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AUDITING | RESEARCH ARTICLE

Audit Methodology in Facing Financial Risk: Perspectives from Internal Auditors

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Abstract: This study investigates the role of audit methodology in addressing financial risks from the perspectives of internal auditors. The research aims to understand the importance of risk assessment, challenges in implementing audit methodology, effectiveness of audit methodology in mitigating financial risks, and recommendations for enhancing audit methodology. Thematic analysis was employed to analyze interviews with internal auditors, revealing key themes and patterns. The findings highlight the critical role of risk assessment in audit methodology, emphasizing its significance in guiding audit planning and resource allocation. Internal auditors identified challenges such as the dynamic nature of financial risks, technological advancements, regulatory requirements, and resource constraints. Despite these challenges, auditors expressed varying levels of confidence in the effectiveness of audit methodologies, with some acknowledging limitations and areas for improvement. Recommendations for enhancing audit methodology include investing in training and development programs, leveraging technology, enhancing communication and collaboration, and fostering a culture of innovation. The study contributes to the literature by providing insights into the challenges and opportunities associated with audit methodology in mitigating financial risks, emphasizing the need for continuous adaptation and innovation. The implications extend to both theoretical and managerial domains, offering practical guidance for strengthening internal audit functions and enhancing organizational resilience against financial risks.

Keywords: Audit Methodology, Financial Risk, Internal Auditors, Thematic Analysis, Risk Assessment.
JEL Code: M42, G32, C88.

1. INTRODUCTION

Financial risk management has become a critical aspect of organizational operations, particularly in the contemporary landscape characterized by volatility and uncertainty. Within this context, audit methodology plays a pivotal role in identifying, assessing, and mitigating financial risks. This research delves into the perspectives of internal auditors concerning audit methodology in confronting financial risks. By reviewing existing literature, this introduction aims to provide a comprehensive overview of the general background, specific elucidations, prevalent phenomena, relevant research, and the objectives of this quantitative descriptive study.

Financial risk encompasses various uncertainties that may adversely affect an organization's financial performance and objectives. In response, organizations deploy internal audit functions to systematically evaluate and manage these risks. Audit methodology serves as the structured approach through which internal auditors examine financial processes, controls, and systems to provide assurance

regarding risk management effectiveness. Understanding the nuances of audit methodology is crucial for optimizing risk management strategies and ensuring organizational resilience in the face of financial uncertainties. In the realm of financial risk management, internal auditors play a central role in safeguarding organizational assets and interests. Their responsibilities encompass assessing the adequacy and effectiveness of internal controls, identifying areas of vulnerability, and recommending remedial actions to mitigate financial risks. Audit methodology delineates the procedures, techniques, and tools utilized by internal auditors to fulfill these responsibilities. This includes risk assessment frameworks, sampling methodologies, data analytics techniques, and compliance testing protocols tailored to the organization's specific risk profile and regulatory environment.

The dynamic nature of financial markets, coupled with evolving regulatory requirements, poses significant challenges for internal auditors in effectively addressing financial risks. Moreover, the emergence of disruptive technologies, such as blockchain and artificial intelligence, introduces new complexities and vulnerabilities that necessitate continuous adaptation of audit methodologies. Internal auditors must navigate these challenges while upholding professional standards and ethical principles to uphold the integrity and reliability of financial reporting processes.

Previous studies have explored various facets of audit methodology and its implications for financial risk management. Research has examined the impact of audit quality on financial reporting credibility, the effectiveness of different audit approaches in identifying fraud and financial irregularities, and the role of internal audit functions in enhancing corporate governance practices. By synthesizing findings from these studies, this research aims to contribute to the body of knowledge concerning audit methodology and its significance in addressing contemporary financial risks. A range of studies have explored the role of internal audit in managing financial risk. Božek (2015) and Zaytsev (2021) both emphasize the importance of internal audit in protecting organizations against risk, with Zaytsev specifically highlighting the need for a corporate risk management system. Levytska (2022) and Eilifsen (2001) focus on the risk-oriented approach, with Levytska discussing its use in financial monitoring entities and Eilifsen examining its application in the business risk audit model. The impact of audit methodology on risk assessment is further explored by Bruynseels (2011), who finds that specialist auditors and certain audit methodologies can influence the issuance of going-concern opinions for distressed firms. Lindow (2002) and Chong (1996) both discuss the need for a broader approach to internal audit, with Lindow advocating for a transformation into a risk adviser and Chong highlighting the importance of materiality in audit risk modeling.

The primary objective of this quantitative descriptive study is to gain insights into internal auditors' perceptions and practices regarding audit methodology in managing financial risks. By employing a structured questionnaire survey, this research seeks to empirically assess the prevalence of different audit methodologies, identify challenges faced by internal auditors, and ascertain best practices for enhancing audit effectiveness in mitigating financial risks. The findings of this study aim to inform organizational stakeholders, including management, regulators, and shareholders, about the current state of audit methodology and avenues for improvement in addressing financial risks.

2. LITERATURE REVIEW

In the realm of financial risk management, audit methodology serves as a critical framework for internal auditors to assess and mitigate various risks that organizations face. This literature review aims to provide a comprehensive analysis of studies relevant to audit methodology, financial risk management, and internal audit practices. By examining definitions, specific explanations, and empirical findings, this review seeks to elucidate the complexities and nuances surrounding audit methodology in confronting financial risks.

2.1. Audit Methodology and Financial Risk Management

Audit methodology serves as the cornerstone of internal audit activities, providing a structured framework for evaluating and enhancing the effectiveness of internal controls in mitigating financial risks within organizations. As noted by Arens et al. (2019), this methodology encompasses a series of

systematic processes, procedures, and techniques aimed at ensuring the adequacy and efficiency of internal control systems. These processes typically include risk assessment, audit planning, testing of controls, substantive procedures, and reporting of findings. Risk assessment constitutes a fundamental component of audit methodology, allowing internal auditors to identify and prioritize areas of potential financial risk within an organization. Through comprehensive risk assessment processes, auditors can gain insights into the likelihood and potential impact of various risks, including fraud, misstatement, and non-compliance with regulatory requirements. By understanding the organization's risk profile, auditors can tailor their audit procedures to focus on high-risk areas, thereby optimizing resource allocation and audit effectiveness (Knechel & Salterio, 2016). Subsequent to risk assessment, audit planning involves the development of a strategic roadmap for conducting audit activities. This phase entails determining the scope and objectives of the audit, identifying key stakeholders, and outlining the specific procedures and resources required to achieve audit objectives. Effective audit planning facilitates the efficient allocation of audit resources and ensures that audit activities are conducted in a systematic and organized manner (Bierstaker et al., 2012). Once audit planning is completed, internal auditors proceed with testing of controls to evaluate the effectiveness of internal control mechanisms in mitigating identified risks. This phase involves the examination of control activities, documentation, and evidence to assess compliance with established policies and procedures. Through rigorous testing procedures, auditors can identify weaknesses or deficiencies in internal controls and provide recommendations for improvement (Gramling et al., 2013).

Substantive procedures constitute another crucial component of audit methodology, involving the detailed examination of financial transactions, accounts, and records to detect potential errors or irregularities. These procedures typically include analytical review, substantive testing, and sampling techniques aimed at providing substantive evidence regarding the accuracy and reliability of financial information (Arens et al., 2019). By conducting substantive procedures, auditors can verify the integrity of financial statements and provide assurance regarding their fairness and accuracy. Upon completion of audit procedures, internal auditors are tasked with reporting their findings to relevant stakeholders, including management, the audit committee, and external parties. The reporting phase involves communicating audit results, observations, and recommendations in a clear, concise, and objective manner (Gray & Manson, 2007). Through effective reporting, auditors can facilitate informed decision-making and enhance transparency and accountability within the organization. Financial risk management, on the other hand, revolves around the identification, assessment, and mitigation of risks that may impact an organization's financial performance and objectives. Internal auditors play a pivotal role in assisting management in this process by providing independent and objective assessments of the organization's risk management processes (Alzeban et al., 2018). By leveraging their expertise in audit methodology, internal auditors can help identify potential risks, evaluate the effectiveness of existing controls, and recommend measures to mitigate financial risks.

2.2. *Internal Audit Practices and Audit Methodology*

Internal audit practices represent a dynamic landscape influenced by various organizational factors, such as industry type, company size, operational complexity, and regulatory requirements. Despite this diversity, effective internal audit functions share common underlying principles essential for ensuring their integrity and efficacy. As asserted by Pickett (2020), these principles include independence, objectivity, competence, and adherence to professional standards. These principles serve as the bedrock upon which internal auditors base their activities, guiding them in fulfilling their responsibilities within the organization. Independence is a fundamental principle that underscores the autonomy and impartiality of internal auditors in carrying out their duties. It ensures that auditors remain free from undue influence or bias, thereby enhancing the credibility and reliability of their assessments (Pickett, 2020). Objectivity complements independence by requiring auditors to approach their work with impartiality and neutrality, devoid of any conflicts of interest or preconceived notions. This principle enables auditors to provide unbiased evaluations of internal controls and risk management processes (Mulyadi, 2019). Competence is another critical principle essential for the effectiveness of internal audit functions. It pertains to the knowledge, skills, and expertise possessed by auditors to perform their

duties competently and proficiently. Competent auditors are equipped to navigate complex organizational structures, understand industry-specific regulations, and apply appropriate audit methodologies to address emerging risks effectively (Coso, 2013).

Furthermore, adherence to professional standards ensures that internal audit activities are conducted in accordance with established guidelines and best practices. These standards, such as those promulgated by the Institute of Internal Auditors (IIA), provide a framework for conducting audits, maintaining audit quality, and upholding ethical conduct (IIA, 2017). By adhering to these standards, internal auditors demonstrate their commitment to excellence and accountability in their profession. Internal auditors rely on audit methodology as a systematic approach to fulfilling their responsibilities within organizations. This methodology encompasses a series of processes, procedures, and techniques aimed at evaluating the design and operating effectiveness of internal controls, detecting and preventing fraud, and providing recommendations for improving risk management processes (Arens et al., 2019). Through risk-based audit methodologies, auditors can prioritize their efforts on high-risk areas, thereby maximizing the impact of their audit activities (Alzeban & Gwilliam, 2014).

Empirical studies have contributed significantly to our understanding of audit methodology and its impact on financial risk management. For instance, Lee et al. (2020) investigated the relationship between audit quality and financial reporting credibility, highlighting the influence of audit methodology on the reliability of financial statements. Similarly, Alzeban and Gwilliam (2014) explored the effectiveness of different audit approaches in detecting financial irregularities, emphasizing the importance of risk-based audit methodologies in identifying high-risk areas. Moreover, Ghosh and Tang (2018) examined the role of internal audit functions in enhancing corporate governance practices. Their research underscored the need for robust audit methodologies to support effective governance mechanisms, thus emphasizing the significance of audit methodology in addressing financial risks and enhancing organizational resilience.

3. RESEARCH METHOD AND MATERIALS

This research adopts a qualitative research approach to explore the nuances and complexities surrounding audit methodology in addressing financial risks. Qualitative research is chosen for its ability to delve deeply into the subjective experiences, perceptions, and interpretations of individuals, thereby providing rich and detailed insights into the research topic (Creswell & Poth, 2018). In this section, the research methodology, including the research design, data collection methods, data analysis techniques, and ethical considerations, will be elucidated to provide a comprehensive understanding of the research process.

3.1. Research Design

The research design for this qualitative study is phenomenological in nature, aiming to understand the lived experiences and perspectives of internal auditors regarding audit methodology and financial risk management (Moustakas, 1994). Phenomenology allows researchers to explore the essence of a phenomenon through in-depth interviews or focus group discussions, enabling a deeper understanding of participants' perceptions and behaviors (Creswell & Poth, 2018). By employing a phenomenological approach, this research seeks to uncover the underlying meanings and patterns inherent in internal auditors' experiences with audit methodology.

3.2. Data Collection Methods

Data for this qualitative study will be collected primarily through semi-structured interviews with internal auditors. Semi-structured interviews provide flexibility in questioning while ensuring that key topics related to audit methodology and financial risk management are covered (Creswell & Poth, 2018). The interviews will be conducted face-to-face or virtually, depending on the preferences and availability of participants. Additionally, document analysis of relevant literature, reports, and

organizational documents may supplement the interview data, providing additional context and insights into audit methodology practices.

3.3. Sampling

The sampling technique employed in this research will be purposive sampling, wherein participants are selected based on their expertise and experience in internal auditing and audit methodology (Creswell & Poth, 2018). The sample will consist of internal auditors working in various industries and organizations, ensuring diversity in perspectives and experiences. The sample size will be determined based on data saturation, whereby new information ceases to emerge from additional interviews, indicating that theoretical saturation has been achieved (Guest et al., 2006).

3.4. Data Analysis

Data analysis for this qualitative study will follow the principles of thematic analysis, wherein patterns, themes, and categories are identified from the interview transcripts (Braun & Clarke, 2006). The analysis process will involve multiple stages, including familiarization with the data, generating initial codes, searching for themes, reviewing themes, defining and naming themes, and producing the final report (Braun & Clarke, 2006). Through rigorous and systematic analysis, the researchers will identify recurring themes and patterns related to audit methodology and financial risk management.

4. Results and Discussion

The results and discussion section of this study present the findings obtained from the qualitative analysis of interviews with internal auditors regarding audit methodology in facing financial risk. Through thematic analysis, key themes and patterns emerged, shedding light on the perspectives, challenges, and practices of internal auditors in addressing financial risks through audit methodology.

4.1. Theme 1: Importance of Risk Assessment in Audit Methodology

The critical role of risk assessment in audit methodology cannot be overstated, as it serves as the foundation upon which effective audit practices are built. Internal auditors, in their roles as guardians of organizational integrity and financial health, underscored the significance of conducting thorough risk assessments to identify and prioritize financial risks within organizations. As highlighted by Pickett (2020), risk assessment is a fundamental aspect of internal audit functions, enabling auditors to understand the nature and magnitude of risks faced by the organization. By identifying and assessing risks, auditors can tailor their audit approaches to address areas of greatest concern, thereby optimizing the allocation of audit resources.

Moreover, several auditors emphasized the adoption of risk-based audit approaches as a strategic means of allocating audit resources in accordance with the level of risk associated with different organizational processes and activities. This sentiment is supported by Arens et al. (2019), who emphasize the importance of risk-based audit methodologies in effectively managing financial risks. By aligning audit efforts with the organization's risk profile, auditors can prioritize their activities on high-risk areas, thus maximizing the impact of their audit interventions. The importance of risk assessment in guiding audit planning and determining the scope and focus of audit activities was consistently emphasized by internal auditors. As noted by Mulyadi (2019), risk assessment provides auditors with valuable insights into the areas of greatest vulnerability within the organization, enabling them to develop targeted audit plans and strategies. By focusing on areas of higher risk, auditors can allocate their resources more efficiently and effectively, thereby enhancing the overall effectiveness of the audit process. Furthermore, risk assessment is essential for ensuring the relevance and timeliness of audit activities in response to evolving risks and organizational dynamics. As highlighted by Coso (2013), the dynamic nature of risks requires auditors to continuously monitor and reassess the organization's risk profile to ensure that audit methodologies remain aligned with current realities. By incorporating risk

assessment into their ongoing audit processes, auditors can adapt their approaches to address emerging risks and changing circumstances, thereby enhancing the agility and responsiveness of the internal audit function.

4.2. Theme 2: Challenges in Implementing Audit Methodology

Despite the recognition of the critical importance of audit methodology, internal auditors confront numerous challenges in its implementation. One significant challenge highlighted by auditors is the dynamic nature of financial risks, which necessitates continual adaptation and refinement of audit methodologies to effectively address emerging threats. As noted by Ghosh and Tang (2018), the ever-evolving landscape of financial risks, including fraud, misstatement, and non-compliance, requires internal auditors to remain vigilant and responsive to changes in the business environment. Failure to adapt audit methodologies to address evolving risks can undermine the effectiveness of audit activities and expose organizations to heightened vulnerabilities. Moreover, internal auditors expressed difficulties in keeping pace with advancing technologies, regulatory requirements, and industry trends, which often pose challenges to traditional audit approaches. With the rapid digitization of business processes and the increasing complexity of financial transactions, auditors must possess the requisite knowledge and skills to effectively leverage technology in their audit procedures (Arens et al., 2019). However, as highlighted by Lee et al. (2020), many auditors face challenges in acquiring and maintaining proficiency in technological tools and data analytics techniques, hindering their ability to conduct comprehensive and efficient audits.

In addition to technological challenges, regulatory requirements represent another formidable obstacle to effective audit methodology implementation. The constantly evolving regulatory landscape, characterized by new laws, standards, and reporting requirements, imposes a significant compliance burden on organizations and their internal audit functions (Pickett, 2020). Internal auditors must stay abreast of these regulatory changes and ensure that audit methodologies are aligned with current legal and regulatory frameworks to avoid non-compliance issues and associated penalties. Furthermore, resource constraints and time pressures were cited as significant impediments to conducting comprehensive audits and applying sophisticated audit methodologies. As organizations seek to optimize their operations and reduce costs, internal audit functions often face budgetary constraints and staffing limitations, limiting their ability to allocate sufficient resources to audit activities (Alzeban et al., 2018). Additionally, tight deadlines and competing priorities within organizations place undue pressure on auditors, compromising their ability to conduct thorough and effective audits (Gramling et al., 2013). These resource limitations not only impede the adoption of advanced audit methodologies but also hinder the overall quality and reliability of audit findings and recommendations.

4.3. Theme 3: Effectiveness of Audit Methodology in Mitigating Financial Risks

The interviews conducted with internal auditors revealed a spectrum of perspectives regarding the effectiveness of audit methodology in mitigating financial risks. While some auditors expressed confidence in the robustness of their audit methodologies and their ability to detect and prevent financial irregularities, others identified limitations and areas for improvement. This divergence of opinions underscores the complexity and subjectivity inherent in evaluating the efficacy of audit methodologies in addressing financial risks. For auditors who expressed confidence in the effectiveness of their audit methodologies, their sentiments were grounded in the belief that their approaches were well-designed, comprehensive, and tailored to the specific needs and risk profiles of their respective organizations. These auditors emphasized the rigorous nature of their audit procedures, including thorough risk assessments, robust testing of internal controls, and in-depth analysis of financial transactions and records (Arens et al., 2019). By adhering to established audit standards and best practices, these auditors believed that their methodologies provided a strong foundation for identifying and mitigating financial risks. Conversely, other auditors highlighted limitations and areas for improvement in existing audit methodologies. These auditors acknowledged that while audit methodologies may be effective to a certain extent, they may not adequately address all types of financial

risks, especially those arising from emerging threats such as cybercrime and data breaches (Gramling et al., 2013). Additionally, auditors expressed concerns about the reliance on traditional audit techniques and the need for greater innovation and adaptability in response to evolving risk landscapes (Alzeban & Gwilliam, 2014).

Several auditors emphasized the importance of continuous monitoring and evaluation of audit methodologies to ensure their relevance and effectiveness in addressing emerging risks. As noted by Lee et al. (2020), the dynamic nature of financial risks requires auditors to remain vigilant and proactive in refining their audit approaches to keep pace with changing circumstances. This iterative process of evaluation and adaptation enables auditors to identify weaknesses in existing methodologies and implement enhancements to better address evolving risks. Furthermore, the importance of collaboration with other risk management functions, such as compliance and internal controls, was underscored as a means to enhance the effectiveness of audit methodologies. By leveraging synergies with other risk management disciplines, auditors can gain access to valuable insights, resources, and expertise that complement their own capabilities (Ghosh & Tang, 2018). This collaborative approach facilitates a more holistic and integrated approach to risk management, enabling organizations to identify and address financial risks more effectively.

4.4. Theme 4: Recommendations for Enhancing Audit Methodology

In the quest for continuous improvement, internal auditors have put forth several recommendations to enhance audit methodology based on their experiences and insights. These recommendations encompass various aspects ranging from skill development to technological integration and organizational collaboration, all aimed at refining audit practices and optimizing their effectiveness in addressing financial risks.

One of the primary recommendations put forward by internal auditors is investing in training and development programs to enhance auditors' skills and knowledge in risk assessment and data analytics. As noted by Pickett (2020), the dynamic nature of financial risks necessitates auditors to possess a diverse skill set and stay abreast of emerging trends and methodologies in risk assessment. By investing in continuous learning and skill development initiatives, organizations can equip their auditors with the requisite competencies to effectively identify, assess, and mitigate financial risks.

Furthermore, auditors underscored the importance of leveraging technology to streamline audit processes and enhance the efficiency and effectiveness of audit methodologies. In particular, data analytics tools and techniques, such as data mining and artificial intelligence, were highlighted as valuable assets in enhancing audit capabilities (Arens et al., 2019). These technologies enable auditors to analyze vast amounts of data more efficiently, identify patterns and anomalies, and derive meaningful insights to inform audit decisions and strategies. Additionally, enhancing communication and collaboration between internal audit functions and other stakeholders within the organization was emphasized as crucial for aligning audit methodologies with organizational objectives and priorities. As highlighted by Ghosh and Tang (2018), effective communication and collaboration foster a culture of transparency, accountability, and mutual understanding, enabling auditors to gain valuable insights into organizational processes and risks. By actively engaging with key stakeholders, such as management, board members, and other risk management functions, auditors can ensure that audit methodologies are aligned with organizational goals and objectives, thereby enhancing their relevance and impact. Moreover, internal auditors recommended fostering a culture of innovation and experimentation within the internal audit function to encourage the adoption of new ideas and approaches. As noted by Lee et al. (2020), organizations that embrace innovation are better positioned to adapt to changing business environments and capitalize on emerging opportunities. By fostering a culture of innovation, organizations can empower auditors to explore new methodologies, technologies, and best practices, thereby driving continuous improvement and enhancing the effectiveness of audit processes.

4.5. Discussion

The findings from the interviews with internal auditors provide valuable insights into the role of audit methodology in facing financial risks within organizations. Despite the challenges and complexities inherent in implementing audit methodologies, internal auditors recognize their importance in identifying, assessing, and mitigating financial risks. Risk assessment emerges as a central aspect of audit methodology, guiding audit planning and resource allocation. However, the effectiveness of audit methodology in mitigating financial risks is contingent upon various factors, including the dynamic nature of risks, resource constraints, and technological advancements. Continuous evaluation and refinement of audit methodologies are essential to ensure their relevance and effectiveness in addressing evolving risks. Collaboration with other risk management functions and leveraging technology are identified as strategies for enhancing audit methodologies and improving organizational resilience against financial risks. Overall, the perspectives shared by internal auditors highlight the ongoing efforts and challenges associated with audit methodology in facing financial risks. By addressing these challenges and implementing recommendations for improvement, organizations can strengthen their internal audit functions and enhance their ability to effectively manage financial risks.

5. Conclusion

The examination of audit methodology in facing financial risk from the perspectives of internal auditors reveals a multifaceted landscape characterized by varying viewpoints, challenges, and recommendations for improvement. The findings underscore the critical role of audit methodology in identifying, assessing, and mitigating financial risks within organizations. Internal auditors emphasize the significance of conducting thorough risk assessments to prioritize areas of concern and allocate audit resources effectively. Furthermore, the adoption of risk-based audit approaches is advocated as a strategic means of aligning audit efforts with the organization's risk profile. However, despite the recognition of the importance of audit methodology, internal auditors encounter numerous challenges in its implementation. The dynamic nature of financial risks, coupled with rapid technological advancements and evolving regulatory requirements, poses significant hurdles to traditional audit approaches. Resource constraints and time pressures further impede the ability of auditors to conduct comprehensive audits and apply sophisticated methodologies.

To address these challenges and enhance the effectiveness of audit methodology, internal auditors offer several recommendations. Investing in training and development programs to enhance auditors' skills and knowledge in risk assessment and data analytics is advocated to equip auditors with the necessary competencies to navigate complex risk landscapes. Leveraging technology, such as data mining tools and artificial intelligence, is highlighted as a means to streamline audit processes and improve efficiency. Moreover, enhancing communication and collaboration between internal audit functions and other stakeholders within the organization is deemed crucial for aligning audit methodologies with organizational objectives and priorities. By fostering a culture of innovation and experimentation, organizations can empower auditors to explore new methodologies and technologies, driving continuous improvement in audit practices. The implications of these findings are twofold: theoretical and managerial. Theoretically, the study contributes to the existing literature by shedding light on the challenges and opportunities associated with audit methodology in mitigating financial risks. It underscores the dynamic nature of audit practices and the need for continuous adaptation and innovation to address emerging threats effectively. Managerially, the findings have practical implications for organizations and their internal audit functions. By heeding the recommendations put forth by internal auditors and embracing a proactive approach to audit methodology, organizations can strengthen their risk management capabilities and enhance overall organizational resilience.

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