

STUDYING THE IMPACT OF AUDIT COMMITTEE CHARACTERISTICS ON IMPLEMENTATION OF INTERNAL AUDIT RECOMMENDATIONS

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Abstract. Examining and monitoring management's response to the advices and findings of internal audit is one of the roles of audit committee. Regulators and others have determined the importance of interaction between the audit committee and internal audit. In this research, the variable of characteristics of the audit committee is the independent variable, and implementation of internal audit recommendations is dependent variable. One of the roles of the audit committee is examining and monitoring management's response to the advices and findings of internal audit. This study provides empirical evidence about the relationship between the characteristics of the audit committee and perceptions of implementation of internal audit recommendations. The statistical sample of this study is 100 active companies in Tehran Stock Exchange in 2016. The results also showed that the perceptions of implementation of internal audit recommendations are influenced by frequent meetings between the audit committee and certified internal auditors.

Keywords: Audit committee, internal audit, implementation

1. INTRODUCCIÓN

The importance of effective internal audit and existence of an effective Assessment Committee (AC) as the foundation for a good company is increasingly recognized as a result of various financial collapses (Bedard et al., 2010). Many of these collapses occurred in the early 2000s which caused capital markets to become sure about the collapse. As a result, the role of Internal Audit Function (IAF) and AC's role in helping those boards of directors who take the responsibility of their financial commitments receives much attention (Puri, Trehan and Kakkar, 2010). AC, as the company's governance mechanism, takes the responsibility of accurate examination of the company's financial information and facilitating internal audit and financial auditors' work. AC is also responsible for monitoring IAF. In order to carry out these tasks, AC should assist IAF in doing the responsibilities of the committee. In addition, AC and IAF should be attached to senior management, such that they will not be weakened by other organizational tasks (Su and Bani, 2011). Significant researches in the literature indicate that AC features affect internal audit (Adel and Maissa, 2013; Abbott, Parker and Peters, 2010; Barva, Rama, and Sharma, 2010; Callahan and Soileau, 2010; Cahill, 2006; Mat Zain, Subramaniam and Stewart, 2006; Goodwin and Yeo, 2003). The budget of internal audit is particularly related to the number of AC meetings, indicating that continuous AC supports IAF, which results in higher budgets of internal audit (Baroet et al., 2010). However, the impact of these characteristics on perception of the success rate of implementation of internal audit recommendations has not been examined in empirical researches. This lack of research stimulates the present study which tries to fill this gap by empirical examination of this issue that whether AC's specific characteristics influence effectiveness of internal audit (EIA) or no. In this study, the perceptions of Certified Internal Auditors (CIAs) about implementation of EIA internal audit recommendations are evaluated. Another factor examined by the present research is determining the impact of each AC characteristic on EIA. Therefore, in fact it can be said that the results of this study complete the existing research and, through a particular method, refers to further research opportunities.

The present study also develops initial researches through providing a different evaluation of EIA. This article examines the relationship between AC

characteristics and perceptions regarding the extent to which internal audit recommendations are implemented, while previous studies have focused on other indicators such as independence report and quality assurance review stages (Callahan and Soileau, 2010), internal audit budget (Carcello, Hermanson and Raghunandan, 2005), and the size of internal audit unit and perceptions of employees having auditing experience (Mat Zain et al., 2006); and it is said that the higher is AC independence, the more is perception of successful implementation of internal audit recommendations. Similarly, there are perceptions that implementation of internal audit recommendations is higher when there is more expertise among AC members, and when AC has frequent meetings. Four AC characteristics (AC independence, AC expertise and members, number of sessions, and number of members) are known as the characteristics affecting EIA. We formulated some hypotheses about the impact of these characteristics on EIA, and we evaluated the hypotheses through regression models about the data collected from 100 active companies in Tehran Stock Exchange. The existing hypotheses result from the issue that the much effective impacts of AC on internal audit are created very independently, competently and interactively. Such a committee is able to act within its control and therefore, internal audit recommendations which lead to higher effectiveness of internal audit should probably be implemented.

Abbott et al. (2010) examined the relationship between monitoring AC and resources directed toward internal control activities. They stated that ACs invest in IAF through more monitoring of IAF generally, with financial commitment of more hours to this activity, and by the extent of implementation of more IAF recommendations. Mat Zain et al. (2006) found a positive significant relationship between evaluation of internal auditors in their participation in audit of financial statements and three specific AC characteristics including the ratio of independent AC members, their knowledge and experience in accounting and audit, and the rate of AC review of internal audit programs, budget, and coordination of recommended programs in Malaysian context. Therefore, in order to understand the potential participation of internal auditors, there was a relationship between AC characteristics and implementation of IAF recommendations.

The AC specific characteristics may support or prevent internal auditors that this means that AC may or may not be useful in the implementation stage. Mihret and Yismaw (2007) identified the necessity of management support in providing the needed resources for IAF in order to make possible the successful implementation of advices. Adams (1994) used organizational theory to explain why maintaining a powerful internal audit sector is of interest for the management. Obviously, audit effectiveness purpose is reasonable because it cannot be realized without the management's commitment to implement the recommendations of internal auditors (Van Gansberghe, 2005; Sawyer, 1995). It is important to acknowledge that none of the identified factors is definitely independent, because AC behavior in a region may be conditional to its actions in another region. Many researchers (Mat Zain et al., 2006; Goodwin, 2003) found that AC nature is determined by the degree of its independence, the expertise of its members, the number of members, the number of meetings, and the amount of interaction with the internal auditor. Mat Zain et al. (2006) stated that when AC is very independent and the members have accounting and auditing knowledge, the internal auditors have more partnership with financial reporting. Therefore, it can be said that the more effective is the AC, the more active are the company's internal auditors for engaging in financial reporting, and therefore, greater amount of implementation of recommendations becomes obvious. So, this study provides some hypotheses about the impact of CAC on EIA. These hypotheses are evaluated using the responses of 100 companies active in Tehran Stock Exchange. Figure 1 presents the research model

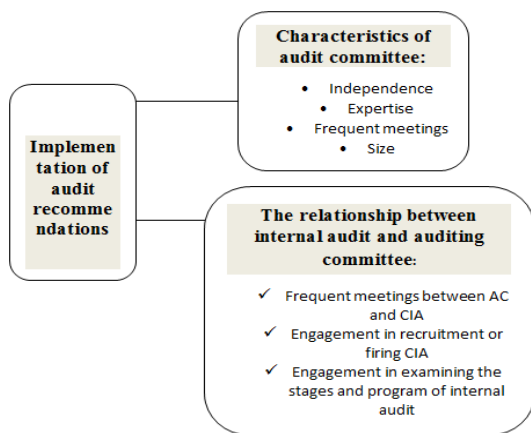


Figure 1: Research model

The research hypotheses seek to determine the exact relationships between AC identified factors

and perception of implementation of IAF recommendations. Previous studies have shown that AC characteristics have relationship with interaction with internal audit, the costs paid to external auditor, and choosing the auditor (Vermeer, Raghunandan, and Forgione, 2009; Carcello et al, 2002; Raghunandan, Read, and Rama, 2001). However, still it is not known how is the relationship between AC characteristics (number of members, expertise of audit committee members, independence, and the number of meetings) and implementation of audit recommendations. Therefore, this study develops the resources particularly in terms of the impact of AC characteristics on audit recommendations.

2. RESEARCH METHODOLOGY

The data were collected through a survey that evaluation of internal audit recommendations is identified through which. The survey questionnaire was consistent with most of the initial internal audit researches about CIA (Abbott et al., 2010; Mat Zain et al., 2006; Carcello et al., 2005). A total of 100 questionnaires were sent to CIAs of 100 companies active in Tehran Stock Exchange in 2016. 100 respondents were received from this distribution. Of course, this response rate is only logical when it is compared with the rate obtained by previous studies. For example, Zaman and Sarens (2013) studying the informal interaction between ACs and IAF obtained a response rate of 27.8% among the CIAs of the mentioned companies in the United Kingdom. The Australian study by Leung, Cooper, and Perera (2011) focused on accountability structures and IAF-related managerial relationships, that the response rate was 21.4%. The questionnaire has been designed in order to obtain perceptions of internal audit recommendations and AC characteristics, and has five sections. Section (A) collected general information about respondents and their internal audit features (university degrees, professional qualifications, work experience, and budget allocation). Section (B) evaluated AC characteristics. Section (C) focused on the interaction between internal audit and AC. Section (D) was related to the perceptions of implementation of internal audit recommendations; and Section (E) focused on management support for internal audit.

The research control variables are based on the results of previous researches (Alzeban and Sawan, 2013; Alzeban and Gwilliam, 2014; Mihret and Yismaw, 2007), which state that management support has a positive and significant relationship

with implementation of internal audit recommendations. The researchers also monitor CIA's tenure and believe that it affects IAF quality (Pizzini, Lin, and Ziegenfuss, 2011; Walker, Shenkir and Barton, 2002). 9 other variables existing in the regression model evaluate the hypotheses as follows: H₁ as independence tests; H₂ as expertise; H₃ as frequent meetings; H₄ as size.

Table 1. Descriptive statistics and figures

Variables	Minimum	Maximum	Mean	Standard Deviation
Advice	7	77	33.5	18.1
Support	1	5	2.7	0.79
Tenure	0.9	6	2.3	0.72
Independence	34%	100%	80%	14%
Expertise	2	5	5.2	0.81
Frequent meetings	2	10	2.5	1.2
Size	2	5	6.3	1.4
Meeting	2	7	4.4	1.1
Appointment	0	1	0.71	0.4

3. RESULTS

According to Table 1, the results of descriptive statistics show that 80% of ACs are composed merely of independent managers and all CAs have at least two experts in accounting or auditing (with an average of 5.2). The AC samples are met on average 2.5 times a year with a minimum of 2 and a maximum of 10 meetings. In addition, the average size of ACs is 6.3 managers. The meetings of ACs with CIAs are held with an average of 4.4 times a year and are involved with decision making about appointment and dismissal of CIAs (0.71). In addition, AC samples are involved in examining programs, planning, and budget of internal audit, and there is partnership of internal audit in risk management. However, the average score of AC examination of financial reporting, internal control, and IAF compliance with law and regulations is somewhat lower than 3.2. Table 2 presents the correlation matrix of control, independent, and dependent variables in this study. The dependent variable in this research is advice which has a positive and significant relationship with five variables of support, independence, expertise, tenure, and appointment ($p < 0.01$) and meeting ($p < 0.05$); and is consistent with previous studies

(Naiker and Sharma, 2009; Raghunandan and Rama, 2007; Zhang et al., 2007; Archambeault and DeZoort, 2001). The variable of holding frequent meetings has a positive relationship with advice, but it is not significant ($p < 0.05$). There is a negative relationship between two variables of advice and size ($p < 0.05$) which is consistent with previous studies (Adel and Maissa, 2013; Barva et al., 2010; Abbott et al., 2002).

Table 3 presents regression results. The overall model has been set with R² and is significant at $p < 0.01$. The coefficients of control variables (support ($p < 0.01$) and tenure ($p < 0.05$)) are significant. Independence coefficient in the test variables shows a positive and significant correlation (which confirms hypothesis 1) and states that existence of independent AC members is related to greater understanding of this issue that in fact the internal audit recommendations are implemented. In addition, regression results indicate that, among AC features, independence helps advice more. Regression results also show a significant correlation between perceptions of implementation of internal audit recommendations (advice) and the amount of knowledge of AC members about accounting and auditing issues ($p < 0.05$), and thus confirms H₂. The positive correlation shows that the higher is the AC knowledge, the greater is the likelihood of implementation of internal audit recommendations.

Table 2. Pearson correlation coefficients for variables

Variables	1	2	3	4	5	6	7	8	9
Advice	1.00								
Support	**	1.00							
Tenure period	0.55	**	1.00						
Independence	**	0.59	**	1.00					
Expertise	0.43	**	0.37	**	1.00				
Frequent meetings	**	0.35	**	0.53	*0.20	1.00			
Size	0.50	**	0.33	*0.20		*	1.00		
Meeting	**	0.43	-0.23		-0.09	0.22		1.00	
Appointment	0.44	-0.07		-0.05	*0.23	0.02	-0.06		1.00

* Correlation coefficient is significant at 0.5.

** Correlation coefficient is significant at 0.01.

Table 3. Regression results

Variable	Expected sign	β	T	P amount
Advice	4.596	0.000	-	-
Support	+	0.269	3.234	0.000
Tenure period	+	0.347	2.187	0.012
Independence	+	0.765	2.260	0.002
Expertise	+	0.347	2.403	0.010
Frequent meetings	+	0.69	0.592	0.709
Size	+	-0.088	-0.821	0.478
Meeting	+	0.342	2.066	0.003
Appointment	+	0.187	1.807	0.033

F=20.034

p<0.01

The coefficient of meetings is positive ($p<0.05$), but it is not significant (it does not confirm H_3 hypothesis). However, the regression results refer to negative correlation between AC size and advice; thus, it rejects H_4 hypothesis. These results do not show any relationship between AC size and perceptions of implementation of internal audit recommendations. This relationship is negative and consistent with previous studies (Adel and Maissa, 2013) which find no relationship between AC size and interaction with internal audit. Regression results indicate partial support for H_5 because, while one dimension of meeting, meaning interaction of AC with internal audit, has a positive and significant relationship ($p<0.01$) with advice, the dimension of appointment has a positive relationship with advice but it is not significant. In summary, the results indicate that frequent meetings between AC and CIA has a positive and significant relationship with perceptions of implementation of internal audit recommendations (advice) at $p<0.01$. This process shows that the more AC meets CIA, the more this committee will be aware of the issues that internal auditors face. Therefore, it will be involved more in the issue of advice and internal audit report and thus, it will examine and monitor the management's response to the advices as well as the findings of internal

auditors, more. In addition, the results indicate that AC participation in appointment and dismissal of CIA has a positive relationship with advice ($P=0.05$), which indicates that this partnership offers more empowerment of IAF, and therefore, it offers more perceptions of implementation of internal audit recommendations. Generally, the findings of the present study showed that AC independence and AC members' knowledge of accounting and auditing have a significant impact on implementation of internal audit recommendations. So, it can be said that the more the AC is effective, the more internal auditors can participate in financial reporting, and the more internal audit recommendations are implemented.

CONCLUSION

In the present study, the researcher, considering specific demographic variables (education, size, and budget) in this model has examined sensitivity of his results. When these variables were introduced, very good results remained for this research. The overall model set with R^2 is significant at $P<0.01$. While the analysis refers more to significant relationship at $p<0.01$ between perceptions of implementation of audit recommendations (advice), the other three variables (training, size, budget) are also significant ($p<0.05$).

This process shows that these variables have a complementary role in promoting implementation of internal audit recommendations. In addition, the results also show that organizations, that provide sufficient resources (in terms of size and budget) to IAF, may increase implementation of internal audit recommendations; that this is consistent with the results by Mat Zain et al. (2006). In fact, the larger is the size of internal audit sector, and the higher is the ratio of internal audit staff having accounting and auditing experience, the more is internal auditors' evaluation of their participation in external auditing. Therefore, it can be said that the more are the resources belonging to IAF, the greater will be the internal auditors' evaluation of their participation in external audit, and the more will be the number of implemented internal audit recommendations.

The overall model set with R^2 is significant at $P<0.05$. Therefore, all three AC characteristics (independence, expertise and the number of meetings) have a significant relationship with advice at $p<0.01$. This study examines the impact of AC characteristics on perceptions of implementation of internal audit recommendations. Our results provide evidence that existence of

specific characteristics (AC independence, AC members' expertise, number of meetings, and AC size) affects perceptions of implementation of internal audit recommendations. In addition, it was said that with the existence of independent members in AC, which is the largest participant, what characteristics are more involved in this relation. This process shows that ACs with independent members support IAF more and therefore, probably they have a better impact on risk management within the organization. These findings confirm the results by Barva et al (2010) which states that the composition and persistence of AC have relationship with investing in internal audit. In addition, the findings confirm the results by Mat Zain et al. (2006) regarding AC characteristics and evaluation of internal auditors about their participation in financial statements auditing, which points out that when AC members are independent, internal auditors have more partnership with external auditing. As a result, it can be said that existence of an independent AC promotes more occurrence of perceptions of implementation of internal audit recommendations and, thus, more partnership from internal auditors to external auditing.

It is expected that CIAs with longer tenure in internal environment of their organizations and implementation of internal audit recommendations are very knowledgeable. This study is added to the existing resources and provides information for other researchers about the need for standards that address AC dimensions and the relation with internal audit. The important partnership with internal audit resources is related to CIA tenure and perceptions of implementation of internal audit recommendations.

This study is subject to certain limitations that provide opportunities for future research. The researcher has collected his data through examining CIAs and has focused on the perception of the personnel about the extent to which their recommendations are implemented by auditors. A survey with a sample of audits may reveal a different image in terms of beliefs about the level of implementation of CIA recommendations and the reality of situation, as is evaluated by coherent changes of the exercise. Similarly, demographic factors such as age and gender, which have not been considered in this study, may be effective based on the capacity of respondents (or CIAs or audits) to create positive or negative perceptions of the conducted efforts to comply with the advices. Also, focus on variables such as internal audit budget, internal audit size, and participation in CIA change, and examining whether these are related to

implementation of internal audit recommendations, are other limitations of this research.

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