

COOPERATION AND COORDINATION BETWEEN INTERNAL AND EXTERNAL AUDITING

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Rezumat

Between external and internal auditors it is necessary to be a good cooperation and coordination; both professionals have to be involved in building a good working relationship. Objectives of the external and internal auditors are different from the company point of view, but in the achievement of the specific goals, there are interactions and work cooperation. If the internal auditors work together with the external auditors the results will be an increasing of the quality and the effectiveness of the organization's systems and activities. If the external auditors work together with the internal auditors will result a decreasing of the amount of the testing they do, and as consequences' a reducing of the fees. Because there are many benefits of the cooperation between external and internal auditing it is important to find out how could be coordinated these two professional activities. This study has the purpose to examine the most important provisions that promote such kind of cooperation and work like necessary tools for coordination and to identify the Romanian's internal and external auditors perceptions regarding that cooperation and coordination. The objective of the study is to identify the nature of the relationship between the internal audit function and the organizations' external auditors regarding their interactions and their cooperation.

Cuvinte cheie: external auditing, internal auditing, ISA, internal auditing standards

Clasificare JEL : M41, M42

1.Introduction

Internal audit assists company's management in the effective governance of the organization, improving effectiveness and efficiency of the organization's systems by making recommendations based on objective analyses and assessments of its processes.

The external auditor has to understand what internal controls are relevant to the audit with the purpose to choose the audit procedures that are appropriate in these circumstances. It is important to underline that the external auditor have not the objective to express an opinion about the effectiveness of the entity's internal control, which is the objective of the internal auditor, but external auditors will rely on the work of internal auditors regarding this aspect.

Relationship between internal audit and external audit will help and improve the work of both auditors, avoid duplication, and ensure the maximum coverage of the risks faced by the entity. It will also help the governing body obtain a comprehensive view of the controls and the risks of the entity (ECIIA, 2013).

The most important provision for external auditors that establish whether the external auditors can use the work of the internal auditors is provided by the ISA (International Standard on Auditing) 610. ISA 610 sets out how the knowledge and experience of the internal audit function can inform the external auditor understands of the entity and its environment.

Thus, external auditors will examine the objectivity of the internal audit function, the technical competence of the internal auditors and whether the work of the internal auditors is likely to be carried out with due professional care (IFAC, 2013). There are different studies that identify objectivity, competence, and work performance, like most significant factors on the judgment of external auditors whether or not to rely on the work done by the internal auditors (Haron et al, 2004).

There are, also, the international standards for internal auditing that define how internal audit may rely on other assurance providers, external auditors (IIA, Standard 2050).

The standards for both internal and external audit require effective information sharing and coordination. The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function (ECIIA, 2013).

2. Literature review

According to the IIA (Institute of Internal Auditors): “Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes” (IIA).

According to IAASB (International Auditing and Assurance Standards Board): “The external auditor shall express an opinion whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

The external auditor's responsibilities are to identify and assess the risks of material misstatement of the financial statements, to perform audit procedures and to obtain sufficient and appropriate audit evidence that represent basis for the auditor's opinion” (IAASB).

Effective coordination and cooperation between internal and external auditors give a lot of benefits, regarding the quality and audit cost, and contribute in improving auditors' works (Endaya, 2014).

As (Albrecht, 2007) shows the cooperation between internal and external audit can be divided into several stages of maturity:

- level 1 Separation: Situation without any kind of cooperation
- level 2 Alignment: Separate investigations with specific exchange of information and coordination
- level 3 Cooperation: Permanent communication, synergies to the testing strategy, collective risk assessment and audit
- level 4 Partnering: Intensive cooperation, close combination of information, knowledge and experience exchange, collective tools and audit

International Standards for the Professional Practice of Internal Auditing (Standard 2050 Coordination) requires to the chief audit executive to share information and to coordinate activities with other external providers of assurance in order to ensure proper coverage and minimize duplication of efforts.

Also, the professional standards sets the role of corporate governance in enhancing coordination and cooperation among auditors, thus the accomplished objective will be to coordinate the activities of and to communicate information among the board, external and internal auditors, and management (Standard 2110 Governance).

ISA 610 provides the external auditor with guidelines for use when determining whether, and to what extent they can rely on the work of the internal auditors. External auditors need to consider:

- (a) The objectivity of the internal audit function,
- (b) The technical competence of the internal auditors,
- (c) Whether the work of the internal auditors is likely to be carried out with due professional care, and
- (d) Whether there is likely to be effective communication between the internal auditors and the external auditor.

Regulatory bodies recognize the importance of a good working relationship between internal and external auditors, thus a position paper published by the European Confederation of the Institute of Internal Auditing (ECIIA, 2013); recommend more frequent meetings between internal and external auditors and mutual respect and confidence through the recognition that they both perform their work with relevant professional standards.

Interaction and cooperation between the internal auditors and external auditors should help the governing body obtain a more comprehensive view of operations and risks whilst eliminating areas of possible duplication of audit effort. Good communication between internal and external audit should also be of benefit to senior managers as both audit engagements and subsequent recommendations to the improvement of risk management and internal control will be better coordinated.

ISA 610 (Revised 2013) includes new requirements and guidance addressing the external auditor's use of internal auditors to provide direct assistance (Figure 1). Where such use is not prohibited by law or regulation, the ISA provides a robust framework to ensure that direct assistance is obtained only in appropriate circumstances, that the external auditor considers the relevant limitations and safeguards, and that the auditor's responsibilities are clearly set out (ACCA, 2015).

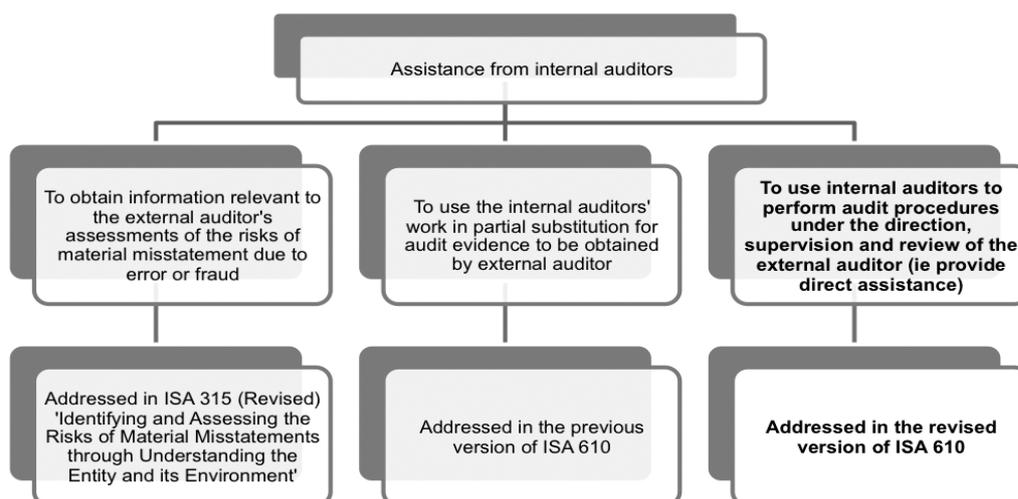


Figure 1. Assistance from internal auditors to external auditors

A minimum level of interaction will avoid duplication and overlap, throughout audit planning, will make known auditors reports one to each other, will establish meeting at least once a year to discuss common issues and concerns and ensure coordination.

A higher and more frequent level of cooperation may include:

- exchange of information and discussion
- lackness of internal controls could be made available by internal auditors to the external auditors
- to know methodology for understand the audit approach for each other
- to enable access to specific working papers
- Regular meetings between the internal auditors and external auditors to discuss any relevant issues (ECIIA, 2013).

In order to identify strategies that could to improve the coordination and cooperation between internal and external auditors, some authors found out that the effective communication becomes critical and requires some terms such as should be frequent, open, direct, and timely. This communication may be written; electronic; face to face; telephonic or combination of all above (Endaya, 2014).

The North American Pulse of Internal Audit completed a survey was in 2014, and the respondents were asked to assess the impact of external audit's increased scrutiny of their work. Among respondents from publicly traded companies experiencing increased scrutiny from external audit since 2013, 55 percent said they anticipate an increase in the number of hours that their internal audit functions will provide direct assistance to external audit while 38 percent expect the number of hours devoted to external audit assistance to stay the same. In like manner, 65 percent of these respondents indicated that they expect an increase in external audit fees while 29 percent expect such fees to remain level. If these projections hold true, a large number of internal audit functions will be spending more time on work for the organization's external auditors and boosting fees in the process.

In 2015 The Center for Audit Quality (CAQ) and The Institute of Internal Auditors (The IIA) sought to explore how internal and external auditors might optimize their intersecting roles and responsibilities, and they were organized three roundtable discussions with internal auditors, external auditors, and audit committee chairs. Results of these discussions are summaries, as follow:

- the external auditor has used the work of internal auditors only in the assessment of the effectiveness of companies' internal control over financial reporting;
- communication earlier in, and more often during, the audit process about what the external auditor needs in order to use the work of internal audit's testing of controls, improved training of internal audit, and discussions with the audit committee can result in better coordination;
- Audit committees sit at the hub of the internal and external auditors and are therefore positioned to maximize the roles of each party where there are intersecting responsibilities;
- The PCAOB requirements that had become more stringent in its documentation requirements, and external auditors were including much more of the information given to them by internal auditors in their working papers. but as result, all these were increasing tension between external and internal audit;
- the discussions were identified several specific tactics that external audit and internal audit may want to consider to help improve audit efficiency:
 - Coordinating internal audit and external audit to be sure they are not done twice.

- To the extent possible, having internal audit use the same templates as external audit, so external audit does not have to spend as much time reformatting.
- Discussing the allocation of work to be performed by the internal auditor for use in the external audit — and what the external audit team will do on its own.

In Romania an agreement was signed regarding cooperation and coordination between internal and external auditing, thus the Chamber of Financial Auditors of Romania (CAFR) and the Association of Internal Auditors of Romania (AAIR), based on CAFR Council Decision no. 48/26 June 2014, were adopted the International Internal Audit Standards issued by the Institute of Internal Auditors Global (Global Institute of Internal Auditors - Global IIA). The agreement contains provisions related to material development and cooperation of the two professional organizations in order to achieve the objective of cooperation and coordination.

The purpose of this resolution is to offer support for professional external auditors performing internal auditing. In accordance with the Decision of the Chamber no. 73 / Dec 2014, CAFR and AAIR developed and published at the end of June 2015 "Guide to the implementation of international standards for internal audit".

As OUG 75/1999, the law that regulates financial audit in Romania, also the Guide establishes certain requirements in relation to internal and external audit, for example the provisions that require to the internal audit department manager to be member of CAFR, and the fact that CAFR is involved to develop internal auditing standards.

According to the authors is that Romania Chamber of Auditors should not regulate the profession of internal auditing, because in this way the collaboration between the two professions is just an overlap of responsibilities.

3. Methodology

This research will be more qualitative than quantitative, most of all, the purpose of the paper is to identify different opinions and attitudes regarding the nature and the cooperation between the internal and external auditors, resulting from studies and surveys that was conducted by researchers, professional bodies, or other relevant sources.

The research methodology uses deductive methods regarding theoretical concepts involved and inductive methods like observation and induction based on the practical experience and as the result of a structured questionnaire that authors have applied to the internal and external auditors.

The study is an analytical survey, which aims to explain the perceptions regarding relationships between internal and external auditors rather than to describe a population opinion. Thus, representativeness of the sample to the population was not the target of the study; attempt was instead made to ensure validity of the data, and to present opinions of auditors with the experience in auditing clients that have an internal audit function.

An important objective of the cooperation between the internal and external auditors is to find out whether external auditors can rely on the work of internal auditors, thus the paper presents the opinions of some internal and external auditors through an online survey distributed to 14 internal auditors and 23 external auditors.

A 3-point Likert-type scale was used to measure auditors' opinions, descriptors and corresponding numerical codes, provided as response options, were: 'good' [3], 'bad' [2], and 'not exist' [1].

The survey had 3 structured questions that required a 'good' or 'bad' or 'not exist' response, and 3 open-ended questions, the participants were supplied their own opinions. All the responses were analyzed with the purpose to determine the relationship and the interaction between external and internal auditors and the reliance of the external auditors on the internal auditors activity.

4. Results

The online survey had a response rate of 65% for internal auditors, 9 responses were collected and a response rate of 79% for external auditors, 18 responses were collected.

Regarding '*Relationship between internal and external auditors*' internal and external auditors responses were mixed, respectively 79% of respondents agreed that the relationship is 'good', 14% of respondents said that the relationship is 'bad' and 7% said that the relationship is 'not exist'.

At the '*Interaction between internal and external auditors*' 91% of the respondents responded with 'good' respectively 4% of respondents said that the interaction is 'bad' and 5% said that the interaction does 'not exist'.

In responding to the '*Reliance of the external auditors on the internal auditors activity*', 58% of the respondents responded with 'good' respectively 34% of respondents said that the reliance is 'bad' and 8% said that the reliance does 'not exist'.

As result of the study, both, internal and external auditors, consider that a cooperation between them increases the audit work efficiency, because they could make exchange of knowledge and obtain a better coordination of work of the both professions.

Internal auditors must respect the Code of Ethics requirements regarding to have competence and objectivity in performing all kinds of professional activities that could be used by external auditors. At this level, the reliance of the external auditors in the internal auditors work could be expressed as follow:

		OBJECTIVITY		
		High	Moderate	Low
COMPETENCE	High	<i>greatest</i>	<i>medium</i>	<i>No reliance</i>
	Moderate	<i>great</i>	<i>less</i>	<i>No reliance</i>
	Low	<i>No reliance</i>	<i>No reliance</i>	<i>No reliance</i>

Figure 2. Relationship between internal auditors competence and objectivity and the reliance of external auditors in their works

Also, the survey have had three open-ended questions, the results are summarized as follow:

Q1: Why the external auditors avoid to use the work of the internal auditors?

The most answers conduct to the follow:

- lack of competence of internal auditors;
- lack of independence of internal auditors;
- lack of knowledge of internal auditing standards.

Q2: Regarding what procedures the external auditors consult the internal auditors?

The most answers conduct to the follow:

- timing and extended of procedures;
- internal control assesment;
- risk assesment.

Q3: Regarding what matters the external auditors communicate with the internal auditors?

The most answers conduct to the follow:

- audit planning;
- risk analysis;
- internal control assesment.

5. Conclusions

This study has examined the relationship and the interaction between external and internal auditors and external auditors' reliance on internal audit work and the results suggested a mostly good relationship, a very good interaction and an almost good reliance of the external auditors on the internal auditors' activity.

External and internal auditors have common objectives, so an effective coordination and cooperation enabling them to provide better audit services to the clients.

Relevant professional standards and bodies recommend both internal and external auditors to improve the level of coordination and cooperation between them and that will have better results on the quality and cost of the audit.

In Romania the process of cooperation and coordination evolved as a result of the agreement signed, but until the certification as internal auditor continues to be a dream the efforts in this direction must go further.

Internal and External Auditors could have a lot of benefits of cooperation at different levels, as follow:

- *in the area of risk management*, could be: the use of a common methodology, better results in terms of risks identification, evaluation and management; and assessment of the risks through the use of internal and external information;
- *in internal control assessments* could mainly generate: the integration of the internal control processes review (combination of financial and operational processes); do not test the same aspects, common language, the best qualified persons, interesting discussions could offer differing views in the benefit of the organization;
- *in the planning activity*: a better coverage of the audit universe, a reduction of the audit, optimal allocation of the resources;
- *in the testing activity*: could perform the testing together, could exchange the working papers in order to avoid to perform the same testing.
- *in the reports activity*: the External Auditors could receive a “draft” of Internal Audit Report and to discuss the main conclusions with the Intenal Auditors, also the External Auditors could communicate their reports and management letter to the Internal Auditors, in respect of the same purpose.

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