



EUROPEAN CONFEDERATION OF INSTITUTES OF INTERNAL AUDITING (IVZW)

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Dear Sir,

The ECIIA (the European Confederation of Institutes of Internal Auditing) would like to thank DG-Market for offering it the opportunity to comment on your Green Paper "Corporate Governance in Financial Institutions and Remuneration Policies"

We are pleased to participate in your initiative to explore ways of improving corporate governance practices in financial institutions.

The ECIIA is a confederation of national associations of internal auditing located in 35 countries, including all those of the EU, representing over 35000 internal audit professionals. As such, the ECIIA is an associated organisation of the global Institute of Internal Auditing (the IIA), a professional organisation of more than 170000 members in some 165 countries. Throughout the world, the Global IIA is recognised as the internal audit profession's leader in certification, education and research regarding internal auditing. The Global IIA also maintains the International Professional Practices Framework- IPPF.
(<http://www.theiia.org/guidance/standards-and-guidance/interactive-ippf/>)

The IPPF, promulgated by The Global IIA, is a globally recognised, reliable and robust standard setting framework which includes the Definition of Internal Auditing, the Code of Ethics, the International Standards for the Professional Practice of Internal Auditing (*International Standards*) and guidance on implementing these standards either through Practice Advisories, Practice Guides or Position Papers.

This worldwide organisational structure and globally recognised guidance framework for our profession allows us to provide you with some **general comments** on

- internal auditing's contribution to effective corporate governance.
- its interaction with other monitoring/controlling functions, such as the risk management function and the external auditors, referred to in paragraph 3.4 and 3.7 respectively of your paper.

(1) **internal auditing's contribution to effective corporate governance.**

To underpin the relevance of the internal auditing profession to the theme of your paper we would like to draw your attention to the (IIA) definition of internal auditing, which is today universally recognised:

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes.

Evaluating governance structures and risk frameworks, as well as providing counsel for improvement is indeed internal auditing's core business. As such, the ECIIA was surprised to notice that the green paper did not identify the internal auditing function as one of the ways (cf. Ch.5 "Options for the Future") to respond to the deficiencies highlighted in the Larosière report. This is to some extent more surprising as internal auditing is clearly recognised as a key component of good organisational governance in relevant European directives (CRD and Solvency II), as well as in regulatory guidance issued by pertinent global and regional supervisory bodies, such as the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS) and the Committee of European Banking Supervisors (CEBS). For further details please see the ANNEX.

From the details in the annex to this letter, it should be noted that, as a baseline, pertinent legislation and regulation for financial institutions view internal auditing as an activity organised within the institution to provide objective assurance to its governing body (1) and senior management (1) that risks are understood and managed appropriately; and which additionally, serves as an in-house consultant proposing solutions for improving the institution's governance and risk management structure. As such internal auditing actively contributes to effective corporate governance providing however, that certain conditions that are key to fostering its independence and professionalism are met.

ECIIA therefore proposes that future EC guidance/regulation for improving corporate governance practices in financial institutions should recognise the need for establishing and maintaining an adequately and competently staffed internal auditing function which acts in accordance with the International Professional Practices Framework (IPPF, see page one).

As a safeguard against potential impairment of Internal Audit's independence, ECIIA is particularly concerned that International Standards relating to internal auditing's reporting lines within an organisation be implemented. These require that the internal auditing function reports to a sufficiently high level in the financial institution to be able to perform its duties and that it should have an active and effective reporting line to the governing body, or relevant sub-committee of that governing body. This body (or 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/ Head of Internal Audit, as well as his/her performance evaluations and compensation changes;
- overseeing the overall quality of the assurance and consulting services provided by the internal auditing function;
- receiving and reviewing the reports produced by Internal Audit and the actions taken by management to implement any recommendations made.

(1) *for the purpose of this comment letter:*

- ✓ governing body is the board of directors in a one tier-, respectively the supervisory board in a two tier structure.
- ✓ senior management is the executive committee in a one tier-, respectively the management board in a two tier structure.

Further , with regard to the use of any “proportionality principle” for establishing, or not, an internal auditing function in financial institutions, ECIIA believes that establishing and maintaining an independent internal audit function should be the rule, not only for large and medium size institutions but also for smaller entities, the more so because the latter may not be able to deploy a full organisational structure to ensure the effectiveness of its governance and risk management processes. In any case, for small financial institutions that have not established an “in-house” internal auditing function, it should be a requirement for the organisation to disclose to its stakeholders on an annual basis that it has considered how the necessary assurance on the effectiveness of internal governance systems is to be obtained (if not through internal audit).

In the case where an organisation decides to outsource internal audit engagements, the ECIIA is of the opinion that, within the organisation, a senior executive should be assigned the responsibility for internal auditing, having the role to oversee, manage, inform and take accountability for regarding the effective functioning of the outsourced activity.

Commento [p1]: The question is – does this take away the accountability that the contracted outsourced firm has for the production of an independent internal audit service?

- (2) On **the interaction of the internal audit function with other controlling functions**, the ECIIA believes that some regulatory guidance may help clarify the roles and responsibilities of the various actors of an organisation’s governance and risk management processes.

