

Measuring the Internal Audit's Value in the Banking Sector

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Abstract

The significance of the function of audit in banking industry has considerably augmented during the crisis period, control processes and risk management has become the main focal point in the management system. The internal audit's task is assisting the management by protecting the patrimony of banks and reputation, and guaranteeing the overall growth and progress of the institution, while providing a wide-ranging analysis and inclusive insights on the activities.

This report aims to point out the methods which are used to determine the internal audit's value in banking sector and to find out the most important method which is considered to have an effect on the organization of the results of internal audit. The study results show that most of the organizations use the methods that contain majorly quantitative and minor qualitative elements. The differences are there between banking institutions and other organization types while using methods and practices, also on the effect seen in the measurement of the value of internal audit.

Keywords: Banking Industry, Value-addition, Performance management, Internal Audit.

Objectives

To explore the methods used of measuring the internal audit's value in banking sector and to also identify the most important methods which are considered to have an effect on the organization of the results of internal audit.

Introduction

Banking is one of the important sectors in any economy. It is the base for the financial condition and has a major role in the development of the economy. During the last few decades, banking management and processes have emerged due to financial globalization, liberalization and technological improvements. Recently, banking industry is facing a dynamic and great challenging atmosphere where there must have been compliances with the new regulatory reforms, strong corporate governance and expansion of the products and services' offers. Most of the banking organizations have no other options but to explore solutions in order to obtain a

balance with risk management, profit maximization and assurance of observance of applicable rules and regulations. The international economic crisis has determined the need to reconsider certain operations whose performance is significant for the banking industry's healthy functioning; one of the functions is represented as internal audit, which should be responded with modern and advanced challenges, expectations and modifications.

According to IIA, "The internal auditing is defined as an objective, independent assurance and consulting activity which is designed for adding value and improving the operations of an organization." It assists an institution to accomplish the objectives by designing a systematic and disciplined approach for evaluating and improving the efficiency and effectiveness of managing risk, control and administration processes. Although the function of internal audit does not directly affect and identify the solutions for the complications of the banking sectors, but it performs a crucial role in supporting the institution in maintaining and achieving the significant balance, by catering to the assessments of the environment of internal control and recommending the improvement in management processes of risk and ensuring the compliance with rules and regulations.

Research Methodology

The methodology of research employed to develop this research paper study include certain elements. An analysis of results of the case studies and research projects, and various reports and studies advanced by organizations of professional consulting and other services. By performing this analysis we would be able to understand the most significant indicator for tracking the results and reporting the internal audit performance of activities and how the internal audit function has added the value to the organization. The various practices and methods of internal audit that can increase the value-addition for the institution is also synthesized.

Analysis

Key Performance Metrics of the measurement of internal audit function

The internal audit activity's value has been appreciated while considering the perceived contribution for the governance and smooth functioning of the activity of organization. The assessment of the performance of activity of internal audit has directly influenced the same perception as mentioned above. While taking into consideration the significance of performance measurement of internal audit, various studies have been conducted to evaluate the practices and methods which are used for measuring the internal audit performance activity.

Performance measurement systems are different significantly among various audit functions which is a result of great organizations' diversity served by the functions. While practices, there have been various classification systems of performance measurement which is used in function internal audit. Balanced scorecard is the one of the most common systems approach that shows the arrangement of the objectives and activities of audit department of the industry. While using the method, combinations of metrics/indicators can be given special attention and must be adapted by each stakeholder's category as possible.

Another method of classification has been represented as input-process-output approach where:

- Input has been represented as the qualities of organization and its auditors;
- Process has been represented as the whole process and all the activities of auditing;
- Results or output have been represented as the final outcome of audit process which consists of counseling services, assurance provided, understanding level provided, improvements made in the business process as a result of auditing, etc.

Although there are different indicators used for measuring performance of internal audit and they vary from an organization to other organization, various studies have highlighted some important indicators which are used as regardless of any organization, like;

- Making surveys/ stakeholders questionnaire, interviews and meetings;
- Adequate audit missions are established with the planned ones;
- Compliance with the established standards, code of ethics and internal audits.

It has been concluded that it is mandatory for the audit leaders to choose the necessary performance indicators and audit methodology that must best fit for the objectivity of the audit activity regardless of any methods and techniques of audit used. While taking into consideration the expectations of management teams, audit committee and other stakeholders while ensuring the efforts made must have been aligned with the objectives and strategic goals of the company while adding prospective value to it.

The study further found out that there is no best set of unique performance metrics for the measurement of internal audit. The managers and leaders of audit function generate their own metrics or indicators to meet the mandate requirements like mission, strategy and vision and the expectations of their stakeholders. Also, the internal audit function which helps in generating the metrics/indicators express the real value which is provided to the stakeholders and used to

correlate the performance indicators with the expectations of their stakeholders to attract the preferable appreciation from the stakeholders.

Practices provided by internal audit for supporting the value growth

Many of the recent studies summarize certain examples of real and compelling processes that encourage the value addition by internal audit function; some of them are briefed here:

- ✓ Assessment of performance of Internal Audit
- ✓ Organization of assurance forum
- ✓ Commitment of Stakeholder
- ✓ Ensuring that IT expertise exist
- ✓ Benchmarking uses
- ✓ Clear audit missions existence
- ✓ Provision of quantifiable results or recommendations
- ✓ Harmonization of activities of internal audit with strategies of stakeholders
- ✓ Fixed investments in innovative and new solutions
- ✓ Focusing on the fundamental control causes and deficiencies to be included in the internal audit reports
- ✓ Continuous methodologies for improvement are used

The research and analysis highlighted that the audit managers and leaders have the resources and the possibility to deliver based on the objectives of strategy present a greater significance to the company in which they perform and it has been confirmed that stakeholders have been benefited by the delivery of higher value addition by the function of internal audit. Due to this reason, managers are required to project the whole audit function accordingly, which is based on getting the consent regarding the stakeholders' expectations and collaborations.

While considering the dynamic and complicated environment of risk in which the organizations operate and work, the directors' board and the senior management should be also involved with the designing of internal auditing function and also support the required investment for the development and growth of capabilities of internal audit, while encouraging the orientation towards delivery of growth value to the company.

Research Findings

Although there have been many distinctions between the standards used to measure the internal audit's performance which have been dependent upon the specifics for each and every

institution, the attained studies and researches have pointed out some of the successful practices which is used for measuring performance are as following:

- Stakeholders' and customers' satisfaction surveys are conducted;
- Keeping track upon the planned and the completed number of assignments of audit;
- Extension to which performance standards' compliance with the internal audit definition, Code of Ethics and standards are ensured;
- Using balance scorecard for determining the contribution of audit for adding value as well as improving the overall achievement and performance for the company.

While taking consideration the internal audit's role to access and improve the effectiveness and efficiency of processes of risk management, we assume that the internal audit's value addition to the industry should be considered as it has also contributed to the reduction of risk losses or to the reduction of potential losses, and made improvement in risk profile for the credit company.

Conclusions

In the past decades, some crucial changes have been occurred while paying attention to the value added assessment, performance and effectiveness of function of the internal audit. Current studies have shown that banking industries and supervisory and administrative authorities would like to extend the contribution of internal audit, to get more value addition to the operations of the organization and to contribute for achievement of their objectives, through a more effective role in the corporate governance and risk management.

Internal auditing can help in assisting the banking industry for achieving the required changes and also identifying the best possible balance between cost, risk and value. While determining the extension by which the function of internal audit achieved its objectives and goals and responds the expectations of the stakeholders, it has become necessary to evaluate the performance.

Leaving behind which tools & techniques are to be used for measuring the internal audit's performance, the chief executives of audit must select the most appropriate performance methodology that measures the objectives and characteristics of audit activity that fits them best. In addition, before the metrics selection for measurement of performance, the audit functions' leaders have to be taken into consideration major expectations of the stakeholders. Like this, the measurement of the performance of internal audit can be taken into place in

addition with harmonizing the activities of audit with the tactic and strategic goals related to the banking organizations and also enhance the addition of value by the function of internal audit.

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