Audit Committee’s View of Relations between External and Internal Auditors

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Duties of the Board

• The Board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.

• The Board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company’s auditor.

(UK Corporate Governance Code, 2010, page 7)
Duties and responsibilities of the Audit Committee (1)

- To monitor the integrity of the financial statements of the company and any formal announcements relating to the company’s financial performance, reviewing significant financial reporting judgments contained in them;

- To review the company’s internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company’s internal control and risk management;

- To monitor and review the effectiveness of the company’s internal audit function;
Duties and responsibilities of the Audit Committee (2)

• To make recommendations to the Board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;

• To review and monitor the external auditor’s independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;
Duties and responsibilities of the Audit Committee (3)

• To develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm, and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken.

(UK Corporate Governance Code, 2010, page 20)
What does research reveal (1)?

1. In the 1990s, audit committees were hesitant about overseeing cooperation between internal and external auditors even though it was one of their assigned responsibilities (DeZoort, 1997: 208)

2. External auditors choose to coordinate their efforts with internal audit as inherent risk increases (Felix et al, 2001: 514)

3. A high degree of coordination and cooperation between internal and external auditors is encouraged by the Panel On Audit Effectiveness (2002. p62.)

4. Coordination of internal and external audits has risen considerably (12%, 1968; 81%, 1984; 100%, 2004: see Schneider, 2009)

5. Relationships between internal and external auditors deteriorated shortly after SOX (Nagy and Cenker, 2007:44)
What does research reveal (2)?

6. In cases where significant nonaudit services are provided, external auditors appear more affected by client pressure and less concerned about internal audit quality and coordination when making internal audit reliance decisions (Felix et al., 2005:31)

7. Level of audit committee member expertise is associated with increased use of internal audit and higher external audit fees as committees seek higher quality auditing (Goodwin-Stewart and Kent, 2006:387)

8. The greater the governance strength of the audit committee, the greater the assessed quality of internal audit and the greater the overall level of coordination between internal and external audit. Audit committee accounting expertise positively affects the level of internal/external audit coordination (Krishnamoorthy and Maletta, 2008:1)
What does the Audit Committee expect from Internal Audit?

- Risk based annual plans and required resources
- Progress against plans
- Updates on the implementation of audit recommendations
- IA annual report and statement of assurance
What does the Audit Committee expect from External Audit?

• Risk based planning of the audit

• Audit completion memorandum/ The management letter

• Update on the implementation of the audit recommendations
Common problems of cooperation that the audit committee must help resolve

1. Last minute changes by external auditors

2. Lack of acknowledgement of internal auditors’ contributions to the overall control environment

3. Insufficient involvement of internal auditors at the corporate level

4. Potential duplication of efforts by internal and external auditors such as those created by SOX requirements
What can the Audit Committee do to promote effective co-operation between IA and EA (1)?

The committee can promote effective co-operation between the two groups of auditors through:

1. Taking an active interest in the issues associated with audit and encouraging co-operation between the two groups of auditors;
2. Identifying opportunities for co-operation from the respective audit plans;
3. Encouraging regular and structured dialogue between the two groups of auditors;
4. Encouraging both auditors to adopt an active role in seeking opportunities for co-operation;
5. Approving areas of co-operation.

(NAO, Co-operation between Internal and External Auditors: A good practice guide, pages 5 and 7)
What can the Audit Committee do to promote effective co-operation between IA and EA (2)?

6. By ensuring the attendance by external auditors of audit committee’s meetings, the committee would allow itself the opportunity to take a broader view of audit activity in the organisation and allowing its members to discuss issues which external audit might wish to raise. Only by having this broad view of audit activity can the committee be pro-active in encouraging and helping identify opportunities for co-operation between internal and external audit”.

(NAO, Co-operation between Internal and External Auditors: A good practice guide, page 7)
What can the Audit Committee do to promote effective co-operation between IA and EA (3)?

In summary, through encouraging:

1. The holding of periodic meetings
2. Scheduling of audit work
3. The provision of access to internal audit working papers
4. External audits’ review of internal audit reports
5. Discussion of possible accounting and auditing issues
6. Identification of any new reporting or regulatory requirements that may affect audit requirements
7. Identification of any changes in the organisation that may affect audit requirements
8. Identification of significant audit issues for investigation
As Chair of the Audit Committee, my optimum scenario is a total audit effort which has been delivered to the organisation and the different stakeholders in an:

- Effective
- Efficient
- and Economical manner
As Chair of the Audit Committee,

1. I would like the relationship between the two groups of auditors to be seen as a relationship of equals and that any cost savings achieved through the use by the external auditors of the internal auditors’ work to be ploughed back into funding the internal audit activities.

2. I believe that fostering a positive and pro-active relationship between the two groups of auditors is imperative if the organisation is to achieve ‘value for money’ from the total audit effort.