

Significance of Internal Audit Committee in Corporate Governance and Its Implications in Protecting the Financial Markets and Its Value in Corporations – An International Perspective

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ABSTRACT

Accountants in Public Practice Environment such as those working in the Big Four firms or some mid-tier firms or Professional accountants in business (PAIB) employed by private sector businesses, offer a wide array of specialised services in the domain of business advisory and consulting, audit and assurance, financial management, taxation services, forensic accounting, internal audit services. Internal audit is gaining playing unprecedented significance in risk management and business assurance. It is the systematic approach to effective risk management, review of internal control, information and control of business and Governance processes. This study tries to assess Internal Auditors' role in Accounting Work Environment with respect to international Corporate Governance recommendations including the Sarbanes–Oxley Act (2002), EU Transparency Directive (2013), OECD Principles (2015), UK FRC Corporate Governance Code (amended 2018), ASX Corporate Governance Council, Corporate Governance Principles and Recommendations (ASX Principles, 2019).

Keywords: *Audit, ASX Corporate Governance Council, Corporate Governance Principles, FRC Corporate Governance Code*

Internal Auditors' Role in Accounting Work Environment

Accountants in Public Practice Environment such as those working in the Big Four firms or some mid-tier firms or Professional accountants in business (PAIB) employed by private sector businesses, offer a wide array of specialised services in the domain of business advisory and consulting, audit and assurance, financial management, taxation services, forensic accounting, internal audit services. Internal audit is gaining playing unprecedented significance in risk management and business assurance. It is the systematic approach to effective risk management, review of internal control, information and control of business and Governance processes.

The importance of Audit Committee in relation to the conformance aspects of corporate governance is indispensable. It is considered to be the connector conduit between the

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company and its BOD, investors and the external auditor. It ensures that the work of the external auditor maintains the professional standards of utmost integrity, objectivity, due diligence, confidentiality and independence. All listed companies in most countries have been recommended to have mandatory audit committee. Listed entities in the S&P all Ordinaries Index are required to have an audit committee for that whole financial year under the listing rules. The structure and disclosure requirements of the audit committee have been recommended in various Corporate Governance guidelines drafted from time to time. To ensure the independence, integrity and minimise risk of conflict of interest it is recommended that the audit committee comprise only of non-executive members a majority of whom should be independent. An audit committee without any executive director shall facilitate communication with the external auditor without the intervention of the CEO or CFO and hence promote good governance.

In response to massive Corporate Governance failures in the past decades, most of the international Corporate Governance recommendations including the Sarbanes–Oxley Act (2002), EU Transparency Directive (2013), OECD Principles (2015) [4-5], UK FRC Corporate Governance Code (amended 2018) [6], ASX Corporate Governance Council Corporate Governance Principles and Recommendations (ASX Principles, 2019) [1-3] emphasizes on the documentation of the internal controls that affect the communication of financial information to the investing public and stakeholders. These acts have provisions for ‘whistleblower protection’, i.e., protection from dismissal, demotion, suspension, harassment given to an employee of a listed company who ‘blows the whistle’ about a fraud committed against shareholders to the regulatory body or to the audit committee of the corporation and same protection is provided to the members of the internal audit committee. The role and responsibilities of the audit committee should be explicitly written in the form of a charter. All companies listed in the United States stock exchange and subsidiaries of these corporations functioning overseas must have an audit committee as per the recommendations of the US Sarbanes–Oxley Act, 2002. The Sarbanes–Oxley Act requires audit committees to establish procedures for hearing complaints. The Sarbanes–Oxley Act also provides that the audit committee has the responsibility to ‘hire and fire’ auditors.

Responsibilities of the Internal Audit Committee

- Review of the adequacy and objectivity of operational and internal controls and internal audit function
- Evaluation and review of the half and full-year financial statements with particular focus on changes in accounting policies and estimates, audit adjustments and compliance with accounting, legal and regulatory requirements prior to board’s approval (Percy 1995)
- Improve and strengthen the internal control structure and by improving the quality of financial disclosures, effectiveness of the audit function and coordinated audit planning
- facilitate appropriate communication channels between management, the board, external auditors and internal auditors
- Resolve disagreements between management and external auditors
- Act as advisory to the board of directors on independence issues and conflicts of interest

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Corporate Governance Principles and Recommendations on Internal Audit Committee – An International Perspective

Corporate governance framework aims to protect the interest of the stakeholders. The corporate governance framework should include the disclosure of the relevant material information regarding financial and operating performance of the company, relevant non-financial information needed to protect the interest of the stakeholders, major ownership of shares including Voting rights, related party transactions, foreseeable risk Assessment, Governance structures, guidelines regarding Appointment reappointment, termination, Remuneration of the board members and the key executives must be explicitly stated. All relevant information about the board members, a transparent selection procedure of the board members and the directors, if there are any conflict of interest that must be disclosed. The independence of the directors regarding any third-party transaction or related party transaction or if any conflict of interest must be assessed and disclosed.

<p>THE ASX PRINCIPLES AND RECOMMENDATIONS [1-3]</p>	<p>The audit committee should be of sufficient size and independence and its members between them should have the accounting and financial expertise and a sufficient understanding of the industry in which the entity operates.</p> <p>Principle 4 of Corporate Governance stresses on safeguarding the integrity of Corporate Reporting of listed entities through formal, rigorous and independent internal audit process</p> <p>ASX Recommendation 4.1 states the following:</p> <p>That board of a listed entity should have an audit committee with i] At least three members, all of whom should be non-executive directors and a majority of whom should be independent directors without any conflict of interest</p> <p>ii] The audit committee should be chaired by an independent director who is not the chair of the board</p> <p>iii] and disclose conflicts of interest if any</p> <p>Audit committee must disclose –</p> <ul style="list-style-type: none"> • the charter of the committee • the relevant qualifications and experience of the members of the committee • the number of times the committee met throughout the reporting period and the individual attendances of the members at those meetings <p>If the listed entity does not have an audit committee, then disclose that fact and the processes it employs that independently verify and safeguard the integrity of its corporate reporting.</p> <p>Under the ASX Listing Rules, audit committees are compulsory for all companies listed in the top 500 (Standard & Poor’s listing of the ASX) according to market capitalisation (i.e. total market value of the shares) [1-3].</p>
<p>OECD PRINCIPLES [4-5]</p>	<p>Internal audit committee should assist the External auditors. The committee should review for related-party transactions and ensure proper management of conflict of interest and protect the interest of the company and its shareholders. Sufficient number of non-executive board members capable of exercising independent judgement to tasks where there is a potential for conflict of interest should form a part of the Audit committee and depending upon the company’s size and risk</p>

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	<p>profile, also in respect to risk management and remuneration. When committees of the board are established, their mandate, composition and working procedures should be well defined and disclosed by the board.</p> <p>Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.</p> <p>An annual audit should be conducted by an independent, competent and qualified auditor in accordance with high-quality auditing standards in order to provide reasonable assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects. External auditors should be accountable to the shareholders and owe a duty to the company to exercise due professional care in the conduct of the audit.</p>
<p>UK FINANCIAL REPORTING COUNCIL CORPORATE GOVERNANCE CODE [6]</p>	<p>The UK FRC corporate governance code states that the board should establish transparent policies and procedures to ensure effectiveness of audit functions and integrity of the financial statements. The board should present a balanced and understandable assessment of the companies' Financial performance Analysis, Risk assessment, Internal control framework and effectiveness of the internal control system, its working environment and future prospects.</p> <p>The provisions state that the board should establish an audit committee comprising of Independent non-executive directors' minimum three in number and for small companies the minimum number of independent non-executive directors should be two. The code debars the chair of the board from being a member of this committee.</p> <p>The main responsibilities of the audit committee comprise of monitoring of the integrity of the financial statements, reviewing the financial Performance, providing advice on annual report and accounts, reviewing the companies' internal financial control risk management systems.</p> <p>Committee is entitled to make recommendations to the board regarding the appointment, reappointment removal of the external auditor as well as decision regarding the remuneration of the external auditor. It reviews the effectiveness of the external audit process taking into consideration the UK professional and regulatory requirements as specified from time to time. In case the board does not agree with the audit committee regarding the appointment reappointment or removal of any external auditor The reason for disagreement as well as the reason for recommendation should be clearly mentioned. In the absence of any internal audit function how internal assurance is achieved and how it affects the external audit should also be taken into consideration by Board. Since the chair and the CFO are not independent the chair should not be a member of the audit committee.</p>



There is no single best model for corporate governance and many countries their governments, regulatory bodies have attempted to address the issues of corporate governance

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across all corporate levels. The OECD principles [4-5], ASX principles [1-3] and FRC code [6] of corporate governance reflects the principles-based approach which provides more flexibility in implementing different dimensions of corporate governance across organisations. The rules-based approach which is adopted by US Sarbanes Oxley Act and the consumer Protection Act 2010 is more specific providing detailed guidelines of Corporate Governance rules. It does not give the flexibility of non-compliance. Rules based approach makes it mandatory for formation of an audit committee with at least four eligible members and the members must be all independent directors having the necessary financial qualification to execute the responsibilities of the audit work.

- Audit committee has its own limitations under the various international guidelines as the audit committee may not be empowered to enforce its recommendations
- The formation of an audit committee often becomes a cause of dissent between the executive and non-executive members of the board
- The Audit Committee often lacks the necessary skills and might have the necessary competencies, conflict of interest also often exists
- The board should always ensure that the audit committee performs with Integrity, due diligence and competencies
- The big four firms even mid-tier firms play a predominant role in public practise of auditing offering a wide array of consulting and legal services even advises with regard to taxation and accounting

Importance of Corporate Governance in protecting the need of various stakeholder groups – Influence and Interest grid model

	<p>Subjects – High interest but low power to influence the strategic decisions; Employees and shareholders fall in this category</p>	<p>Players – They enjoy Both high interest and high influence in organisational decision making. Players are the members of the BOD, HNI [High net worth individuals], FII [Foreign institutional investors] DII [Domestic institutional investors] who might have huge amount invested in the business of the company. They are highly affected by the organisational performance.</p>
	<p>Crowd - Low Interest Low influence on the strategic decisions, Small scale suppliers, Small scale customers and small Contractors Are crowds</p>	<p>Context setters – Although context setters have low interest in the organisational performance but they have immense power to influence the strategic decisions just like the government policies, norms which when change can impact the organisation both favourably and adversely. The regulatory bodies Our context setters which try to protect the interest of the stakeholders even though they do not have any direct financial interest in the organisation.</p>
	<p>Influence </p>	

CONCLUSION

The main objective of this study was to examine the basic objectives of corporate governance in formation of audit committee to protect the interests of various stakeholder groups. The study incorporated the guidelines of various international Standards regarding formation of

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audit committees and an international perspective regarding the formation of audit committee the role and significance has also been discussed. The study emphasises on the importance of formation of audit committees to protect and monitor the interest and influence of the stakeholder groups. Companies must ensure that the audit committee performed without any conflict of interest, the independence of the directors representing the audit committee must be duly verified and rotation of the directors must be maintained. Minority shareholders, crowds, employees, small retail investors are often deprived of their benefits. The study aims to strengthen the effect of corporate governance mechanism on firms' performance and protection of interest of majority and minority stakeholders from an international perspective through effective formation monitoring and effective performance of the audit committee.

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Conflict of Interest

The author(s) declared no conflict of interest.

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