

“The Paradox of Dual Reporting and Internal Auditor’s Independence”

Presentation by:

Fiona J. Korir (Ph.D Fellow)

Friday, 23rd June, 2017

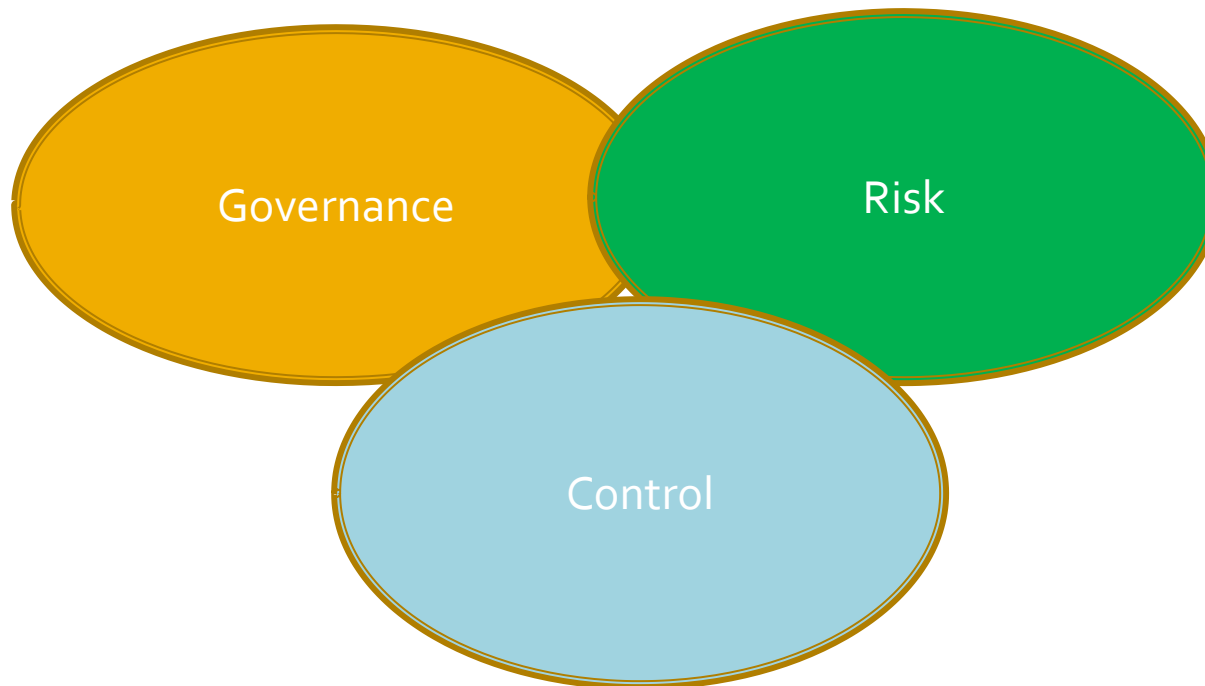
What is internal auditing?



- It is an independent objective assurance and consulting activity designed to add value and improve organizations operations
- It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.

What are the functions?

- In summary it can be presented as follows
 - 1.) Assurance= Governance, risk and control



Cont.....



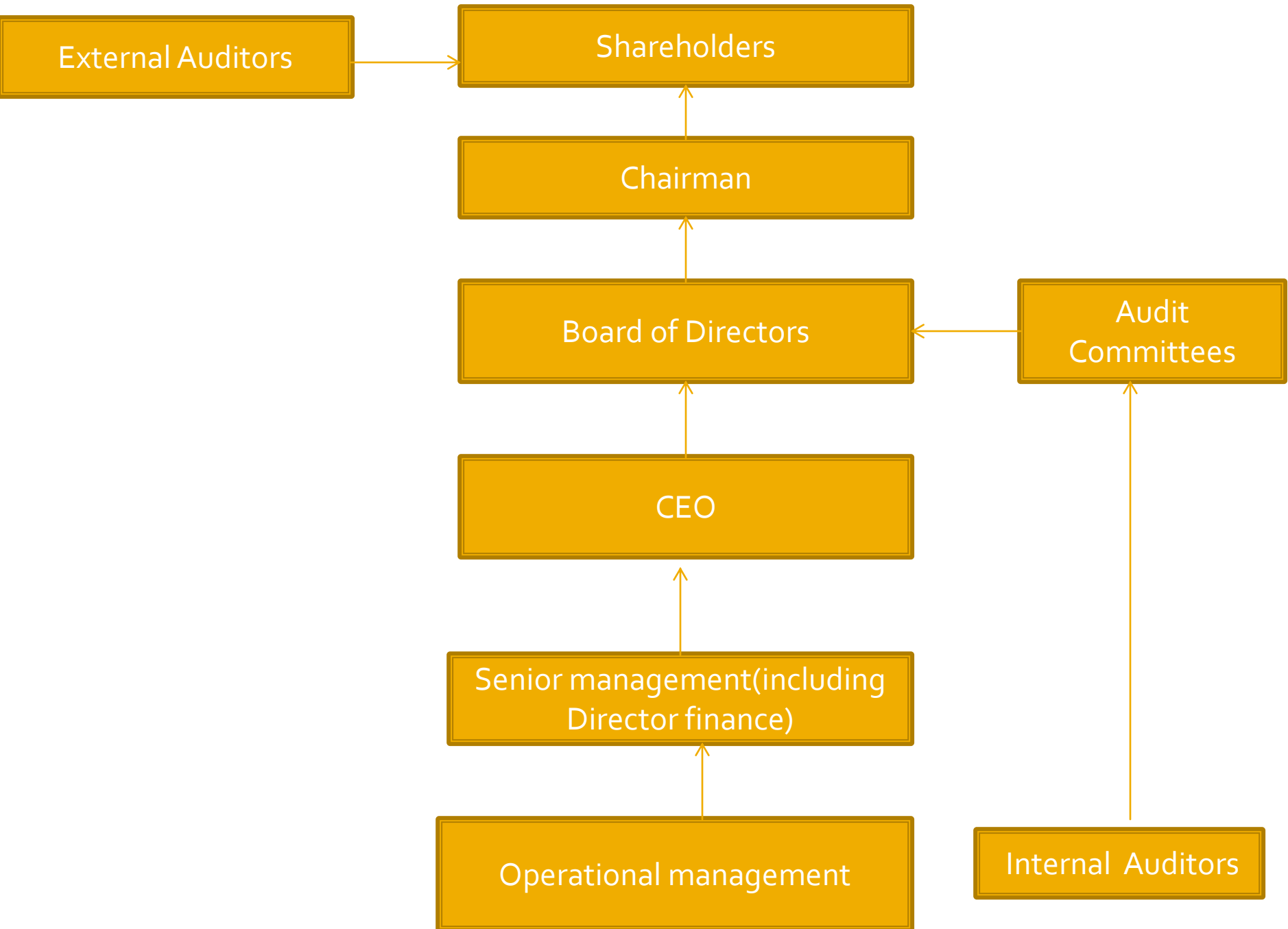
2.) Detection and prevention of errors and frauds

Ensuring proper execution of internal control systems and frequent advices to the audit committees on the reviews of the ICS with the rapid changing trends in the market.

How is the existing reporting structure in the industry?



- With the three main functions of internal auditing functions it forces the office to report to different individuals at different capacities.
- Consider the simple organizational structure that most of the organizations use;



Cont....



- From the organization structure its clear that the internal auditors can report to more than one authorities, namely to the
- Management(i.e to both senior management and the operational management)
- To the board(To the audit committees)

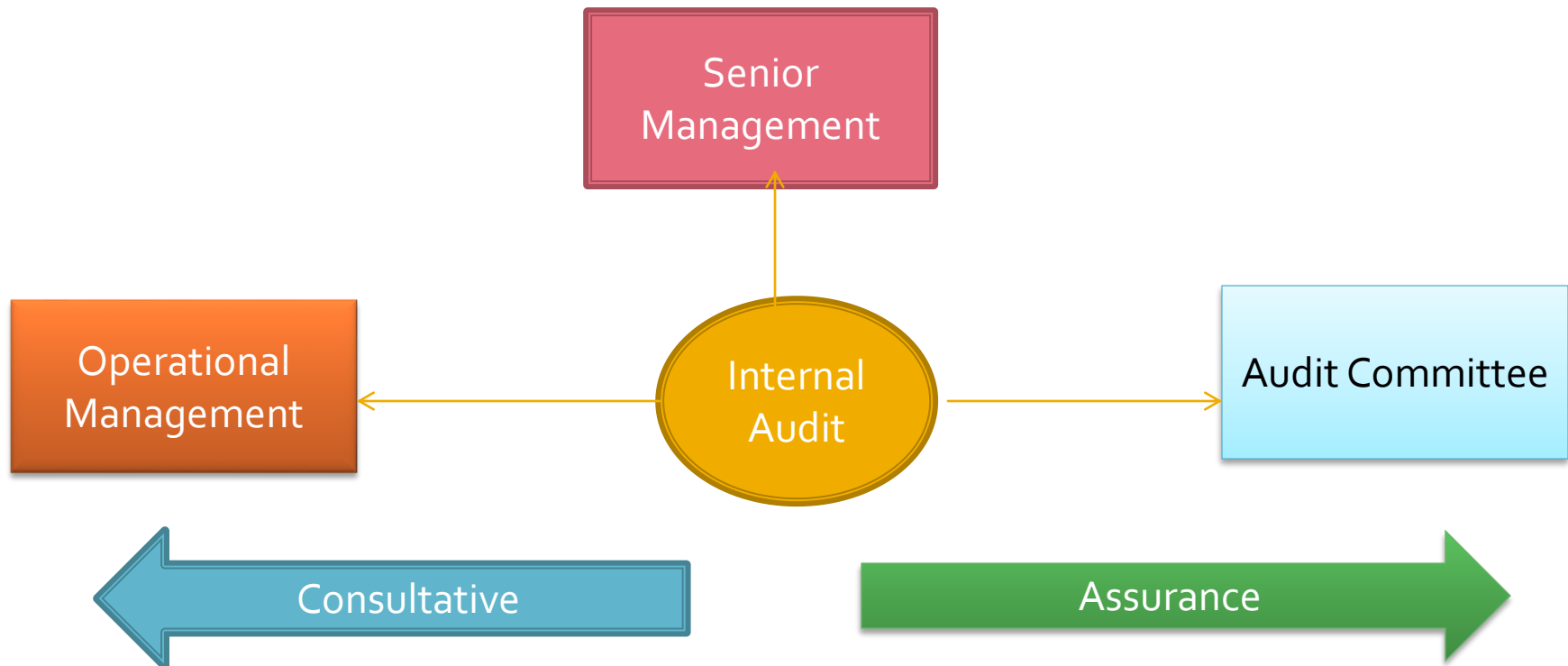
What are the demands expected from the CAE by the parties?



- Operational management; only interested in advice that may improve efficiency and effectiveness of their operations.
- Senior management may be interested with activities that may directly affect the bottom line or potentially their bonuses.
- Audit committees may greatly focus on risk management and control activities.

Cont.....

- All these competing demands can be visualized in the figure below;



What are the perceived problems with the existing reporting structure?



- Compromising Internal Auditors independence which adversely affects the assurance process
- Substandard accounting disclosures which encourages fraudulent reporting
- Misappropriation of the companies/government resources

Cont.....



- The reports from Internal audit department can only be reliable if the internal audit officers are left to work independently
- **Independence** is the freedom from conditions that threaten the ability of the **internal audit** activity to carry out **internal audit** responsibilities in an unbiased manner.

Standards and reporting relationships



- IASB resolves all these issues in two sections of the standards;
- 1) **Purpose, Authority and Responsibility**
That the purpose responsibility and Authority of IA be defined in a charter consistent with the standards and approved by the board.

Cont.....



2) Organizational independence

- CAE should report to the level within the organization that allows the internal audit activity to fulfill its responsibility
- It should be free from interference in determining the scope of internal auditing, performing work and communicating results.

Suggested research findings on Dual reporting of the IA.



- Following the literature that has been done in emerging economies, the internal auditor occupies a unique position. He or she is employed by the management but is also expected to review the conduct of management which can create significant tension since the internal auditor's independence from management is necessary for the auditor to objectively assess the managements actions.

cont.....



- Following Groff, Pietra & Sitar(2016) on contemporary role of internal auditing in corporate governance, its clear that, with the dynamic changes in business environment and the increase in corporate scandals, the reporting structure of the internal audit department, the operating management and the supervisory board keep on changing as shown below;

Reporting structures in 1980,s

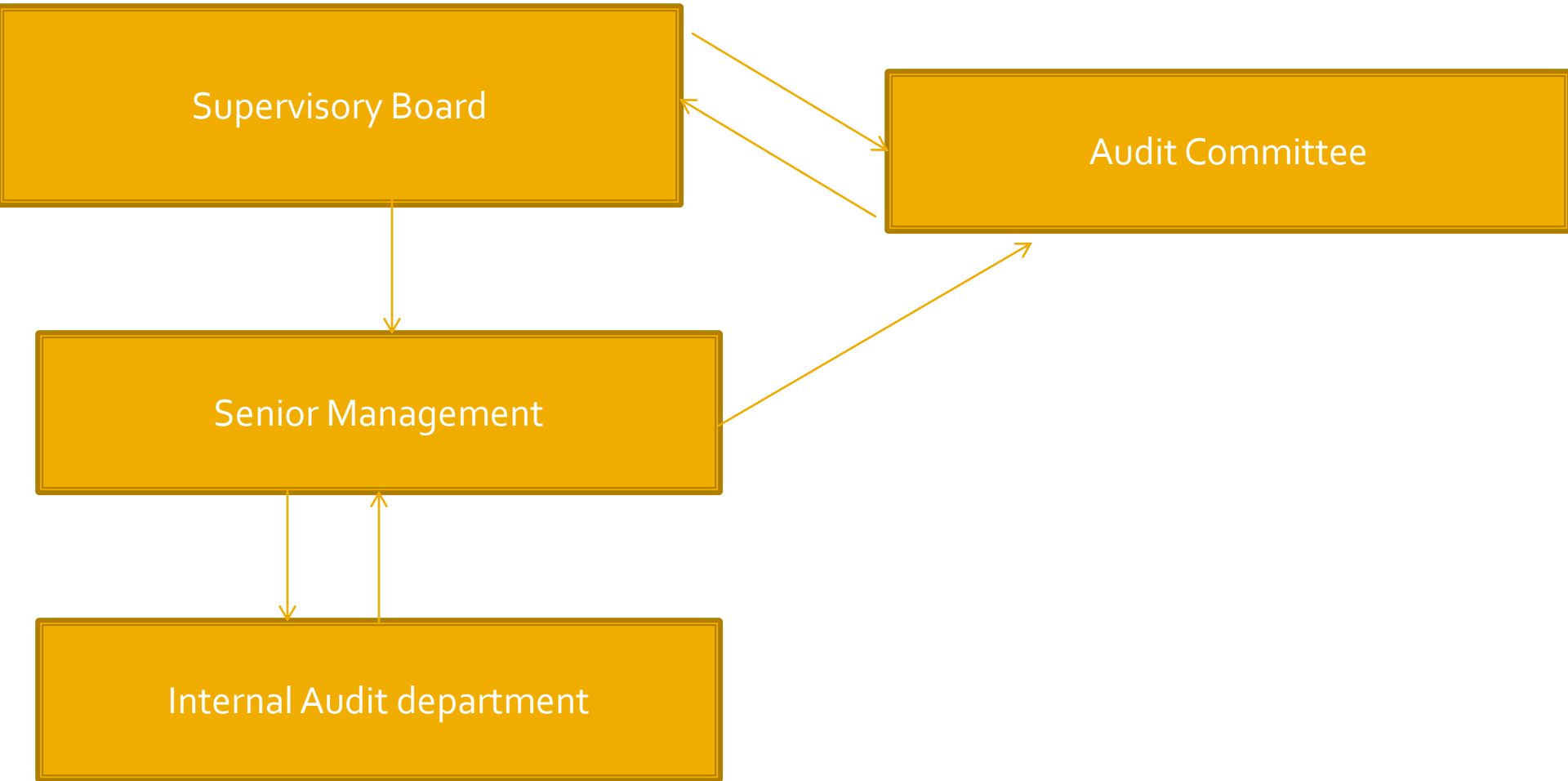


Supervisory Board

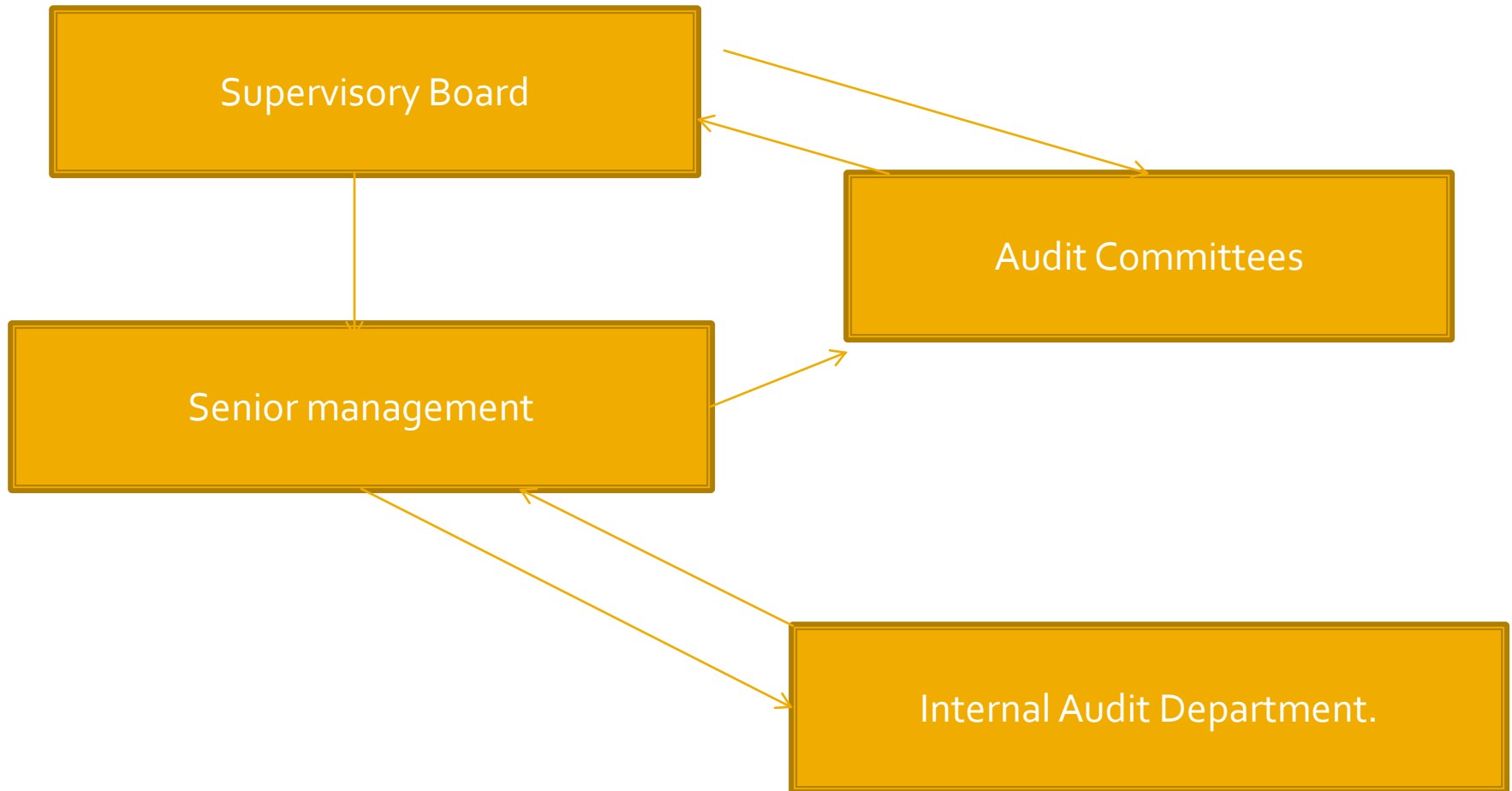
Audit Committee

Senior Management

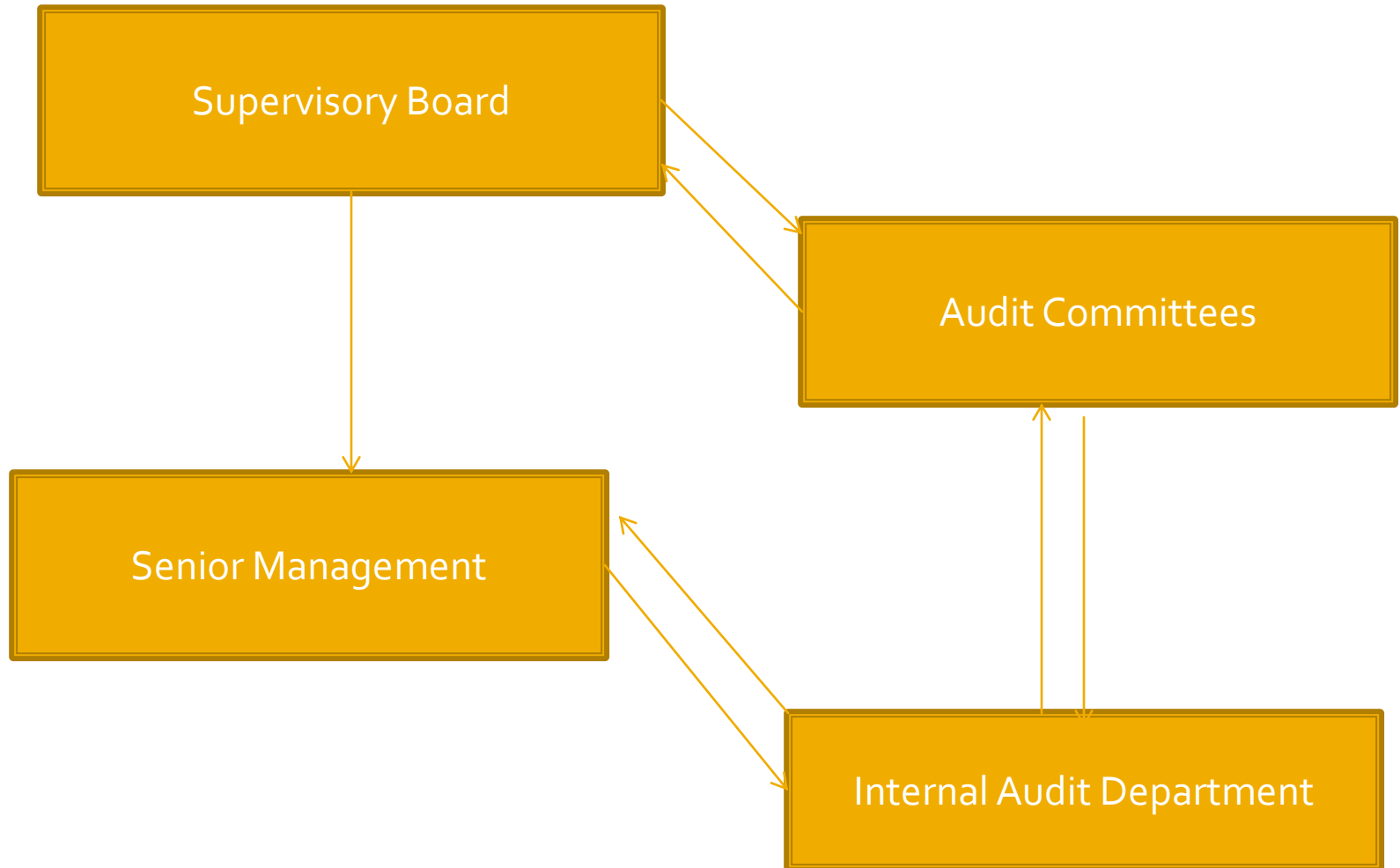
Internal Audit department



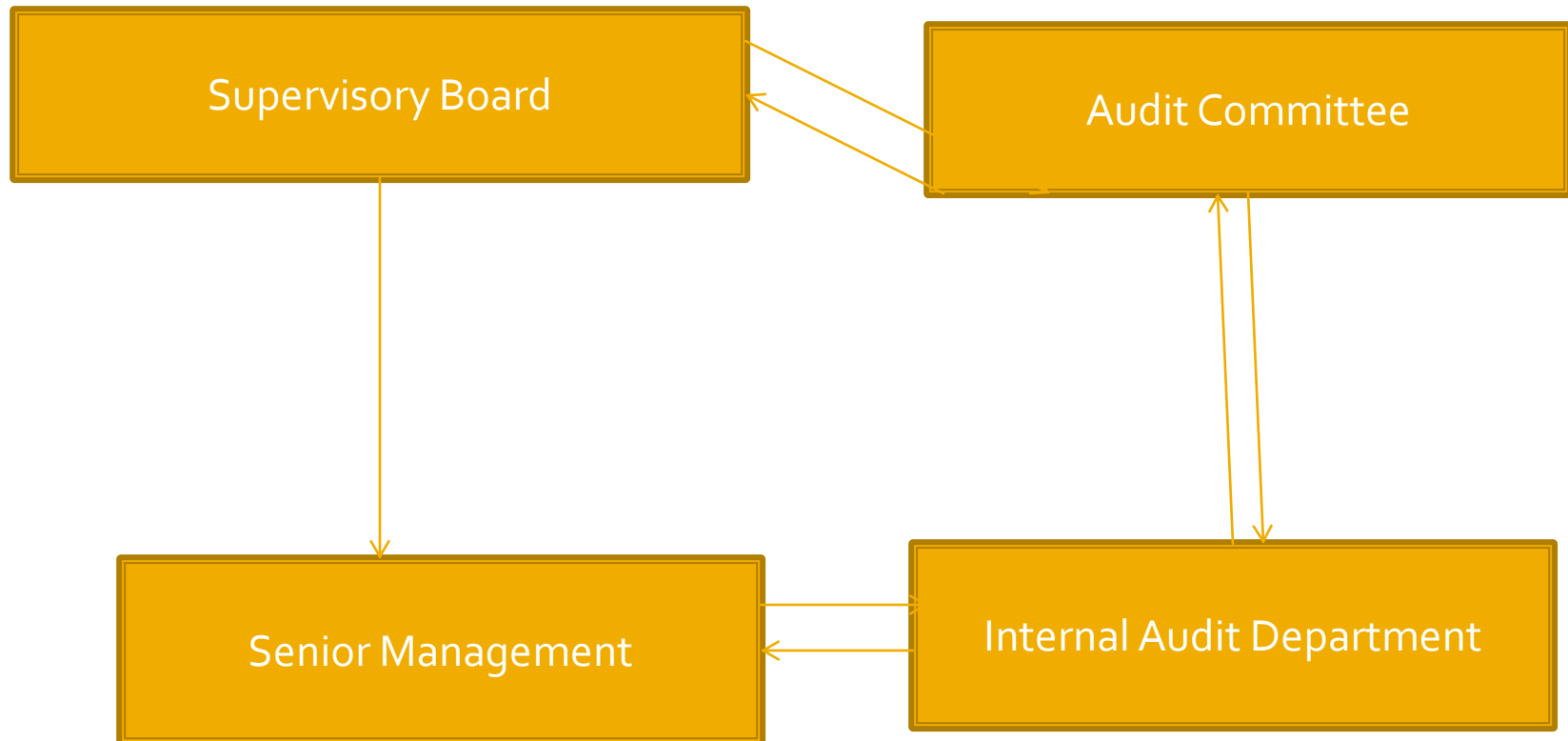
Reporting structures in 2000,s



Reporting structures in 2010,s



Future Reporting structure



Conclusion.....



Question:

What are the suggested ways of resolving the paradox of dual reporting and internal auditors independence?

Cont.....



Reporting Structure

- a) The Internal Audit department should report directly to the audit committee or its equivalent.
- b) For day to day administrative purposes, the CAE should report to the most senior executive (i.e., the chief executive officer [CEO]) of the organization.

Cont....



- The CAE should have direct communication with the audit committee which reinforces the organizational status of internal auditing, enables full support and unrestricted access to organizational resources, and ensures that there is no impairment to independence. This provides sufficient authority to ensure broad audit coverage, adequate consideration of engagement communications, and appropriate actions on recommendations.

Cont.....



- Independence is further enhanced if the CAE reports to the board through its audit committee on the planning, execution, and results of audit activities.

Cont.....



- **Appointment, dismissal and remuneration**
The audit committee should be responsible for the appointment, removal, and fixation of compensation of the CAE.

Cont.....

- **Internal Auditors duties and responsibilities**
The committee should safeguard the independence by approving the internal audit charter and mandate periodically.

Cont.....



Professional ethics

- The internal auditor should have an impartial, un-biased attitude and avoid conflict of interest situations, as that would prejudice his/her ability to perform the duties objectively.
- Internal auditors should not accept gifts or favors from others such as employees(senior staff) clients or business associates.

Cont.....



- The internal auditors should adopt a policy that endorses their commitment to abiding by the Code of Ethics, avoiding conflicts of interest, disclosing any activity that could result in a possible conflict of interests.

Cont.....



Rotation of Assignments

Staff assignment of internal auditors should be rotated periodically whenever it is practicable.

Reviews of internal Audit reports

The results of internal audit work should be reviewed before they are released in order to provide a reasonable assurance that the work has been performed objectively.

FORUM FOR QUESTIONS

Cont.....



Contacts

Cell phone no.0722-962148

Email:fionajepkosgei@gmail.com

• THE END