A Conceptual Framework of Potential Conflicts with the Role of the Internal Auditor in Enterprise Risk Management

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Abstract

Internal auditors are expected to be increasingly involved in Enterprise Risk Management (ERM) by adding value to the organization and providing assurance that the entity’s risk exposures are properly understood and managed. The Institute of Internal Auditors’ (IIA, 2009) revised position paper defines the internal auditor’s role in ERM as measuring and monitoring performance, and at the same time evaluating the effectiveness of management’s risk monitoring process. In this paper, the author proposes a conceptual framework to assess whether potential conflicts exist with the role of the internal auditor in companies with fully implemented ERM frameworks. The existence of conflicts would depend on whether the internal auditor’s independence and objectivity is impaired. The proposed conceptual framework suggests that the internal auditor’s independence and objectivity would not be impaired when it leads and maintains the ERM framework. In addition, the internal auditor’s independence and objectivity would not be impaired when it spends more time performing ERM consulting activities versus providing assurance on controls. Finally, the proposed conceptual framework suggests that the internal auditor’s independence and objectivity would not be impaired when it reports to a separate board risk management committee. From the review of prior literature on the internal auditor’s role in ERM, hypotheses are developed to suggest a relationship between the internal auditor’s independence and objectivity with performing a leading and maintaining role in ERM, providing assurance on controls and consulting services, and reporting to a separate risk management committee that can be empirically tested in future research.

Keywords: Internal auditor, Enterprise risk management, Consulting activities, Internal controls

1. Introduction

The importance of enterprise risk management (ERM) and the role of the internal auditor in ERM have grown in recent years. Major accounting scandals and the global financial crisis have revealed the need for better oversight of risk at the board and senior management levels. Moreover, the U.S. Securities and Exchange Commission (SEC, 2013) considers ERM and the internal auditor as key aspects of its redesign national examination program, which requires registrants to engage their corporate governance structure around ERM and internal controls. The ERM framework considers the internal control environment to encompass a broader range of risks and controls that goes beyond SOX-based regulations. The broader view of risks is of significant interest to external stakeholders. The ERM framework includes strategic, operation, compliance, and financial reporting risks while SOX-based regulations focus almost exclusively on internal controls over financial reporting.

The effective and successful implementation of ERM is related to an objective internal audit function. As a result, internal auditors are expected to be increasingly prominent in ERM by adding value to the organization and providing assurance that the entity’s risk exposures are properly understood and managed. Furthermore, internal auditors are increasingly called on to serve two masters: those primarily responsible for governance (audit committee) and those being governed (management). At issue are the recommendations by the Committee of the Sponsoring Organizations of the Treadway Commission (COSO, 2004), and the IIA (2009) revised position statement on the role of the internal auditor in ERM.
COSO (2004) defines the internal auditor’s core role regarding ERM as “assisting management and the board of directors or audit committee by examining, evaluating, reporting on and recommending improvements to the adequacy and effectiveness of the entity’s ERM framework” (p. 88). COSO’s ERM framework does not require the internal auditor to manage risks. The IIA in coordination with its IIA UK and Ireland affiliate (2004), on the other hand, defines internal auditing as “an independent, objective assurance and consulting activity. Its core role with regard to ERM is to provide objective assurance to the board on the effectiveness of risk management” (p. 4).

Although the recommendations of COSO (2004) and the IIA (2004) position statement on the roles of the internal audit function regarding ERM are specific, the IIA (2009) revised position statement allows for numerous types of internal audit consulting activities related to ERM, and extensive variation in the internal auditor involvement in ERM. This flexibility of the IIA (2009) guidance on the internal auditor’s role in ERM contributes to an ongoing debate. One of the issues surrounding ERM is whether internal auditors fail in their role to audit controls, and instead manage risks when they become involved in ERM (e.g., Banham, 2004; Beasley, Branson, & Hancock, 2009; Beasley, Clune, & Hermanson, 2006).

Several researchers have raised concerns about the internal auditor’s dual role of consulting and assurance in the light of its need for independence and objectivity (e.g., Brody & Lowe, 2000; Hermanson & Rittenberg, 2003; Krell, 2005; McCall, 2002; Selim, Woodward, & Allegrini, 2009). Fraser and Henry (2007) argued that internal auditors may lose their independence and objectivity if they become too involved with strategic areas of the business including risk management process. Beasley et al. (2006) found that the internal auditor’s role should be limited in an ERM environment. While, Walker, Shenkir, and Barton (2002) argued that no precise method or “silver bullet” exist for the role of internal auditor in the ERM framework. While using the internal audit as a monitoring mechanism to reduce agency costs is consistent with the agency theory (Adams, 1994; Jensen & Meckling, 1976), management’s responsibility includes monitoring or managing organizational risks, and implementing controls to mitigate such risks; not the internal auditor. From an agency perspective, internal auditors can be considered part of the corporate governance structure because they monitor the financial reporting process (e.g., Beasley & Salterio, 2001; Cohen, Krishnamoorthy, & Wright, 2002). The IIA has promoted the internal audit function as an independent function that provides value-added assurance and consulting services. This evolving and expanding role of internal audit has also been promoted as the cornerstone upon which effective corporate governance is built.

In today’s business environment, the internal audit function has become a major component of modern corporate governance, providing support to the audit committee, board of directors, and other parties with corporate governance responsibilities (e.g., Gramling, Maletta, Schneider, & Church, 2004; Ruud, 2003). Moreover, legislation such as the Sarbanes Oxley Act (2002) has also indirectly reinforced the increased importance of the internal audit function as a key corporate governance mechanism. The expanding role of internal audit in contemporary corporate governance has generated renewed attention on independence. For example, Mutchler, Chang and Prawitt (2001) highlighted the importance of independence by suggesting that an increase in internal auditors’ responsibilities will lead to a greater demand for accountability, independence, and objectivity. Internal auditors are in a unique situation as providers of both assurance services within the organization and ERM consulting related value-added services to managers. This dual role has generated significant debate as it has the potential to place the internal auditors in a situation of conflict. Moreover, as employees of the organization, the ability of internal auditors to exercise objectivity has also been questioned (Paage, 2007). Chapman (2001) argued that the primary goal of the internal auditor is objectivity, which involves an unbiased attitude and the avoidance of conflicts of interest.

1.1 Motivation

The purpose of this study is to propose a conceptual framework that can be used in future study to empirically examine the role of internal auditors’ involvement in ERM. The proposed conceptual framework will make significant contribution to the existing literature. In this paper, the proposed conceptual framework seeks to assess whether the expansion of the internal audit function to perform the dual role of providing consulting and assurance services conflict with its value as an assuror and independent analyst of the effectiveness of the risk management process. That is, does the provision of any consultative activity impair the value of the assurance process? The proposed conceptual framework also seeks to determine whether the internal auditor’s independence and objectivity is impaired when it performs a leading and maintaining role in companies with fully implemented ERM framework, and what the appropriate reporting role of the internal auditor should be in companies with a separate board risk management committee.

I proposed that the conceptual framework can be empirically examined in future research by using survey questionnaires to collect data and OLS regression to test the hypotheses. The questionnaires should be prepared in
accordance with quality control requirements for questionnaire design and distributed electronically with a cover letter through the IIA to its members that are registered as chief audit executives (CAEs). This study proposes three research questions identified from the review of prior literature in Section 2:

**RQ1:** Is the internal auditor’s independence and objectivity impaired when it leads and maintains a fully implemented ERM framework, and at the same time performs its core role of auditing controls?

**RQ2:** Is the internal auditor’s independence and objectivity impaired when it spends more time performing ERM related consulting services for management versus evaluating the adequacy and effectiveness of internal controls in a company with a fully implemented ERM framework?

**RQ3:** What should the internal auditor reporting role be in a company with a separate board risk management committee and a fully implemented ERM framework?

This study should be of significant interest to academics, policy makers, and practitioners interested in the association between ERM and the internal auditor’s role in ERM. The proposed conceptual framework should provide useful insights to the IIA in guiding its members on the internal auditor’s role in ERM. Moreover, it is important to understand whether there are conflicts when the internal auditor reports to both the audit committee on assurance regarding internal controls, and to a separate board risk management committee on ERM related consulting activities and assurance on risk management process.

The remainder of the paper is organized as follows. Section 2 presents a background on ERM, discussion of prior literature in relations to this paper, and develops the hypotheses. This is followed by the research methodology which includes a discussion of the proposed conceptual framework. Section 4 presents the conclusion, and suggestions for future research.

**2. Background, Prior Literature, and Hypothesis Development**

**2.1 Background on ERM**

Traditionally, organizations have managed risks classified as key by using a siloed approach where each area of the organization manages its own risks. ERM has emerged as a holistic perspective that integrates and coordinates risk management across the entire organization (e.g., Beasley, Clune, & Hermanson, 2005; Liebenberg & Hoyt, 2003; Pagach & Warr, 2011). Selim and McNamee (1999), highlighted that “a common framework and language of risk is the hallmark of ERM.” The primary objective of ERM is to maximize stakeholders’ value (COSO, 2004; Beasley et al., 2006; Hoyt & Liebenberg, 2011; Pagach & Warr, 2011). COSO (2004, p. 2) defines ERM as:

> A process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.

Internal auditing has become a key driver of ERM, with internal auditors providing both assurance and consulting services regarding risk management process. Although internal auditor can add significant value in ERM, there is a risk that it could compromise its independence and objectivity. The IIA (2004), in recognition of this possibility issued a position paper stating the roles of the internal audit function in ERM. This position paper was revised in 2009 and outlines three categories of internal audit roles in ERM:

1. The recommended or core roles of internal audit in ERM;
2. The roles that are legitimate provided they are undertaken with safeguards; and
3. The roles that should not be undertaken.

The specific roles under each category are listed in detail in Table 1. The roles identified under the second category may present significant challenges to the internal auditor’s independence and objectivity as it allows for flexibility and extensive variation in the internal auditor involvement in ERM. Fraser and Henry (2007) argued that “while internal auditors may be involved in ‘facilitating’ workshops and conducting face-to-face interviews with line management it may be difficult to distinguish providing impartial advice from taking executive decision” (p. 6). The IIA and COSO both highlight that management has the ultimate responsibility for ERM.
Table 1. The roles of internal audit in ERM

<table>
<thead>
<tr>
<th>Category 1: Core internal audit roles in ERM</th>
<th>Category 2: Legitimate internal audit roles with safeguards</th>
<th>Category 3: Roles internal audit should not undertake</th>
</tr>
</thead>
<tbody>
<tr>
<td>Giving assurance on risk management processes</td>
<td>Facilitating identification and evaluation of risks</td>
<td>Setting the risk appetite</td>
</tr>
<tr>
<td>Giving assurance that risks are correctly evaluated</td>
<td>Coaching management in responding to risks</td>
<td>Imposing risk management processes</td>
</tr>
<tr>
<td>Evaluating risk management processes</td>
<td>Co-ordinating ERM activities</td>
<td>Management assurance on risks</td>
</tr>
<tr>
<td>Evaluating the reporting of key risks</td>
<td>Consolidated reporting on risks</td>
<td>Taking decisions on risk responses</td>
</tr>
<tr>
<td>Reviewing the management of key risks</td>
<td>Maintaining and developing the ERM framework</td>
<td>Implementing risk responses on management’s behalf</td>
</tr>
<tr>
<td></td>
<td>Championing establishment of ERM</td>
<td>Accountability for risk management</td>
</tr>
</tbody>
</table>

Source: IIA (2009)

The IIA (2004) describes internal audit as the “champion” of ERM but suggests that, as risk management becomes increasingly embedded in the organization, internal audit’s role may diminish.

2.2 Prior Literature and Hypothesis Development

2.2.1 The Internal Auditor’s leading and maintaining Role in ERM

Extant empirical literature on the role of internal auditors in companies with fully implemented ERM framework is limited. A few researchers examined the factors associated with ERM adoption (e.g., Beasley et al., 2005; Kleffner, Lee, & McGannon, 2003; Liebenberg & Hoyt, 2003), and the role of the internal auditor in the implementation of ERM (e.g., Beasley et al., 2006; Gramling & Myers, 2006; Walker, Shenkir, & Barton, 2003). For example, Walker et al. (2003) identified the major foundational elements in an ERM implementation and the role of internal auditing in the ERM processes in five leading U.S. companies on a case-by-case basis. They found evidence that the internal audit function is heavily involved in ERM in each company, but in different ways. The findings also revealed that the chief audit executive (CAE) participates significantly in ERM leadership role in each company. While, Walker et al. (2003) provided descriptive information about the role of internal audit in the implementation of ERM processes their study did not consider the internal auditor’s role in companies with fully implemented ERM framework. That is, whether the internal auditor roles conform with the appropriate internal audit roles identify by the IIA (2009).

Tillinghast-Towers (2001) performed a survey in 2000 of approximately 130 executives, including both internal auditors and other management executives to determine the internal auditor’s involvement in ERM. Based on responses of 32 percent of the responding organizations, they provided descriptive information that the internal audit involvement is only in ERM committees/working teams. Gramling and Myers (2006) reported the findings of an IIA Research Foundation study conducted in 2005 that examined the internal audit specific role in ERM for conformity with the appropriate internal audit roles identify by the IIA (2004). The results revealed that internal audit was primarily responsible for ERM in 36 percent of the organizations surveyed. The survey results also showed that the current levels of responsibility that the internal audit departments have may differ somewhat from the core and legitimate roles recommended by the IIA (2004) position paper. However, the respondents’ comments offer some evidence that internal auditors understand the underlying concepts of the IIA’s guidance. These studies did not focus on the role of the internal auditor in companies with fully implemented ERM framework.
Sarens and de Beelde (2006) used a qualitative study to examine the role of the internal auditor in risk management in ten different large manufacturing and service Belgian companies by comparing the roles performed by internal auditors in these companies to ten Belgian subsidiaries of U.S. companies. Sarens and de Beelde (2006) provided evidence that internal auditors play a proactive role in risk management, and also take a wider focus on internal controls. The authors highlighted that internal auditing is still a relatively young profession in the Belgian context, and many large companies have recently established an internal audit function. Sarens and de Beelde (2006) also found that in the context of the Belgian companies, internal auditors’ role in risk management is strongly linked with the development stage of the risk management system. That is, internal auditors play an important pioneering role in the creation of a higher level of control awareness and a more formalized, standardized, transparent and documented risk management system.

In an exploratory study, Beasley et al. (2006) used survey to examine the overall impact of ERM on the internal audit function of a sample of organizations around the world during different stages of ERM development. The findings showed, based on responses from 122 organizations that ERM’s greatest impact on the internal audit function occurs when the organization’s ERM framework is more completely in place. Sarens and de Beelde (2006), and Beasley et al. (2006) did not used the IIA’s (2009) revised guidance to examine the role of the internal auditor in companies with fully implemented ERM framework.

During the early stages of ERM development, internal auditors assume greater risk management responsibilities because the internal audit function plays a leading role in ERM consulting related activities. These activities include maintaining and developing the ERM framework, championing the establishment of ERM, and performing its core roles of providing assurance on controls. However, in companies with fully implemented ERM framework, it is expected that the internal auditor will continue to be highly involved in leading and maintaining the ERM framework, providing other ERM consulting related activities outlined in Category 2 of Table 1, and at the same time, perform its core roles of providing assurance on controls. The conceptual framework proposes that performing these activities will not impact the internal auditor’s independence and objectivity. Therefore, the following hypothesis is proposed:

**H1**: For companies with fully implemented ERM framework, the internal auditor’s independence and objectivity will not be impaired when it is highly involved in leading and maintaining the ERM framework, and at the same time performing its core roles of auditing controls.

### 2.2.2 The Internal Auditor’s Dual Role and the Impact on Its Independence and Objectivity

ERM brings a structured, consistent and coordinated approach to managing risks. The IIA (2009) guidance requires the internal auditor to provide ERM consulting related value-added services to management in addition to assurance on controls. Moreover, since the passage of SOX, audit committees and other governance participants have placed greater reliance on internal auditors (Carcello, Hermanson, & Raghunandan, 2005). While the internal auditor involvement in ERM can add value to the organization, the expansion of its role to provide consulting services may conflict with its value as an assuror and independent analyst of the effectiveness of the risk management processes. Several researchers have raised concerns about the internal auditor’s dual role of consulting and assurance in risk management in light of its need for independence and objectivity (e.g., Brody & Lowe, 2000; Fraser & Henry, 2007; Hermanson & Rittenberg, 2003; Krell, 2005; McCall, 2002; Selim et al., 2009). However, limited empirical research exists on the impact of the internal auditor’s independence and objectivity when it performs its dual role of providing assurance and consulting services in companies with fully implemented ERM framework.

Selim et al. (2009), is one of the few studies that examined the effect of the internal auditor’s dual role using the IIA (2009) revised guidance. Selim et al. (2009) investigated the nature, extent and consequences of the definitional change on internal audit’s dual role of consulting and assurance activities in light of its need for independence and objectivity by conducting questionnaire surveys of IIA members in the UK/Ireland and Italy. The findings showed that internal auditors in both jurisdictions were more involved in project management and disaster recovery while Italians were more involved with legislative compliance. The findings also showed mixed results both within and across countries of the impact of the internal auditor’s dual role of assurance and consulting on its independence and objectivity. Selim et al. (2009) did not investigate whether the provision of any consultative activity by the internal auditor impairs the value of the assurance process in companies with fully implemented ERM framework.

In a recent study, de Zwaan, Stewart, and Subramaniam (2011) used an experimental design that consisted of 117 certified internal auditors in Australia to examined whether internal auditors’ involvement in ERM and its relationship with the audit committee have an impact on perceptions of their willingness to report a breakdown in risk procedures. de Zwaan et al. (2011) also investigated ERM’s use and the internal audit’s role in private and public sector entities in Australia. The findings showed that the perceptions of internal auditors’ willingness to report
a breakdown in risk procedures to the audit committee are impacted by a high involvement in ERM. The results revealed that a high level of internal audit involvement in ERM activities including the roles the IIA identified should not be undertaken pose a threat to the internal auditor’s objectivity. However, the likelihood of reporting does not appear to be affected by a strong relationship with the audit committee, regardless of the level of ERM involvement. That is, when internal auditors have a strong and close relationship with an effective audit committee, they will be more likely to withstand pressure from other managers to compromise their objectivity. The findings also showed that most internal auditors are involved in core activities including providing assurance on risk management, while a smaller number indicated that they engaged in activities that could compromise their objectivity.

The internal auditor is often called upon to serve two masters: those primarily responsible for governance (audit committee) and those being governed (management). For instance, management requires the internal auditor to perform consulting activities, and at the same time provide assurance on internal controls, which may impact its independence and objectivity. The audit committee, on the other hand is more interested in assurance regarding controls. Furthermore, the IIA (2009) requires the audit committee to provide oversight of the internal audit by reviewing and approving the internal auditor’s staffing schedules and financial budgets. However, when the internal auditor performs assurance related activities this may conflict with management’s objectives of the internal auditor (Hermanson & Rittenberg, 2003). Thus, management may require the internal audit to allocate more of its resources toward ERM consulting value-added activities. Hence, instances may occur in which the two primary consumers of the internal auditor resources may disagree with respect to the allocation of those resources (Hermanson & Rittenberg, 2003). If the internal auditor spends more of its resources performing management consulting related activities than auditing controls this may impact its independence and objectivity.

In a recent paper, Abbott, Parker, and Peters (2010) examined the association between the audit committee oversight and the amount of internal audit resources allocated to internal control-based activities relative to consulting related value-added activities for management. Abbott et al. (2010) provided evidence that when the internal auditor serves two masters: the audit committee and management the mean overall measure of their audit committee oversight variable is approximately 48 percent, suggesting that the audit committee is a near-equal partner with management. Abbott et al. (2010) did not examine whether the internal auditor’s dual role of providing assurance and consulting services in companies with fully implemented ERM framework impairs its independence and objectivity.

Although, management (e.g., CEO and CFO) have the ultimate responsibility for internal controls, the CEO and CFO have distinct financial reporting and compensation related incentives that differs from the audit committee members. The evaluation of an audit committee’s effectiveness is heavily weighted toward the strength of the company’s internal control structures and financial reporting environment, and not towards responsibilities for the firm’s economic performance (Abbott et al., 2010), which is management’s responsibilities. An audit committee’s litigational and reputational concerns can engender a demand for the internal auditor to focus its efforts on evaluating financial statement related internal controls (Krishnan, 2005). Thus, the audit committee may require the internal audit to allocate more of its resources toward internal control evaluation. However, the ability of the internal auditor to satisfy the audit committee’s requests may be constrained by budgetary limitations and competition with management for the direction of scarce resources (Hermanson & Rittenberg, 2003; Pei & Davis, 1989). In contrast, management may view the internal auditor’s role as a method for achieving operational goals and generating cost savings (Hermanson & Rittenberg, 2003). Management may divert internal audit resources from providing assurance on controls toward operational audits and other ERM consulting related value-added services that produce immediate results (Hermanson & Rittenberg, 2003). This suggests that the internal auditor may spend more of its resources performing management consulting related activities than auditing controls, which may impact its independence and objectivity.

The key factor in deciding whether conflicts exist when the internal auditor performs its dual role of providing ERM consulting related value-added activities and assurance services is to determine whether the internal auditor assumes any management responsibilities, including managing risks. The conceptual framework proposes that the internal auditor’s independence and objectivity will not be impaired when it spend more time performing consulting related value-added activities relative to providing assurance on controls in companies with fully implemented ERM framework. Therefore, the following hypothesis is suggested:

**H2**: For companies with fully implemented ERM framework, an increase in the amount of time the internal auditor spends performing ERM consulting related value-added activities versus providing assurance on controls will not impair its independence and objectivity.
2.2.3 Separate Board Risk Management Committee and the Internal Auditor’s Reporting Role

Traditionally, organizations have not designated a function to manage risk or a board committee with oversight responsibilities for risk management. The audit committee and internal audit function have become increasingly involved in ERM, however, uncertainty exists as to whether these groups have the time and expertise to handle risk management issues. Fraser and Henry (2007) argued that because most risks have a financial component the internal audit departments or audit committees may be filling the gap. However, the importance of independent assurance raises the question of whether risk management and internal audit should be separated. The issue also arises as to whether the internal auditor may lose its independence and objectivity if it becomes too involved with the risk management process.

In recognition of the need for the internal audit function to maintain its independence and objectivity, several large organizations, especially in the financial services industry have established a risk management function and a separate and distinct board risk management committee. A risk management committee assists the board in exercising its responsibilities, as it allows for a sharper focus on risks and risk management by allocating additional time to the subject without competition from other topics on the agenda (Frigo & Anderson, 2009). According to Frigo and Anderson (2009), a separate risk management committee will allow risks and risk management to become the primary agenda focus, and not another topic on the list. A risk management committee can also result in increased transparency to the risk management process and can enhance directors’ understanding of the organization’s risks and the related risk management processes. A risk management committee comprising both executives and non-executives provides a broad spectrum of expertise, and is considered to be a more effective forum than the audit committee in monitoring the quality of risk management and creating a holistic approach for risk management. Furthermore, although internal auditors typically perform a risk assessment that involves most, if not all, the risk categories of the organization, and report the findings to the audit committee, the audit committee is more interested in assurance regarding controls.

Reporting channels are critical to the internal auditor’s independence and objectivity, hence the different structures and responsibilities create difficulties in what the reporting role of the internal auditor should be in companies with a separate and distinct board risk management committee. The IIA (2009) requires internal auditors to provide independent and objective assurance on the effectiveness of how well risks are managed, and whether internal control processes are operating, as required, to manage risks to an acceptable level. In recognition of the need for objective assurance, the IIA (2004) highlights the separation of internal audit from the risk management process, but did not address what the reporting relationship of the internal auditor should be in companies with a separate board risk management committee.

Risk management is a tool of management while internal audit is a tool of the organization (Frigo & Anderson, 2009). Thus, circumstances may arise where management seeks to channel internal audit focus away from a particular area of risk. If internal auditors report to the board risk management committee, they may be perceived as an extension of management, which could impact their independence and objectivity. Therefore, the question arises as to what the appropriate reporting role for the internal auditor should be in companies with fully implemented ERM framework and a separate board risk management committee. There are a variety of opinions about how the reporting relationship for the internal auditor should be structured. Some companies have established the internal auditor reporting to both the risk and audit committees. Other companies have established the internal auditor reporting to the audit committee and periodically to the risk management committee, while several organizations have structured the internal auditor reporting only to the audit committee.

It is important that internal auditors maintain a degree of independence and objectivity to ensure they are in a position to critically assess the effectiveness of risk management process and the adequacy of the internal control environment. Management has responsibility for implementing risk management processes and managing risks. Therefore, if management exercises significant influence over internal audit activities the potential exists for areas of inefficiency, and fraudulent activities to escape internal audit’s scrutiny (Frigo & Anderson, 2009).

In companies where the internal auditor reports to both the audit and risk management committees, the key to determine whether the internal auditor’s independence and objectivity may be impaired is to ascertain whether the internal auditor reports on managing risks to the risk management committee instead of on the adequacy and effectiveness of the risk management process. Since the internal auditor’s core role in ERM is to provide assurance on the effectiveness of management’s risk processes, the conceptual framework proposes that in companies with separate board risk management committee and fully implemented ERM framework, the internal auditor will report on the auditing of controls and the effectiveness of the risk management processes instead of on management.
assurance on risks, that is, managing risks. Therefore, the internal auditor’s independence and objectivity will not be impacted when it reports to a separate board risk management committee. Accordingly, the following hypothesis is suggested:

**H3:** In companies with separate board risk management committee and fully implemented ERM framework, the internal auditor’s independence and objectivity will not be impaired when it reports to the board risk management committee on auditing controls and the effectiveness of management risk processes versus management assurance on risks, that is, managing risks.

### 3. Method

#### 3.1 Proposed Conceptual Framework

In this study, a conceptual framework is proposed that can be used in future research to empirically examine whether potential conflicts exist with the internal auditor involvement in companies with fully implemented ERM framework, that is, whether the internal auditor’s independence and objectivity would be impaired when it becomes involved in ERM. According to prior literature, potential conflict with the internal auditor’s role is influenced by several variables including, performing its dual role of assurance on controls and consulting services. Leading and maintaining role in the ERM framework, and reporting to a separate board risk management committee are variables that may also impact the internal auditor’s independence and objectivity.

To empirically examine the conceptual framework, I propose that future research can use survey questionnaires to collect data and OLS regression to test the hypotheses. The questionnaires should be prepared in accordance with quality control requirements for questionnaire design, and distributed electronically with a cover letter through the IIA to its members that are registered as CAEs.

#### 3.2 Participants

To collect information on whether potential conflicts exist with the role of the internal auditor involvement in companies with fully implemented ERM framework, I propose that an e-mail based survey questionnaire should be prepared in accordance with quality control requirements for questionnaire design (Dillman, 2000; Oppenheim, 1992; Preece, Rogers, & Sharp, 2002). The survey should be administered electronically as an attachment to a cover letter e-mail through the IIA to its members who are registered as CAEs (Beasley et al., 2005) within the USA.
3.3 Questionnaire Design
I propose that the questionnaire be designed with five sections as follows:

1. The first section should contain questions that can be used to test the hypotheses (H1 – H3);
2. the second section should contain biographical questions about the CAE, CEO, and CFO background;
3. the third section should contain questions about the characteristics of the company’s audit committee, and internal audit function;
4. the fourth section should contain questions about the company’s board risk management committee; and
5. the fifth section should contain questions about the overall company.

3.4 Research Design
To empirically test the hypotheses (H1-H3) in future research, I propose that the following OLS regression model be used:

$$\text{Impairment of IA INDEP} \& \text{ OBJ} = f(\text{IA Leads & Maintains ERM, IA Dual Role in ERM, IA Report to RMC, ERM Fully Implemented, AC Request, CEO Request, CFO Request, Years as CAE, LNREV, Banking, Education})$$

where

$$\text{Impairment to IA INDEP} \& \text{OBJ} = f(\text{IA Leads & Maintains ERM, IA Dual Role in ERM, IA Report to RMC, ERM Fully Implemented, AC Request, CEO Request, CFO Request, Years as CAE, LNREV, Banking, Education})$$

3.4.1 Definition of Variables
3.4.1.1 Dependent Variable
The dependent variable, Impairment of IA INDEP & OBJ addresses the question, “Do potential conflicts exist when the CAE becomes involved in ERM?” (i.e., is the CAE independence and objectivity impaired in its involvement...
with ERM). Respondents should be provided with an 11-point scale with 1 = will not be impaired, 6 (the mid-point) = no effect, and 11 = will be significantly impaired. The higher the score the greater is the likelihood that the internal auditor’s independence and objectivity will be impaired.

3.4.1.2 Independent Variable

The main independent variables: IA Leads & Maintains ERM, addresses the question, “Is the internal auditor’s independence and objectivity impaired when it is highly involved in leading and maintaining the ERM framework, and at the same time performing its core role of auditing controls?” This variable measures the extent to which the CAE has been active in providing ERM leadership and maintaining ERM, and at the same time performing its core role of auditing controls in a company with a fully implemented ERM framework. Respondents should be provided with an 11-point scale with 1 = highly involved in performing IA roles considered as core (Category 1) as well as those with safeguards (Category 2), 6 (the mid-point) = no effect as CAE involvement is low as it performs only IA roles considered core (Category 1), and 11 = highly involved in performing IA roles considered as core (Category 1), those with safeguards (Category 2), and roles with a threat to the internal auditor’s independence and objectivity (Category 3). The higher the score the greater is the likelihood that the internal auditor’s independence and objectivity will be impaired.

The variable, IA Dual Role in ERM addresses the question, “Is the internal auditor’s independence and objectivity impaired when it performs its dual role of providing ERM consulting related value-added activities and providing assurance services in companies with fully implemented ERM framework?” This variable measures the number of hours the CAE spends performing its dual role of providing assurance services versus ERM consulting related value-added activities in a company with a fully implemented ERM framework. That is, whether the CAE is assuming management responsibilities (managing risks) or providing assurance on controls. Respondents should be provided with an 11-point scale with 1 = spends more hours providing assurance services versus performing ERM consulting related value-added activities (managing risks), 6 (the mid-point) spends the same number of hours performing ERM consulting related value-added activities (managing risks) and providing assurance services, and 11 = spends more hours performing ERM consulting related value-added activities (managing risks) versus providing assurance services. The higher the score the greater is the likelihood that the internal auditor’s independence and objectivity will be impaired.

The variable, IA Report to RMC addresses the question, “Is the internal auditor’s independence and objectivity impaired when it reports to a separate board risk management committee on management assurance on risks, that is, managing risks, versus reporting on auditing controls and the effectiveness of management risk processes?” This variable measures the type of information that the CAE reports to the board risk management committee. That is, whether the CAE reports on management assurance on risks (managing risks) versus on auditing controls and the effectiveness of management risk processes. Respondents should be provided with a 5-point scale with 1 = reports on auditing controls and the effectiveness of management risk processes versus on management assurance on risks (managing risks), and 5 = reports on management assurance on risks (managing risks) versus on auditing controls and the effectiveness of management risk processes. The higher the score the greater is the likelihood that the internal auditor’s independence and objectivity will be impaired.

Other independent variables include: ERM Fully Implemented, AC Request, CEO Request, CFO Request, Years as CAE, LNREV, Banking and Education. These variables are similar to the variables used in (Beasley et al., 2006).

ERM Fully Implemented = a value of 1 if the ERM framework is fully implemented in the company; otherwise 0. The variables AC Request, CEO Request, and CFO Request measure the extent to which the audit committee and senior management have requested “greater internal audit activity in ERM consulting related services. Respondents should be provided with a 5-point scale with 1 = no request, and 5 = a large number of requests. Years as CAE measures the number of years the CAE is in place. LNREV measures the natural log of the company’s most recent annual revenues, first expressed in millions of U.S. dollars.

Industry variables for Banking and Education are included to determine whether industry is associated with the impact of ERM on internal audit. Banking = a value of 1 if the company is in the banking industry; otherwise 0. Education = a value of 1 if the company is in higher education; otherwise 0.

4. Conclusion

In summary, this paper discusses the relationship between the internal auditor’s independence and objectivity being impaired (i.e., potential conflicts with the internal auditor’s role in ERM) with variables that influence the internal auditor’s involvement in ERM. As suggested, the variables that might impact the internal auditor’s independence and
Objectivity in companies with fully implemented ERM framework are the internal auditor playing a leading and marinating role in ERM, performing its dual role of assurance on controls and ERM consulting related services as well as reporting to a separate board risk management committee. Three hypotheses are developed under the proposed conceptual framework that can be empirically tested in future work. The author proposes using survey questionnaires distributed electronically through the IIA to its members who are CAEs to collect data and using OLS regression model to test the hypotheses. The empirical results will contribute to the emerging literature on the role of the internal auditor in ERM and its implications for the internal auditor’s independence and objectivity. The empirical study will also address the call by (Stewart & Subramaniam, 2010) for future research in this area. Future studies should also examine ERM effectiveness, and the role of SOX in ERM.

References


