

A Study On Appointment Of Internal Auditors By Companies In Mumbai Area

Dr. Rajesh Kumar Agrawal
Director
ICSI-CCGRT
Navi Mumbai, India

Abstract—According to Section 138 of Companies Act 2013, the internal auditor shall be either Chartered Accountant or Cost Accountant or such other professional as may be decided by the board to conduct Internal Audit functions and activities of the company. This study aims to explore whether the Companies in Mumbai area are appointing Internal Auditor and the reasons for not appointing Internal Auditor, if any and also to explore the expertise, qualities and capabilities which enables Company Secretary to perform the role of Internal Auditor. A questionnaire was designed and distributed to the companies located in Mumbai area. The result shows that the companies located in Mumbai area are appointing Internal Auditor. The research also provides the possible obstacles for non-appointment of Internal Auditor by the companies and how to remove such obstacles. This study also examines the steps to be taken to enable Company Secretary to perform the role of Internal Auditor.

Keywords— Company Secretary, Internal Auditor, Risk Management, Internal Control System

I. INTRODUCTION

In India, appointment of internal auditor has been made mandatory by the Companies Act 2013 for listed and certain other classes of companies. Internal audit has emerged as an important function to support Corporate Governance and cover Risk Management, in addition to the usual financial and operational aspects. The internal auditor evaluates internal controls in the context of changing internal and external environment to provide an assurance that internal controls are adequate. The role of internal audit is much broader than that of external audit as it involves all the risks faced by an organization and the procedure by which they are managed.

The Institute of Internal Auditor (IIA) considers internal auditors to help organizations achieve their objectives through a systematic and disciplined approach to the evaluation and improvement of the effectiveness of risk management, control and corporate governance.

The board of company has been given freedom to appoint any professional and competent person to be its internal auditor. As per Rule 13 of Companies (Accounts) Rules, 2014 the listed company is mandatorily required to appoint an internal auditor or a firm of internal auditor whereas an unlisted company is required only when having paid up capital of Rs.50 crore or more or turnover of Rs.200 crore or more or outstanding loans and borrowings of Rs.100 crore or more or having outstanding deposits of Rs.25crore or more and a private company is required only when having turnover of Rs.200 crore or more or outstanding loans and borrowings of

Rs.100 crore or more. The Rule also states that the internal auditor may or may not be an employee of the company.

The concept of internal audit was not expressly provided in the 1956 Act, but, was parked in Companies (Auditor's Report) Order, 2003 (CARO). But the 2013 Act has an express provision about internal audit recognizing the utility of such an audit in terms of better internal control and corporate governance. In section 143(11) of Companies Act,2013 it is clearly stated that the Central Government may order for the inclusion of a statement on specified matters in the Auditor's report for specified class or description of Companies. Accordingly, CARO-2015 is issued by the Central Government in pursuance with the provisions Section 143(11) as an additional matters to be included in auditor's report. Hence, the companies (Auditor's Report) Order, 2015 is applicable from FY 2014-15 and the matters specified therein shall be included in each report made by auditor u/s 143 on the accounts of every company to which CARO-2015 applies. Therefore, this research attempted to study the appointment of internal auditors in the companies and the scope of the Company Secretaries in the field of internal audit.

II. OBJECTIVES OF THE STUDY

- To study about how many companies has appointed Internal Auditor in Mumbai area.
- To examine the obstacles for non-appointment of Internal Auditor by the companies, if any.
- To study about how to remove obstacles for non-appointment of Internal Auditor by the companies.
- To study about how many Companies has appointed Company Secretary as an Internal Auditor.

III. LITERATURE REVIEW

In the subsequent pages an attempt has been made to review the literature pertaining to the internal audit. The literature has been collected through various journals, magazines, websites and other published sources.

1) Osama Abdulmunim Ali & Walid Omar Owais research titled "Internal Auditors' Intellectual (Knowledge) Dimension in Creating Value for Companies-Empirical Study of Jordanian Industrial Public Shareholding Companies" published by Canadian Centre of Science and Education (December 7, 2012): Has attempted to study the importance of human resource represented by intellectual capital with its

capability to add value to companies to enable them to compete in all local and international fields for internal auditors in companies. The research concluded that the internal auditors in companies must be continuously concerned with developing their skills and technical experiences in order to increase the efficiency and value of companies. The auditors must adopt the most important factor (the intellectual factor) in creating added value to companies, and the auditors must be keen continuously to increase the company's value. The mean of this factor was 4.22 which was the highest in this study, and its standard deviation was 0.59.

2) *Ya-fang Wang & Yu-Tiang Huang research titled "The Association Between Internal Control Situations and Specialist Auditor Choices" published by Canadian Centre of Science and Education (May 17, 2013):* Sought to investigate by uncovering the empirical results of the influence of internal control quality on the probability of audit turnover. This study investigated the association between internal control situations and external auditor selections, providing evidence that companies with material deficiencies in internal control system are significantly more likely than companies with sound internal controls to terminate their auditors. The results indicates that companies with material deficiencies in internal control system are less likely to change to specialist auditors. It provides evidence that when companies with material deficiencies in internal control system hire specialist auditor to restore their internal control situations, they are likely to pay higher audit fees to do so.

3) *Rose M. Thompson research titled "A Conceptual Framework of Potential Conflicts with the Role of the Internal Auditor in Enterprise Risk Management" published by Accounting and Finance research (July 1, 2013):* Discussed the relationship between the internal auditor's independence and objectivity being impaired (i.e., potential conflicts with the internal auditor's role in ERM) with variables that influence the internal auditor's involvement in ERM. Three hypotheses are developed under the proposed conceptual framework that can be empirically tested in future work. The proposed conceptual framework suggests that the internal auditor's independence and objectivity would not be impaired when it spends more time in performing ERM consulting activities versus providing assurance on controls and when it reports to a separate board risk management committee. The empirical results will contribute to the emerging literature on the role of the internal auditor in ERM and its implications for the internal auditor's independence and objectivity.

4) *Orhan Bozkurt research titled "The Effects of Internal Audit Procedures and Auditors' Responsibilities on the Independent Audit Decisions" published by the Research Journal of Finance and Accounting (2014):* Aimed to examine how internal audit procedures and responsibility perceptions of the auditors impact the audit decisions of independent external auditors. The results of the study shows that procedural readiness and sense of responsibility of the internal auditor will improve the efficiency of external audit. This study designed to learn the opinions of Turkish auditors and

accountants and to contribute to the literature. In order to get objective and reliable data expected to be obtained from the independent external auditors, internal procedures shall be made more straightforward and internal auditors shall be willing to cooperate with external auditors more.

5) *Quasim Mohammad Zureigat & Abdullah Al-Moshaigeh on their research titled " Measuring the Performance of Internal Audit Function in Saudi Listed Companies: An Empirical Study" published by Canadian Centre of Science And Education (June 25, 2014):* Aimed to explore whether Saudi listed companies are using performance measures to evaluate their internal audit function and, if they are, what performance measures they use to evaluate internal audit functions and the identity of important measures from the perspective of internal auditors. A questionnaire was designed and distributed to internal auditors in Saudi listed companies. The result shows that Saudi listed companies are using both quantitative and qualitative performance measures. Also, internal auditors are considering quantitative measures more important than qualitative measures. An additional investigation on the factors that affect the performance of internal audit function, and how companies are implementing the performance measures is important, especially in emerging economies like Saudi.

6) *Mohd. Hanafi Omar, Hasni & Stewart, Jenny on their research titled " The Effect of Incentive-Based Compensation on Internal Auditors' Perceptions of Objectivity" published in International Journal Of Auditing (March, 2015):* Used an experimental approach to examine whether IBC (incentive-based compensation) paid to internal auditors based on company performance and individual performance does impact their objectivity. The study also investigated whether the cultural background of internal auditors affects their objectivity in the context of IBC. The experimental results indicate that IBC is a threat to internal auditor's objectivity when it is based on company performance, but is less of a threat when it is based on individual performance.

IV. STUDY DESIGN AND METHODOLOGY

A. Area of the study

The area of the study is confined to Mumbai city.

B. Tools used

In order to collect the data needed for this study, a questionnaire was designed that contains questions concerning appointment of Internal Auditors. Moreover, the participants are asked about the reasons for non-appointment of Internal Auditor, if any. This information is captured through the use of open ended and close ended questions.

C. Sample size

For the purpose of study, a sample of 20 companies was selected and questionnaires were circulated to express their views.

D. Sampling method

The samples for the study were selected on the basis of Convenient Sampling Method.

E. Sources of data

1) *Primary data:* The primary source of information was collected from a questionnaire prepared and distributed to the selected companies in Mumbai city.

2) *Secondary data:* The secondary source of information was from books, existing researches and reports, internet and magazines in order to build the theoretical frame for the research and to achieve its objectives.

F. Analysis of Data

In the analysis and interpretation of data, Percentage Analysis tool was used.

G. Limitations of the study

The study is absolutely confined to Mumbai city. 20 companies were considered for this study because of the time constraint.

H. Sectors covered

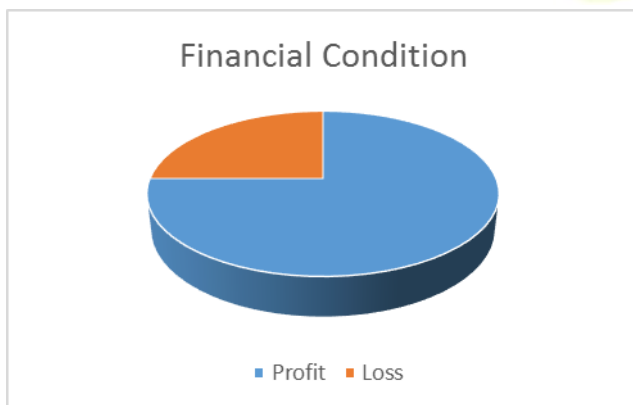
Steel, Stock Exchanges, Banking, Financial services, Power, Chemicals, Information Technologies, Real estate, Infrastructural development, Rubber, Manufacturing, Cellular, Cement, Leisure facility, Core investment company, Hospitality, Animal food, agri-input & poultry, Assets reconstruction company.

V. STATISTICAL ANALYSIS

The descriptive statistics prepared based on the analysis of information and data collected from selected companies through various questionnaires are presented below:

A. Financial condition of the company

The study from the following chart shows that out of selected 20 companies, 15 companies are in profit i.e., 75% and remaining 5 companies are in loss i.e., 25%.



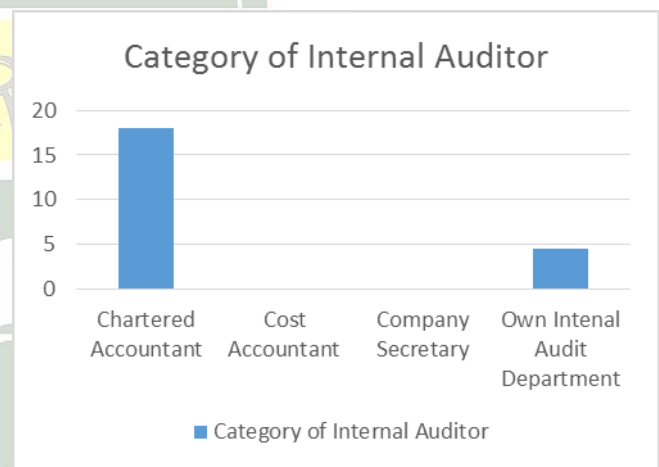
B. Appointment of Internal Auditor

The study shows that all companies under study have appointed internal auditors.



C. Category of Internal Auditor

From the following table it clearly shows that out of selected 20 companies, 18 companies have appointed Chartered Accountants as Internal Auditor (i.e. 90%) and 2 companies have set up their own Internal Audit Department (i.e. 10%) while none of the companies have appointed Company Secretary and Cost Accountant as their Internal Auditor.



VI. FINDINGS, CONCLUSIONS AND SUGGESTIONS

It comes to know from this study that all the companies under the study have appointed internal auditor so the question of non-appointment of internal auditor did not arise. The applicability limit in Companies Act, 2013 is set very high, it should be brought down as it is bringing only selective and limited number of companies within its ambit. In order to make the internal audit function more effective the internal Auditor who is not in the employment of the company shall be Practising Chartered Accountant or a Practising Company Secretary and Practising Cost accountant. To complete the research study, certain general questions have been asked to the companies to get the details such as obstacles or reasons for non-appointment of internal auditor, how to remove such obstacles and steps to be taken to enable a Company Secretary to play the role of internal auditor.

It is to be concluded that the reasons for non-appointment of internal auditor includes obstacles such as lack of internal control, ineffective implementation of statutory bodies, having an internal audit department comprising employees, expectation of management from statutory auditors to do audit

in total, lack of management awareness of the operational risk or low corporate governance standard. These obstacles can be removed by educating the management about the legal need, inform management about benefits of having internal auditor, by conducting seminars and conveying through paper medium about various operational risks involved, timely detection and resolution of issues, fraud and manipulation or by informing companies about mandatory appointment of internal auditor under Companies Act,2013 and SEBI guidelines.

It is also to be concluded that to enable Company Secretary to play the role of internal auditor, internal audit can be made part of the Secretarial Audit. Company Secretary are eligible to be appointed as internal auditor of the company as the law permits them to do so and they possess knowledge about all the statutory requirements and various applicable laws. They have ability as financial expert. They have up to date practical and conceptual knowledge of laws. Hence, people should be educated about the appointment of Company Secretary being appointed as internal auditor.

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