Mr. Salman Khurshid  
Minister of State (I/C)  
For Corporate Affairs

Mr. R. Bandyopadhyay  
Secretary  
The Ministry of Corporate Affairs

A Wing  
Shastri Bhawan  
Rajendra Prasad Road  
New Delhi -110 001, India

Re: CORPORATE GOVERNANCE VOLUNTARY GUIDELINES 2009  
Appointment of the Internal Auditor

Dear Sir,

The Institute of Internal Auditors (The IIA), representing more than 170,000 internal audit professionals worldwide, would like to share our view on the Corporate Governance Voluntary Guidelines 2009 issues by Ministry of Corporate Affairs. We refer to the following notes in Para IV. E titled Appointment of the Internal Auditor:

In order to ensure the independence and credibility of the internal audit process, the Board may appoint an internal auditor and such auditor, where appointed, should not be an employee of the company.

We disagree with the statement above. First, internal auditing is a profession which is distinct from external auditing or other professions with its own set of standards, certification, and professional practices. The independence of the internal audit function is not determined by whether the function is internally or externally sourced, but by the reporting relationship with the board and audit committee, and internal auditor’s objective mindset. Furthermore, credibility of the internal audit function is a result of professional knowledge and training, day-to-day understanding of the organization and its operations, and value-added contribution to the organization through assurance and consulting services.

The IIA has developed the globally accepted definition of internal auditing, as follows:

“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.”

Throughout the world, The IIA requires its members adhere to the same Definition of Internal Auditing, Code of Ethics and International Standards for the Professional Practice of Internal Auditing (Standards). Internal auditors serve an integral role of governance in protecting the stakeholders of an organization by improving the strength of an organization’s governance, risk and controls systems.
Internal audit activity’s independence

The IIA Standards require the internal audit activity to be independent in performing their work. By independence, we mean the internal audit activity is free from conditions that threaten its ability to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the chief audit executive has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship, such as administratively reporting to senior management for assistance in establishing direction, support, and operational interface; and functionally reporting to the organization’s most senior oversight group -- typically, the audit committee -- for strategic direction, reinforcement, and accountability.

Internal auditor’s objectivity

The IIA Standards require the internal auditors to be objective in performing their work. Objectivity is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others.

Internal auditor’s credibility

Credibility is determined by expertise and trustworthiness. Internal auditors have a broad knowledge and understanding of the business processes in a company, including internal control knowledge. The International Professional Practices Framework, established by The IIA, has equipped internal auditors worldwide with standards and guidance for many years. In addition, The IIA’s Certified Internal Auditor (CIA) designation has come to represent the hallmark of professional accomplishment in the practice of internal auditing. More than 90,000 internal auditors are certified throughout the world. With broad and specific education, knowledge and experience eligibility requirements that a candidate must meet to take the exam and acquire the certificate, the CIA credential has become a symbol of professionalism and credibility on internal auditing.

Because of its unique and objective perspective, in-depth organizational knowledge, and application of sound audit principles, an independent internal audit activity is well positioned and trusted to provide assurance and add value to an organization and its oversight entities.

Internal auditor vs. external auditor

Although internal auditors and external auditors are both independent of the activities they audit, internal auditors are integral to the organization and provide ongoing monitoring and assessment of all activities. On the contrary, external auditors are independent of the organization, and provide an annual opinion on the financial statements. The work of the internal and external auditors should be coordinated for optimal effectiveness and efficiency.

Providing assurance on accounting and financial controls is part of internal auditor’s work. However, The IIA also advocates that internal auditing is an activity that covers a broad spectrum of business processes, ensuring the organization is managing its significant risks appropriately. Evidence has proved that internal auditors have provided independent
assurance on many other disciplines, mandates and regulations. Just because internal auditors are “internal,” one should not infer that they are not independent or objective.

Regulators can help to ensure adequate support for the internal audit activity
From The IIA’s experience around the world, regulators can be most impactful to effective internal auditing when they require that: there is a substantive internal audit activity for every public-listed organization; the internal audit activity has the stature as demonstrated through direct lines of reporting and communication to the board or audit committee; and there are adequate resources for the internal audit activity, in stature, quantity, quality and scope of coverage.

Sourcing the internal audit activity
Internal auditors may be internal employees, external resources, or a combination thereof based on the specific needs of the organization and the audit engagement. The IIA Standards require that internal auditors must determine appropriate and sufficient resources to achieve engagement objectives based on an evaluation of the nature and complexity of each engagement, time constraints, and available resources. Each member of the internal audit activity need not be qualified in all disciplines. Sometimes outsourcing or co-sourcing certain audit engagements is an appropriate action when resources or expertise are limited within the organization. With variations within countries and industries, the IIA’s annual membership survey shows that approximately 85% - 90% of internal audit activities have staffs who are the employees of the organization.

In conclusion, the IIA agrees with the Voluntary Guidelines regarding the corporate governance, board and audit committee responsibility. But we believe that internal auditors can be the employees of the organization and the responsibility for establishing and overseeing the scope and performance of internal auditing cannot be outsourced. The success of an internal auditor is dependent on meeting the requirements of The International Professional Practices Framework, established by The IIA, which include directives on independence and objectivity. The effectiveness of an internal audit activity would not be improved, but likely be hindered, with the requirement that internal auditors are not to be employees of the organization. With the above considerations, we respectfully suggest your Ministry reconsider the new requirement regarding the appointment of the internal auditor.

The IIA welcomes the opportunity to discuss any and all of these comments with you. Please feel free to reach out to us at our global headquarters or to The IIA’s representative in India, IIA India.

Best regards,

Richard F. Chambers, Certified Internal Auditor
President and CEO
The Institute of Internal Auditors
Email: richard.f.chambers@theiia.org

E-mail: guidance@theiia.org
Urton L Anderson, Certified Internal Auditor
Chairman
Internal Audit Standards Board
Email: Urton.Anderson@mccombs.utexas.edu

cc: Mr. P.C. Anand
President, IIA India
Phone: 91 44 24 991779
E-mail: pc.anand@vsnl.com

Mr. Anil Bhandari
Contact Person, IIA India
Phone: 91 22 4221 5330 or 91 98 21037605
E-mail: anil.bhandari@anbindia.com

306 Mansarovar Building
90 Nehur Place
New Delhi 110019
INDIA

About The Institute of Internal Auditors
Established in 1941, The Institute of Internal Auditors (IIA) is an international professional association of more than 170,000 members with global headquarters in Altamonte Springs, Fla., United States. The IIA is represented worldwide through 103 national institutes, including India, and is recognized as the internal audit profession's leader in certification, education, research, and professional guidance. Members work in internal auditing, risk management, governance, internal control, information technology audit, education, and security.