

# Problems and Countermeasures on Corporate Internal Audit in China

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## Abstract

Along with the increasing embeddedness of corporate reform, current China has to confront the significant issues of how to establish and improve corporate governance structure, optimize internal control, promote effective use of corporate resources, and avoid fraud and waste. Corporate internal audit is the auditing, monitoring and evaluating on corporate internal economic activities, so as to strengthen internal management and increase economic efficiency. Its purpose is to expose and reflect real status of corporate assets, debts, profit and loss, to investigate various illegal problems on corporate financial receipts and expenditures, to maintain China's ownership rights, to promote clean government establishment, to prevent the loss of state-owned assets, and to serve the governmental macro-control. Therefore, based on relevant theories of internal audit, this paper is to analyze several problems on internal audit and propose countermeasures to the internal audit problems under China's modern enterprise system.

**Keywords:** Internal audit, Problems, Countermeasures

Internal audit refers to an economic monitoring activity that sections or independent auditing organizations and persons inside enterprises, according to national laws, regulations and policies, apply special process and methods to audit the financial receipts and expenditures and economic activities of their own sections and enterprises, to find out their authenticity, legitimacy and validity, and to propose suggestions. The research on internal audit can promote the effectiveness and efficiency of internal audit, benefit effective running of corporate internal control system, improve the quality of accounting information, strengthen corporate internal management, increase business efficiency and effect, and ensure the security and integrity of corporate assets.

## 1. An analysis on current problems of corporate internal audit

Differently from western countries, China's internal audit was established and developed under the Government's help. However, compared to social audit and governmental audit, China's internal audit obviously lags behind no matter on institution setup or on functional effect.

### 1.1 Low emphasis on internal audit at management level

Internal audit has developed for over two decades, but people still can't be embedded inwardly, especially most of corporate directors, who think internal audit is dispensable, and has no direct relationship with corporate economic benefit. Some corporate directors consider internal audit restricts their self business rights and weakens their authority. Thus, they either do not set internal audit department, or deprive its rights even if it exists. The staffs in internal audit department are even excluded and isolated, and can't play their roles as expected.

### 1.2 Poor independence of corporate internal audit

Independence is the soul of audit. Only the independent audit can play monitoring roles indeed. Of course, internal audit is not an exception. However, as internal audit is guided and authorized by self management level, simultaneously, the audit objects are self economic activities, internal audit is not independent in two directions. Seen from Figure 1, internal audit is not independent from not only principal but also objects, which limits internal audit playing its roles.

### 1.3 China's internal audit legal system lags behind

With the development of market economy and embeddedness of reform, many new situations and problems have emerged continuously. However, China has no integrated internal audit laws yet so far. Present internal audit regulation is "Audit Requirements for Internal Audit Work" which was issued in 1987 and can't meet the requirement of current economic situation.

## **Insert Figure 1 Here**

### *1.4 Low quality of corporate internal audit staff*

China's enterprises pay little attention to internal audit, so it stays at low position inside enterprises. It is difficult to attract talents into internal audit team. Therefore, renewal of the team can't be accomplished, which results in single knowledge structure of audit staff, especially lack of risk management knowledge and information technology knowledge.

Firstly, they are lack of cultural knowledge, theoretical level and professional technique. At present, most of internal audit staffs change their profession from financial department or other departments, so their scarcity of knowledge disenable them get competent in internal audit work. Secondly, there are few full-time employees, but many part-time ones. The problems also represent as: lack of further education, unreasonable knowledge structure, shortage of systematic audit specialization knowledge and skill learning, poor mastery of modern audit means, vacancy of EDP internal audit and network information internal audit. Lastly, individual audit staffs are lack of professional ethics, influenced by unhealthy social ethos. They behave irregularly on audit and their audit style is not solid as well, which ruins their authority and image.

### *1.5 Poor authority of corporate internal audit*

China's internal audit staffs come form internal enterprises, who are guided directly by their own enterprises, so they hardly show the authority of internal audit.

Being a significant characteristic, authority is as important as independence. As internal audit is lack of authority it should have had, it is hard to play monitoring roles.

### *1.6 Narrow work scope of corporate internal audit*

Currently, China's internal audit still centers on traditional financial audit, auditing, evaluating and reporting the authenticity, legitimacy and compliance of corporate activities. Or they are restricted by directors' opinion, which brings poor initiative and aimless work. Thus it can't meet the requirements of modern enterprise system on internal audit.

Modern enterprise system requires internal audit make pre-, interim, and post-monitor and evaluate. As internal audit exists inside audited organizations, its functions should be more inclined to pre-audit and interim auditing with increasing economic benefit as a target, and emphasize on accomplishing managerial functions.

### *1.7 Technical means of internal audit lag behind*

China's audit means is still manual audit, which greatly restricts the efficiency of internal audit monitoring. As for audit procedure, auditing risks increase due to incomplete consideration on audit scheme, imperfect audit evidence, non-detailed audit work division, non-standard operation of audit staffs, and so on.

## **2. Countermeasures to strengthening roles of corporate internal audit**

We need to make good use of efficient and effective internal audit, neither only depending on individual enterprise nor social restriction, but all efforts from the state, society and enterprises. Definitely speaking, we propose the following countermeasures.

### *2.1 China needs to improve the legal construction of internal audit*

"No rules, no standards." China is lack of special laws and regulations on internal audit, which is the key reason why internal audit can't guarantee its desired effect. Therefore, we suggest the government to fully study current economic trend on internal audit and issue feasible laws and regulations on internal audit in order to legally guarantee the necessity, work scope, authority and practice regulation of internal audit.

### *2.2 Implement principal system of internal audit*

According to the above discussion, the shortage of independence and authority is the key factor that internal audit can't play its roles. However, if internal audit is charged by relevant staffs of audited organizations, and guided by the management of that as well, internal audit, in any case, can't guarantee its independence and authority. If the government can qualify internal audit staffs, systematically manage qualified staffs, appoint them according to corporate practical needs, assess and monitor them and distribute salary to them by the government, and implement regular turn, the independence and authority of internal audit will be greatly promoted, at the same time, the quality of the staffs also will enormously increase.

### *2.3 Popularize modern audit technique greatly*

Compared to social audit, internal audit usually can't well grasp modern audit technique owing to little

communication with outside and poor quality of staffs. However, as far as monitoring function of audit is concerned, effective audit monitoring means must implement its effect better. Therefore, the government should greatly popularize modern audit technique through certain channels. For instance, if internal audit certification system can be implemented, the test on audit technique should be added into examinations. As for the staffs already in internal audit team, the state also needs to implement corresponding system to further their professional education, so as to renew their knowledge continuously.

#### 2.4 Corporate managers should pay more attention to internal audit

It is not enough for the state and society to regulate and define internal audit functions only. Corporate managers should change their minds, and make clear that internal audit staffs are friends but not enemies and more functions of internal audit are strengthening corporate management, therefore, they are the important force and specialists of corporate management. Only in this way, can managers play roles of internal audit forwardly, cooperate with internal audit staffs positively, eliminate interference mood, and strengthen internal audit work voluntarily.

#### 2.5 Internal audit should expand present working field

Internal audit should transform from “monitoring dominant” to “service dominant”, strengthen service function, highlight the “introversion” of internal audit, base on the requirements of corporate management, and ensure the business target of corporate optimal value. Along with increasingly strengthening corporate internal control, gradual improvement of corporate governance structure, and continuous promotion of accounting information quality, regular audit target or beneficial audit target will be promoted to be main audit target, meanwhile, the focus of internal audit work will transfer as well. In the case of good opportunity, corporate internal audit should be adjusted on its working emphasis correspondingly. And working field also needs to be changed from financial audit to managerial audit. On the basis of effective development or proper appointment of external section’s engaging in financial audit, internal audit department should focus on internal control audit, managerial (operative) audit, economic responsibility audit, contract (agreement) audit, engineering audit, environment internal audit, quality control audit, risks management audit, strategy management audit and management fraud audit.

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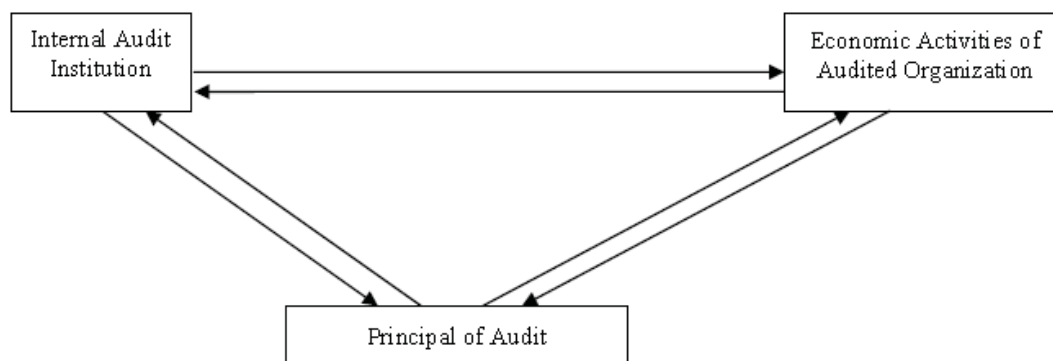


Figure 1. Relationships of Internal Audit