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**CRITICAL RESEARCH ON AUDIT PRACTICES WITHIN THE
DEFENSE INDUSTRIAL BASE**

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Abstract:

Being an essential management function, internal audit activity is a key element in determining the effectiveness of the control (internal control) environment created within the organization, which includes consultancy services, as well as classical auditing processes. Apart from its focus on compliance with the standards and contract requirements, finding irregularities such as internal control deficiencies, ineffective monitoring, complexity, and stability of the organizational structure are the key contributions of internal audit. On the other hand, while internal audit has become a management discipline fulfilled at international standards, the field of defense inherently contains a large spectrum of difficulties. At the nexus of practices, practitioners, and praxis of governance, audit practices within the defense industrial base necessitate a high level of profession combined with industrial experience in the defense sector. Accordingly, an internal audit process holds the potential to assist management in unveiling and controlling key risks while achieving financial regularity and legal conformity. Therefore, this study aims to critically examine the internal audit practices and portray dynamic and applicable methods for a successful process.

Keywords: Audit, Internal Audit, Defense Auditing, Defense Industry.

1. Introduction

Acquiring a professional position within organizational strategy and management, internal audit practice has become the basic element of effective management process. In the past, internal audits used to have a limited duty to protect organizational assets and monitor control procedures. Currently, it has been perceived to be important for an effective corporate risk management upon the emergence and diversification of business risks, and this process has also enabled internal auditors to play a more effective role in organizations[1]. The fact that failure to properly manage risks related to strategic goals in organizations threatens the sustainability of organizations and has the potential to lead to failure has increased the importance of the risk-focused internal audit function. Besides, changes in the business environment, developments in technology, and legal regulations have contributed to the continuous development of internal auditing[2],[3].

In addition to risk and governance, control and compliance processes within defense organizations have significantly transformed to manage the increasing sophistication as well as complexity in the defense industry. Technological developments and the expansion of communication capabilities have accelerated globalization and presented unprecedented growth opportunities in terms of the internal audit profession. Since the defense industrial base necessitates a dynamically changing environment, all types of operations are supposed to be monitored carefully and analyzed continually to reveal critically significant insights. Therefore, internal audit holds the potential to assist management in unveiling and controlling key risks while achieving financial regularity and legal conformity. Therefore, this study aims to critically examine the internal audit practices and portray dynamic and applicable methods for a successful process.

2. Audit Practices within the Defense Industrial Base



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The process of carrying out defense procurement projects involves many risks as it requires the use of high amounts of financial and non-financial public resources and requires the effective, economical, and efficient use of resources. The way to use resources effectively becomes possible through effective management and control of the process. Project auditing is defined as the process of examining a project to verify its compliance with project management standards or examining management, methodology, techniques, procedures, documents, specifications, budgets, expenses, and level of completion of a project in detail[4].

There are two types of uncertainties in complex projects such as defense projects. The first one is predictable uncertainties. It is possible to deal with this type of uncertainty using an organized methodology. For each phase of the project, there is an organized process that includes identifying the project's key components and defining inputs and outputs. Risks arising from uncertainty can be managed by making a plan to minimize them. The second type of uncertainty are uncertainties that cannot be predicted in advance. Herein, alternative and dynamic definitions can be created that can provide flexibility in the program, budget, and work plan in response to this possibility, to cope with unexpected changes, and managers [5],[6]. As in all other projects, cost, performance, and duration are the main variables in defense projects, and these variables, called the "iron triangle", can be measured retrospectively after the project is completed[7].

Auditing practices is mainly divided into internal and external audit. External audit mainly focuses on the financial accounts or risks associated with finance and is appointed by the company shareholders. Its essential responsibility is to perform the annual statutory audit of the financial accounts while developing an opinion about a true and sufficient indication of the company's financial position. Due to security concerns, defense projects are inclined to be conducted through a partly hidden agenda. Therefore, internal audit practices become more initial compared to external audits since internal audit reports are delivered directly to the audit committee. In order to achieve financial efficiency, auditing practices seek and put forth irregularities such as stability and complexity of the organizational structures, internal control deficiencies, and ineffective monitoring[8].

According to the Audit Report of results of Turkish Defense Industry; the responsibilities of the staff and the directorates and the limits of delegation of authority are clearly determined within the organizational structure of the Turkish Defense Industry Agency. Responsibilities and limits of delegation of authority are prepared, circularized, and announced to the personnel by the Presidency. The strategic plan was prepared in accordance with the legislation, with the contributions of the administration's units and staff, by taking stakeholder opinions. The Public Administration published its 2018 Performance Program on time and in accordance with the relevant legislation provisions, and it was observed that in the Performance Program, the Performance Target Tables, Activity Cost Tables, Administration Performance Table, Total Resource Requirement Table, and Table of Expenditure Units Responsible for Activities and information such as performance target, performance indicators, activities, and resource needs weren't included. On the other hand, studies have been carried out within the scope of corporate risk management. The update is planned to be carried out after the Ministry of Treasury and Finance publishes the Risk Guide. Necessary measures have been determined to reduce internal and external risks that may prevent the achievement of goals and objectives. Most importantly, a management information system - Program Management Information System - PMIS, which would produce the necessary information and reports needed by the management and provide the opportunity for analysis, was created, and put into operation[9].



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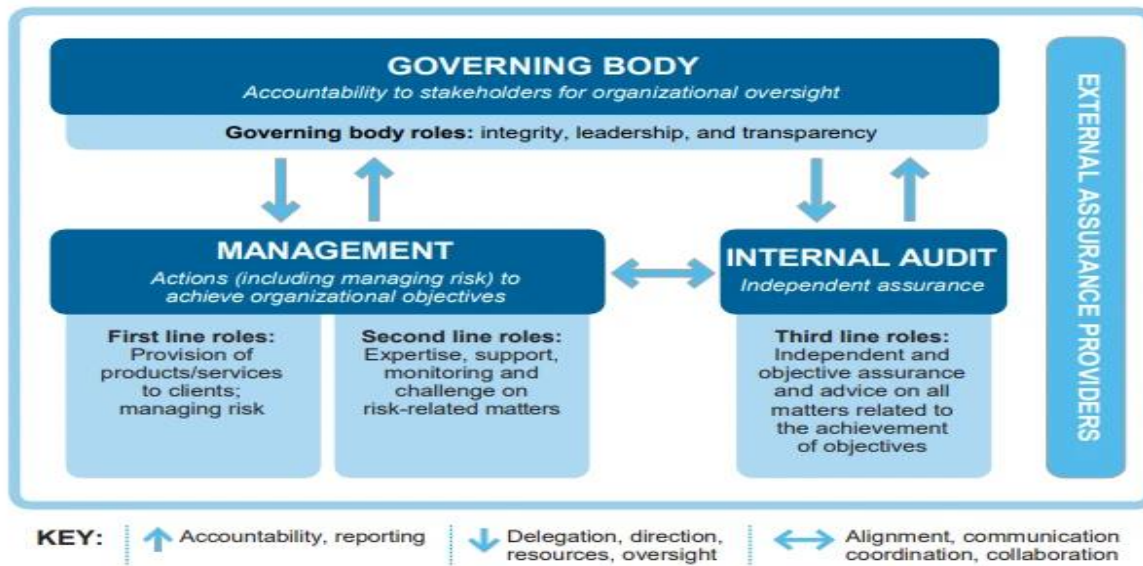


Figure 1. The Three Lines in Defense[10]

In order to ensure an effective management and governance process, the Institute of Internal Auditors developed a new model for auditing called the three lines of defense. The new model introduces the first line of defense as management, the second line as risk management and compliance, and the third line as internal audit[10]. The next chapter further discusses risk-based internal audit approach.

3. Risk-Based Internal Audit Approach

Internal audit is the risk-oriented evaluation of the processes in the system from risk, control, and governance perspectives in order to use resources effectively, economically, and efficiently. Internal audit activity is not a unit or person-based approach but is based on examining systems as a whole and analyzing them in a risk-oriented manner. Instead of examining unit or person-based risks based on the system approach, internal audit examines the risks at all points of the process in an integrated manner, and annual internal audit programs are prepared on this basis[11]. The fact that the management of defense projects, which is a high-risk process, is examined by internal audit from this perspective and is included primarily in internal audit programs is a result of the risk-focused internal audit approach.

Although the number of risks identified for defense projects to date is highly diversified, these risks can generally be classified into three types of risk categories: technological risks, contractual risks, and organizational risks[12],[13]. Being defined as risk-based auditing that associates internal auditing with the enterprise risk management framework of the organization[14], the internal audit approach contributes to the effective execution of corporate risk management processes. The risk-based internal audit approach aims to focus the limited internal auditor resources on the highest risk areas of the organization and to use resources effectively by identifying the highest risk points of each audited process[15]. Internal auditors, who are supposed to provide suggestions to reduce risk, add value to the organization with this approach.

4. Conclusion



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It is a well-known fact that the gap between auditing for effectiveness/performance and compliance/conformance is not caused by deficient processes, standards, requirements, and contracts. The essential reason behind failure is mainly based on a lack of dynamic corporate structure to address ineffectiveness on time while ensuring internal audit process quality in the defense industrial base. It is found out that internal audit is more prominent due to the privacy of the defense industry projects.

In order to enhance internal audit quality, key factors can be listed as good governance, managerial support, proper and sufficient training for auditors, as well as comprehensive audit plans. Besides, the personnel should comprehend the fact that internal auditing is essential for the overall organizational mission. At the nexus of practices, practitioners, and praxis of governance, audit practices within the defense industrial base necessitate a high level of profession combined with industrial experience in the defense sector. Therefore, a number of initiatives are recommended to be implemented to enhance the capabilities and quality of internal audit:

- Enhancing process improvement through adding value to the organization’s bottom line,
- Adapting an inclusive approach and determining every single person within the defense industrial base as a stakeholder,
- Encouraging participation and collaboration,
- Encouraging a positive and dynamic approach in audit reporting,
- Enhancing risk management approaches in audit planning,
- Monitoring audit plans,
- Sharing and discussing audit results with the personnel by adopting a constructive approach.

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