

# **The role of internal audit function in corporate governance: an empirical study on commercial banks in Lebanon**

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## **INTRODUCTION**

The need to focus on improving corporate governance has increased in many developed and developing economies during the past few decades, especially in the wake of economic collapse and financial crises (Brown & Caylor, 2006). According to the comprehensive report submitted by the Organization of Economic Cooperation and Development (OECD) in 2004, Corporate Governance is defined as the supervision and guidance system adopted by the company. It is also a key element in improving economic efficiency and economic growth in addition to strengthening investor confidence. Corporate governance includes a set of relationships between management, board of directors, shareholders and other stakeholders. It also provides a structure to determine the means to achieve the company's goals and to monitor the performance within the company. Good corporate governance should provide proper incentives to the Board of Directors and the company's management to seek to achieve the goals that are in the interest of the company and its shareholders and should facilitate effective control (OECD, 2004).

The elements of corporate governance include the audit committee, external auditor, internal audit, and the Board of Directors. In addition, other parties can be included, such as shareholders and professional organizations and other stakeholders (Staciokas & Rupsys, 2005). To secure the operations of governance of a strong company, there must be cooperation between the various components of the system of governance, internal auditors, executive management, financial management, board of directors, shareholders and external auditors (ECIIA, 2005). Several studies indicated that the role of internal audit in governance must take precedence over other internal audit activities, see (Audrey et al., 2004; Cohen et al., 2004; Laker, 2004 ; Prawitt et al., 2009). According to Okafor & Ibadin (Okafor; Ibadin, 2009) that the internal audit exercise a critical role in improving corporate governance in organizations.

To achieve the quality of governance, the company must focus on all cornerstones of corporate governance and in particular the internal audit function. It assesses the commitment to the ethics of the organization and its goals, programs and activities. It is also an important source to other cornerstones such as the external audit, the Audit Committee, Board of Directors and senior management. The internal audit function is to control and maintain the quality of corporate governance. This research focuses on the role of the internal audit function in corporate governance in commercial banks in Lebanon.

## **OBJECTIVE OF THE STUDY**

This research aims to examine the role of the internal audit function in corporate governance in commercial banks in Lebanon. The paper focuses on examining the relationship between each element of corporate governance and internal audit. This will be done through the analysis of a literature review to develop hypotheses that highlight the degree of influence of the quality of the internal audit function on the quality of corporate governance. The importance of this research is that it fills a gap in the studies on the relationships between internal audit and other elements of corporate governance in commercial banks in Lebanon. In practice it will help workers in internal audit department in commercial banks in Lebanon to focus on the features of quality of internal audit function. An empirical study is conducted for that purpose to answer the following research questions:

- Does the quality of the relationship between the internal audit function and the audit committee improve the quality of the internal audit function in the commercial banks in Lebanon?
- Does the quality of the relationship between the internal audit function and external audit improve the quality of the internal audit function in the commercial banks in Lebanon?
- Does the quality of the relationship between the internal audit function and senior management improve the quality of the internal audit function in the commercial banks in Lebanon?
- Does the availability of other determinants of the quality of the internal audit function, like independency and objectivity, and the proper size of the internal audit department, and the presence of experienced and qualified internal audit team, improve the quality of the internal audit function in the commercial banks in Lebanon?
- Is there a positive relationship between the quality of the internal audit function and improving the quality of corporate governance in commercial banks in Lebanon?

## **METHODOLOGY**

For the collection of data, a questionnaire is randomly distributed among internal auditors within various commercial banks in Lebanon. These banks don't include merchant banks, housing banks and the National Bank for Industrial Development and Tourism. Analysis of the data will be based on the defined elements of corporate governance and their relationship with internal audit. Preliminary statistical analysis found several significant tests supporting the hypothesis that the quality of the internal audit function improves the quality of corporate governance.

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