

CHAPTER 18. EVALUATING INTERNAL AUDIT'S IMPORTANCE AND VALUE-ADDED IN CORPORATE GOVERNANCE AND RISK MANAGEMENT: AN EMPIRICAL INVESTIGATION

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ABSTRACT

In the present study, the importance of internal audit is examined and its value added, in the Greek PLCs. Having, as its main objective the promotion of the orderly and efficient operation of the organization, the internal audit controls and evaluates all those organizational measures used: a) to ensure the implementation and compliance of all individual departments of the organization with the objectives and policies established by the management, b) to safeguard the assets of the organization, by identifying mistakes, waste, fraud, organizational weakness, ineffective use of natural and human resources, c) to evaluate and ensure the reliability and accuracy of accounting data and financial information in general, d) to evaluate the effectiveness of internal organization and operations. To conclude with, internal audit contributes to the proper operations and to the efficiency of all processes as well as to the proper management of risks, to the maintenance of a proper corporate governance system and to the achievement of business objectives.

KEYWORDS: Internal audit, risk, controls, corporate governance, efficiency, system of controls.

18.1. INTERNAL AUDIT

Internal audit is defined as an independent, objective appraisal function and consulting activity designed to add value and improve the operations of an organization. Specifically, by adopting a systematic and professional approach to evaluating and improving the effectiveness of risk management processes, internal control systems and corporate governance, it helps the organization to achieve its objectives (IIA, 2020).

Internal audit provides an organization with two broad categories of services, evaluation services and consulting services. Within these services, internal audit can perform the following (Cox, 2016):

- Various types of audits such as compliance, financial, information technology.
- Business audits to review efficiency, effectiveness, commonly referred to as performance audits.
- Special audits requested by management.
- Self-assessment of the control system to be effective.
- Facilitate communication between management and external auditors.

THE NEED FOR INTERNAL AUDIT

Internal audit professionals have a responsibility to assist the organization in effectively allocating responsibilities, to promote the establishment of cost-effective audits, to assess risks and to recommend measures to mitigate these risks. Internal auditors are an integral part of the management team and provide top management with analysis, assessments, advice and information on the activities they examine, while also monitoring the organizational ethics of the organization. Evaluating emerging technologies, analyzing opportunities, evaluating quality, economy and efficiency, as well as providing valid and timely communication are just some of the activities of internal auditors, on a daily basis. The full scope of their responsibilities provides a broad perspective for the organization and this, in turn, makes them a valuable resource for the executive management

and the board to achieve the overall goals and objectives, as well as to strengthen internal control and governance (IIA, 2019).

By assessing significant risks, identifying necessary improvements and reporting them to an organization's executive management, internal audit helps executives and boards to demonstrate that they effectively manage the organization on behalf of stakeholders.

THE ROLE OF INTERNAL AUDIT IN CORPORATE GOVERNANCE

The purpose of internal audit is to prevent and deter errors in its preventive nature of operations. In this context, internal audit should be designed and operate to correct any weaknesses or inadequacies in control systems and reduce the organization's exposure to risks. In this sense, internal auditors play an important role in strengthening corporate governance. (Menexiadis et al., 2020).

The internal control system in a company includes all the procedures set by the management and the board of directors, in order to ensure the efficiency and effectiveness of the operations, the reliability of the financial information and compliance with legislation. The legislation requires listed companies to regularly review and evaluate the internal control systems they apply and to set up an audit committee (ECHR, 2013).

18.2. RESEARCH RESULTS

In a research by Zafeirakos and Tachynakis in 2007, the degree of integration of internal audit in the structure of Greek companies was examined, as well as the degree of cooperation of internal with external auditors. With regards to the degree of cooperation between internal and external auditors, they concluded that their relationship has room for improvement in order to achieve the best results. The research concluded that while Greek companies consider the operation of internal audit a key element of corporate governance and supervision, it had not yet been widely incorporated by companies and that there were many points that could be improved (Zafeirakou & Tachynakis, 2007).

A more recent survey in 2011 examined the effectiveness of internal control in Greek hotels for the period 2005-2009. The survey was conducted with questionnaires on business executives of eighty-five large hotels. The fields of research were based on internal control data as proposed by COSO. Regarding the control environment, it was initially found that business management recognizes the crucial role of internal control in the business environment. For the risk assessment element, the results showed that risk assessment plays an important role in the efficient operation of hotel businesses. Regarding the element of control activities, the research showed that they are largely implemented. Finally, for the monitoring element, it was found that it exists to a large extent for the evaluation of the quality of the performance of the internal control system. Overall, this empirical research has shown that elements of internal control are of great importance (Karagiorgos et al., 2011).

In a later research in 2017, it was found that there was a large degree of agreement on the importance of internal audit in the efficient operation of banks, especially with regard to the provision of reliable information and effective risk management. Although the value of internal audit was recognized as a key element in improving the operation of a bank, there was a reservation as to whether this improvement could be achieved. (Siouziou et al., 2017).

The Menexiadis & Iosifidou research in 2020, investigated the importance of internal control. Initially they found that the Greek PLCs use internal control systems and also have invested in their effectiveness. Finally, taking into account that the Board of Directors of companies is responsible for corporate governance, they have a developed culture on the subject and regardless of the results of each period, they follow good corporate governance practices (Menexiadis & Iosifidou, 2020).

18.3. RESEARCH QUESTIONS

As the importance of internal audit is multidimensional, constantly evolving and decisive for the operation of companies, the study of the degree of adoption of internal audit procedures by Greek organizations is particularly useful. Therefore, the research questions are the following:

RQ 1: To what extent do Greek organizations adopt and promote the operation of internal audit?

RQ 2: How and to what extent does the operation of internal audit, add value to Greek organizations?

The survey involved a total of 57 senior executives of PLCs, with a staff of over 250 employees, an annual turnover of over 40 million euro and total assets worth over 20 million euro.

The survey questionnaire was based on closed and open type questions with Likert scale. For data analysis the statistical program SPSS was used.

18.4. RESEARCH RESULTS

In the present research, the views of senior business executives regarding the implementation and contribution of internal audit systems to PLCs were investigated. An appropriate 3-item questionnaire was used for this purpose. The first part contains information about the organization as well as the position of each respondent in it, the second part concerns the organization and operation of the internal audit service as well as the existing treatment of risk management issues and harmonization with the strategic planning of the organization and the third part of the questionnaire concerns the assessment of the added value to the organization by the internal audit.

Table 18.1 shows the views of the respondents as to at what level of management the internal audit reports to. 86% thinks that it reports to the Audit Committee, while 14% believe that internal audit reports to the Chairman of the Board and the Board in general.

		Frequency	ValidPercent	CumulativePercent
Valid	To the Chairman of the Board	4	7	7
	On the Board	4	7	14
	To the Audit Committee	49	86	100.0
	Total	57	100.0	

Table 18.1 Respondents' views as to the level of management, the internal audit reports to.

In Table 18.2, 96.4% of the respondents reply that there is a procedures manual, while 3.6% reply negatively.

		Frequency	ValidPercent	CumulativePercent
Valid	Yes	54	96.4	96.4

	No	2	3.6	100.0
	Total	56	100.0	
Missing	System	1		
Total		57		

Table 18.2 : Is there an approved Procedures Manual?

Table 18.3 lists the views of respondents as to whether the current staffing is sufficient for the needs of internal audit. It can be observed that 84.2% consider that it is sufficient, while 15.8% disagree.

		Frequency	ValidPercent	CumulativePercent
Valid	Yes	48	84.2	84.2
	No	9	15.8	100.0
	Total	57	100.0	

Table 18.3: Does existing staffing meet the needs of the internal audit service?

Table 18.4 presents the views of the respondents regarding whether the annual evaluation of the audit work is done by the head of the internal audit services.

		Frequency	ValidPercent	CumulativePercent
Valid	Yes	56	100.0	100.0
Missing	System	1		
Total		57		

Table 18.4: Is the audit work evaluated annually by the head of the internal audit services?

Table 18.5, lists the respondents' views on the importance that companies attach to internal audit and whether they adopt ways and procedures to achieve it. The answers accept values from 1 to 5 (1-Not at all, 2-Small, 3-Moderate, 4-Large, 5-Too much) and the increase of the average is identified with the increase of the importance given by the companies in the internal control. Respondents are placed between answers "high" and "too much" voltage to the second, as to whether control function and the overall effectiveness of control procedures (4.55). Between the same scales but with a tendency towards the answer "Large", they are placed in terms of the fact that the internal auditors have audit experience (4.48), that the whole internal control system is evaluated (4.41), that policies and procedures have been developed for each operational function (4.34), that internal auditors are trained (4.34), and that the principles of corporate governance are applied and adopted

(4.31). Continuing we observe that they are placed in the answer "Big", in terms of recognizing and delimiting the business risk (4.14), that mechanisms are applied for the identification and assessment of obstacles to the achievement of the objectives of each operation (4.11), that from the hierarchical structure the separation of duties and responsibilities of the staff becomes apparent (4.10), the existing mechanisms recognize the current needs of the company (4.07), the measures to achieve the business objectives are understood by all staff (3.97), that models of analysis are applied of business risk in order to manage it more effectively (3.90), management frequently communicates the importance of ethical values and integrity to employees (3.83) and that information is transferred to all hierarchical levels of employees and in all directions (3.79). Finally, they answer between the answers "Medium" and "Large" with a tendency towards the latter, as to whether the Management has established efficiency measures for the procedures of the company (3.69).

	Mean	Standard Deviation
Business risk is recognized and delimited	4.14	0.639
Business risk analysis models are applied in order to manage it more effectively	3.90	0.724
The principles of corporate governance are applied and adopted	4.31	0.850
Management frequently communicates the importance of ethical values and integrity to employees	3.83	0.759
The separation of the duties and responsibilities of the staff becomes apparent from the hierarchical structure	4.10	0.817
Measures to achieve business objectives are understood by all staff	3.97	0.823
Mechanisms are in place to identify and assess obstacles to achieving the objectives of each operation	4.11	0.751
Policies and procedures have been developed for each business operation	4.34	0.897
The operation and the overall effectiveness of the audit procedures are checked	4.55	0.632
Existing mechanisms recognize the current needs of the business	4.07	0.799
Information is transferred to all hierarchical levels of employees and in all directions	3.79	0.774
Management has established efficiency measures for the company's processes	3.69	0.967
The whole internal control system is evaluated	4.41	0.867
Internal auditors have audit experience	4.48	0.738
The internal auditors are trained	4.34	0.936

Table 18.5: Importance that organizations place in internal audit.

With regards to the views of the respondents regarding the ways that internal audit adds value to the organization, as well as what activities it affects, the questions accept values from 1 to 5 (1-Not at all, 2-A little, 3-Moderate, 4-A lot, 5-Too much) and the increase of the average is identical with the increase of the contribution of the internal audit, according to the point of view of the respondents.

Table 18.6 presents an evaluation of the ways in which internal audit adds value to the organization. As the internal audit is an added value for the organization, they are placed between the answers "Very" and "Too much" with a tendency towards the first (4.34). They are also placed in the answer "Much" regarding the effect of internal audit on corporate governance (4.24), internal audit helps to manage the assessment of business risks (4.17), the cooperation of the internal audit service with the management improves the management of control issues (4.14), internal audit has a catalytic role in achieving business objectives (4.14), contributes to more efficient management of quality and environmental safety (4.03), to more efficient management of quality, health and safety at work (4.00) and more effective strategic planning (3.93).

	Mean	Standard Deviation
Internal control helps manage business risk assessment	4.17	0.711
The cooperation of the internal audit service with the administration improves the management of audit issues	4.14	0.639
The effect of internal control on corporate governance	4.24	0.872
Internal control contributes to the most effective strategic planning	3.93	0.704
Internal control contributes to more efficient management of quality, health and safety at work	4.00	0.598
Internal control contributes to more efficient management of quality and environmental safety	4.03	0.680
Internal control plays a catalytic role in achieving business goals	4.14	0.789
Internal control is an added value for the business	4.34	0.670

Table 18.6 Evaluation of the ways in which internal audit adds value to the organization.

Table 18.7 lists the answers of the respondents regarding the evaluation of the activity cycles that the internal audit has added value to the organization in the last three years. Regarding the Accounting - Financial Cycle, they are placed in the answer "Very" (3.83), while between the answers "Moderate" and "Very", with a tendency towards the second, they are placed in relation to the Purchase - Procurement Cycle (3.71), the Claims – Cash – Securities Cycle (3.69), the Liabilities Cycle (3.69), the Management Cycle (3.69) and finally, the Expenditure Cycle (3.55). Regarding the Sales Cycle (3.41) and the Stock Cycle (3.38), they are placed between the answers "Moderate" and "Very", with a tendency towards the first and moderate consider the contribution of internal audit in the Cycles of other functions (3.00).

	Mean	Standard Deviation
Cycle of fixed assets	3.00	0.964
Stock Cycle	3.38	0.728
Purchase-Procurement Cycle	3.71	0.659
Claims -Cash-Securities	3.69	0.660
Liabilities Cycle	3.69	0.660

Expenditure Cycle	3.55	0.827
Sales Cycle	3.41	0.733
Management Cycle	3.69	0.660
Accounting- Financial Cycle	3.83	0.848
Cycles of other functions	3.69	0.761

Table 18.7 Evaluation of the activity cycles that the internal audit has added value to the organization in the last three years.

18.5. CONCLUSIONS

The research examined the views of senior executives regarding the implementation and contribution of internal audit to PLCs. The majority of respondents replied that the internal audit function mainly reports to the audit committee, that there is an approved procedures manual, as well as that the existing staff meets the needs of the internal audit service. In addition, in terms of the importance that organizations place to internal audit, respondents agree that the operation and overall effectiveness of audit procedures are controlled, while less agree that management has established efficiency measures for business processes.

Regarding the ways in which internal audit adds value to the business, respondents agree to a greater extent that internal audit is an added value activity for the organization, while the latter ranks the view that internal audit contributes to more effective strategic planning. In addition, respondents believe that internal audit over the last three years has contributed more to the financial accounting cycle and less to the asset cycle.

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