a survey of senior management and members of the board of directors / audit committee.

Factors that adversely affect the work of IAS include:

- 1) Insufficient provision of internal control system with human resources;
- 2) Time-consuming to obtain the necessary information;
- 3) Insufficient degree of cooperation from the audited units;
- 4) Poor support from senior management;
- 5) Insufficient provision of financial resources (insufficient budget);
- 6) Insufficient level of professionalism of IAS employees;
- 7) Insufficient support from the board of directors / audit committee;
- 8) Inadequate powers of IAS employees.

Of the eight indicated negative factors, six can be solved by administrative means. But the personnel deficit of internal auditors is becoming a socio-economic problem. The number of internal control system that attract external specialists to fill the lack of special skills and knowledge and eliminate the existing shortage of personnel in internal audit (outsourcing, cosoring), in 2017 year increased to 39% compared with 29% in 2015.

Alexey Sonin, head of the Russian Association Institute of Internal Auditors, [21] expressed deep concern over the fact that the Russian higher school does not train professional internal auditors. At present, the main backbone of highly qualified internal auditors is former BIG 4 employees who have come to this field of activity.

4 CONCLUSIONS

The period of getting used to the Russian economy by internal audit has already ended. The Russian internal audit not only introduced Western experience, but also improved it with its own best practices. The profession of an internal auditor becomes a number of promising professions with great socio-economic potential. The considered trends in the development of internal audit in Russia allow us to state that this process is going purposefully towards the achievement of world landmarks.

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