

The Role Of Internal Auditing In Sustainable Development And Corporate Social Reporting

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Abstract

Sustainability means a lot more than just the economic, environmental, and social challenges an organization faces in its everyday and future operations: it means the ethics in these operations, touching on all the lives of those in the organization, its stakeholders, and the planet. The objectives of all sustainable development programs must be measured, and the

results are to be reported in and outside the organization. Stakeholders and society need to be assured independently in that such measures are recorded accurately and in timely fashion before being reported. There are opportunities for internal auditing to contribute to its independent and objective assurance services as an auditor as well as a consultant and teacher. Such a contribution can take best-practice internal auditing to a high level of added value. The internal auditor is a vital conduit to the creation of trust.

The internal auditor contributes to a number of corporate social reporting (CSR) and sustainability issues by keeping management updated on the aspects of operational and compliance issues, which is part of their core function, as well as brand management audits and through participation in the stakeholder dialogue process. Furthermore, the increasing importance of CSR and sustainability and its impact on risk management bring additional challenges involving the control environment, including the provision and installation of effective management and reporting systems, which will provide clarity and transparency, and therefore trust. The internal auditor has an integral role in determining the materiality of the content of the CSR and sustainability report. This is a responsibility that can only increase with the burgeoning of CSR and sustainability reports, both in volume and size of content.

Today, internal audit function that is the most important factor in creating sustainable value to improve the value of the company and firm performance is important to correct implementation and to be sustainable. Therefore, enterprises should assign enough importance to internal auditing and should pay attention to create a sustainable audit system. The aim of this study is to investigate the system of sustainable internal audit which is the essential element for sustainable development and corporate social reporting.

Keywords: Corporate Social Reporting, Internal Auditing, Sustainable Development, Corporate Social Responsibility, Sustainable Management Systems.

1. INTRODUCTION

Sustainable development process drawing attention of both public sector and private sector for decades have brought forward the concept of corporate sustainability. Particularly the belief that the sustainable development process cannot be achieved without the support of the entities has necessitated the consideration of sustainability process in the entities. In this regard, sustainable policy and strategies have been developed via sustainable management systems.

Variation of management policies and strategies has led to variation in the risk areas that the entity will come across during its activities. Relevant variation have also created differences in the roles and responsibilities of internal auditing that supports (COSO, 2006) the designation of policies, procedures and strategies by the management and gives assistance to the management, board of directors and audit committee responsible for the operation of this

process with respect to review, assessment, reporting and increasing the effectiveness and adequacy of corporate risk management processes.

In this study, the role and responsibilities of internal audit in corporate sustainability have been reviewed. In this perspective, particularly internal auditing and current structure of internal auditing has been reviewed and then new roles and responsibilities of internal auditing in the corporate sustainability have been searched.

2.Internal Auditing

Internal auditing is an independent and objective activity of assurance and consulting aimed to develop the activities of an entity and add value to these activities (D. Pehlivanlı, 2010, 7). The purpose of internal auditing is to remedy each process to mitigate risks in the entity and increase operating income (M.A. Yousuf, 2010). Internal auditing is aimed to give assistance to the management, board of directors and audit committee in reviewing, assessing, reporting and increasing the effectiveness and adequacy of corporate risk management processes (COSO, 2006).

A fair internal auditing process must be relevant to both management and application performance of the entity and auditing financial and operational risks of the entity. For this reason, internal auditing is an important instrument of the firm in maintaining its operations in a successful fashion. What is important is to use this instrument as required and in an efficient manner so that the results are reflected on the activities of the entity (G.Aras,2012,2).

According to the Standard 2130 of the Institute of Internal Auditors (IIA), internal audit contributes to the progress of the entities in following dimensions (The Standard 2130 of IIA):

- Designation of organizational values and objectives and communication of these objectives and values to staff,
- Supervision of whether the objectives are achieved,
- Maintenance of accountability,
- Protection of organizational values.

Reasons necessitating the existence of internal auditing can be enumerated as follows (D. Pehlivanlı, 2010, 19).

- Responsibility and accountability: Obligatory transfer of authority and responsibility due to the growth of enterprise; the need to search the effectiveness of the staff and the compliance of senior management with policies,

- Agency theory: The need to employ salaried executives as a result of professionalism and growth of the entities and to determine to what extent these executives fulfill their responsibilities,
- Consulting and assistance to the management: The objective of internal auditing is not only to discover the errors and deceits but also to provide consulting in areas where the entity management needs advice.
- Savings need: Today, since costs are minimized in every field in order to survive intensive competition conditions, internal auditing units also help in finding areas to maintain savings for entities.
- Need to oppose fraudulent transactions: Internal audit is responsible for discovering fraudulent acts of entity owners, executives or staff.

Internal audit also has roles and responsibilities for the corporate management which is the assurance of sustainability and a process assisting the entity in working efficiently, drawing human capital and financial capital and earning profits for all shareholders by balancing their interests (M. Ertuğrul, M. Sarıkaya, A.A. Özdemir, M. Kılıç, S. Yılmaz, 2009, 9) to operate efficiently. Within this framework, risk management, control and corporate management processes as well as independent and unbiased assurance and consulting activities of the entities and corporations are also under the responsibility of internal auditing. Making significant contributions to the establishment of administrative accountability process in entities, internal auditing creates added value for the entities with its opinions and recommendations about appropriate performance of the activities as well as the performance of appropriate activities (A.K. Uzun, 2012).

3. Corporate Sustainability

Sustainable development is the process of preventing waste of resources and directing investments, technological innovations and industrial improvements in order to meet the needs and requests of persons today and in future (Brundland Commission, 1987). Ever-increasing roles of the entities in society have resulted in the consideration of sustainable development concept more in business environment. As companies represent the productive sources of the economy today, it is accepted that the society cannot achieve sustainable development without the support of the companies. Therefore, private sector companies must work actively to create economic values and to mitigate environmental and social problems emerging from their activities as well as producing goods and services increasing living standards (M. Sarıkaya, F.Z. Kara, 2007, 225). This situation introduced the concept of corporate sustainability. Corporate sustainability is to satisfy the needs of direct and indirect shareholders of an entity without making concessions from the facilities in order to meet the requirements of future shareholders (M. Ertuğrul, M. Sarıkaya, A.A. Özdemir, M. Kılıç, S. Yılmaz, 2009, 9).

4. Role of Internal Audit in Corporate Sustainability

Sustainability with environmental, social and economical dimensions necessitated the formation of consumer behaviors and other market dynamics within the framework of sustainability and designation of a sustainable management system by the companies. For this reason, risks and opportunities to emerge with respect to this process have also been inserted among the priorities that the companies must take into consideration (IMKB, 2011, 4-6). New function of the internal auditing is to define and understand the risks and opportunities created by the sustainability process as well as to determine how these opportunities and risks will affect the entity; to assess and report sustainability indicators and results of climate changes. (www.deloitte.com/.../Role%20of%20Int%20). Sustainable development has a very strong link with ethics. Companies must gain the trust of others not only for the financial resources, but also for all resources used in the organization in order to create value. Trust can be established only with transparency. In order to render the risks of company founders or management consistent and balanced, to supervise that the company comprehends the business field and competition conditions well and takes balanced decisions and to ensure sustainability of the company, internal audit assessments must be made in a prudential, fair and value increasing manner in line with ethical principles (http://www.deloitte.com/assets/Dcom-Turkey/Local%20Assets/Documents/turkey-tr_fbs_kurumsallasma_051110.pdf).

Corporate sustainability necessitated the designation of sustainable management systems. The advantage of the relevant management system is that the system is an auditable structure covering economic, environmental and social assumptions with a systematic, transparent, consistent and reliable understanding manner (H.Niveuwlands, 2006, 37). Internal audit is responsible for providing advisory services in this field with the senior management and must follow up the entire process related to sustainability in the organization (H.Niveuwlands, 2006, 49-66).

Sustainable management process is consisted of (H.Niveuwlands, 2006, 37):

- Determination of sustainable policies and strategies,
- Information risk management and planning,
- Improvement and application,
- Control and correction,
- Management review and continuous improvement.

	Traditional Management Understanding	Sustainable Management Understanding
Objective	Economic Growth and profitability Welfare of the shareholders	Sustainability and standard of living Welfare of the stakeholders
Products	Design based on function, style and price	Design appropriate to the environment

	Single use package product	Packaging friendly to the environment
Environment	Dominance on the environment Air pollution and wastes are accepted as exteriority.	In harmony with nature Elimination and management of air pollution and wastes
Operating Functions	Financing for profit maximization in short term Accounting for traditional costs Human resources management for labor force effectiveness	Financing for sustainable growth in long term Accounting focused on environmental costs Human resources management aimed to make the business meaningful and protect security and health in the work place
Performance Measure	Financial results	Financial, economic, social and environmental results

Figure 1: Differences in Management Understanding (N. Tökgöz, S. Önce, 2009, 253).

As it is obvious from Figure 1, first step of sustainable management system is to issue sustainable policies. Internal auditing must review sustainable policies determined and determination process of these policies on a periodical basis. On the other hand, it is also responsible for reviewing whether sustainable policies are in compliance with strategic plans and other organizational policies. Furthermore, internal auditing must monitor and search all relevant laws, regulations, protocols and industrial standards (H.Niveuwlands, 2006, 49-66).

For the sustainable management process to reach its objectives and targets, job descriptions of the staff should be made appropriately. Duties, roles and responsibilities of the staff must be clearly defined and it must be ensured that the staff has access to necessary sources in order to fulfill their duties and responsibilities. The role of internal auditing at this stage is to determine whether the staff appointed to the relevant duty is appropriate to the related job description. In this regard, internal audit may resort to personnel files as well as survey application. Another step of sustainable management process is risk management. Internal auditing assumes a key role in this field. Internal auditor must develop a risk management system covering sustainable perspective. In this process, internal auditor must give assistance to the management for improvement, consideration and identification of risk management methodologies by taking over a consultant's role and collect evidence substantiating whether risk management process has achieved its objectives (H.Niveuwlands, 2006, 49-66).

Corporate scandals unveiled in recent years, higher levels of information and awareness of investors, environmental, ethical and social performances of the enterprises which have become more important and sustainable development process have created differentiations in the role of internal auditing. Particularly the fact that traditional internal auditing does not represent risks related to sustainability process has been one of the essential factors affecting the role of internal auditing in the enterprise. (<http://www.cipfa.org>).

The risks which sustainable management system shall be exposed to may refer to environmental, health and security risks in addition to the risks which each enterprise may be exposed to. Nevertheless (H.Niveuwlands, 2006, 49-66),

- Organizational reporting structure,
- The possibility of causing environmental losses or fines,
- The possibility of causing injuries and deaths,
- The possibility of encountering adverse propaganda,
- Loss of reputation or image can also be described as the risk areas that the enterprises may come across in this process.

From this perspective, International Professional Practices Framework (IPPF) Issued by International Institute of Auditors (IIA) enlists the risks related to the sustainability process (<http://www.theia.org>).

1. Strategic risk: Enterprises may go through changes in areas such as market placement, consumer preferences, strategic investments (such as renewable energy) and stakeholder communications along with sustainability and climate change. Therefore, senior management or board of directors of the enterprise must determine how they can make use of these changes in order to derive competition advantages. For example, manufacturing environment sensitive products (green products).
2. Compliance risk: Together with climate changes and sustainable development, regulations in many areas such as national, international and regional areas have become a current issue. The biggest risk in this field is related to the measurement of the results concerning regulations. The fact that the applications are in different fields which are health, security, human rights, labor acts, anti-bribery and environmental; and both their results and measurements of these results show variance are among the key risks that the enterprises experience. For instance, while environmental risks have direct impacts such as emission costs, they have also indirect impacts such as the increase in energy prices.
3. Financial risk: Climate changes and changes related to sustainable development may directly or indirectly affect share certificate values of the enterprises. For example, compliance to this process not only leads to new costs, but also new market losses. Furthermore, corporate ratings given at the end of sustainability performance may cause the enterprises to lose value in the eyes of the investors. All these developments may also be end up with customer losses in addition to market losses.
4. Reputation risk: Corporate reputation is a collective concept covering the opinions of all stakeholders about corporate reputation, internal identity and particularly the opinions of the customers about the corporation as well as external image. A strong reputation ensures sustainable competition advantage. Reputation risk is described as potential negative reputation about the business practices of corporations. It increases social and environmental roles of the sustainable enterprises. For this reason, failure in fulfilling these responsibilities increases reputation risk of the enterprise (E.Uzunoğlu, B.Öksüz, 2008, 114-116).

Due to this process, most of the enterprises prepare and issue sustainability reports, in other words, corporate social responsibility reports today for the following purposes (A.B. Bařar, M. Bařar, 2006, 216):

- To increase the possibility of monitoring process towards certain targets and facilitate the application of environmental strategies,
- To increase more awareness about environmental issues within the enterprise,
- To express enterprise message explicitly within and outside the enterprise,
- To increase credit rating due to transparency, to ensure increase in cost savings and efficiency,
- To increase the spirits of the staff, reputation of the enterprise and business development opportunities.

Social responsibility or sustainability reporting is reporting of the activities and results of the activities that an enterprise conducts within the framework of the obligations emerging from its social responsibility (U. Kaya, A. Karakaya, 2008, 154). Together with this process, internal audit has assumed the obligation of creating opportunities to ripen sustainability program of the enterprise, maintaining reliability and appropriateness of integrated reporting process and control reports of this process in addition to giving assurance for operation activities.

The biggest expectation of the enterprises from sustainable development and social reporting is satisfaction of their basic requirements. Internal auditing is responsible for transferring the objective, yield and risks of sustainability program causing an additional cost for the enterprises to the business management or board of directors. Enterprises generally think that this process brings nothing, but additional costs and show a proactive approach against the risks imposed by the process. In this respect, internal audit must state the importance of these risks to the enterprises and create certain plans in order to remove the risks. On the other hand, it must be ensured that senior management or board of directors also participate in the sustainability process (www.deloitte.com/.../Role%20of%20Int%2).

Internal audit must be informed about the risks of corporate social responsibility process discussed together with sustainability process. Nevertheless, internal auditors must have sufficient information and capabilities in order to fully understand this process (J. Ridley, K. D'Silva, M. Szombathelyi, 2011, 482). Internal auditors must answer the following questions in order to turn the corporate social responsibility and sustainability process into an opportunity (J. Ridley, K. D'Silva, M. Szombathelyi, 2011, 483):

- Why should we pay attention to corporate social responsibility as an enterprise?
- What is corporate social responsibility and where are we in this corporate social responsibility?

- Who are the interest groups of the enterprise and what are the needs of these groups?
- What are the enablers?
- What is triple bottom line?
- Which enterprises are close to sustainable development?
- Which managers report the results in the enterprise and give assurance to the report results?
- What is the role of internal audit in this process?

The reporting system of the sustainable management system must issue the report related to environmental audit. However, the report must be issued in time and cover all results related to the enterprise. Internal audit must be held responsible for the control of this process.

5.CONCLUSION

Internal auditing covering various audit activities such as compliance audit, activity audit and information systems audit has been one of the indispensable activities of the enterprises particularly with its function and scope for the reliability of financial reporting system in companies and institutions, compliance with laws and regulations, protection of operating assets, maintenance of economic, effective and efficient conditions of the activities, security and reliability of information systems (S. Selimoğlu, 2011). The differences emerging in the role of internal audit together with the corporate sustainability process defined (M. Ertuğrul, M. Sarıkaya, A.A. Özdemir, M. Kılıç, S. Yılmaz, 2009, 9) as the sustainability of an enterprise as a whole in terms of economic, ecological and social perspectives can be summarized as follows (The IIARF- Sustainability and Internal Audit):

- To design and improve sustainable management system,
- To raise awareness about the sustainability with the help of training programs organized for the staff,
- To coordinate audit activities of external auditors,
- To make suggestions related to the determination of external evaluators.
- To assure that the objectives of the enterprise are fulfilled on condition that all negative impacts related to all interest groups are minimized and the conditions to affect interest groups positively are maximized,
- To ensure compliance with rules and regulations related to the values with a sense of responsibility,
- To ensure that the resources are used at maximum level with a sense of responsibility and reliable records are kept for all interest groups including shareholders and staff of the enterprise,
- To preserve both internal assets of the enterprise and external assets (air, energy, nature etc.).

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