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## **ISSUES OF ORGANIZATION AND IMPROVEMENT OF THE ENTERPRISE'S INTERNAL AUDIT SERVICE**

### **Summary**

Audit Methodology refers to the policies and procedures adopted by the firm and applied by the engagement team to conduct an audit of financial statements of consistent quality. There are a number of methods that auditors can use. Some of these are aimed at preventing wrongful or illegal actions. The challenges of today's changing world provide great opportunities for management and the Board of Directors and point to the need for competent internal audit. Especially in these times of constant change, internal audit is very important for efficient operations, effective internal controls and risk management, strong corporate governance and, in some cases, the survival of the organization. Planning, field work, reporting and control are the main directions of internal audit. Internal audit uses economic information in fulfilling its operational objectives, and this information is a set of facts and data about the production and financial activities of the joint-stock company. The audit obtains information from various and different sources, therefore, the main task of the audit is to make a comprehensive comparison of the information obtained. Internal audit, within its scope of activity, verifies that the accounting records of a joint-stock company are based on existing regulatory legal acts and international requirements, and protects the company from potential future risks.

**Keywords:** *Internal audit, information security, organizational methodology*

**UOT:** 336

**JEL:** E58, F31, F38, G18, E42

**DOI:** <https://doi.org/10.54414/KGIA3086>

### **Intradaction**

Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization achieve its objectives by bringing a systematic, disciplined approach to assessing and improving the effectiveness of risk management, control, and governance processes.

### **Effective organization and formation of internal audit service**

According to Article 1 of the Law of the Republic of Azerbaijan "On Internal Audit", internal audit is an objective, assurance and advisory activity that helps the business entity achieve its goals by systematically approaching the assessment and development of risk management, control and management effectiveness aimed at

the development and improvement of the activities of the business entity. In other words, internal audit is a system of regular observation and inspection of the work of enterprises and organizations in order to assess the validity and effectiveness of management decisions made in enterprises and organizations, to identify shortcomings and deficiencies, deviations, and to inform the management in a timely manner to make appropriate decisions on eliminating, reducing and managing risks in financial and economic activities [4]. According to the same Law, the internal audit service is a structural unit (Audit Committee, department, division, section, internal auditor) that carries out internal audit activities in the business entity. According to Article 2 of the Law, the Law "On Internal Audit"

applies to economic entities operating in the territory of the Republic of Azerbaijan and subject to mandatory audit, regardless of their ownership and organizational and legal form, while other economic entities may apply the provisions of this Law on a voluntary basis.

In the developed countries of Western Europe and America, internal audits are carried out by auditors working in enterprises and organizations, hospitals, municipalities, industrial companies, etc. In the industrially developed United States and Great Britain, the establishment of internal audit institutions is more commendable. In those countries, internal audit in the private sector is separated from state audit by a very thin line. Thus, state auditors work in the US Office of General Budget and Control, which is considered an organ of the US Congress and is engaged in the organization of accounting, audit audits and research in these areas. The Office of General Budget and Control conducts audit audits of the implementation of congressional laws and the feasibility of implementing economic programs in departments, agencies, and federal government programs. A copy of the reports of the Office of General Budget and Control is submitted to the US Congress. Many government agencies maintain their own special auditors and inspectors. Local authorities also have internal audit departments. For example, there are many internal auditors in federal agencies (Department of Defense, Department of Labor, Department of Internal Resources), state agencies (education, health, and finance), and local governments (city, county, and tax districts). In performing their professional duties, internal auditors of companies use, in addition to internal audit standards, state audit standards developed by the General Budget Control Department [5]. In the current market economy, since the economic and legal relations of economic entities with each other are not fully regulated by higher organizations and state authorities, it is more expedient to gradually shift from external control to internal control of the financial and economic activities of enterprises. In order to eliminate shortcomings and deficiencies, it is first necessary to identify the causes that caused them. In modern conditions, there is a greater demand for internal auditors who can identify the causes of

distortions in the financial statements of enterprises, reduce their solvency and worsen the financial situation of the enterprise, and identify resources for improving the organization of production and financial and economic activities, compared to inspectors who can identify all the causes leading to violations of existing legislation.

The heads of enterprises firmly believe that internal audit departments are a special advisor to the enterprise and an integral element of management. These departments direct the activities of enterprises and organizations to risks, and at the same time assist the management in coping with various other strategic tasks - ensuring the reliability of financial information for making management decisions, effectively using resources to improve the quality of the product (work performed, service provided), and increasing labor productivity and profitability of production. Based on the important role of internal audit, many economic entities in Azerbaijan have also decided to establish internal audit departments. Currently, special attention is paid to the establishment and activities of financial institutions in the organization of the internal audit service in Azerbaijan. Thus, in accordance with the Resolution No. 155 of the Cabinet of Ministers of the Republic of Azerbaijan dated October 5, 2007 on approving the terms of phased application of the Law of the Republic of Azerbaijan "On Internal Audit" on economic entities subject to mandatory audit, the establishment of internal audit services has begun in a number of enterprises and organizations.

The role of the internal audit department is to provide the organization's senior management and governing bodies with an objective source of information regarding:

- Organizational risks;
- Control environment;
- Operational efficiency;
- Compliance with existing laws and

regulations.

Technically, Internal Audit is a cost center in a company - it does not generate revenue. However, a good internal audit function can play a very important role in the survival and prospere-

urity of any organization. Unlike external auditors, internal auditors go beyond financial statement reporting risk to consider broader issues such as the organization's reputation, operational efficiency, strategic growth, its environmental impact, and the way it treats its employees. An objective assessment of an organization's processes and activities can provide valuable insights that personnel who perform or manage the actual operations cannot see due to the paradigm or limited perspective that comes from being part of the process being assessed (Smetanko O.V., 2013).

An internal audit should consist of four general activity phases - Planning, Fieldwork, Reporting and Control. Below is a brief summary of each phase (Clarke I., 2022):

### **Planning**

Every internal audit should begin with a plan. During the planning process, the internal audit team defines the scope and objectives. This helps determine what the internal audit should focus on. Once the scope is defined, the following steps should be taken:

- The internal audit team shall determine the internal audit requirement(s);
- Reviewing guidelines relevant to the audit (e.g., laws, regulations, industry standards, company policies, procedures, etc.);
- Review the results of previous inspections;
- Setting a timeline and budget for the audit;
- Create an audit plan and internal audit checklist(s) to be executed;
- Identify process owners to participate;
- Schedule the first meeting to begin the review.

### **Field work**

Fieldwork is the actual act of auditing. Throughout this phase, the audit team executes the audit plan. This typically includes:

- Interview key personnel to confirm understanding of process and controls;
- Review of relevant documents and artifacts for an example of control execution;
- Testing of controls for a sample over a specified period of time;
- Documentation of work performed;

- Identifying exceptions and recommendations.

### **Report**

During the reporting phase, internal audit prepares a draft audit report. The report should be written in a clear and concise manner to avoid misinterpretation and to encourage the intended audience to actually read and understand the report. The findings should be accompanied by recommendations that are actionable and lead directly to process improvements. The internal audit reporting process should include the following:

- Report preparation;
- Reviewing the project with management to ensure the accuracy of the results;
- Submission and dissemination of the final report.

### **Control**

The final stage is an important one that is often overlooked. Follow-up is essential to ensure that recommendations are implemented to address identified outcomes. This process should include appropriate follow-up with the process owners who are responsible for implementing the recommendations, as well as the Board's oversight of the company's overall status in addressing the findings identified by internal audit. If the organization does not follow through on implementing the recommendations, changes are unlikely to be made (Clarke I., 2022).

### **Method**

The article uses methodology to study the topic, including methods such as analysis and synthesis and systematic evaluation.

### **Research model**

Improving internal audit methodology, taking into account international experience in the corporate governance system, contributes to the sustainable development of the economy and, as a result, is an important tool for improving the social conditions of society.

According to the conducted research, today there is a significant lack of methodological materials and recommendations on the establishment, implementation and operation of the internal audit service. Therefore, there is a need to

apply a comprehensive approach to the justification models, principles and factors that affect the process of organizing (forming) the internal audit service and further integrating it into the corporate governance system of the joint-stock company. The study considered models, factors, conditions, prerequisites and approaches related to the establishment of the internal audit service.

### Analysis

Many sectors of control and internal audit attach importance to the production of reliable accounting information through accounting information technology. Randal and Beasley (2019) defined internal audit as the assurance of the accuracy of accounting and financial information provided by financial services and accounting departments.

Internal audit is based on the management and efficiency of the information system, from the input, processing and production of data to third-party beneficiaries. The internal audit system is based on the relationship between the external auditor, financial services and accounting departments to verify the authenticity of the accounting information system and the financial performance of the company.

Information refers to a set of data related to changes in the joint-stock company. Internal audit uses economic information when fulfilling its activity objectives, and this information is a set of facts and data about the production and financial activities of the joint-stock company. The information used in internal audit activities is classified according to certain characteristics (table 1).

Internal audit can obtain information from various sources, therefore, the information provided should be broadly comparable. The regulatory and legal aspects, accounting reports necessary for each aspect of the joint-stock company and the internal audit program should be determined.

### Organizational methodology

The existence of diverse structures and complex management systems creates objective pre-

requisites for the establishment of an internal audit service in the corporate governance structure (<https://www.wirc-icai.org/images/material/Internal-Audit-Methodology-VV.pdf>, 2021).

### Internal Audit Methodology - Lifecycle

- Understand the business and identify key business risks;
- Identify critical business processes that mitigate these risks;
- To analyze these processes and assess risks;
- Conduct internal audits and assess the effectiveness of operational controls through extensive use of standardized checklists (RCM) and data analytics (<https://www.wirc-icai.org/images/material/Internal-Audit-Methodology-VV.pdf>, 2021);
- Reporting observations to management at a specified frequency;
- Provide a summary of key issues to the Audit Committee;
- Assess management's progress against the agreed action plan and whether its actions are being implemented adequately and in a timely manner.

### Strategic Analysis Methodology

Understanding Business:

- Industry data
- Company information
- Industry-wide data sources
- PEST/SWOT analysis

Key Aspects:

- Industry-wide issues and goals
- Company strategic goals
- Key stakeholders
- Key historical issues
- Company-specific business model

Using the proposed stages and approaches in creating an internal audit service will allow us to determine the principal goals at the stage of its formation and integration into the corporate governance system, and to differentiate functional duties and powers between internal auditors and management staff.

Table 1

### Classification of information provision of internal audit activities

Classification signs	Classification group content
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Source of information provision depending on the type of information	Legislative acts, information on actual indicators, literature sources, regulatory information, Audit specific information sources.
Requirements for information sources	Timeliness, reliability, completeness
Method of obtaining information	Analysis of the general economic, regional and sectoral characteristics of the economic entity; Familiarity with the audited organization and production technology; Collection of information about the structure of the economic entity's private capital and personnel, the range of products produced, the methods used for accounting, and the internal control system; Collection of information about the legal and financial obligations of the economic entity, its main buyers and shippers
Confirmation of information and place of receipt	Information collected by the auditor directly at the entity being studied (internal confirmation); Information collected by the audited entity for the auditor's review and use; Information provided by third parties, including experts.
Sources of information depending on the documents being researched	Documents regulating the activities of an economic entity (accounting policy, charter, internal information); Documents reflecting the results of activities (economic analyses, accounting reports and statistical reports); Various audit reports, court and arbitration claims; Planning documents for the activities of an economic entity (business plans, projects); Operational and current activity documents of the economic entity; Results of initial accounting documents, accounting registers, and inventory of assets and liabilities.
Information sources on usage directions	Rational planning and efficient audit; Determining audit risk and materiality levels; Detection of contradictory information; Identification of third parties and transactions involving third parties; Selecting methods and types of analytical procedures to perform and audit evidence to obtain.

**Source:** Ganizadeh R. (2008).

The basic principles of the structure and organization of internal audit, which ensure the achievement of the objectives of internal audit in the company, are ([https://www.rosneft.com/upload/site2/document\\_file/P4-01\\_P-02\\_EN.pdf](https://www.rosneft.com/upload/site2/document_file/P4-01_P-02_EN.pdf), 2015):

➤ **Independence principle:** The organizational independence of Internal Audit is ensured through the separation of administrative and functional reporting.

Internal Audit reports functionally to the board of directors of the joint-stock company.

Functional management of internal audit involves the consideration by the management of the joint-stock company of significant limitations of authority and other restrictions that may adversely affect the effective performance of the internal audit function:

- approval of LNDs at the “Policy” level in the field of internal audit (internal audit rules defining the objectives, tasks and powers of internal audit);
- making decisions on the appointment and dismissal of the head of internal audit;



- review of action plans and reports on internal audit activities;

- Approval of the budget of the Internal Audit Service of the joint-stock company and the remuneration of the Head of Internal Audit;

Internal audit reports administratively to the Executive Director of the joint-stock company. Administrative management of internal audit includes the following:

- allocation of necessary funds within the approved budget;
- approval of internal audit action plans;
- review of reports on internal audit activities;
- managing policies and procedures for internal audit activities.

The head of internal audit ensures that sufficient resources are available and used effectively to implement the internal audit activity plan.

**Principle of objectivity:** Internal auditors are impartial in their work and avoid any conflict of interest. Internal auditors should not participate in the making of management decisions related to the financial and economic activities of the Company and in audits in the event of a real or potential conflict of interest or any other circumstances that impair their independence and (or) objectivity.

To avoid conflicts of interest (threats to the loss of internal audit independence and the objectivity of the auditor's opinion), the head of internal audit and internal auditors refrain from the following:

- Audit of the areas of activity for which they are responsible during the year preceding the audit;
- Participation in audits and other assignments when there is a conflict of any professional or personal interests (financial, property, family or any other interests in the activities of the audited entities);
- Engaging in any activity that may compromise or prejudice their impartiality;

Internal auditors report to the head of internal audit any factors that negatively impact the independence and objectivity of internal audit, including limitations on their authority and conflicts of interest.

## Conclusion

Internal audit, when properly implemented, will provide independent, objective assurance and consulting services designed to add value and improve an organization's operations. It helps an organization achieve its objectives by bringing a systematic, disciplined approach to assessing and improving the effectiveness of risk management, control, and governance processes.

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## ОРГАНИЗАЦИОННЫЕ ВОПРОСЫ И СОВЕРШЕНСТВОВАНИЕ ВНУТРЕННЕЙ АУДИТОРСКОЙ СЛУЖБЫ ПРЕДПРИЯТИЯ

### Резюме

Методология аудита относится к политике и процедурам, применяемым фирмой и командой по проведению аудита финансовых отчетностей с обеспечением их стабильного качества. Существует несколько методов, которые могут использовать аудиторы. Некоторые из них направлены на предотвращение неправомерных или незаконных действий. В условиях быстро меняющегося мира управление и советы директоров сталкиваются с новыми вызовами, которые требуют компетентного внутреннего аудита. Особенно в условиях постоянных изменений, внутренний аудит играет важную роль в эффективной работе, надежности внутреннего контроля и управлении рисками, а также в обеспечении сильного корпоративного управления, что порой становится вопросом выживания организации. Планирование, полевые работы, отчетность и контроль — основные направления внутреннего аудита. Внутренний аудит использует экономическую информацию для выполнения своих операционных задач, представляющую собой набор фактов и данных о производственной и финансовой деятельности акционерного общества. Аудит получает информацию из различных источников, и поэтому его основной задачей является проведение всестороннего сопоставления полученной информации. В рамках своей деятельности внутренний аудит проверяет, что бухгалтерские записи акционерного общества соответствуют действующим нормативно-правовым актам и международным требованиям, защищая компанию от потенциальных будущих рисков.

**Ключевые слова:** Внутренний аудит, информационная безопасность, организационная методология

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## MƏSƏLƏNİN TƏŞKİLATI TƏRƏFİ VƏ MÜƏSSİSƏNİN DAXİLİ AUDİT XİDMƏTİNİN TƏKMİLLƏŞDİRİLMƏSİ

### Xülasə

Audit metodologiyası, təşkilatın vəzifəsini yerinə yetirən audit komandası tərəfindən maliyyə hesabatlarının auditini aparmaq üçün qəbul edilən siyasət və prosedurları bildirir. Auditorların istifadə edə biləcəyi bir neçə metod mövcuddur. Bəzi metodlar, qanunsuz və ya yanlış hərəkətləri qarşısını almağa yönəlmişdir. Bu günün dəyişən dünyasının çağırışları, idarəetmə və İdarə Heyətinə böyük imkanlar yaradır və kompetent daxili auditin zəruriliyini göstərir. Xüsusilə daim dəyişən dövrlərdə daxili audit, təsirli fəaliyyət, effektiv daxili nəzarət və risklərin idarə edilməsi, güclü korporativ idarəetmə və bəzən təşkilatın sağ qalması üçün çox vacibdir. Planlaşdırma, sahə işləri, hesabat vermə və nəzarət daxili auditin əsas istiqamətləri təşkil edir. Daxili audit özünün əməliyyat məqsədlərini yerinə yetirərkən iqtisadi məlumatlardan istifadə edir ki, bu da səhmdar cəmiyyətinin istehsal və maliyyə fəaliyyətinə dair faktlar və məlumatların cəmidir. Audit müxtəlif və fərqli mənbələrdən məlumat əldə edir, buna görə də auditin əsas vəzifəsi əldə edilən məlumatların ətraflı müqayisəsini aparmaqdır. Öz fəaliyyət çərçivəsində daxili audit, səhmdar cəmiyyətinin mühasibat uçotunun mövcud tənzimləyici hüquqi aktlara və beynəlxalq tələblərə uyğunluğunu yoxlayır və təşkilatı potensial gələcək risklərdən qoruyur.

**Açar sözlər:** Daxili audit, informasiya təhlükəsizliyi, təşkilati metodologiya