



The Role of
**Internal Audit
in Corporate
Governance &
Management**

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■ Executive Summary

This research project, based on a study undertaken in Australia, aims to evaluate the role of internal audit in corporate governance and management. It identifies the accountability structures and objectives of internal audit, considers the nature of internal audit functions and the extent of application of *The Institute of Internal Auditors Standards of Professional Practice*, reviews the relationships of the chief audit executives (CAEs) and assesses the nature of financial report risks and other issues covered by internal auditors. The research was conducted using a two-pronged approach. The online survey was designed to elicit the state of practice, the accountability structure and perceptions of CAEs, with respect to their roles and performance. The 25 face-to-face in-depth interviews provide context to the findings of the online survey. Interviewees include 18 CAEs and seven senior business representatives drawn from different states of Australia, representing multinational companies, regulators, and the public sector.

The research findings include a diversity of accountability structures for CAEs and a range of internal audit activities, with the application of the *IIA Standards* being in need of improvement. Internal auditors are positive about their role in corporate governance but are less confident with respect to how to put such a role into practice. Internal audit is focused on internal controls and risks, while compliance is the major type of work undertaken on governance standards. Internal auditors generally enjoy regular access to CEOs and audit committees, but some are concerned with the level of support received from management. Certainly, they regard their effectiveness to be dependent on the calibre and personalities of the members of the board and management. The researchers make the following recommendations to be considered by The Institute of Internal Auditors and other regulating and governing bodies.

Recommendations

- Boards of directors should be encouraged to establish and maintain direct reporting by the CAE to the board or its audit committee, to

discuss issues relating to risks, discrepancies and controls. Where there are dual reporting lines to the CEO and the board, they should be clearly defined, so that any risks which may jeopardise the integrity of the flow of information are minimised.

- There should be a facilitation process for CAEs to work with non-executive directors and audit committees. This process may be in the form of training, or information sharing, so that the non-executive directors and audit committee members can appreciate the financial, control and risks profile of the organisation. The interviews have highlighted the interest of some CAEs in providing training and 'in-house' education to non-executive directors. Such facilitation processes can fast-track non-executive directors' understanding of the business and also enhance the relationship between the CAE and the board.
- Internal audit should be entrusted by the organisation to ensure that complete, timely and reliable information is provided to the board and key senior management. The integrity and transparency of information flows and the frequency and format of reporting by CAEs, should be as consistent and as flexible as necessary.
- Governance policies, such as an accountability framework, should be made clear to all levels, including extended operations, joint ventures and other forms of commercial alliances. The accountability policies should be monitored and reviewed regularly by the CAE and reported to the board.
- Internal audit should have a clear set of published audit objectives to ensure that corporate governance mechanisms such as the internal control systems, the risks management processes, and the financial reporting systems, are monitored at all times.
- Specific benchmarks and standards for corporate governance and management processes should be clearly documented, with reference to the *IIA Standards for Professional Practice*. There should be regular meetings with the board or its audit committee, and with the CEOs, to ensure frequent review and timely action is undertaken.
- Financial report matters and policies regarding earnings measurement should not be left for the external auditors alone. There should be proper co-ordination and dialogue between the CAE and the external auditor, particularly with respect to possible earnings management risks.
- There should be ongoing communication amongst the CEO, the audit committee, the CFO and the CAE, so that concerns, perceptions and misunderstandings are discussed. This communication is essential to arrive at some congruence in direction in order to achieve good corporate governance. Such processes can also ensure that the audit committee is more involved and proactive in matters such as earnings management. (It is noted that audit committee involvement is more concerned with conflicts of interest and disclosure issues in financial reporting).

- Boards/CEOs should be encouraged to promote the functions and status of internal audit, by ensuring that the internal audit function has well defined reporting responsibilities and is provided with sufficient resources.
- An internal audit charter is a statement of self-governance within the internal audit function. The internal audit charter should be mandatory for all internal audit functions and should incorporate all essential matters, which include its accountability structures, responsibilities, quality assurance standards and methodology.
- There should be clear guidance for internal auditors to establish a balance between compliance and advisory roles. The former requires a set of generally accepted and practised benchmarks and standards, while the latter adds value to the organisation through innovative insights and techniques for improvement.
- To enhance the role of internal audit in corporate governance, emphasis should be placed on the capability of internal audit in providing assurance to management and the board on the integrity of information flows, including the monitoring of all internal systems which generate information – internal control, risk identification and assessment, management and communication processes, and the provision of timely advice to management and the board.
- Internal auditors are a pool of talented personnel, who perform expert functions in the areas of control evaluation, risk assessment and compliance monitoring. To maintain the confidence of stakeholders, internal auditors should practise in a well-acknowledged professional regime, where there is a set of required knowledge and skills, confirmed by the C.I.A. certification process.

The above recommendations are supported by the findings as discussed in detail in the following research report.