

Internal Audit Functions on External Auditor's Reliance in Hotel Sector in Sri Lanka

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Introduction

In today's world focus on corporate governance which has directed attention on roles played by internal and external auditors. Many successful organizations today are recognizing the importance of internal audit function as a key component of governance frame work within the organization. The growth of internal auditing over the years has led to more consideration for relying on internal audit work by external auditors. For the external auditor to rely on any work performed by the internal audit function the external auditor must assess the quality of the internal audit function. Internal audit function should have the considerable flexibility that external auditors have in using the work of the internal audit function should translate into a strong encouragement for companies to develop high-quality internal audit functions. SLAUSs 610 Considering the Work of Internal Audit described the relationship between external auditors and internal audit and outlining the various ways in which the external auditor can improve their efficiency and effectiveness by utilizing the work of the internal auditors. Several things to be considered in the process of establishing the internal audit work by the management in the organization. This research, attempts to identify the most significant factors in the strength of internal audit functions towards the external auditor's reliance in the organization. All business functions therefore become effective and efficiency throughout the sound internal control system by preventing duplication of work in auditing. Then the organization can achieve higher performance throughout the business functions and also sound internal control system leads to reduce external auditor's work throughout this the organization reduce the expenditure on external auditing.

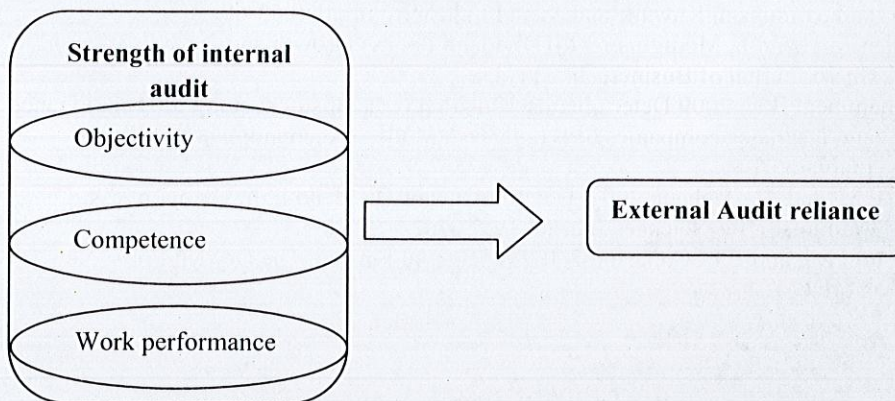


Figure 1: Conceptual Framework

Methodology

Objectivity has been defined as the organizational status of the internal auditor and organizational policies affecting the independence of the internal auditor. Internal audit staff should perform their activities in the perspective of professional capacity and best interest of entity rather than bias. In the concept of objectivity, the level of transference between internal auditor and management play vital in the company. Here, the board should establish formal and transparent arrangements for considering how they should apply the financial reporting and internal control principle and for maintaining an appropriate relationship with the internal auditor. The researcher has gathered information from external auditor about evidence of managerial reporting relationship (ex, External auditor's satisfied with internal audit report & finding), Evidence of breadth and scope of investigatory scope (ex, External auditor's satisfied with investigation any area by internal auditors & Freedom for conflict duties) and evidence of recommendation implementation to measure the objectivity (ex, External auditor's satisfied with deposition of recommendation of internal auditor & ability of internal auditor's access to audit committee).

The Competency of internal auditor

The Competence is defined by Arens and Loebbecke (1991) as being that quality of a person that accepts a professional engagement and which also has the necessary technical knowledge in order to fulfill that engagement. Internal auditor should have professionally certificated. That means internal auditor should have knowledge, skills and experience regarded to their profession. The researcher has gathered information from external auditors about evidence concerning auditor qualifications and training, evidence of audit planning and supervision and evidence of auditor tacit knowledge to measure the competence of internal auditors.

Work performance of the internal auditor

Work performance has been defined as internal control and risk assessment, and substantive procedures performed by the internal auditor. Work performance means evaluating whether the internal auditor's work that have already been done by the internal auditor are effective or not in their assigned responsibilities in the organization. The researcher has gathered information from external auditors about evidence of internal audit effort, evidence of execution of internal audit plan and evidence of thoroughness and quality of internal audit reporting to measure the work performance of the internal auditor.

Dependent variable

External auditor's reliance

External auditor's reliance is the belief of the external auditor on internal audit work. When external auditor considers internal auditor's work comply with the all mandatory requirement and policy and procedures in the organization.

Five point Likert scale method was supported to convert qualitative data into quantitative data. Results in Five point Likert scale method gives as follows

1<x<2.5= Almost disagree

2.5<x<3.5= Moderate

3.5<x<5= Almost agree

Results and discussion

Multi Variant Analysis is a statistical method that allows simultaneous investigation of more than two variables. The regression equations are as follows. Multiple regressions,

$$ER = \alpha + \beta_1 o + \beta_2 w + \beta_3 c + K$$

After applying the data to the regression model, the results are as follows.

$$\text{External auditor's reliance} = -0.192 + 0.08 \text{ Objectivity} + 0.071 \text{ Competence} + 0.10 \text{ work performance}$$

Value -0.192 that is "α", represents the value of external auditor's reliance at zero level of strength of internal audit function.

The Objectivity, Competence and Work Performance of internal audit functions are moderate level in majority of hotels in Sri Lanka. The relationship between strength of internal audit function and external auditor's reliance was strong positive relationship found by the researcher because the correlation coefficient was 0.928 in the research study. Then external auditors can enhance the reliance of the internal audit functions if there is strong strength of internal audit functions. The researcher examined external auditors to use internal auditors as an assistant throughout the external audit process. Therefore, external auditors can make use of some of the internal works that are already done by the internal auditors. On the other hand research revealed that the external auditor can reduce timing, nature, and extend of audit procedure by using internal audit work. The relationship between the objectivity of internal audit function and external auditor's reliance was strong positive relationship, because correlation coefficient was 0.825 in the research study. The relationship between the competence of internal audit functions and external auditor's reliance was strong positive relationship, because correlation coefficient was 0.845 and relationship between the work performance of internal audit functions and external auditor's reliance was strong positive relationship, because correlation coefficient was 0.863 in the research study. Furthermore, the strong positive relationship were to be all the three factors with external auditor's reliance therefore high Objectivity, Competence and Work Performance of internal audit functions increased external auditor's reliance.

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