



Corporate Governance Codes on Internal Audit

Current status in the EU

*Progress through Sharing
Sharing through Knowledge
Knowledge through Research*

Corporate Governance Codes on Internal audit

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Article 41 of the 8th EU Directive, section 2b, states that:

“[...] the audit committee shall, inter alia: monitor the effectiveness of the company’s internal control, internal audit where applicable, and risk management systems [...]”¹

The ECIIA conducted a review of the Corporate Governance Codes currently in place in its member bodies in order to determine the extent that internal audit is considered in the governance structure of listed companies under the typical “comply or explain” regulations.

The research revealed that approximately 90% of EU member countries require or recommend the presence of an internal audit function in listed companies.

In addition, internal audit is generally compulsory within the financial institutions sector, in relation to Basel Committee and insurance regulatory requirements.

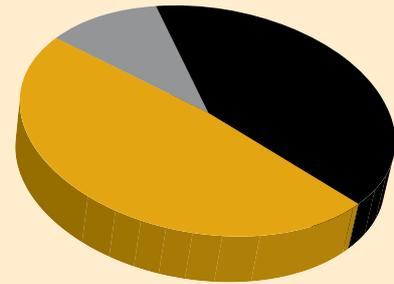
At the same time, there is little regulation provided as to how to ensure that this function is effective mainly as regards to essential requisites such as independence and scope.

Benchmarking activity has revealed that as a consequence of the financial crisis many corporations have slashed resources in internal audit departments while maintaining their full mandate.

ECIIA’s Recommendation

The ECIIA believes the following key principles below are applicable universally to all organizations regardless of sector or industry.

The governing body of an organization is responsible for strategic risk oversight. The board and audit committee (or equivalent) should be required to, among other things, define a clear delegation and accountability for risk management and internal control



- 41% of the codes consider an internal audit function mandatory
- 48% of the codes strongly recommend the presence of an internal audit function
- 11 % of the codes do not have a specific requirement or recommendation about internal audit

through the “Three Lines of Defence” model. In this model, internal audit assumes responsibility for providing overall assurance to the governing bodies, consistent with existing financial sector regulation. On this basis, internal audit should be required for most organizations. Factors that need to be considered are the complexity of the organisation and the need for the governing body to obtain systematic, continuous independent assurance, rather than the size of the company.

¹ It should be noted that two countries have not transposed yet the 8th Directive into national codes.

Internal audit must be properly structured in order to achieve the objective of global assurance.

- organizational independence
- exclusion of limitations to its scope of review
- full and unrestricted access to any information and person necessary to achieve its objective
- the adoption of The IIA's *International Standards for the Professional Practice of Internal Auditing (the Standards)*, including internal and external quality assessment reviews.

In addition, regulatory references to 'the auditor' should be specific as to whether they are referring to external audit or internal auditing.

For more information, please refer to the separate guidance papers provided by the ECIIA, mainly "Corporate Governance Insights: Reinforcing audit committee oversight over global assurance and internal audit" (May 2012, <http://www.eciia.eu/about-us/news/new-publication>) and other papers produced jointly with other European associations. ²

The positions in this paper are consistent with the IIA Advocacy Platform issued in 2012.

² Joint publications of ECIIA and FERMA (European Federation of Risk Manager Associations: Guidance on the 8th EU Directive regarding "Monitoring the effectiveness of internal control, internal audit and risk management systems", in two parts: "Guidance for Boards and Audit Committees", published on the 21st of September 2010 and "Implementing the 8th EU Company Law Directive Article 41 – 2b for Senior Management - Questions and Answers for Executive Committees" issued on the 14th of December 2011.

Annex

Internal Audit foreseen by Corporate Governance Code:

COUNTRY	NAME OF CODE/DOCUMENT	EXTRACT OR COMMENT
Finland	<i>Finnish Corporate Governance Code 2010</i>	The company must disclose the manner in which the internal audit function of the company is organized. The disclosure must include the organization of the internal audit function and the central principles applied to internal audits, such as the reporting principles. The organization and working methods of the internal audit function depend on e.g. the nature and scope of the company's operations, the number of personnel and other corresponding factors.
France	<i>Recommendations on Corporate Governance March 2011</i>	The audit committee is responsible, inter alia, for the following: oversight of statutory and internal audits, the assessment of the work of internal auditors, the selection of statutory auditors and checking the independence of internal auditors.
Greece	<i>Corporate Governance Codes and Principles – Greece December 2010</i>	The board establishes an internal audit department in accordance with Greek legal requirements, which operates under written terms of reference. The internal audit function must be independent from other business units and should report administratively to the chief executive and functionally to the audit committee of the board.
Italy	<i>Corporate Governance Code December 2011</i>	The issuer shall establish an internal audit function. The internal audit function shall report to the board. The internal control and risk management system involves each of the following corporate bodies depending on their related responsibilities: board of directors, that shall provide strategic guidance and evaluation on the overall adequacy of the system ... and internal audit, entrusted with the task to verify the functioning and adequacy of the internal control and risk management system. Internal audit function has a central position in the control system, that is charged of the "third level" of control. The internal audit function should be absolutely independent.
Latvia	<i>Principles of Corporate Governance and Recommendations on Their Implementation 2010</i>	The board shall perform certain tasks, including: ... timely and qualitative submission of reports, ensuring also that the internal audits are carried out and the disclosure of information is controlled.

COUNTRY	NAME OF CODE/DOCUMENT	EXTRACT OR COMMENT
Luxembourg	<i>Corporate Governance The Ten Principles of Corporate Governance of the Luxembourg Stock Exchange September 2009</i>	An independent internal audit function should be established.
Malta	<i>Code of Principles of Good Corporate Governance October 2005</i>	The audit committee should establish and maintain access between the internal and external auditors of the company and should ensure that this is open and constructive.
Romania	<i>Bucharest Stock Exchange Corporate Governance Code 2008</i>	The board should adopt appropriate rules in order to avoid its members or the company's employees becoming guilty of insider dealing or market manipulation of its securities. The audit committee and the internal auditor should regularly provide the members of the board with information on the provisions governing these areas.
Slovakia	<i>Corporate Governance Code for Slovakia January 2008</i>	The board should include certain key functions, including: ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular systems for risk management, financial and operational control and compliance with the law and relevant standards.
Slovenia	<i>Corporate Governance Code December 2009</i>	The audit committee offers professional support to the supervisory board in approving the annual internal audit plan, ensuring prompt monitoring of risk management.
Spain	<i>The Unified Good Governance Code of Listed Companies (19 May 2006)</i>	Listed companies should have an internal audit function, under the supervision of the audit committee, to ensure the proper operation of internal reporting and control systems. The audit committee, mandatory in listed companies by law, should monitor the independence and efficacy of the internal audit function, and, amongst others, verify that senior management are acting on the findings and recommendations of its reports.

Internal Audit recommended by Corporate Governance Code:

COUNTRY	NAME OF CODE/DOCUMENT	EXTRACT OR COMMENT
Austria	<i>Austrian Code of Corporate Governance January 2009</i>	Depending on the size of the enterprise, a separate staff unit is to be set up for internal auditing, which shall report to the management board, or the task of conducting internal audits may be contracted out to a competent institution.
Belgium	<i>The Belgian Code on Corporate Governance 2009</i>	An independent internal audit function should be established, with resources and skills adapted to the company's nature, size and complexity. If the company does not have an internal audit function, the need for one should be reviewed at least annually. Internal audit is mandatory in the financial sector.
Bulgaria	<i>Bulgarian National Code for Corporate Governance – October 2007</i>	The board of directors should establish the corporate risk management policy as well as control and ensure the proper functioning of the company's risk management and internal audit systems.
Cyprus	<i>Corporate Governance Code 3rd Edition September 2009</i>	Directors should, at least annually, conduct a review of the effectiveness of the company's internal control systems... ..Companies which do not have an internal audit department should consider annually the need for one and should report and justify its non-existence in the company's annual report on corporate governance.
Czech Republic	<i>Corporate Governance Code based on the OECD Principles (2004)</i>	Companies that do not have an internal audit function should regularly reconsider its establishment.
Denmark	<i>Recommendations on Corporate Governance August 2011</i>	The committee of corporate governance recommends that the supreme governing body, on the basis of a recommendation from the audit committee, once every year decide whether to establish an internal audit for support and control of the company's internal control and risk management systems and state the reasons for its decision in the annual report.
Estonia	<i>Corporate Governance Recommendations 2005</i>	The management board should ensure that it undertakes proper risk management and internal audit controls in the activities of the Issuer.
Germany	<i>Corporate Governance Code May 2010</i>	The supervisory board should set up an audit committee which, in particular, handles issues of accounting, risk management and compliance, the necessary independence required of the auditor, the issuing of the audit mandate to the auditor, the determination of auditing focal points and the fee agreement.

COUNTRY	NAME OF CODE/DOCUMENT	EXTRACT OR COMMENT
Hungary	<i>Corporate Governance Recommendations March 2008</i>	As an integral part of the system of internal controls, it is recommended that the company sets up an independent internal audit function ("internal audit") which reports directly to the audit committee.
Ireland	<i>Corporate Governance Code For Irish Domiciled Collective Investment Schemes September 2010</i>	The board shall ensure that internal control procedures are monitored to ensure they are effective. In doing so, the board may rely on the internal audit functions of service providers provided they are of a level which the board is satisfied will give an appropriate level of assurance relative to the service providers' role and involvement in the operational functions of the collective investment scheme or management company (whichever is applicable).
Netherlands	<i>Dutch Corporate Governance Code December 2008</i>	The internal auditor shall operate under the responsibility of the management board. Best practice provision V.3.1 The external auditor and the audit committee shall be involved in drawing up the work schedule of the internal auditor. They shall also take cognizance of the findings of the internal auditor. V.3.2 The internal auditor shall have access to the external auditor and to the chairman of the audit committee. V.3.3 If there is no internal audit function, the audit committee shall review annually the need for an internal auditor. Based on this review, the supervisory board shall make a recommendation on this to the management board in line with the proposal of the audit committee, and shall include this recommendation in the report of the supervisory board.
Sweden	<i>The Swedish Code of Corporate Governance February 2010</i>	For companies that do not have a separate internal audit function, the board of directors is to evaluate the need for such a function annually and to justify its decision in its report on internal controls in the company's corporate governance report.
United Kingdom	<i>The UK Corporate Governance Code June 2010</i>	The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.

Internal Audit not foreseen:

COUNTRY	NAME OF CODE/DOCUMENT	EXTRACT OR COMMENT
Lithuania	<i>The Corporate Governance Code for Companies listed on the National Stock Exchange of Lithuania April 2003</i>	N/A
Poland	<i>Code of Best Practice for WSE Listed Companies 2010</i>	N/A
Portugal	<i>CMVM Corporate Governance Code 2010 (Reccomendations)</i>	The board of directors shall include a number of non-executive members that ensure the efficient supervision, auditing and assessment of the executive members' activity.

The European Confederation of Institutes of Internal Auditing (ECIIA) is the professional representative body of 36 national Institutes of Internal Audit in the wider European area. The ECIIA's objective is to support corporate governance and the internal audit profession in the European Union and in the ECIIA's member countries and to promote the application of the global

institute of Internal Auditors' Standards and Code of Ethics to all internal audit professionals in the public and the private sector. The ECIIA undertakes research on topics related to internal audit, business control, risk management and corporate governance. It publishes position papers, briefings, reports and a newsletter.

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