



## **INTERNAL AUDIT - IMPLEMENTATION, NEED AND BENEFITS IN REPUBLIC OF NORTH MACEDONIA**

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### **Abstract**

The initial beginnings of the development of internal auditing date back to Babylon, where the operations of those who handled money and monetary values were overseen. The existence of a boarding audit at that time is evidenced by the evidence that tax revenues were recorded by two persons: one person was an executor, and the other was a recorder and controller of the collected - collected taxes. During the XVI, XVII and the first decades of the XVIII century the internal audit developed, although at a slower pace in other countries in the world such as: USA, Germany, Spain, Austria, Canada, France and others.

Given that there are different theoretical views on the term internal audit, here is emphasized the fact that the development of the economy, the change of the company organizational structure (segmentation of business and profit centres), the increase in the number of owners of capital (the emergence of share capital), as well as the development of management with all its responsibility for the operation of business entities, etc. conditioned the appearance of the audit in the business entities themselves - i.e. the internal one audit.

The existence of the internal audit is regulated by the Law on Trade Companies in the Republic of Macedonia and by certain statutory and other provisions adopted in the company itself. This means that the internal audit is a result of the need of business entities for more efficient control and more efficient operation and has legal basis for large joint stock companies - entities listed on the stock exchange, entities with special reporting obligations, financial institutions (banking and insurance) and the public sector (state institutions and enterprises in which the state is the dominant owner).

***Keywords: internal audit, tax revenues, control, financial institutions, public sector.***

## INTRODUCTION

Internal audit is an independent and objective assurance and advisory activity designed to add value and improve the performance of the organization. Internal audit helps the organization achieve its goals by using a systematic, disciplined approach to assess and improve the effectiveness of risk management, controls and management processes. On that basis, it can be concluded that the internal audit is not only a control leverage of the management of the company, but also the connection between the internal control system and the external audit, which in turn requires their full cooperation.

Internal audit is conducted in accordance with the principles of legality, independence, impartiality, confidentiality and professionalism. The approach to conducting internal audit is to be independent and evidence-based. All activities related to internal audit should be audited by independent parties, be a self-assessment system, have a sampling plan and monitoring system, be open, constructive and effective.

It arose as a result of the needs of modern business entities to introduce their own, internal and additional form of supervision for control and examination of the system of internal controls (performed by all employees, as an integral part of work responsibilities) and evaluation of its efficiency, identifying weaknesses in its functioning and proposing measures to eliminate the emerging weaknesses.

According to the definition of the Auditing Practice Committee (APC), internal audit is an element of the internal control system set up by the management of the company, banks or other institutions, for the purpose of examination, evaluation and reporting on the functioning of accounting and other internal controls in the operation.

The purpose of internal audit is to provide the head of the entity with an independent objective assessment in order to improve the performance of the entity and the effectiveness of the internal control systems.

The Law on Audit regulates the conditions for auditing legal entities operating in the Republic of Macedonia. The general provisions of this law refer to legal and contractual audit engagements performed in the country. Everything that is not determined in this law is determined by the Law on Trade Companies for performing the audit activities.

If this Law does not stipulate the conduct of administrative procedures for issuing a license for certified auditor, license for operation of an audit company and license for operation of certified auditor - sole proprietor, the provisions of the Law on General Administrative Procedure shall apply.

The implementation of internal audit in the public sector begins with planning which consists of the preparation of: an annual internal audit plan and an audit program for each individual internal audit.

Based on the conducted research in the field of internal audit, it has been determined that it is conducted in different legal and cultural circumstances, within organizations that differ in purpose, size, complexity and structure.

Starting from the term, goals and tasks of internal audit, types of audit, legal framework and standards for internal audit, bonds for conducting internal audit, conducting the internal audit process, the master thesis is entitled:

"Internal Audit - Implementation, Need and Benefits"

## **1.1 Types of audit**

From various aspects in contemporary theory and practice, identified are different types of audit, as follows:

- Audit according to the subject of examination;
- Audit according to the body that implements it;
- Audit according to the area of examination.

### **1.1.1 Audit by subject of examination**

According to the subject of examination we distinguish: audit of financial statements, audit of compliance with procedures, audit of operations and court audit.

#### **Audit of financial statements**

Applies when examining and assessing reality and the objectivity of the financial statements, whether they are prepared in accordance with generally accepted accounting standards. Audit of financial statements includes basic financial statements such as: balance sheet, income statement and cash flow statement.

The management of the audited entity as well as the certified auditors are responsible for conducting this audit. The responsibility of the management comes down to the creation, implementation and maintenance of the accounting records and monitoring of the preparation of the financial reports that should comply with generally accepted accounting standards. The responsibility of the auditors, on the other hand, refers to the examination of the accounting records, gathering relevant evidence, conduct independent audits to determine whether they comply with accounting standards and to express a written independent opinion that the financial statements do not contain material misstatement.

Finally, the audit opinion is made public, so that the numerous users can have confidence that the financial statements show the financial situation realistically and objectively.

#### **Audit of compliance of procedures**

The purpose of this audit is to determine the extent to which the auditing company follows the rules or standards created, established and adopted by higher authorities (contracts, legislation or written consent).

Authoritative instances means the top management that must incorporate the standards of certain areas of its operation in the policy and procedures of the business entity in the preparation of guidelines or manuals.

The conformity audit examines the procedures of a certain set of rules and standards, so that the auditor should notice the deviations prescribed by the rules and standards and timely inform the top management about the observed situation.

#### **Audit of operations**

Audit of operations means examination and evaluation of the total operations, all in order to achieve more efficient operations and to increase the profitability of the business entity. The primary purpose of this audit is to assess the performance of the enterprise and identify areas where measures can be taken to improve the operation of the enterprise. In the audit of operations there are no predetermined standards as in the previous two audits, so the dilemma of the auditors is how to determine in advance the standards, rules or norms that would be performed evaluation of efficiency and effectiveness.

The audit of operations has the following characteristics:

- Auditors conducting audits are independent of the activities they audit;
- The auditor is employed in the auditing company;
- The auditor submits a report on the performed audit and submits it to the officials in the company. This report should address the problems associated with the effectiveness and efficiency of the enterprise.

### **Judicial review**

Today, the number of frauds and illegal operations is increasing, so the court audit aims to detect and promote activities that have the consequences of fraud or other illegal activities, which are integrated in the financial statements of the company that is the client of the audit.

Judicial review is conducted in the following cases:

- Business frauds committed by external and internal entities of the enterprises;
- Criminal investigations;
- Confrontations and disputes between shareholders, managers and partners;
- Marital disputes;
- Economic losses.

The court audit is in charge of detecting and preventing frauds, errors and other inconsistencies in the financial statements, to point out in time all the irregularities.

### **Audit according to the body that implements it**

According to the body that implements it in modern theory and practice, there are two types of audit: internal and external audit.

#### **Internal audit**

The internal audit was created as a result of the need of modern companies to introduce internal, internal, additional form of supervision to monitor the internal controls performed by all employees, as an integral part, to evaluate their efficiency, to detect weaknesses in their functioning and to propose measures to eliminate the observed irregularities.

Internal audit is an activity organized by the management of the company or other business entities to assist in evaluating the performance of the whole or individual segments.

The modern internal audit should cover the following activities:

- Examination of the functioning of the accounting system and the built-in internal (accounting) controls;
- Examination of financial and other data on the need of the management (on the basis of which business decisions are made);
- Examination of the economy, efficiency and effectiveness in the operation, as well as the functioning of the financial controls and special examinations in the company or a separate bank, with a special request of the management.

**External audit** is defined as the process of accumulating and evaluating evidence in relation to information in order to establish and report on a system of correspondence between data and established criteria.

The audit should be performed by competent and independent persons. It is of great importance for the auditor to be an external person, who in his professional work will manifest absolute independence from the client's management. The external auditor gives an accurate picture of the financial condition of the company, thus protecting the interests of the owners.

The emergence of external auditing was initiated by the introduction of pluralism of ownership relations and the separation of the management function from the ownership of capital. It should provide protection of the interests of the owners of the capital and offer reliable information to other users of audit services such as: shareholders, creditors, potential investors, employees and the general public.

The main goal for this type of audit is the elimination of audit risk, ie the elimination of errors in the control system and errors in the financial statements. The external audit performs a complete examination of the documentation or periodic examination depending on the requirements set before it.

### **1.1.3 Audit by examination area**

According to the area of examination, the internal audit is divided into: commercial and state.

#### **Commercial audit**

The term commercial audit is used in transition economies as a synonym for external and independent audit of corporate financial statements. In our country, the term commercial audit was introduced by the 1997 Law on Audit.

Commercial audits are performed by independent auditors and special audit firms. It is implemented on the basis of a valid agreement signed between the company - client of the audit engagement and the audit firm, the primary holder of the obligations for conducting the audit service. This regulates the issues for the beginning of the audit, the subject, the procedures and the completion of the audit (by submitting an audit report), the fee and the method of payment. The contract can be for one year or many years. The independent auditor, in accordance with the contractual provisions, works for the client who pays for the service for the performed audit. However, auditors, regardless of who is hired and paid by the client, always act in function of protecting the interests of the general public. The client is obliged to provide the auditors with access to the business premises and to provide them with the entire documentation, as well as to give them an explanation and other necessary information.

The commercial auditor should respect and act in accordance with the Code of Ethics. This means that the audit process should be performed objectively, impartially, to keep the information secret and not to use it for personal gain.

#### **State audit**

According to the Law on Audit is defined as the examination of the documents, documents and reports of the performed internal control and internal audit of the accounting and financial procedures and other records from aspect of whether the financial statements accurately and objectively represent the financial position and the results of the financial activities, in accordance with the accepted accounting principles and standards and auditing standards.

The state audit is conducted in the name and at the expense of the state. In the Republic of Northern Macedonia, the responsibility for conducting this audit is located in the State Audit Office. According to the Law on State Audit, it is performed continuously during the year, at least once a year for the budget of the Republic of Northern Macedonia, the budgets of the local self-governments and the budgets of the funds. The purpose of the state audit is to ensure the application of all accounting and international standards.

It is necessary to examine the execution and adoption of the budget, as well as the use of budget funds. Furthermore, the management of the property provided from budget funds is examined, as well as the protection of the rights of the persons who receive funds from the funds.

The standards for state audit require the auditor to pay more attention to the efficiency of the work, the realization of the foreseen projects and programs, the purposeful use of public funds, assessment of the reality and objectivity of the presented financial statements.

In the Republic of Northern Macedonia, in accordance with the legislation, the auditing standards of INTOSAI, adopted by the International Organization of Supreme Audit Institutions, are applied.

## **2.1 Legal framework for internal audit**

The legal framework consists of the Law on Audit, the Law on Internal Audit, the Law on Trade Companies, the Law on Banks, Insurance Supervision and the Law on Internal Audit in the Public Sector. Everyone will be worked out here law individually.

### **2.1.1 Law on Audit**

Pursuant to this Law, the conditions for auditing the legal entities operating in the Republic of Northern Macedonia are regulated. The provisions refer to legal and contractual audit engagements performed in the Republic of Northern Macedonia. Everything that is not determined by this law is apply the provisions of the Law on Trade Companies regarding the performance of audit activities. This law uses certain terms and abbreviations, of which several will be singled out:

**Audit** - an independent examination of financial statements or consolidated statements and financial information in order to express an opinion on their veracity and impartiality and their compliance with the accepted financial reporting framework;

**Statutory Audit** - Statutory audit, procedures, audits and assurances on the annual accounts and / or consolidated financial statements or consolidated annual accounts and consolidated financial statements in accordance with IFAC International Standards on Auditing and other relevant IFAC Statements accepted and published in the Republic of Northern Macedonia, in order to express an opinion, conclusion or assurance regarding their veracity and impartiality and their compliance with the accepted financial reporting framework;

**Auditor** - a natural person who holds a certificate of auditor issued by the Institute of Certified Auditors of the Republic of Northern Macedonia and which is registered in the Register of Auditors in accordance with this Law;

**Audit Company** - a trade company registered in accordance with the Law on Trade Companies and which has a license to operate from the Audit Promotion and Supervision Council of the Republic of Northern Macedonia is also registered in the Register of Audit Companies in accordance with this Law;

**Certificate of Auditor** - a certificate issued by the Institute of Certified Auditors of the Republic of Northern Macedonia to persons who have passed the exam for auditors;

**Certified Auditor License** - a license issued by the Audit Promotion and Supervision Council;

**Certified Auditor** - a natural person who has received a license for certified auditor issued by the Audit Promotion and Supervision Council of the Republic of Northern Macedonia and is registered in the Register of Certified Auditors in accordance with this law;

- Institute of Certified Auditors of the Republic of Northern Macedonia - professional chamber association of certified auditors;
- IFAC - International Federation of Accountants;

Audit may be performed by audit companies or certified auditor - sole proprietor under the condition and in a manner determined by this Law and the Law on Trade Companies.

Due to the promotion and supervision during the audit, the Government of the Republic of Northern Macedonia, upon the proposal of the Minister of Finance, establishes a Council for promotion and supervision of the audit of the Republic of Northern Macedonia.

as an independent and autonomous regulatory body, with public authorizations determined in this law. The seat of the Council is in Skopje. The Council acquires the capacity of a legal

entity by registering in the Register of other legal entities kept in the Central Register of the Republic of Northern Macedonia. For his work The Council is accountable to the Government of the Republic of Northern Macedonia.

The Council adopts a Statute approved by the Government of the Republic of Northern Macedonia, which regulates the internal organization, management and governance, procedures for adoption of acts, manner and conditions of employment in the Council, as well as other issues that are important for the operation of The council. The bylaws, for the adoption of which the Council is authorized by this Law, shall be published in the Official Gazette of the Republic of Northern Macedonia.

### **3. IMPLEMENTATION OF THE INTERNAL AUDIT PROCESS**

In the fourth topic Implementation of the internal audit process we meet with the Working tools of the audit, as well as with the Charter for internal audit. This is followed by the planning of the internal audit, the audit programs, the letter of authorization, fieldwork and the audit report where the interim internal audit report, the previous report and the final internal audit report.

#### **3.1 Working tools of the audit**

Internal auditors when performing the activities, use as working tools:

- Guidance on internal audit methods and techniques;
- Internal Audit Charter;
- Guidelines issued by the Central Internal Audit in order better performance of internal audits.

The Central Internal Audit prepares Guidelines for the methods and techniques of internal audit with a detailed description of the internal audit methodology to be applied by each internal audit unit. The manual is used as a basis for training of internal auditors and will be periodically updated in order to incorporate the latest trends and experience in performing internal audits. The manual is published on the website of the Ministry of Finance within six months from the publication of the rulebook.

The Internal Audit Charter defines the performance of internal audit and the rights of internal auditors. A copy of the Charter is distributed at the initial meeting. The document will also be available upon request and will be published on the Internal Audit website.

#### **3.1.1 Internal Audit Charter**

The Internal Audit Charter is a written formal document that defines the purpose, authority and responsibility of the activity.

The Charter should establish the position of the internal audit activity within the organization, authorize access to records, staff, physical property in connection with the performance of engagements and define the scope of internal audit activities.

The primary purpose of the Internal Audit Charter is to assist management in promoting and maintaining internal control in line with operational risks. Specific objectives of the Internal Audit Charter include:

- Providing guarantees for the adequacy of the control within activities and systems of public sector entities, ie to give comments and recommend changes to the mechanisms established by the management to ensure the realization of the objectives of the activities and systems.
- Furthermore, monitoring the implementation of the agreed measures, pointing out to the executive management the shortcomings, as well as to the head of the entity.
- Facilitation of annual risk analysis, assistance of the head of the financial sector in the reporting process for financial management and control.

- Carrying out audits, research and reviews accordingly the requirements of the head of the entity.
- Cooperation with external auditors to ensure economical and effective use of internal and external audit resources.
- Giving management advice on introducing economic controls of new systems and activities.

### 3.2 Internal Audit Planning

Internal audit planning is carried out by preparing:

- Annual internal audit plan;
- Audit program for each individual internal audit.

For planning the work of the audit, the head of the internal audit unit prepares an annual audit plan based on the risk assessment, in accordance with the objectives of the entity and the international standards for internal audit. The head of the entity signs the annual plan for audit. The head of the internal audit unit notifies in writing the organizational units that are subject to audit, for the part of the plan that refers to them. The Head of the Internal Audit Unit submits the annual audit plan for the next year by the Minister of Finance no later than December 15 of the current year.

With the separate processes and the list of systems in the risk assessment for a three-year perspective, an annual audit plan is prepared in accordance with the available and potential resources of the internal audit unit in a period of one year.

The annual plan contains:

- List of systems and processes planned for audit;
- Clear, achievable and measurable objectives for each audit;
- Possible indicators in terms of time frame, available resources and possible engagement of external experts.

External experts are engaged in performing certain types of internal audit, taking into account the scope, complexity, required qualifications or availability of internal resources. In accordance with the need to hire external experts, the budget is planned. When planning the activities of the internal audit unit, the necessary time for preparation of the audit reports, annual and quarterly reports according to the conditions prescribed by law is taken into account.

If there is a significant change in the estimated risk or planned resources during the preparation of the annual plan, then the annual audit plan may be amended. Amendments to the annual plan must be approved by the head of the entity. Changes to the annual plan are reported to the Central Internal Audit.

### 3.3 Audit programs

For each individual audit, the internal auditors prepare an audit program, the content of which is reported to the heads of the organizational units that will be audited, one week before the start of field work.

The basic elements contained in the audit program are:

- Dates planned for: preliminary research, fieldwork, period for drafting the report, reporting on the initial results of the audit, submission of the draft report and distribution of the final report;
- Objectives for the operation of the audited systems and processes to be taken into account in the audit;
- Objectives of internal controls to be assessed by internal auditors;
- Types and levels of research and testing to be performed;

- Internal audit procedures related to data collection, analysis, processing and documentation;
- Division of tasks between the team in case there is more than one internal auditor;
- Specific and strictly limited tasks assigned to external experts if hired.

If necessary, the audit program can be changed during the audit, in accordance with the head of the internal audit unit.

### **3.4 Letter of authorization**

Internal auditors and external experts, before starting the audit, need to have a letter of authorization, signed by the head of the internal audit unit, and while the letter of authorization of the head of the internal audit unit is signed by the head of the entity before are performing each of the audits provided in the annual plan.

The letter of authorization determines:

- Processes and systems that will be audited;
- The audit objectives set out in the annual plan for internal audit;
- The leader and members of the audit team;
- The time frame and deadline for submitting the final internal audit report.

The internal audit team organizes an initial meeting with the heads of the organizational units regarding the scope of the internal audit, in order to inform the audited entities about the implementation of the audit.

Auditors, on the other hand, receive information on:

- The objectives proposed for the audit;
- The goals of the systems and processes that will be subject to audit;
- Control objectives and key controls;
- Data on financial statements, activities, etc.
- Other available documentation;
- Risks that may affect the achievement of systemic and operational goals;
- Past audit reports and implementation of recommendations;

### **3.5 Field work**

Fieldwork is a systematic process of objectively gathering evidence that confirms the expert assessment of the systems and processes being audited. The assessment is a set of findings on the strengths and weaknesses of the systems and processes in relation to the identified risks and objectives. The fieldwork aims to perform all the audit procedures listed in the audit program in order to achieve the goal of the audit.

Auditing methods applied in the field work are in accordance with international standards and recognized professional practices:

- monitoring;
- confirmation;
- verification;
- research;
- analysis;
- Evaluation.

Evidence should provide support for the findings of the audited proceedings. Special attention is paid to the efficiency of the processes in accordance with the operational objectives set out in the audit program.

## Conclusion

The internal audit contributes to the increase of the trust between the enterprises and the public, i.e. it indicates whether the financial statements of the enterprises are prepared in accordance with the generally accepted standards and regulations, as well as with the adopted plans and decisions of the enterprises themselves.

Increasing trust between partners, companies and the public, owners and potential investors, shareholders and management, companies and government agencies, increases the performance of companies.

Internal audit focuses its activities on the analysis of efficiency, economy and effectiveness in operations and through these analyses, internal audit contributes to achieving greater success in operations and improving economic efficiency of businesses and institutions in general by detecting and eliminating weaknesses in their operation. It is an independent and objective activity for assurance, which is created to increase the value and improve the operation and financial discipline of the business entity.

The task of the internal audit is to compile the work plan, examination and evaluation of the available information, as well as the results of the audit and giving recommendations. The main function of internal audit is to assist management in achieving its goals, a systematic and disciplined approach to assessing and improving the effectiveness of risk management and control. Internal auditors, on the other hand, have the task of assessing the purpose and effectiveness of the internal control system and making recommendations for it.

How to improve controls and the heads of the internal audit service have a responsibility to monitor whether the internal auditors behave and comply with the principles of internal audit. Today's modern economic science, the business environment in which we live and the way we have an orderly economic order is irreplaceable without revision.

The audit is controlled and evaluates the quality not only of the preparation of the financial statements, but of the whole business, creating an image and imagination of the future and the capabilities of the individual economic entity. On a multinational scale, auditing in any modern country assumes a respectable position of a regulator of the conduct of the business entity, which protects not only the owners, companies and their partners from ignorance and failure, but thus enables further development of the economy and preservation of stability and system security.

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