



The European Confederation of Institutes of Internal Auditing (ECIIA) is a confederation of national Institutes of Internal Audit in the wider European region. ECIIA exists to promote professional internal auditing - its benefits, competencies, standards and qualifications - to all European institutions, bodies, committees and people of influence.

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Internal audit: a key contributor to effective corporate governance in the European Union

Within an organisation, Internal Audit

- provides senior management and the board⁽¹⁾ with objective assurance on the organisation's governance, risk management and control processes,
- advises on effective ways for improving such processes, and
- helps management to implement these improvements.

In this way, Internal Audit contributes to the achievement of the organisation's strategic, operational, financial reporting and compliance objectives.

Recent amendments to the Fourth, Seventh and Eighth Council Directives, to enhance corporate governance in the European Union:

- Require companies listed on EU exchanges to publish an annual corporate governance statement containing information about corporate governance codes, about shareholder meetings and about administrative, management and supervisory bodies, as well as a description of the main features of the company's internal controls and risk management systems in relation to the financial reporting process;
- Require public-interest entities to establish an audit committee. Amongst other duties, the audit committee is responsible for monitoring the effectiveness of the company's risk management and internal control systems, as well as the financial reporting process;

- Confirmed that all members of the administrative, management and supervisory bodies of the company have collectively the duty to ensure that publicly disclosed financial and key non-financial information (including the newly introduced corporate governance statement) comply with the requirements of the 8th Directive and, where applicable, accord with international accounting standards.

To effectively assume these enlarged duties, the board – or relevant board sub-committee – will seek assurance from senior management regarding the proper design and effective operation of the company's governance and risk management processes. While this "first line" assurance is fundamental, ECIIA believes that – within organisations – Internal Audit is uniquely positioned as a preferred supplier of objective "second line" assurance regarding the effectiveness of organisational governance and risk management processes to achieve the organisations' strategic, operational and compliance objectives. Also, in coordination with the external auditors, Internal Audit can inform the board about material control weaknesses in the applied financial reporting process and to help management improve this process to ensure the reliability of publicly disclosed financial information.

For the reasons mentioned above, ECIIA proposes that Internal Audit is being recognised in related future EC guidance and regulations as a primary source for

objective assurance regarding the effectiveness of an organisation's governance, risk management- and accompanying control processes, including professional advice on potential process improvements.

Specifically, ECIIA proposes that future EC guidance companies listed on EU exchanges should recognise that best practice is to establish and maintain adequately and competently staffed Internal Audit, which act in accordance with the International Standards and Code of Ethics for the professional practice of internal auditing, set by the global Institute of Internal Auditors⁽²⁾.

If such Internal Audit is not present, ECIIA proposes that the companies' corporate governance statements should disclose why it is not in place and explain how objective assurance on governance, risk management and control processes was obtained in its absence.

As a safeguard against potential impairment of Internal Audit's independence and objectivity, ECIIA is particularly concerned that International Standards relating to Internal Audit reporting lines be implemented. These require that Internal Audit reports to a sufficiently high level in the organisation to be able to perform its duties and that it should have an active and effective reporting line to the board – or relevant board sub-committee – and that the board should be assigned responsibility for

- approving the Internal Audit charter;
- overseeing periodic Internal Audit

- plans and allocated resources;
- providing advice to the CEO regarding the hiring or dismissal of the chief audit executive, as well as his/her performance evaluations and compensation changes;
- overseeing the overall quality of the assurance and consulting services provided by internal audit.

As a conclusion, ECIIA strongly believes that effective corporate governance and risk management processes are dependent on the synergy generated among the four principal components of such processes –i.e. board⁽¹⁾, senior management, external and internal auditors. While the related role and responsibilities of the first three contributors are adequately recognised in the 2006 amendments to the Fourth, Seventh and Eighth Council Directives, ECIIA believes that effective corporate governance in the European Union would further benefit from an increased recognition in related future EC guidance regarding the governance and risk assurance services provided by Internal Audit.

(1) i.e. the Board of Directors in a 1-tier, respectively the Supervisory Board in a 2-tier board structure

(2) www.theiia.org/guidance

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