

Internal Auditing in Commercial Banks

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Abstract: Internal auditing has witnessed enormous development in many aspects over last two decades. In the practical performance of internal auditing function, this was a limited activity, restricted in investigation and auditing of financial and accountancy processes. Later, it came to investigate and audit all processes and even became eyes and ears of higher administration. With many economical developments that have occurred and spread of many commercial banks, failure of conditions within various commercial banks and appearance of many professional reports that evaluate governmental control systems during last two decades there is a need for a greater role in verification and evaluation of control dealing with risks. A considerable amount of professional reports confirmed importance and role of internal auditing, inspection and evaluation of control systems and specification and evaluation of dealing with all risks that commercial banks are confronted by. As a result of orientation of organized status of internal auditing, commercial banks moved towards sole independence by coming under supervision of an audit administration committee which board of directors depends upon to acquire authenticated data. Initially, internal auditing was connected to external auditing and it adopted many of methods. In some commercial banks, programs and plans of internal auditing were arranged in accordance with methods and styles of external auditing. However as internal auditing developed as a function and profession, it came to have its own methods and procedures besides private mechanisms which are based upon experience of practical performance, helped by results of theoretical scientific research which deals with study of internal auditing as a function and profession.

Key words: Historical development, internal auditing banks, commercial banks, external auditing, Malaysia

INTRODUCTION

Definition of internal auditing and historical development

Concept of auditing in language: Meaning word of auditing in language is to make sure of correctness of work by examining it and restudying it. Such term has a special meaning in the branch of accounting and financial studies which is the reference to profession called accounts audit and art which it uses in carrying out its task. Conventionally, it means rectification process or adjustment to return matters to their original and to correct its status after getting data, registering them, classifying them and summarizing them by describing them analytically.

Concept of Auditing in conventionality: The term auditing by its current meaning has not been mentioned in Holy Quran, sunnah or speeches and sayings of jurisprudents. However, control system which is considered more comprehensive than auditing term has

been mentioned instead. The term auditor has not been mentioned at heritage books. However the term, the clerk which includes accountant and internal auditor and external auditor altogether has been mentioned.

With respect to its definition, it is a profession exercised at financial corporations and various commercial banks for centuries. It belongs to supreme administration at financial corporations and various commercial banks. It is also influenced with their goals and develops with their development (Ibrahim, 1998). This view is supported by Tamimi (2004) demand on internal auditing has been arisen from need to have an independent verification means with purpose of limiting counterfeit and mistakes in accounting registers and with purpose of protecting assets of financial corporations and commercial banks and their properties continuously in addition to verifying that personnel and employees of financial corporations and commercial banks follow and observe financial and administrative policies, plans and procedures set forth for them.

It is defined and known as being critically controlling authority which works continuously and independently from levels which it controls and monitors. It neither executes any orders nor has right of issuing them (Fathi, 2002).

Abdel-Fattah argues that it is defined by some researchers as part of Internal Control System representing in an independent activity conducted by a division or a departments of financial corporations and commercial banks. Its duty is to examine and audit documents, books, registers, financial lists, different operations and evaluating performance of departments and divisions at financial corporations and commercial banks and then presenting a report to the supreme administrative with results of this evaluation.

On the other hand, Internal Auditors Association (IAA) defines it as independent, subjective, consultative and confirmative activity whose purpose is to add a value to improve the operations of financial corporations and commercial banks. It also helps in achieving desired goals of financial corporations and commercial banks by ways of finding regular and defined method to evaluate and to improve effectiveness of operations of Risk Department (Instate of Internal Auditors, 1994).

It is also defined as the group of the independent activities established by the administration inside the financial corporations and the commercial banks to help it in the various fields with the aim of achieving their administrative and financial goals (Al-Lourdat, 2006).

Noor (1984) also defined that internal auditing is ring of the internal control auditing and a tool in hand of supreme administrations of financial corporations and commercial banks which provides them with continuous information about progress of accounting and financial operations and other daily operating processes.

Internal auditing is also defined as an independent job inside financial corporations and commercial banks for regular evaluation for sake and favor of general administration or supreme administration in financial corporations and commercial banks (Saka, 1997).

In Khalifa (2006) view with respect to Institut Français de l'Audit et du Contrôle Interne (French Institute for Auditing and Control), internal auditing is defined as an independent activity whose goal and aim is to provide financial corporations and commercial banks with sufficient guarantees about control degree in financial and non-financial operations as well as providing advice in order to take necessary and required precautions which will participate in creating and auditing value and avoiding risks that surround financial corporations and commercial banks equally. According to Mansour (1998), term of internal auditing is defined as a

person or a number of persons who are qualified and belonging from organizational way to supreme administration in financial corporations and commercial banks and which is independent from rest of jobs and professions including accounting and financial jobs. It is also an internal control job which is directly related to managers of financial corporations or general manager in commercial banks or most supreme authority in them. Its work is limited to various jobs and circles and operations. Through internal auditing, operations of all various jobs are audited in order to make improvements required for reaching good application of applicable policies and procedures in financial corporations. It also helps them to achieve the goals written down in a methodical regular manner. They are important procedures for managing risks in financial corporations as well as commercial banks to give them suggestions for supporting their effectiveness without imposing any authority on them.

It is also defined as continuous verification in operations, restrictions conducted by employees, personnel in financial corporations and commercial banks (Ahmed, 1990). Some researchers define internal auditing as an independent evaluative job established inside financial corporations, commercial banks with purpose of examining, evaluating activities, businesses conducted by these financial corporations and commercial banks.

Through displaying and examining the previous different definitions, there can give a comprehensive definition for the internal auditing by defining it as an independent job conducted inside the financial corporations and the commercial banks whether these financial corporations and the commercial banks are small or large. Such job is conducted by a person or by a number of persons belonging to the financial corporations themselves or the commercial banks themselves. It is an activity independent from all the businesses and the operations which are under auditing. It is established within the financial corporation or the commercial bank.

History of internal auditing: Al-Lourdat (2006) show that profession of internal auditing is considered one of most important jobs of accounting and auditing. Existence of internal auditing dated back to >6000 years ago whereas it is thought that there was a proof on presence of official systems for registrations and verifications. It was used at that time in far East region. In Europe, interest with internal auditing started in 18th century due to emergence of a great deal of swindle cases. With transfer of accounting to European countries and auditing to United States of America and great development in businesses, a trend towards necessity of presence of an independent controlling job inside financial corporations and

commercial banks. Putin (2005) argues that the due to expansion in military industry during era of second world war and constant and continuous increase in projecting after moving to era of peace, competitions among companies, corporations and banks, requests of governmental authorities for data and figures grew increasingly which require an effective controlling system for monitoring and controlling these companies and corporations and banks and their method of work and exactness of their data and extent of their execution for procedures and policies drawn for them. Therefore, an independent job was created for regular estimation of accounting and financial aspects and other operations conducted inside corporations. Such tasks are carried out by one department which is internal monitoring department.

From among original, basic interests and concerns of supreme administration for financial corporations and commercial banks is to protect assets by keeping exact financial records by complying with policies and procedures set forth for them as well as decreasing cases of deceit, these matters require and necessitate presence of internal auditing job as an extension for work of external auditor. However, scope work of internal auditor focuses on financial aspects for accounting processes as well as activities of corporation only without tackling other administrative sides. At that time, internal auditor has a limited role. Furthermore, there was no need to establish an independent activity inform of Internal Auditing Department among organizational structure for financial corporations and commercial banks (Saka, 1997). Continuous expansion in activities, size of businesses, largeness of financial corporations and commercial banks as well as complexity of operations done by them have led to increasing the interest in controlling job for department and appearance of the need to existence of an independent department or a division for internal auditing which helps administration to conduct its monitoring and controlling role effectively and efficiently through estimating extent of compliance with subjective policies and procedures of financial corporations and commercial banks, protection of their assets, verification of exactness and completion of their accounting registers, data mentioned in these registers, evaluating its operating processes and their efficiency and loyalty of their employees and personnel for them.

Henceforth, it is necessary to admit important role of internal auditing as a monitoring and controlling job that extends to reach all financial and operational aspects in financial corporations and commercial banks (Mansour, 1998).

Khalifa (2006) has stated that extent of internal auditing extended whereas it was used as a tool for inspecting and examining extent of effectiveness of controlling methods and providing supreme administration with exact information. Therefore, it has become a tool for exchanging information, connection among various administrative levels and supreme administration. Such remarkable development for internal auditing has been reflected on shape and form of Regular auditing program since, program in 1st year of appearance of internal auditing focused on revising accounting, financial operations for financial corporations and commercial banks. However after extension and enlargement of volume and extent of internal auditing. Its program has become including all activities of financial corporations and commercial banks.

Failure and bankruptcy cases of a lot of financial corporations and commercial banks in United States in 4th of last century led to necessity and inevitability of admitting internal auditing as a profession which has its constituents and elements that enable it to achieve its purpose behind its establishing whereas Internal Auditors Institute was established in United States in 1941 with purpose of developing internal auditing as an acknowledged profession. Branches of this institute was spread in many of countries all over world and idea concept of professionalism in internal auditing and necessity of developing it as a profession for which its constituents are available from presence of vocational criteria and standards for exercising it and giving it authorization for it with exercising its business and compliance with its rules and its occupational behavior with necessity of continuous education for practitioners of profession of internal auditing following up developments and publications in field of internal auditing (Mohammed, 1996).

Due to these environmental developments that surround financial corporations and commercial banks which were reflected on profession of internal auditing, internal auditing has become a profession exercised as a job within these corporations and banks as well as in various environments from legal or cultural aspects and in financial corporations and commercial banks which are different in their purposes, goals, sizes, organizational structure and legal entity and through individuals inside these financial corporations and commercial banks (Tamimi, 2004).

Through this historical development for internal auditing, we can notice that it has constituents which qualify it to have a great role in decision taking process on all levels, particularly supreme administration. Great

and remarkable move for internal auditing from being an accounting revision to make sure of authenticity of registering financial processes and discovery of mistakes and errors till it becomes a tool for inspecting, examining extent of effectiveness of controlling methods and following up processes. All these matters led to increasing confidence in outputs of this system (Internal Auditing System) and reliance on it in process of decision taking. In such framework, internal auditing has become unsleeping eye on interests of financial corporations in general and commercial banks in particular. Thereupon, its presence has become an indispensable because it is a means that leads to serving multiple parties and maintains protection of funds of banks by being subjective to dangers. It is also concerned with guarantees as of kind of information, its quality, its sufficiency and its equality so, it is used as a basis for taking various resolutions and decisions.

The technological, scientific and practical development has inflicted internal auditing and as other sciences and professions, it gained the great importance due to role it plays, particularly it is characterized with neutralism and that its role is limited to expressing opinion. Then, appearance of mega financial corporations, large commercial banks, large industrial companies and joint stock companies have led to growth and increase of role of internal auditing. In order that these mega financial corporations, large commercial banks, large industrial companies and joint stock companies remain in working in conformity with policies drawn and set forth for them and in order to increase their profits and rise of its financial resources, importance of the auditing and role of auditor in deciding correctness and exactness of financial and administrative statuses for these financial corporations and commercial banks as well as industrial and joint stock companies.

Functions and standards of internal auditing: The job of internal auditing includes fields of controlling, examination, checking, evaluation, economization, coordination follow up and reporting.

Control: It is defined as verification and making sure that work and business proceeds according to goals and policies and programs set for them. In addition, making sure of correctness and soundness of all accounting and non-accounting operations to detect default and shortage in performance and attempting to limit them in future or preventing them definitely.

The control includes supervision and follow up for every level and it extends for every operation in financial corporation and commercial banks to be continuously

aware of all its conditions, circumstances and to rectify averages, criteria and revising them. The purpose of such control is to avoid wasting efforts and coordinating them to achieve goals upon which these financial corporations and commercial banks were established and to find means to help the executing units to achieve and implement their goals and to rectify errors ad to avoid risks that surround them. Therefore, it is necessary to provide information in light of criteria and standards prepared to measure performance sufficiency in these financial corporations and commercial banks in manner which enables them to benefit from them.

In addition, administration in financial corporations and commercial banks needs control to help them to compensate lack and shortage in personal remarks due to extension of gap between supreme administration, executors since, responsibility of execution and the performance is born by supreme administration. Such responsibility requires concentration on non-routine procedures as well as on all changes which may take place in policies or external circumstances which influence in these corporations, banks as well as serious, sensitive operations and those of relative importance whether with respect to fault or deceit or embezzlements (Putin, 2005).

Requirements of the sufficient controlling system:

According to Mohammad, requirements of sufficient controlling system for financial corporations and commercial banks must include what follows:

- Control must be formed in accordance with nature and needs of financial corporations and commercial banks
- Control must be flexible to remain suitable for any sudden change in plans and circumstances
- Control must be put according to administrative organizational structure for financial corporations and commercial banks. So, it must observe tasks, duties, authorities and powers granted for them in arrangement unit with determination of control centers
- Control must be economic whose benefit exceeds its cost in financial corporations and commercial banks
- Control is understood by everyone who uses it. It must include rectified procedure and avoidance of deviations and mistakes and determining liability and presenting its report as soon as possible

Mohammed control is continuously conducted before and after all operations. Best of its types is that one which aims to avoid deviations from plans prior to their occurrence. Preventive control includes getting permission for some of businesses and their

acknowledgment prior to its execution or its controlling according to preset criteria. From among its purposes is to achieve its goals first by first while appendage control is historical conducted after implementation of operations and their privileges. It is characterized by comprehensiveness of checking and examining all accounts which leads to quickness of detection of mistakes which are difficult to be detected solely. It is considered more accurate due to penetrating deeply into inspection. However, its only defect is that it is concluded after lapse of a long time which in turn does not lead to avoidance of wasting resources and their uses.

CHECK OR EXAMINATION

Putin (2005) argue that it is the audition, analogy and comparison for routine operations executed by other employees to make sure of their accounting and technical authenticity and soundness to detect defaults and errors and deceit for which financial corporations and commercial banks suffer. So, check or examination is considered a precautionary measure whose aim is to protect financial corporations and commercial banks.

Mohammed (1996) pointed out that in order to implement sound check or examination what follows must be achieved:

- Checking enrollments and registers to make sure of authenticity of their accounting, statistical data and authenticity of their use
- Making sure that employees execute and carry out policies plans and all procedures set forth for them
- Checking reports prepared from registers and which are taken as bases for administrative resolutions by comparing their figures, information and data which they contain about their main source
- Making sure that expenses are spent in their necessary purposes and that mature revenues are recorded in accounts
- Financial corporations and commercial banks must follow general arrangements and general laws
- Checking all works of employees as well as financial results of financial corporations and commercial banks

Mohammed further argue that the check or examination must include all aspects of business conducted by financial corporations and commercial banks provided that every unit must be viewed solely from all angles and aspects. The auditor depends in his check on a number of resources. The most important of them are what follows:

Internal regulations: The main source contains instructions governing work of financial institutions and commercial banks and confirmed by references that performance is identical with safety regulations and application.

Standards: A specific criterion to measure and judge actual performance of all aspects of activity carried out by financial institutions and commercial banks.

Estimates budgets: It is a measure of actual results to budget estimates, particularly in sub-budgets to show deviations and measure work of each unit related to period of time.

The evaluation: It is ruling on adequacy and effectiveness of all operations, instructions and various means of control to detect weaknesses, errors, fraud and adequacy. However, this does not mean effectiveness.

Evaluation which is most important function of internal audit is central to development of incident in which it becomes both a preventive function and construction, intended to assist all levels of management to meet their responsibilities by providing them with information. It also takes outlook in mind, rules of engagement carried out by main auditors because it requires ability of analytical and constructive thinking and foresight.

From the point view of Mohammed, the internal auditor is always directly responsible and completely in charge of safety of all means of control and effectiveness but it is neither binding system's designs, methods and procedures that is in position to criticize and evaluate systems developed or contributed directly to overall situation. Also to be exercised by auditor evaluation following:

Regulations: Internal regulations are means of administrative control and these regulations must be modern and flexible to change with potential improvements of working conditions.

System accounting: The adequacy of accounting system is seen by references by providing officials with accurate and sufficient information. Thus, accounting controls should be imposed on all operations.

Internal Control System: Internal control system is part of important systems to match port with subject, purpose of assessment of weaknesses, gaps and work to improve it because it represents first guarantee of safety for all operations within bank.

Performance level: Performance level is assessed level of performance through knowledge of existing capacity of work to raise efficiency in production without an increase in costs.

Standards: Administrative control extends to all jobs in financial institutions and commercial banks by standards evaluation focused on examination of same criterion to measure its performance on foundations so as to avoid future distractions and disclosures.

The reports: Adequacy of reports is measured by achievement of goal and delivery of facts to all levels of management within financial institutions and commercial banks with focus control on principle of exception and increase in reports that need to be compiled and summarized.

Estimates budgets: The duties of task of auditor is to assess budget estimates to ensure its usefulness as a criterion of an effective regulatory.

The coordination: The key feature of this coordination according to Lutfi to achieve integration in efforts of group and to make sure that strengthens their balance on each other coordination should include several principles for proper organization of following:

- Building regulation by function rather than by individuals
- Functions are divided into independent units in order to prevent repetition
- Delegation of authority by doing only work required
- Development of specific responsibility of each employee, so that there would be appropriate authority
- The ease and flexibility in organization taking into account adjustments depending on circumstances
- Administrative activity for debugger with need for constant observation of laws and regulations

The rationalization: Referring to Mansour and Al-Tahan (1994), internal auditor is a critic and analyst of reality of his position which allows him good governance of a lot of things after resurrection of an in-depth and comprehensive study of all aspects of different activities.

The internal audit functions as rationalization of management which is a summary of work test and evaluation which will figure in internal auditor's report,

internal audit department has advisory functions to guide management and technical problem-solving methods for following points:

- Attempt to predict future events through scientific research in order to be identical to coordination conditions and future developments
- Optimum use of all factors of production as an increase in efficiency and achieve satisfactory objectives
- Study all possible alternatives before making a decision and try to estimate the results
- The internal auditor's financial analysis is to judge adequacy levels and to study all decisions

The report: The report is a written record that contains data carried out by auditor during an examination and evaluation and it is considered as elite of summary of work done by internal auditor. Moreover, Lutfi has listed some benefits which can be gained by report:

- Always record in a particular area for a certain period beneficial to all levels of management
- The means of delivery of facts to senior management
- Attempting to detect gaps in previous reviews
- The report is to judge work of internal audit itself

The monitoring: According to Mansour (1998), next step after internal auditor finishes his report is to send it to senior management where it will be discussed. Then send it to one who is responsible for examined work in order to respond to comments and queries of internal auditor.

Lastly will start stage of receipt of responses and approval of senior management of internal audit's recommendations and follow-up which will include following:

- Follow-up of internal audit recommendations that were adopted by the senior management
- Test of data provided for the senior management by the executive management
- Follow the steps to be taken to implement the recommendations of senior management
- Make sure of the arrival of mail to executives who have been checking their work
- Emphasis on observations and personal visits to correct all the mistics
- Consideration of all the problems that appear from time to time and follow-up of resolutions

- Examination and analysis of deviations of the estimated budget, standards and change
- Audit of financial statements and its adoption and follow-up test results

CONCLUSION

Researcher concludes by saying that internal auditing has witnessed consecutive developments on level of practice as a job and on theoretical level as a profession. A lot of factors that take place inside financial corporations and commercial banks have also participated and contributed in developing the internal auditing. From among these factors is need to a job of examining, checking, evaluating and following all daily activities conducted by financial corporation and commercial banks as well as increasing effectiveness of controlling systems at these financial corporations.

The laws, legislations and vocational reports relating to profession of accountancy and internal auditing contributed in making a great role for internal auditing in estimating controlling systems and in dealing with risks inside financial corporations and commercial banks. occurrence of these developments in exercising job of internal auditing was related with occurrence of developments in putting theoretical framework for internal auditing including putting a definition for it, standards, criteria, legislation of morals of profession after emergence of internal auditors institute through seeking to consider profession of internal auditing as an integrated profession and enjoys full and complete independence and releasing internal auditor from the subordination to financial manager into subordination to audition department at financial corporations and commercial banks.

System of internal auditing is considered one of most important procedures taken by financial corporations and commercial banks to face the risks and to decrease them since application of an internal controlling system characterized by efficiency and effectiveness. It is applied by individuals and administration provides a protection to financial corporations and commercial banks from probable risks and it also decreases their occurrence. The legislative authorities and international organizations are concerned with internal auditing greatly. They enacted legislations and laws that regulate banking business in framework of evaluation for systems of internal auditing. They requested banks to comply with these laws and legislations.

Central banks in various countries throughout whole world concentrated on internal auditing and issued their local legislations and laws for it to apply them in its commercial banks.

RECOMMENDATIONS

- Conducting the regular inspection for subjective means which are under disposition of administration of corporation or bank with purpose of controlling and running financial corporation or commercial bank
- Verifying efficiency and effectiveness of internal auditing and validity and authenticity of reports and accounting data and comparing them with drawn up and defined policies, systems and rules
- Verifying efficiency and effectiveness of internal auditing and extent of compliance of employees with application of instructions made by department as well as performance efficiency in various departments and divisions in financial corporations and commercial bank
- Improving revenue through performance quality and treating deviations as well as attempting to avoid them in future
- Presenting consultancies during cases of crisis
- Assisting administration of financial corporation in achieving its purpose
- Internal auditing has to increase duration of auditing training courses to facilitate and to improve auditor's performance. In order to achieve this, design and delivery of these programmes and courses must be taken into account
- Managers should make suitable preparation for auditing programmes by selecting auditors. In addition, managers must elucidate purpose of auditing
- All banks should consider auditor as one of requisites for job promotions, solving problems and stopping risks
- Managers are required to establish a formal procedure other than observation to evaluate their employees

It is recommended that managers might build upon employees' practice of self-assessment in addition to considering issues, for example, transfer of learning. However, appropriate evaluation procedure should consider evaluation at four levels; reaction level, learning level, behavior level and result level. In addition to feedback, outcomes of evaluation are integrated into organisation or individual's departmental and corporate level should also be taken into account

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