

# SECURING FUTURES: THE CRITICAL ROLE OF INTERNAL AUDIT IN STATE-OWNED ENTERPRISE MANAGEMENT

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## ABSTRACT

Internal audit, as an impartial validation and advisory function, holds a pivotal role in enhancing the stability, safety, and sound functioning of state-owned enterprises (SOEs). It achieves this by assessing and enhancing the efficiency and effectiveness of internal controls, risk management, and corporate governance processes. SOE internal audits, a vital component of our national audit framework, contribute significantly to the strengthening, expansion, refined management, reform, and innovation within enterprises. These audits employ their supervisory and evaluative functions to uncover and resolve developmental issues while concurrently offering consultancy and support in critical areas such as risk prevention and internal control evaluation, thus effectively bolstering the value of state-owned assets.

However, several factors, including unexplored audit methodologies, management risk preferences, and limitations in information availability, hinder internal audit from realizing its full potential in overall enterprise development and security. This article examines the current landscape of internal audit in Chinese SOEs, its value-added role in development and security, shortcomings, and underlying causes. It also proposes relevant strategies to enhance the value-added role of internal audit within state-owned enterprises.

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**Keywords:** Internal Audit, State-Owned Enterprises, Risk Management, Corporate Governance, Value-added Role

## Introduction

As an independent and objective confirmation and consulting activity, internal audit plays an important value-added role in promoting the safety, stability and healthy operation of state-owned enterprises by evaluating and improving the efficiency and effectiveness of internal control, risk management and corporate governance processes. As an important part of our country's internal audit, state-owned enterprise internal audit, in the aspects of enterprise strengthening and expanding, refined management and reform and innovation, the use of supervision and evaluation function to discover and solve the problems in the development, and both to provide consulting and service functions for major risk accident prevention, internal control evaluation and other aspects, effectively promote the value of state-owned assets. But there are still limited by the audit work mode exploration, management risk preference, information level constraints and other factors, so that the internal audit in the overall development and security of the enterprise there are some obstacles. The following are the characteristics of the current internal audit work of China's state-owned enterprises, the value-added role played in the development and security, the shortcomings and reasons for the analysis, and put forward corresponding countermeasures, hoping to be able to play a value-added role for state-owned enterprises internal audit.

## **1. The current characteristics of internal audit of state-owned enterprises**

### **2.1 The independence and synergy of departments ensure the value-added role of internal audit**

Internal audit is a relatively independent department within the enterprise, and the independence of the organization is the basis and guarantee for the internal audit work. The internal audit department of state-owned enterprises is generally set up under the audit committee of the Board of directors, and the audit committee is directly responsible to the board of directors. The general manager is in charge of the audit department. In addition, due to the inherent advantages of carrying out cross-departmental confirmation and evaluation business, internal audit departments carry out on-site audit in each subsidiary company throughout the year to understand its business development status. While maintaining independence from the audited units, they help find typical problems of similar businesses in different units and solve common problems through audit rectification, so as to reflect the synergy of internal audit. The independence of audit is the guarantee that internal audit can play a value-added role, and the synergy increases the value-added effect of internal audit[1-3].

### **2.2 In terms of audit function, the traditional supervision and evaluation orientation has gradually changed to consulting service orientation**

The risk-oriented value-added internal audit gradually shifted its focus from the traditional supervision and evaluation function to the consulting service function, from the simple error prevention to the improvement of operation, management and economic benefits. On the one hand, internal audit helps the enterprise to find loopholes and weaknesses in production, sales, acquisition, cost settlement, asset management and other aspects, and makes suggestions and promotes rectification in the advantages of its familiarity with the operation and management in the enterprise. As the third line of defense in risk prevention, internal audit plays an important role in risk supervision, and promotes the reform and innovation of important operation and management activities. On the other hand, in terms of strengthening internal control and promoting compliance, it assists in strengthening the construction of internal control system, urges the checks and balances of rights and the legal compliance of operations, and provides valuable audit suggestions for the safety and compliance operation of enterprises.

### **2.3 In terms of audit methods, we tend to make use of big data for audit analysis to improve the comprehensiveness and objectivity of audit problem discovery**

With the era of big data coming, the internal audit of state-owned enterprises can make use of big data for audit analysis, break through the limitations of traditional sample audit, and examine the problems in enterprise operation and management from a more macro perspective. The audit positioning has gradually changed from the management's focus to adding value to the enterprise as a whole. To have a more objective and in-depth understanding of the management loopholes in the development process of enterprises, while promoting the reform and development of enterprises, it controls the risks in the development process, reduces the unsafe factors affecting the reform and development of enterprises, coordinates the weak links in the main business, innovative business and fine basic management of enterprises, and promotes the realization of high-quality development of enterprises.

### **3. The role of internal audit in enterprise development and security from the perspective of the audit problems**

This article takes a state-owned enterprise as an example combined with the main audit problems found by internal audit in recent years, and analyzes how internal audit is risk-oriented through the discovery and rectification of explicit audit value-added problems (monetary type) and non-explicit audit value-added problems (non-monetary type) in order to promote the compliance operation of enterprises, prevent major risks, strengthen the construction of internal control system, and coordinate the development and security of enterprises.

#### **3.1 Focus on key business areas with a risk-oriented approach, prevent capital outflow and recover economic losses by reviewing the explicit value-added audit problems of the amount type**

Capital can be seen as the blood of enterprise economic activities, and it is also a high-risk area that enterprises need to control. Internal audit pays attention to the effect of corporate management, focuses on the two lines of fund receipt and expenditure mainly reflected in sales management, expense control and other aspects, checks the legal compliance of the basis of fund revenue and expenditure, finds management loopholes, prevents capital outflow, reduces economic benefits, and ensures the safety and control of fund revenue and expenditure. For example, in marketing, through the review of pricing implementation related data and the lack of legal compliance basis for the pricing process to analyze the reasons of the revenue reduction and the product pricing management system, which will control the confidentiality risk and reveal the period of benefit transmission risk to avoid the reduction of sales revenue. In terms of cost control, internal audit pays attention to the accuracy and reliability of the cost settlement basis, reviews the contract bidding, settlement and other process data, and requires the audited units to implement audit rectification of the over-settlement part, identify the causes and recover in time, so as to recover direct economic losses[4-6].

#### **3.2 In terms of reform and innovation, through special audits, focus on compliance, quality and efficiency improvement, and promote the steady progress of enterprise reform**

Enterprises need to reform some businesses based on strategic development, or in order to seize opportunities for innovation and development, both of which have great uncertainties. How to control reasonable risk on the road of reform and innovation is a strong responsibility for enterprises. Through special audit projects, internal auditors pay attention to the drawbacks and potential risks of reform and innovation, take legal compliance of operation as the bottom line, pay attention to the rectification of problems existing before reform and innovation, provide reasonable suggestions for future development, and urge enterprises to move forward steadily in reform. For example, by reviewing the legality and compliance of the business during the transition period of procurement reform, they have found the phenomenon of multiple batches of winning bids by same customers in the bidding process, different freight differences on the same road section, arbitrary identification criteria of the validity of quotation data, urged the audited units to make rectification, promoted the reform of the purchasing procurement mode to reduce such problems, and strengthened the control of the process to reduce risks on the road of purchasing reform.

### **3.3 In terms of basic management, focus on non-explicit audit value-added issues, assist in improving the construction of internal control systems, consolidate basic management, and help reduce costs and increase efficiency**

With the improvement of resource awareness and cost awareness, managers of state-owned enterprises have gradually noticed that management must shift to the direction of the cost leadership management. Due to a period of extensive management mode in the process of state-owned enterprise history, some resources are wasted, such as redundancy equipment, overstaffing, extensive material management and other phenomena. Internal audit found loopholes in basic management through on-site observation, and focused on the rationality of material acquisition plan, recycling and utilization of idle equipment, management of off-account materials and other aspects to improve the planning and standardization of enterprise material management. In addition, through the implementation of the annual internal control inspection and evaluation work, evaluate the consistency of the design and implementation of the internal control system, prevent the risk of power abuse arising from the failure of the system according to the actual situation and the failure of internal control caused by the effective implementation of the system, and promote the effectiveness of the internal control of the enterprise.

## **4. Shortcomings and causes**

### **4.1 When internal audit shifts to consulting and service functions, it lacks effective innovation management mechanism**

With the gradual evolution of the audit function to consulting services, many organizations gradually realized the important role of audit, and deeply felt that the internal audit of enterprises can indeed bring value-added effects to the organization, but the specific mode of internal audit have been not found in a very effective way. Particularly, how to turn the supervision and evaluation function of internal audit, which mainly focuses on error prevention and fraud prevention, into provide consulting services for the development and security of enterprises by relying on rich management experience in financial management. project management, laws and regulations, internal control management, risk prevention and control. This not only requires the expansion of the scope of internal audit, but also involves the reform and innovation in the implementation of internal audit projects, opening up new audit consulting service projects on the basis of traditional audit projects, innovating the implementation mechanism of audit projects, and helping the upgrading and transformation of internal audit.

### **4.2 Due to the different risk preferences of the management level, the value-added role of internal audit in the process of organizational development and security is limited**

In the process of enterprise reform and innovation, the value-added role of internal audit is greatly affected by the risk preference of CEO. As the decision-maker and executor of various decisions, the risk preference of the management level will directly affect the value-added role of internal audit in reform, innovation and development. Under the other conditions remain unchanged, the higher the level of risk appetite of the management, that is, the higher the preference for high risk, it will adopt a relatively open financial strategy to deal with debt management. Meanwhile, in order to reduce the negative impact of high risk on the rights and interests of the management, reputation and status, it will build a high-quality internal audit mechanism and give full play to the value-added

function of internal audit. Hao Qingmin et al. found that there is a significant negative correlation between the average age, education level, team size of the senior management and enterprise innovation investment. For state-owned enterprises, senior executives generally have the phenomenon of large age and team size, and may not be inclined to high-risk reform and innovation. Therefore, they may not pay enough attention to the construction of high-quality internal control audit, which is not conducive to the value-added role of internal audit[7].

#### **4.3 The level of informatization lags behind the requirements of the era of big data auditing, and the technical ability of auditors is difficult to meet the high-quality requirements of internal auditing**

With the advent of the big data era, it is difficult for traditional sampling audit methods to achieve full coverage of audit scope. More classic audit issues can already be controlled through ERP, SAP and other computer systems, such as the approval of plans and the allocation of funds. How to break through the classical audit problems that have been found, find a new problem breakthrough, and look for management loopholes at a higher level, put forward new technical requirements for auditors. However, compared with the current international advanced information assisted audit, early-warning mechanism model audit and other methods, the internal audit informatization degree of state-owned enterprises is low. On the one hand, the lack of efficient audit software, being unable to have an audit interface with other information systems, lack of access to the internal production and management system is still relatively common. On the other hand, under the premise of the shortage of internal auditors, internal audit talents with the level of internet informatization are more scarcer, which restricts the innovation and development of internal audit methods and technologies to a certain extent.

### **5. Some suggestions for further exerting the value-added role of internal audit**

#### **5.1 Innovate the mode of conducting audit work and promote the upgrading and transformation of audit functions**

In order to successfully upgrade the consulting function of internal audit, the scope of audit needs to be expanded, from focusing on post-event audit to increasing pre-event and in process audit. To prevent risks in advance through the compliance and enforceability of the prior review system, so as to give full play to the non-explicit value-added role of audit. Through in process audit, non-compliance is found and corrected in time, so as to reduce economic losses and potential risks in the process of development. In addition, in terms of the application of audit results, the results are shared with multiple departments to promote effective audit rectification. For example, a state-owned enterprise shares audit results with internal audit, law department, discipline commission, internal control and compliance department, etc. If other departments have already conducted self-inspection, resources are shared within the department, and the audit does not need to repeat, which improves work efficiency and conserves resources. It's a good way to promote enterprise value-added and play the audit consulting service function work better together with multiple departments.

#### **5.2 Build high-quality internal audit to objectively reflect value at risk from a strategic perspective**

High-quality internal audit requires internal audit to have strong professionalism and objectivity to reflect problems from the overall perspective of the organization objectively, and consider the



realization of the development goals of the enterprise. Besides, it also could put forward constructive suggestions from the perspective of managers to help the enterprise solve problems effectively and give full play to the consulting function. All about it could reduce the cognitive bias and organizational crisis caused by the risk preference of the management. At present, although state-owner enterprises have built a comprehensive risk management system, the overall risk management ability needs to be strengthened and the actual risk prevention and control system such as risk early warning mechanism and emergency plan processing system is still weak. Internal audit should play its duty as a consulting service to help the management team reveal the possible risks and their impact in the enterprise development. It is worth noting that it is necessary to take into account the profitability of risks, rather than just focusing on the loss of risks, so as to promote the comprehensive risk management of enterprises and improve the risk response ability of enterprise.

### **5.3 Accelerate the informatization construction of internal audit and improve the energy efficiency of internal audit work**

The advent of the era of "big wisdom moving cloud" has impacted all aspects of our life. Internal auditors should comply with the development needs of the big data era, establish the big data thinking model, strive to strengthen their own information processing level and accelerate the integration of business and technology. Due to the characteristics of the department, they will have opportunities to approach the data of each business module. So internal auditors should pay attention to the cultivation of divergent thinking, conduct horizontal analysis of related business data and control problems from a more macro level. They also need to break through the inherent limitations of the traditional sample audit scope which is difficult to achieve full coverage so as to reduce the missing items in audit problems. In addition, accelerating the establishment of audit information system software is also an important way for internal audit to improve work efficiency. The audit information system should not only carry out audit analysis independently, but also effectively connect with other information systems that already have more mature. It will help to break the current lack of internal audit authority, obtain first-hand audit data, and promote the continuity of audit, which is better provide constructive suggestions for the development process of enterprises.

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