Internal Audit Issues Facing Corporate Audit Committees

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ABSTRACT

The paper reviews and analyzes professional audit standards, audit committee charters, and research findings pertaining to audit committee oversight of internal auditing and assistance obtained from internal auditing. Issues examined are the development of internal audit charters, authorizing the acquisition of internal resources, reviewing and approving internal audit plans, making personnel decisions concerning the chief internal auditor, holding meetings with the chief internal auditor, and requesting special investigations from internal auditing.

Keywords: Internal auditing; audit committees; audit committee charters.

INTRODUCTION

Corporate audit committees serve their company board of directors by providing oversight and support for the internal audit function. These roles include helping to develop an internal audit charter, authorizing the acquisition of internal resources, reviewing and approving internal audit plans, making personnel decisions concerning the chief internal auditor, holding meetings with the chief internal auditor, and requesting special investigations from internal auditing. In turn, internal auditing often provides assistance to audit committees with their corporate governance roles. This paper analyzes these roles by discussing applicable professional audit standards, corporate audit charters, and relevant research findings.

DEVELOPMENT OF INTERNAL AUDIT CHARTER

The Institute of Internal Auditors (IIA)'s *International Standards for the Professional Practice of Internal Auditing* state that a company's board of directors should approve a charter which indicates the purpose, authority, and responsibility of the internal audit function (IIA, 2003b, section 1000). "The charter outlines the status and jurisdiction of the internal auditing department and facilitates the accomplishment of its objectives of effectively serving the organizations' needs (Rezaee and Lander, 1993, p. 37)." "Charters may describe processes for internal audit planning, budgeting, and reporting. The charter may also contain a summary of internal auditing's organizational structure, staffing, and auditor qualifications (Bailey, 2007a, p. 46)." A recent survey of 9,366 internal auditors by Burnaby et al. (2007) indicates that 72% of their organizations have an internal audit charter.

The purpose of some internal audit departments may be designated largely to conduct operational audits, while others may be charged with conducting mostly financial audits or compliance audits. The type of internal auditors hired by the company should be consistent with the internal audit charter. So, if the charter focuses on financial audits, then the company might wish to hire mostly certified public accountants, whereas if the emphasis is on operational or compliance auditing, then the company might seek to employ mostly non-accountants with specialties such as operations management or information technology management.

Another aspect of the internal audit charter that the board approves deals with the performance of assurance services versus consulting services. Assurance services are those that "involve the internal auditor's objective assessment of evidence to provide an independent opinion or conclusions regarding a process, system or other subject matter (IIA, 2003b, Introduction)." Consulting services, on the other hand, "are advisory in nature, and are generally performed at the specific request of an engagement client (IIA, 2003b, Introduction)." In authorizing the

internal audit function to perform consulting services, the board needs to be aware that those services are more susceptible to objectivity impairment than are assurance services.

Once the internal audit charter is developed, it does not necessarily remain static. “The scope of responsibilities as well as any change in role or function should be the subject of review by the audit committee (Treadway Commission, 1987, p. 37).” The audit committee should conduct periodic reviews for potentially updating the charter in light of new risks facing the company, new internal audit resources, and changing conditions under which the company operates. An analysis of 100 audit committee charters by Bailey (2007a) reveals that 17% require audit committee review of the internal audit charter. Table 1 contains examples of excerpts from audit committee charters that refer to duties to review internal audit charters.

Table 1
Excerpts from Audit Committee Charters that Refer to Duties to Review Internal Audit Charters

<p><u>Dell Inc.</u></p> <p>The responsibilities of the Committee shall include:</p> <p style="text-align: center;">.</p> <p style="text-align: center;">.</p> <p style="text-align: center;">.</p> <p>Reviewing the corporate audit function of the Company, including its charter (Dell, 2007).</p> <p><u>Walt Disney Co.</u></p> <p>The Committee shall have responsibility for determining that the Management Audit department is effectively discharging its responsibilities. In carrying out this responsibility, the Committee shall:</p> <ul style="list-style-type: none"> • review and approve the Management Audit department's charter (Walt Disney Company, 2007).

INTERNAL AUDIT RESOURCES/BUDGET PROVIDED

The IIA Standards state that the chief internal auditor should communicate the internal audit function's resource requirements to the company's board (as well as to senior management) for review and approval (IIA, 2003b, section 2020). The chief internal auditor should also communicate to the board the impact of resource limitations (IIA, 2003b, section 2020). Sometimes internal audit resources are outsourced. The IIA believes that “any recommendation to totally outsource (or outsource a significant portion of) the internal auditing activity should require approval of the audit committee (IIA, 2005, p.4).” A study of 219 chief internal auditors by Abbott et al. (2007) found that companies with independent, active, and expert audit committees were less likely to outsource routine internal audit activities to external auditors than were other audit committees. McDonald's Corporation's audit committee charter makes reference to the audit committee's duties relating to the outsourcing of internal auditing as follows:

With respect to any internal audit services that may be outsourced, the Committee shall be responsible for the engagement, evaluation and termination of the internal audit service providers and shall approve fees to be paid to the internal audit service providers (McDonald's Corporation, 2007).

A survey of 358 corporations by Verschoor (1992) reports that in 58% of them, budgeted internal audit expenses are provided to the audit committee. In a later survey of 114 companies by Raghunandan et al. (2001), 49% indicated that audit committees reviewed the proposed internal audit budget. Still a more recent survey of 119 chief internal audit executives by Kaplan and Schultz (2006) reveals that in 57% of their companies, the audit committee has budget approval for internal audit. An analysis of 100 audit committee charters in 2007 reveals that 65% require the audit committees to review the internal audit department's budgets or resources (Bailey, 2007a). Table 2 contains examples of excerpts from audit committee charters that refer to audit committee duties to review internal audit resources or budgets.

Table 2
Excerpts from Audit Committee Charters that Refer to Duties to Review Internal Audit Resources or Budgets

<p><u>CVS Caremark Corporation</u> At least annually, the Audit Committee shall evaluate the performance, responsibilities, budget and staffing of the Company's internal audit function (CVS Caremark Corporation, 2007).</p> <p><u>Dell Inc.</u> The responsibilities of the Committee shall include . . . Reviewing the corporate audit function of the Company, including . . . staffing (Dell, 2007).</p> <p><u>Home Depot</u> The Committee shall have the power, duty and responsibility to . . . Review, with the independent auditors, the Internal Audit Department and management . . . This review should include a discussion of the responsibilities, budget and staffing of the Company's internal audit function (Home Depot, 2007).</p> <p><u>McDonald's Corporation</u> The Committee shall discuss with the internal auditors, the . . . budget for their respective audits, including the adequacy of staffing and other factors that may affect the effectiveness and timeliness of such audits (McDonald's Corporation, 2007).</p> <p><u>Pepsico</u> In addition to the purposes set forth above, the primary responsibilities of the Committee shall be to . . . Review the internal audit department's staffing, budget and responsibilities (Pepsico, 2007).</p> <p><u>Walt Disney Co.</u> The Committee shall have responsibility for determining that the Management Audit department is effectively discharging its responsibilities. In carrying out this responsibility, the Committee shall . . . review the appropriateness of the funding, staffing and operational independence of Management Audit (Walt Disney Company, 2007).</p>
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While a survey of 118 audit committee members by DeZoort (1997) reports that most of their companies' proxy statements stipulate that the audit committee should monitor the resources allocated to the internal audit function, none of the respondents perceived it to be their responsibility to do so. This would suggest that corporate boards often need to do a better job of communicating to the audit committee that monitoring internal audit resources is one of their duties. However, a more recent survey of 88 publicly traded companies by the IIA Research Foundation (2004a) reveals that 53% of their audit committees review internal audit expenditures as compared to the budget at least on an annual basis. A similar survey by the IIA Research Foundation (2004b) with 67 nonpublic companies reports a rate of 35%.

LINES OF REPORTING

The Treadway Commission (1987) recommended that chief internal audit executives should report to the audit committee at regular intervals on the activities of the internal audit function. A survey of 119 chief internal audit executives by Kaplan and Schultz (2006) reports that the vast majority of them do so -- 85% of chief internal audit executives make quarterly reports to the audit committee.

The American Institute of Certified Public Accountants (AICPA) states that chief internal audit executives should have a solid-line reporting relationship to the audit committee (with a dotted-line reporting relationship to a senior executive in the organization for administrative purposes)" (AICPA, 2007, p. 1). The IIA (2007) concurs, stating that best practices suggest that chief internal audit executives should report directly to the audit committee or its equivalent. The Conference Board Commission on Public Trust and Private Enterprise (Conference Board) also states that the internal auditor "should have a direct line of communication and reporting responsibility to the audit committee (Conference Board, 2003, p. 39)." Hence, there seems to be broad support for internal auditing to report to audit committees.

The Kaplan and Schultz (2006) survey of chief internal audit executives mentioned above indicates that 93% of the 119 respondents have direct access to the audit committee as issues arise. Another survey of 379 chief internal audit executives finds that 55% of them report directly to the audit committee (IIA Research Foundation, 2003). The Sarbanes-Oxley Act of 2002 appears to have dramatically increased this rate, as a later survey of 717 internal audit managers by PricewaterhouseCoopers (2007) reveals that 89% of Fortune 500 respondents and 86% of total respondents report functionally to the audit committee or board of directors. The findings from these surveys suggest that most companies are adhering to the recommendations made by the Treadway Commission, AICPA, IIA and Conference Board. Table 3 contains examples from audit committee charter illustrating directives that the chief internal auditor have direct access to the audit committee.

Table 3
Excerpts from Audit Committee Charters Illustrating Directives that the
Chief Internal Auditor Have Direct Access to the Audit Committee

AirTran Holdings, Inc.

To fulfill its responsibilities and duties, the Audit Committee shall:

- .
- .
- .
- . Review the qualifications of the internal audit staff and concur in the appointment, replacement, reassignment, or dismissal of the senior internal audit executive who shall report to the Chief Financial Officer and have free and open access to the Audit Committee (AirTran Holdings, 2007).

CVS Caremark Corporation

To discharge its oversight responsibilities effectively, the Audit Committee will maintain open lines of communication with the Company's chief financial officer, chief internal auditor, and with the Company's independent auditors, each of whom will have free and direct access to the Audit Committee (CVS Caremark Corporation, 2007).

A potential drawback of having internal audit report to the audit committee is that it could cause mistrust between senior management and internal audit personnel. One such instance is reported by Moeller (2004, p. 43), who described a situation in which there “was almost a fear that the internal audit director was a potential spy who might pass inappropriate, confidential information to the audit committee outside of the regular meeting and reporting schedule.” These types of fears should not cause companies to shy away from having internal audit report to audit committees, but audit committees should recognize that it could give rise to mistrust and therefore should do what it can to foster positive working relationships between internal auditors and senior management.

DECISIONS TO HIRE AND DISMISS INTERNAL AUDIT PERSONNEL

The IIA believes that audit committees should approve decisions for hiring, retaining or dismissing the chief internal audit executive (IIA, 2003a). The importance of the internal audit function also led the Treadway Commission (1987) to recommend that the audit committee should review the appointment and the dismissal of the chief internal auditor. Involvement in dismissal decisions, in particular, is instrumental to the support of the internal audit function. “The audit committee can reduce management pressure and demonstrate support for the internal audit function by ensuring that the chief internal auditor is not dismissed as a consequence of audits which may reflect unfavorably on management (Scarborough et al., 1998, p. 54).” Thus, when the audit committee controls the dismissal process, the chief internal auditor can report negative information about management without fear of management reprisal through dismissal.

Kaplan and Schultz’s (2006) survey of 119 chief internal audit executives reports that in 78% of their companies, the audit committee has appointment approval responsibility for the chief internal auditor. This is in contrast to an examination of 100 audit committee charters in 2007, which found that 54% of them involve audit

committees in the appointment process and only 17% of the audit committees actually approve the appointment of the chief internal auditor (Bailey, 2007b).

A survey of 426 chief internal auditors by Raghunandan and McHugh (1994) found that in 38% of those companies, audit committees would be involved in any decision to dismiss the chief internal auditor. Another survey by Scarbrough et al. (1998) reported that for 48% of the 72 companies in the study, audit committees had either sole dismissal authority or approval authority of executive decisions to dismiss the chief internal auditor. A later survey by the IIA Research Foundation (2003) revealed that 64% of 379 chief internal auditors indicated that their companies involve the audit committee in decisions about appointing or dismissing the chief internal auditor. Thus, it appears that during the ten-year period from 1994-2003, there has been a steady growth in the percentage of companies that involve audit committees in decisions to appoint or dismiss chief internal auditors.

A 2007 examination of 100 audit committee charters reveals that while 53% of the charters involve audit committees in dismissals of the chief internal auditor, only 18% of the audit committees actually approve the dismissal of the chief internal auditor (Bailey, 2007b). These figures suggest that in most companies, internal auditors need to be concerned about repercussions that may ensue if their reports reflect negatively on top management. Examples of excerpts from audit committee charters which make reference to responsibilities for appointing or dismissing internal auditors appear in Table 4.

Table 4
Excerpts from Audit Committee Charters Making Reference
to Responsibilities for Appointing or Dismissing Internal Auditors

AirTran Holdings, Inc

To fulfill its responsibilities and duties, the Audit Committee shall . . . Review the qualifications of the internal audit staff and concur in the appointment, replacement, reassignment, or dismissal of the senior internal audit executive (AirTran Holdings, 2007).

CVS Caremark Corporation

At least annually, the Audit Committee shall evaluate the performance of the senior officer or officers responsible for the internal audit function of the Company, and make recommendations to the Board and management regarding the responsibilities, retention or termination of such officer or officers (CVS Caremark Corporation, 2007).

Dell Inc.

The responsibilities of the Committee shall include . . . Reviewing and agreeing with the appointment, replacement or dismissal of the Vice President of Corporate Audit (Dell, 2007).

Pepsico

In addition to the purposes set forth above, the primary responsibilities of the Committee shall be to . . . Review and approve the performance, appointment or replacement of the Corporation's senior-most internal auditor (Pepsico, 2007).

Walt Disney Co.

The Committee shall have responsibility for determining that the Management Audit department is effectively discharging its responsibilities. In carrying out this responsibility, the Committee shall . . . review and approve the appointment or dismissal of the Vice President of (or corresponding officer responsible for) Management Audit (Walt Disney Company, 2007).

Audit committees involved in dismissal decisions tend to meet more frequently with internal audit than audit committees that are not involved in such decisions (Raghunandan and McHugh, 1994). The implication of this phenomenon is that if an audit committee is charged with these types of decisions, then it would be advisable to get to know the chief internal auditor and his or her work better by holding more frequent meetings. Chief internal auditors generally perceive they would have more independence and more success in the implementation of audit recommendations in situations where audit committees have dismissal authority (Raghunandan and McHugh, 1994).

This suggests that companies wishing to send signals of support to internal audit would be advised to have their audit committees involved in any decisions to dismiss chief internal auditors.

COMPENSATION POLICIES FOR INTERNAL AUDITORS

Since the chief internal auditor is accountable to the audit committee, there is a basis for audit committee input into the compensation of the chief internal auditor. When audit committees have a role in setting the compensation of the chief internal auditor, internal auditing is more likely to be independent of management. The IIA (2003a) believes that audit committees should approve proposed compensation changes for the chief internal audit executive.

A survey of 61 chief internal auditors and 52 audit committee members by Kalbers (1992) found that most audit committees do not have much responsibility for setting the compensation of the chief internal auditor. An examination of 100 audit committee charters reinforces this as it finds that only 10% of the charters specify that audit committees participate in establishing the compensation of the chief internal auditor (Bailey, 2007b). It seems, then, that for companies looking to strengthen internal audit independence, one potential mechanism in many cases would be to have audit committees play a larger role in setting the compensation of the chief internal audit executive.

REVIEW OF INTERNAL AUDIT PLANS

The Conference Board (2003) suggests that audit committees should review for approval “a multi-year audit plan of not less than three years, centered on the corporation’s risks and vulnerabilities” and that the audit committee should review and update this risk-based plan on an annual basis. A survey by Verschoor (1992) reveals that long-range plans for internal auditing were presented to audit committees in 52% of the responding 358 corporations.

The IIA (2003a) believes that audit committees should approve annual internal audit plans. In a survey of 118 audit committee members, the respondents generally acknowledged that reviewing internal audit plans is one of their assigned responsibilities and that this responsibility was generally listed in their companies’ proxy statements (DeZoort, 1997).

A study of 150 companies revealed that 66% of audit committee charters discussed the audit committee’s duty to review the internal audit plan and procedures (Carcello et al., 2002). A later study indicates that 75% of audit committee charters analyzed require the audit committee to review the internal audit plan (Bailey, 2007a). Table 5 provides excerpts from audit committee charters illustrating audit committees’ duties to review internal audit plans.

According to KPMG (2004), audit committees are becoming more closely involved in, and increasingly signing off on, the annual internal audit work plan. Three surveys appear to confirm this phenomenon – in 1992, 89% of 358 companies surveyed reported that details of the annual internal audit plan were provided to the audit committee (Verschoor, 1992); in 1998, 83% of the respondents in 72 companies indicated that their audit committees reviewed proposed internal audit programs (Scarbrough et al., 1998); in 2001, 93% of respondents in 114 companies indicated that their audit committees reviewed proposed internal audit programs (Raghunandan et al., 2001). The first of these three surveys reports that about one-third of the 358 audit committees suggested an increase in the scope of the annual internal audit work plan, with only 1% suggesting decreases or deletions (Verschoor, 1992).

In evaluating the internal audit work plan, the audit committee should scrutinize not only the areas that internal audit will examine, but also the areas that will not be examined with supporting explanations such as the significance of the various business units. The audit committee should also assess whether the audit plan considers the key risks facing the company.

Table 5
Excerpts from Audit Committee Charters Illustrating Audit Committees' Duties to Review Internal Audit Plans

<u>AirTran Holdings, Inc</u> To fulfill its responsibilities and duties, the Audit Committee shall . . . Review the activity and effectiveness of the Internal Audit Group including the scope of the internal audit plan for the current year (AirTran Holdings, 2007).
<u>Chevron</u> The Committee shall review, based on the recommendation of the independent auditors and the General Manager–Corporation Auditing, the scope and plan of the work to be done by the Corporation Auditing Department, and the results of such work (Chevron, 2007).
<u>CVS Caremark Corporation</u> At least annually, the Audit Committee shall review the annual internal audit plan with the senior officer or officers responsible for the internal audit function of the Company. The review shall focus on the scope and effectiveness of internal audit activities and the department's capability to fulfill its objectives (CVS Caremark Corporation, 2007).
<u>Dell Inc.</u> The responsibilities of the Committee shall include . . . Reviewing with the Vice President of Corporate Audit the proposed scope and plan for conducting internal audits of Company operations (Dell, 2007).
<u>McDonald's Corporation</u> The Committee shall discuss with the internal auditors, the internal audit service providers and the independent auditors the overall scope, plans and budget for their respective audits (McDonald's Corporation, 2007).
<u>Pepsico</u> In addition to the purposes set forth above, the primary responsibilities of the Committee shall be to . . . Review the audit plans and activities of the independent auditors and the internal auditors (Pepsico, 2007).
<u>Proctor & Gamble</u> The Committee will undertake the following activities . . . To review and approve the annual internal audit plan (Proctor and Gamble, 2007).

In addition to scrutinizing the internal audit plan, audit committees often review the percentage of completion of the annual internal audit plan. A survey of 88 publicly traded companies indicated that this type of review took place for 90% of the respondents (IIA Research Foundation, 2004a). A similar survey conducted with nonpublic companies found a rate of 82% (IIA Research Foundation, 2004b).

MEETINGS

The Treadway Commission (1987) recommended that chief internal audit executives should have direct and unrestricted access to the audit committee, should meet privately with the audit committee on a regular basis, and should attend all audit committee meetings. The Conference Board also recommends that the internal auditor attend all regularly scheduled audit committee meetings and meet with the audit committee in executive session (Raghunandan et al., 2001). It is not clear whether they intend for these executive session meetings to be regular or on an as-needed basis. Regular private meetings would avoid any awkwardness that could occur if the chief internal auditor would call for an executive session with the audit committee during an audit committee meeting. The IIA (2003a) believes that audit committees should be responsible for conducting, periodically, private meetings with the chief internal audit executive without management personnel present. The IIA (2007) suggests that these private meetings should focus on assurances that the internal audit is not being limited in scope, concerns about senior management personnel, any necessary administrative matters, and any other items that either party wishes to raise.

The Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees (Blue Ribbon Committee, 1999), appointed by the National Association of Securities Dealers and the New York Stock Exchange, also believes it is important to have formal mechanisms to facilitate confidential exchanges between internal auditors and the audit committee. The Committee suggests that these mechanisms may either be regular meetings

independent of management or regular confidential memos or reports circulated only to the audit committee. “If such meetings or correspondence are regularly scheduled regardless of the identification of irregularities or problems, independent dialogue between the audit committee and the internal auditor should lose its ‘taboo’ nature and no longer imply treason against management (Blue Ribbon Committee, 1999, p. 39).”

For companies listed on the New York Stock Exchange, audit committees are required to periodically meet separately with internal auditors and this must be specified in the audit committee’s charter (NYSE, 2004, § 303A.07(c)(iii)(E)). A study of 150 companies by Carcello et al. (2002) revealed that 44% of audit committee charters discussed the audit committee’s duty to have private meetings with internal auditing. Table 6 provides excerpts from audit committee charters which describe requirements to meet separately with internal auditors:

Table 6
Excerpts from Audit Committee Charters Which Describe Requirements to Meet Separately with Internal Auditors

<u>Chevron</u> Periodically, the Committee shall meet separately with each of management, internal auditors and the independent auditors (Chevron, 2007).
<u>Dell Inc.</u> From time to time, the Committee shall meet separately and privately with the independent auditors, with the Vice President of Corporate Audit and with management to discuss matters warranting attention or private consideration by the Committee (Dell, 2007).
<u>Home Depot</u> [T]he Committee should meet at least quarterly with management, the Vice President of Internal Audit and the independent auditors, in separate executive sessions (Home Depot, 2007).
<u>McDonald’s Corporation</u> In planning the annual schedule of meetings, the Committee shall ensure that sufficient opportunities exist for its members to meet separately with the independent auditors, the head of internal audit (and/or internal audit service providers), management, and to meet in private with only the Committee members present (McDonald’s Corporation, 2007).
<u>Pepsico</u> The Committee will meet, at least quarterly, with management, the senior-most internal auditor, and the independent auditors in separate sessions to discuss any matters which the Committee or these groups believe should be discussed privately with the Committee (Pepsico, 2007).
<u>Proctor & Gamble</u> the Committee will undertake the following activities . . . To periodically meet separately with internal auditors (Proctor and Gamble, 2007).
<u>Walt Disney Co.</u> The Committee shall . . . meet periodically with management auditors in private session (without the participation of management or the independent auditors) (Walt Disney Company, 2007).

A 1992 survey of 61 chief internal auditors found that 69% indicated that they met privately with the audit committee at least once during the previous year (Kalbers, 1992). Another 1992 survey of 358 corporations revealed that 77% of them reported that their directors of internal audit had at least one private meeting with the audit committee during the previous year, with two private meetings being the average (Verschoor, 1992). In 89% of these corporations, the directors of internal audit attend each audit committee meeting. In a 1998 survey of 72 companies, 76% reported that their chief internal auditors had private access to the audit committee and 91% reported that the audit committee met at least once a year with the chief internal auditor (Scarbrough et al., 1998). Another survey of 114 companies in 2001 revealed that, on average, audit committees had 3.3 meetings per year with the chief internal auditor, and that audit committees provided private access to the chief internal auditor in 71% of the companies (Raghunandan et al., 2001). A later survey in 2003 indicated that 95% of 379 chief internal

auditors responded that private sessions with their audit committees are available to them. – 67% reported that a private session with the audit committee was a regular agenda item; 28% reported that a private session was available to them by request only (IIA Research Foundation, 2003). These findings reveal that during the period from 1992 to 2003 the percentage of internal auditors who meet privately with the audit committee has steadily grown to the point where almost all chief internal auditors now have the opportunity for private sessions with audit committees.

All in all, the analyses of audit committee charters and survey results indicate that there is widespread support, in policies and in practice, for audit committees to have regular meetings with internal auditors, including private sessions either on a regular or as-needed basis. When audit committees include one or more company executives, the outside members of the audit committee can meet privately with the chief internal auditor.

REQUESTS FROM AUDIT COMMITTEES

Internal auditors sometimes support the audit committee by performing special projects or investigations at the request of the audit committee. Examples might be an investigation of emerging risks to the company or a report on financial accounting developments.

A survey of 358 corporations by Verschoor (1992) found that about 17% of audit committees suggested the addition of a specific new audit to the annual internal audit plan. A survey of 119 chief internal audit executives by Kaplan and Schultz (2006) reports that 46% of them indicate that they have performed one or more audits in the previous year directly as a result of the audit committee's request. This trend suggests that audit committees might be more demanding of internal auditing as far as what audits are to be performed.

ASSISTANCE IN MANAGING THE BOARD AND ITS ACTIVITIES

The IIA believes that internal auditors have much to offer company boards of directors to assist them in managing the boards. Internal auditors can assist with board committee functions by “review[ing] board meeting schedules, establishment of agendas, dissemination of advance information, and adherence to the committee charters. Internal auditors can also evaluate whether the board committees maintain a calendar of responsibilities and regularly monitor performance to published responsibilities (IIA, 2006, p. 7).” In a survey of 61 chief internal auditors, over one-third reported that they have “quite a bit” of input in preparing the audit committee meeting agenda (Kalbers, 1992). A survey of 358 corporations indicates that for 70% of them, the director of internal audit either reviews or takes the minutes of audit committee meetings (Verschoor, 1992).

When the time comes for a board to perform a self-assessment on its governance, internal auditors “could assist the board in these responsibilities by facilitating data collection and reporting results to the board (Verschoor, 1992, p. 8).” KPMG (2004) suggests that internal audit can coordinate audit committee self-assessments. Another potentially useful role for internal audit is to assist with recruitment processes of board members by reviewing recruitment standards and policies and by evaluating whether practices meet organizational objectives (IIA, 2006). The AICPA also believes that internal auditors can assist company boards in managing the audit committee by keeping the audit committee charter and consulting with the audit committee chair and chief financial officer in developing meeting agendas (AICPA, 2007).

Internal auditors can also play an important role in helping boards manage their organizational governance activities. The IIA suggests that internal auditors can help develop and maintain the board governance policy manual, evaluate compliance procedures, and make recommendations for improvement. “Internal auditors can review whether all the key responsibilities related to organizational governance have been assigned, assigned to the proper parties, and whether the performance management system and disciplinary action processes are effective (IIA, 2007).”

Executive compensation is another area in which internal auditors can provide the board with assistance. In particular, the IIA suggests that internal auditors can be of use in monitoring indirect forms of compensation such as stock compensation programs, personal use of the organization's resources, and reimbursement of excessive

expenses. “Internal auditors could focus on the accuracy and completeness of information provided to the board, the judgment exercised by management when classifying indirect executive benefits, and adequacy of the board’s attention to this topic (IIA, 2007, p.8).” Table 7 contains excerpts from audit committee charters which illustrate internal auditors’ input into the audit committee’s oversight of indirect management compensation.

Table 7
Excerpts from Audit Committee Charters Which Illustrate Internal Auditors’ Input into Oversight of Indirect Management Compensation

CVS Caremark Corporation

At least annually, the Audit Committee shall review the annual report from the internal auditors covering the internal auditor's review of the officers' and directors' travel and entertainment expenses (CVS Caremark Corporation, 2007).

Pepsico

In addition to the purposes set forth above, the primary responsibilities of the Committee shall be to:

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Review with the senior-most internal auditor and the chief compliance officer the results of reviews by the internal auditors or independent auditors of (a) officers' expense accounts and use of corporate assets (Pepsico, 2007).

The IIA (2007) believes that internal auditors can be of benefit to the board in the area of board education and training. This would include education on the significant issues facing the company, changing technology, and emerging risk areas. Internal auditors can assist the board by “providing development of training content, delivery of training, and administrative support (IIA, 2007, p.7).” In a survey by Burnaby et al. (2007), 34% of 3,424 internal auditor respondents indicated that their internal audit department has provided training to audit committee members.

KPMG (2004) suggests that internal audit can assist with the orientation of new audit committee members. This would include an overview of the company history, organizational structure, mission statement, business environment, and primary products or services offered by the company. “The internal audit departments should also provide a series of ‘financial literacy’ seminars to assist certain audit committee members (and other interested board members) in understanding fundamental accounting and auditing issues (DeZoort et al., 2000, p. 13).” This would help fulfill the recommendation made by the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees that members of audit committees be financially literate within a reasonable time period following their appointment to the audit committee (Blue Ribbon Committee, 1999).

The IIA (2006, p. 8) suggests that “internal auditors can assist the board in their management of external auditors by evaluating external auditor performance, their relationship with management and ways of handling disputes, the extent of additional work outside the normal audit engagement, and fees.” Internal auditors are in a good position to inform the audit committee members about the relationship between management and the external auditors. Internal auditors can provide details about the work currently being done by the external auditors, any significant past or current disagreements between management and the external auditors, and management letter comments together with an explanation of how the comments are being addressed by management. A survey of 358 corporations finds that about 65% of internal audit directors submit information to their audit committees concerning the results of matters contained in the external audit firm management letter (Verschoor, 1992). Table 8 contains excerpts from audit committee charters illustrating that internal auditors, among others, are asked to provide input to the audit committee on external auditors’ qualifications, performance, and independence. A survey of 379 chief internal audit executives reports, however, that only in about 10% of their companies does management or the audit committee ask for the internal auditor’s evaluation of the external auditors (IIA Research Foundation, 2003).

Table 8
Excerpts from Audit Committee Charters Which Illustrate that Internal Auditors Are Asked to Provide Input to the Audit Committee About External Auditors

AirTran Holdings, Inc

To fulfill its responsibilities and duties, the Audit Committee shall:

... evaluate the independent auditor's qualifications, performance and independence, including a review and evaluation of the lead partner of the independent auditor, and taking into account the opinions of management and the Company's internal auditors (AirTran Holdings, 2007).

CVS Caremark Corporation

The Audit Committee shall:

obtain the opinion of management and the internal auditors of the independent auditor's performance (CVS Caremark Corporation, 2007).

Proctor & Gamble

The Committee will undertake the following activities:

To annually evaluate the independent auditor's qualifications, performance and independence, including a review and evaluation of the lead partner, taking into account the opinions of Company management and the Company's internal auditors, and to report its conclusions to the Board (Proctor and Gamble, 2007).

CONCLUSION

The growth of internal auditing has brought about an increased oversight role for corporate audit committees. At the same time, internal audit resources and capabilities make it possible for internal auditors to assist audit committees in their corporate governance roles. This paper has analyzed these roles by discussing applicable professional audit standards, corporate audit charters, and relevant research findings. From these discussions, both audit committee members as well as internal auditors can gain a better understanding of their roles in corporate governance.

AUTHOR INFORMATION

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