

## Section 1. Accounting

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### INTERNAL AUDIT AND INSPECTION IN LOCAL SELF-GOVERNANCE

**Abstract.** The objective of a previous article is to explore the differences between the functions of an internal audit and inspection in local self-governance. Somehow, there is confusion, about the objectives of internal audit and inspection. Occasionally, the terms “Internal Audit” and “Inspection” are used interchangeably, even though they are very different from each other. In this article, I am trying to explain the objectives of an internal audit and inspection, as well as to find out the difference between them.

This article is dedicated to explaining the goals of internal audit and inspection and seeing the difference between them.

While the research process, the materials of the Institute of Internal Auditors (IIA) were used. Moreover, the laws and normative acts adopted by Georgian legislative and executive bodies, the International Professional Practices Framework (IPPF), as well as guidelines and standards of the International Organization of Supreme Audit Institutions (INTOSAI) for the public sector, and the methodologies, reports, and publications developed by the Central Harmonization Unit (CHU).

**Keywords:** Internal Audit and Inspection; local self-governance.

The internal audit and inspection are two key noteworthy instruments, used by organizations, to ensure their affiliation with regulations, policies, and procedures. Auditing is an independent evaluation of an organization’s financial reporting, while an inspection is a review of operations, operating rules, and regulations.

An auditing is an independent evaluation of the financial statement of the organization, while an inspection is a review of the organization’s operation and its compliance with applicable laws and regulations.

The organizations carry out the auditing, to assess, whether their financial statement accurately

reflects their financial position and identify the potential areas of financial risk.

In addition, the inspection is carried out to assess the organization’s compliance with laws and regulations, and to identify the potential areas of non-compliance.

The ISO 9000: 2015 standards, developed by the International Organization for Standardization (ISO) define an inspection as “Establishing compliance with specific requirements”.

Below, there are five key differences between an inspection and an internal audit:

- The main difference between the internal audit and inspection is the source. The Internal

audit generally looks at the process, while the inspection is focusing on the operation of the institution;

- One more difference between the internal audit and inspection, is the depth of discussion. Inspection, as a rule, is limited to certain specified requirements. If the action meets the specific requirements, it is acceptable, otherwise, it is considered negative. An internal audit is usually a more in-depth review of the process;
- Internal audit is a much more formal and documented process, than the inspection;
- The primary goal of internal auditing is to improve the processes. Inspection, on the other hand, is usually used to determine whether a process meets the specifications;
- Internal auditing focuses on the future, by identifying the weaknesses of the system and exploring opportunities to improve processes. Inspection is focused on the past performance of the process.

According to the annual reports of the Central Harmonization Unit (CHF), the units of an internal audit were mostly developed based on the general inspection, which to some extent, has caused the sharp separation between internal audit and inspection. Inspection units investigate the various misconducts, as well as find out the existence of actions incompatible with the goals of the institution and its subsequent study.

But, equating the role of internal audit with general inspection and disciplinary activities, remains a problem.

There are frequent cases, when the internal audit is not able to separate, and distance itself from its previous general inspection, on which bases their entities were formed.

Today, it is common to focus more on inspection, than on internal auditing. On the whole, it creates several problems. Therefore, it is better, if internal auditors will not be engaged in the activities of inspection, which is a very rare case in the existing reality.

It is essential, to separate the inspection and internal audit from each other, both on a legislation and practical level. This is more or less decided in local self-governance units, but still, there are some exceptions, when their functions are confused. The reason is the lack of human resources.

In general, the main goal of an inspection is uncovering the violations, various misbehaviors, and actions incompatible with the goals of the organization, as well as performing their control. Inspection is the component of control, implemented by so-called post factum (“ex-post”), and acts as a complaint-oriented feedback mechanism. They carry out routine and very detailed inspections. The basis of a complaint is an important tool for attention. Furthermore, one of the key areas of inspection is to check out the regulation of public sector funds and their proper usage.

The Internal audit is studying the systems and processes, to identify the risks and weaknesses.

After finding the deficiencies, it evaluates the financial management and control (FMC) systems realistically and objectively, using appropriate professional methods. Afterward, presents the management (leadership), and the recommendations for improving the management and control system.

It is noteworthy to mention, that the internal audit is not able to ensure and eliminate fraud, violations, and misconduct. The head of the institution is obliged to manage, and control the process, as well as to establish an effective and productive internal control environment, taking into account the introduced recommendations. The vital role is to support the improvement of managerial functions within the institution. On the other hand, the function of the inspection is directly related to the same leadership and under the direct instruction of management, carries out investigations, controls, and verifications.

Furthermore, based on the complaints, it carries out ex-post control and administrative investigation.

Since an inspection is a part of managerial responsibility, it should not be used to evaluate FMC

systems. All this represents the internal audit function (Resolution of the Government of Georgia N593, “On the Approval of the Internal Audit Methodology”, Tbilisi. 2016).

Noteworthy to mention, that according to the “Law of Georgia on Public Service” the structural units of inspection carried out (article 89), the disciplinary proceedings in public institutions. Therefore, the internal audit service in local self-government, having the inspection unit, is obliged to make the disciplinary proceedings based on the above-mentioned law.

Moreover, the structural unit at the self-government level can carry out various activities, as well as develop a risk assessment system for corruption.

**Conclusion.** Thus, internal audit and inspection are two different types of inspection, that have a significant role in local self-governance. Internal auditing aims to check, if the organization protects the standard, and whether the inspection is obliged to check the implementation of the standards.

To perform their takes and objectives in local self-governance, their functions have to be strictly separated.

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