Internal audit in Lithuanian commercial banks: an important part of corporate governance or just another department?

Kristina Karmanova

Uppsala University
Department of Business Studies
Program: Master in Accounting, Auditing and Analysis
Supervisor: Karin Brunsson
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Abstract:

**Purpose**: the purpose of the thesis is to find out how Lithuanian commercial banks position their internal audit function within their organizational structure to overcome the tension of working with the management and keeping the distance to be able to report on them at the same time; and is internal audit function considered as one of the cornerstones of corporate governance. Moreover, comparison of banks is made to inspect any patterns, differences and similarities concerning the origin of the capital.

**Method**: to answer the research question a qualitative approach was chosen: analysis of audited financial reports in the period of 2008-2011, organizational statutes and all available public information in 7 Lithuanian commercial banks is performed. Moreover email-interviews were held with all chief internal auditors.

**Findings**: the internal audit function in Lithuanian commercial banks is not considered as one of the cornerstones of corporate governance – the function only participates in the corporate governance through the audit committee. Threats for independence are mitigated by giving the responsibility to the audit committee to appoint and dismiss the chief internal auditor and to approve the annual audit plan; and by composing the audit committee with at least one financial expert. Moreover, there is no clear pattern or distinction between internal audit positioning in foreign-capital and Lithuanian-capital banks.

**Concluding remarks**: the need for improved controls is a very important issue in the public debate. The position that internal auditors are put in nowadays is very challenging – internal auditors are expected to provide both assurance and consulting services and maintain their independence at the same time – and organizations handle it differently.

**Keywords**: Internal audit, Audit committee, Management, Independence, Objectivity, Lithuania, Commercial banks.
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THE NEED FOR INTERNAL AUDIT FUNCTION

Since yet another Lithuanian bank “Ūkio Bankas” recently went bankrupt primarily because it was discovered that their operations were too risky, it has become very important to know that Lithuanian commercial banks have a proper and effective risk management system and that it is well taken care of.

Organizations have many assurance providers including, but not limiting to, external auditors, risk management, compliance, quality assurance, IT functions and internal auditors. In some organizations the role of internal auditor does not get widely recognized, because of its intangible nature. Change in the environment leads to new risks, which in turn create the need for new internal controls in order to manage these risks. According to Sarens and De Beeld (2006) this creates an opportunity for internal auditors to play an influential role.

The requirements to improve corporate governance systems within organizations appeared after accounting scandals and corporate disasters, such as Enron, WorldCom, Parmalat, happened. As Savčuk and Tamošiūnienė (2007a) write, these scandals were often accompanied by questions concerning where auditors, members of the board and regulators were. It is obvious that no organization can afford the costs of governance failures. This is where internal auditors come in to the picture, playing a very important role. Jeffrey et al. (cited in Savčuk and Tamošiūnienė, 2007a) empirical study proved that the existence of efficient audit leads to higher quality of financial statements and that losses, caused by fraud, were lower when companies had an internal audit function. Moreover, Rupšys and Boguslaukas (2007) state that a knowledge economy has transferred specialized contemporary organizations into knowledge-intense and information-dependent systems, which require specific internal controls.

According to Norman et al. (2010), in corporate governance the internal audit function is considered to be one of the four cornerstones, together with: senior management, the board of directors and external auditors. Traditionally the role of internal auditors was assurance related – to provide assurance to the board that management is working in the best interest of the organization (Limmroth, 2012). With internal auditor’s growing role in modern corporate governance, independence has gained renewed attention and the Institute of Internal Auditors (IIA), a guidance setting body for internal audit activities, has promoted the internal audit function as an independent function that provides both assurance and consulting services (IIA, 2003). Regolosi and d’Eri (2012) devote the internal audit function as being the most appropriate solution to meet objectives of assurance and consulting audit. The IIA puts an emphasis on the importance especially for major corporate governance actors to understand the value that internal auditors bring to organizational operations by identifying opportunities to enhance efficiencies and effectiveness (IIA, 2009).

Organizations have different views regarding their staff: an internal auditor can either be perceived as a profession in its own right, or as a rotational training ground for organizational leaders (Anderson et al. 2012). In some organizations internal auditors may serve in a consulting capacity, while in other organizations such activities might be prohibited. Therefore, IIA published the best practise guidelines in order to ensure internal audit independence. IIA is suggesting a dual reporting relationship: to report functionally to the audit committee and administratively to the CEO or the management (IIA, 2012b).
**Problematization**

Audit services are intangible in their nature; therefore, it is difficult to evaluate them and there is the need to clearly define them. Internal audit activities should follow the Institute’s of Internal Auditors (IIA) standards. The IIA, established in 1941, is a guidance setting body for internal audit activities. The current definition of internal auditing, provided by the IIA (2003), is 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.*

Assurance services are independent services that shall improve the quality of information for decision makers. The scope of assurance service is: to evaluate risk exposures in governance, operation and information systems; assess the effectiveness and efficiency of operations; safeguard the assets and perform financial, compliance and system security audits. The scope of consulting service is to provide operational advice to the management. The consultancy role includes analysis of situation, risk analysis and evaluation, developing potential solutions to the problems and training programs for other employees of the organization (IIA, 2003; HM Treasury, 2010). Internal auditors should be important providers of independent evaluations of internal control and risk management – hence, assurance – which is, or can be, combined with more practice-oriented management assistance – hence, consulting (Sarens and De Beelde, 2006). This definition now requires internal auditor to assume a consultant’s role and be a participant while straying away from the traditional independent reviews (Haron et al., 2012). They now appear also as a team of administrative help.

Holt (2012) mentions that some chief internal auditors are now anxious to return to the traditional oversight role and assurance activities, claiming that failure to address strategic, compliance and operational risks undermines effectiveness of internal auditing, diminishes their value to stakeholders and exposes organization to higher operational and financial risks in the future. Holt’s statement somehow implies that internal auditors cannot do both and that adding consulting activities leaves no, or much less, time for assurance services. Allocating more resources for internal audit and expanding internal audit department within the organization can probably solve this problem, according to Anderson et al. (2012). It is important to note that consulting services were added but did not replace assurance services.

The problem that internal audit definition, provided by the IIA, creates is that there is no absolute distinction between consultancy work and assurance work. It is also possible that assurance work may create the need for consultancy work as well as having an in-built consultancy element by making recommendations. Similarly, HM Treasury (2010) write that consultancy work enriches and makes a contribution to the overall assurance that can be delivered.

In practice it is a very difficult task, when internal auditors are expected to serve management and control it at the same time. This, however, does not just create an expectation gap, but somehow fades away the illusory mask of independence that auditors are supposed to wear (Norman et al., 2010). Management evaluates internal audit performance and can promote internal auditors to the
higher positions within organization (ibid). At the same time, in some organizations internal audit is like a training ground for the future, and management becomes possible future bosses (Christopher et al., 2009). The essential part, stated by Christopher et al. (2009), is that the internal audit function must be free from influence or interference from management, but an additional problem arises when many managers are seeing the internal auditor’s work and that they are reporting to the audit committee only as a formality in order to satisfy corporate governance requirements. It is within these areas that the impairment of the internal audit function’s independence poses a threat (ibid).

After the issue of Sarbanes – Oxley act (passed by the U.S. Congress in 2002 to increase transparency, protect investors and prevent accounting fraud, which require internal controls to be assessed and audited), the internal audit function has shifted away from traditional assurance services towards consulting. This created a conflict between assisting management and the need of objectivity and independence to provide assurance (Holt, 2012). The independence problem is widely discussed because of all the corporate scandals in the 2000s, which implies that management, that is keen on committing fraud, could use the internal audit function for its own benefit to possibly hide their fraudulent activities.

To secure the internal auditors’ independence their function has to be properly positioned within the company’s structure. But it is difficult to define what is ‘proper’ for different organizations. This is why it is up to every organization to decide what kind of work they want from their internal auditors. The Sarbanes – Oxley Act (2002) requires audit committee’s oversight over financial reporting and also mandates reporting on internal controls (Abbott et al., 2010). Even though internal audit participates in both the internal control structure and the financial reporting process, the Sarbanes – Oxley Act does not state requirements for internal audit. Therefore, internal auditors are faced with a problem of how to overcome the tension of working together with management to improve performance while at the same time remaining sufficiently distant from management in order to report on their performance.
The aim and the construct of the study

According to Maxwell (2008) anyone can find an empirically answerable but not yet answered question to which the answer is not worth knowing, implying that the purpose of the study has to be interesting and relevant. I have distinguished the relevance of the study among three kinds of goals: personal, intellectual and practical goals (ibid.). Personal goals are based on a curiosity about internal audit’s state in Lithuanian commercial banks. At the same time, these goals overlap with intellectual goals, which are focused on understanding problems in internal auditing, gaining insight into what is going on in this field nowadays and why it is happening.

Additionally, these personal goals overlap with practical or research goals, which are focused on accomplishing something – in this case, meeting the need for research in internal audit in Lithuania. Very little has been researched in internal audit function in Lithuania and it is still a relatively young profession across organizations. The latest study on internal audit in Lithuania was done in 2007 (Savčuk and Tamošiūnienė, 2007b), but since July 2008 Lithuanian companies are required to have an audit committee. Moreover, the Lithuanian environment is very different from the Anglo-American, where this profession is more developed (Sarens and De Beelde, 2006). Moreover, another practical goal is based on contribution to the research on internal audit in banks. Banking industry is very important as it has a big impact on the economy and this makes the banking sector more problematic.

The aim of this study is addressed to the problem, defined in the previous section, and is formulated as the need to find out how Lithuanian commercial banks position their internal audit function within their organizational structure to overcome the tension of working with the management and keeping the distance to be able to report on them at the same time. To reach this aim, I have interviewed chief internal auditors in all 7 Lithuanian commercial banks via email and, in order to provide an adequate qualitative analysis, I collected relevant documents: companies’ statutes, audited financial reports for the years 2008-2011 and other publicly available information.

The paper is structured as follows. The next section deals with the role of internal auditors in the corporate governance process and gives an overview of the empirical studies existing in this area followed by the formulation of the research question. The fourth section provides an overview of internal audit’s development and current state in Lithuania. Next follows the thorough explanation of the research method, empirical findings from the interviews and document analysis. Conclusions are presented in the final section, which also includes limitations and suggestions for future research.
CONCEPTUAL FRAMEWORK

This section of the paper provides the constructed overview of prior research findings on internal audit, which also informs and guides towards the research problem. It is not just the informative literature review, which, as Maxwell (2008) puts it, would be focused on ‘covering the field’. It is rather focusing specifically on the research that is particularly relevant to the study.

**Difference in internal and external auditors**

Internal audit has relations to other professions, such as: Chief Internal Controls Officer (providing recommendations for internal controls effectiveness improvement); Risk managers (internal auditor’s role is to evaluate the company’s risk management); Compliance officers (whose responsibility it is to oversee and manage compliance issues within the organization); Controller (business controller is involved in day-to-day events, just as internal auditor is as well, but the later has a wider view, looking into the future) and most importantly External auditors (internal audit’s problems are similar as for external audit: advocacy (consulting) role while still maintaining independence and objectivity (Ahlawat and Lowe, 2004)). In order for these two audits not to be compared, there is a need to define differences between internal and external audit (Spencer Pickett, 2011):

- Internal auditors train and educate the others to do a better job instead of doing it themselves (in a sense, internal auditors can be called the ‘invisible heroes’). External auditors get the responsibility to do the checking on internal audit activities, amongst other check-ups.
- Internal auditors cannot be independent from the entity (they are hired by the company) and have their objectives set by the entity, whereas external auditors can and have to be independent and have their objectives set by the regulators.
- Internal auditors serve the entity; external auditors express an opinion on the financial statements of the entity.

External auditors’ reliance on an internal audit function is very complicated and context specific (Abbott et al., 2012). When external auditors conduct the audit they need to study and evaluate not only the internal control system but also the internal audit function, in order to determine internal audit activities of convenience for the purpose of planning the audit procedure (Haron et al., 2012). SAS No. 65 (i.e. Statement on Auditing Standards “The Auditor’s Consideration of the Internal Audit Function in an Audit of Financial Statements”) directs external auditor to consider continuing education of internal auditors (Abbott et al., 2012). The standard also directs the external auditor to evaluate the internal audit function’s oversight status. In some cases the external auditor takes direct assistance from internal auditors, but before using internal auditor’s provided reports the external auditor has to make sure if the internal audit function is objective; if it has sufficient technical competence; if work is carried out with professional care and that communication will be effective (Abott et al., 2012).

Both external and internal auditors provide assurance, but to different parties: an external auditor provides assurance to shareholders, whereas internal auditor – to the board (via the audit committee) (Christopher et al., 2009). The reason for assurance gap is that internal auditors belong
within internal control of the entity and their work can only be used to reduce the control risk. Thus, internal auditor cannot help external auditor with detection of risk; external auditors have to understand the entity themselves. In the end, external auditors cannot work with internal auditors when they do substantive procedures and external auditors have to test each piece of internal information.

Furthermore, there is a need to clearly set the difference in objectives of internal and external audit. An external auditor tests the underlying transactions, which form the basis for the financial statements. On the other hand, the internal auditor seeks to advice management on the effectiveness of risk management and internal control system (Spencer Pickett, 2011) as well as provide assurance to the board about management’s activities. Even though it might seem that external and internal auditors are doing similar jobs – just because they are both called auditors – responsibilities and objectives are clearly different and external actors should understand the necessity of both functions within the governance processes.

**Corporate governance structure and internal auditor’s role in it**

In order to fully understand the internal auditor’s role in the organization, there is a need to understand the corporate governance system as a whole. Corporate governance is the system by which companies are directed and controlled (involves a set of relationships between company’s management, board, shareholders and other stakeholders). It is a very hot area with all the corporate scandals and failures happening (e.g., Enron, WorldCom, HQ Bank) that had a terrible effect on stakeholders. These scandals lead to a decrease of trust in accounting and auditing systems. Therefore, Sarbanes-Oxley act was passed by the U.S. Congress in 2002 to increase transparency, protect investors and prevent accounting fraud (SOX, 2002).

K. H. Spencer Pickett (2011) explains the corporate governance model with principal – agent relationships: the owners are principals for the board of directors, which is the principal for the management. Moreover, the internal auditor is an agent for the board, appointed to check up on the management’s implementation of internal control system, and the external auditor is an agent for the owners, appointed to provide assurance for the financial information. Internal auditors are accountable to the board, but at the same time they have a reporting line to the management. This structure gets more complicated when both internal and external auditors provide additional consulting services for the management that sets a base to question their independence and objectivity.

After the before mentioned scandals internal control is positioning itself in the core of the business, of the control system and effective governance. In other words, internal auditors are intermediates that join the board, external auditors and the management to a consistent corporate governance system. According to Spencer Pickett (2011) the internal audit is likely to be the only function in the company that has a deep and close understanding of risk and control. Therefore, an internal auditor has two main responsibilities: to provide advice to the management and objective and independent assurance to the board about the effectiveness of internal controls and other risk management activities.
Internal audit characteristics

After the accounting and internal control failures of Enron, WorldCom, etc. many internal auditors concentrated on reporting controls and Sarbanes – Oxley act (SOX, 2002) compliance. However, the function has refocused on broader risk management and control issues (Anderson et al. 2012).

“Internal auditors review and appraise the adequacy, effectiveness and efficiency of the internal control system in order to provide its independent opinion on it” (Sarens and De Beelde, 2006, p. 72). Instead of only watching and rejecting, the internal auditor’s consulting role is an active involvement in the development, reengineering and facilitation of control-self-assessment, which is performed by the management (Sarens and De Beelde, 2006). By playing this role internal auditors are trying to transfer their knowledge to the managers. But it has to be clear that business unit must take over the responsibilities as soon as they are competent enough.

Mahzan et al. write that “there has always been a question as to whether internal auditors would be more empowered if they think of internal audit as a profession in its own right; supported by the organisation they serve, rather than as some type of stepping stone into corporate management” (2012, p. 74). Authors continue arguing that empowerment is stronger when the internal audit function is embedded into the regulatory framework. Even though some authors (namely Sarens et al., 2012) state that the internal auditor’s role in the corporate governance is mainly played via its relationship with the management and the audit committee, more often internal audit is seen as one of the four cornerstones of corporate governance, together with the management, the board and external auditors (Gramling et al. 2004; Holt, 2012; IIA, 2003; Mahzan et al. 2012; Sarens et al., 2012; García et al., 2012).

Among the cornerstones of corporate governance internal audit has historically been perceived as a function, that fulfils internal information needs (Regoliosi and d'Eri, 2012). But more recently Regoliosi and d’Eri (2012) have characterised internal audit as an activity, which serves all corporate governance bodies. The internal audit function is in charge of exercising oversight over the effectiveness of the chosen corporate governance and risk assessment models (Regoliosi and d’Eri, 2012). Christopher (2012) even states that internal audit is the cornerstone on which effective corporate governance is built.

Internal auditing should evaluate and also contribute to the improvement of control, risk management and governance (IIA, 2009). With the rise of internal control development, internal auditing becomes more and more significant (Sarens and De Beelde, 2006). Internal auditors are exhorted “to embrace the opportunity to contribute to the achievement of corporate objectives through risk management” (Sarens and De Beelde, 2006, p. 66). Moreover, they should demonstrate the potential to add value in order to break away from historical characterization as ‘watchdogs’ and ‘policemen’. In other words, a proactive (consulting) role creates new ways to demonstrate value. Internal auditors have a duty to the governance and therefore they must educate both the management and the board on this duty. It is a support service to the organization (Limmroth, 2012). Yet, to this day organizations struggle to understand if they make appropriate investments in internal audit, because of the heterogeneity of different internal audit functions, which makes it difficult to make informed decisions over internal auditor’s role in the corporate governance structure (Anderson et al. 2012; Holt, 2012).
Management and boards of organizations are theoretically inclined to show their increased reliance on internal auditors to assist them toward meeting their-own governance accountabilities (Christopher, 2012). According to Mahzan et al. (2012) there is a need for the regulators and the organization’s governance structure to provide internal auditors with clear authority and to identify their roles and responsibilities, because otherwise role ambiguity can lead to internal auditor feeling incapacitated. Authors ground this argument by stating that internal auditors with higher authority may receive higher recognition and therefore have less role ambiguity. Mahzan’s et al. (2012) findings revealed that role ambiguity was negatively associated with the job performance of internal auditors. Moreover, internal auditors seem to enjoy the authority over and the independence from the management (Peursem, cited in Mahzan et al., 2012, p. 91). Internal audit authority should be established through a proper internal audit function positioning within the corporate governance structure.

The importance of internal an audit function within the organization can also be justified with the fact that a strong internal audit function is a deterrent to financial reporting irregularity in the presence of unambiguous potential GAAP (i.e. Generally Accepted Accounting Principles) violation (Arel et al., 2012). Krogstad et al. (cited in Sarens et al., 2012, p. 192) state that internal audit function is bringing a systematic, disciplined approach to the evaluation and improvement of the effectiveness of internal control, risk management and governance processes. There are no requirements on how big the internal audit department should be, because the size alone does not address the efficiency of the function companies must look at their individual risk profile to make staffing decisions. In general, those that face a large number or particularly complex risks would require a range of specialists and expertise (IIA, 2009).

To sum up, roles are constantly evolving, but in general the internal auditor’s role is to assists all members within the management team and the directors by furnishing them with appraisals, recommendations, analyses and comments concerning activities reviewed (Mahzan et al., 2012). It also depends a lot on internal auditors themselves and how they want to present themselves to their colleagues: a ‘policeman’/‘watchdog’ or in a more friendly manner, showing that they are there to help improve, by creating risk and control awareness on behalf of both the management and the board (Sarens and De Beelde, 2006). However, the major assurance task for internal auditors remains to be the provision of an objective and independent evaluation of the internal control system. This is considered to be the core business of internal audit.
**In-house vs. outsourced internal audit activities**

Organizations can choose whether to establish an in-house internal audit section or outsource these activities to a third party. Outsourcing internal auditing activities have become popular since the mid-1990s, and researchers have found that the quality of services provided by third parties is at least as high as that of in-house services (Anderson et al., 2012). It all depends on what the organization wants from the internal auditor. For full potential – in-house internal auditors have proved to be more efficient, because they are witnessing the whole fiscal year and they can bring an up-close and personal perspective on results of organization’s operations (IIA, 2009). Internal auditors can become a very valuable resource to the audit committee in their oversight role for accuracy, disclosure and financial completeness. But in cases when internal audit function within the company is established solely for control assurance – outsourced internal auditors tend to focus mostly on risks and in turn raise less concerns about their independence (Abbott et al., 2010); in other words, their objectivity is less questioned.

Operational audit (which reviews the functioning of the organization’s management and operational procedures) is the most common mission of in-house internal audits (Abbott et al., 2010). However, it is the least common for outsourced services (Anderson et al. 2012). Thus, the organization needs to clearly understand what function they want their internal auditors to perform. The organization can benefit from employing personnel who have specific expertise in internal auditing. This way an internal audit function may be able to achieve its objectives with fewer professionals (Anderson et al., 2012). Chief internal auditor’s experience influences his/her relationship with senior management and the board of directors (Anderson et al. 2012). The Certified Internal Auditor (CIA) designation is the only certification for internal auditors that is globally accepted (Anderson et al. 2012); therefore, it enhances perceived professionalism and to some extent makes the profession more trustworthy. Moreover, it communicates the ability of becoming a key player in organizational success, hence, play a vital role in the corporate governance structure (IIA, 2003).

Abbott et al. (2012) mention that the objectivity of the in-house internal auditors may be impaired, particularly because they may be accountable to management for access to various resources and a possible promotion. Mahzan et al. (2012) are also consistent with this view claiming that the nature of employer-employee relationship may provide the environment in which decisions and views of internal auditor can be influenced inappropriately.

Despite all those differences, Mahzan et al. (2012) conclude that there are only minor feature differences between in-house and outsourced internal auditors. The perception that outsourced internal auditors have greater objectivity comes from the cases when outsourced internal audit hours result in a larger reduction of audit fees in comparison with in-house hours (Abbott et al., 2012). However, empirical results removed this possible benefit for the company with the inclusion of organisational oversight status and budgetary resource measures (Mahzan et al. 2012).
**Development of the internal audit function**

The development and changes of the internal audit function is evident: the traditional oversight function (watchdog of controls) is replaced by the value-adding business advisor, through prevention of problems and identification of potential risks (Ahlawat and Lowe, 2004). Within years the internal auditor’s role has moved from being an inspector to a very beneficial occupation as the quality monitoring and, according to Abbott et al. (2010), the importance of the roles of both internal audit function and audit committee in monitoring control activities have grown in recent years. It is becoming a very different profession from what it was in the past and it requires new talents. The change was necessary because traditional internal audit activities were not able to meet evolving needs of organizations (Regoliosi and d’Eri, 2012).

There is now an increasing pressure for the internal auditor to add “value” (Peursem, 2005). Christopher et al. (2009) also write about growing internal auditor’s responsibilities: growing demand for greater accountability, independence and objectivity. Doubts about internal auditor’s independence and objectivity have persisted after the Sarbanes – Oxley act (Norman et al 2011). Even in the U.S. it took 60 years for the boards to start value the importance of internal auditors (Makara and Palubinskienė, 2004).

Spencer Pickett (2011) describes changes in the internal audit function’s focus and its consequences through the changes in lines of defence. The first line of defence is risk taking (to own risks and controls; implement internal control; execute measures and control). The second line of defence is risk monitoring (risk control; compliance and other control functions – independent from the business). Finally, the third line of defence is risk assurance/controlling (evaluate framework and governance; report to the board of directors). According to “IIA Sweden” representatives (Hjelm and Schöldström, 2012), the internal audit function is moving towards a pure third line of defence. Thus, the assurance gap appeared when the focus changed from “internal control testing” to “end-to-end process audits”. Current demands for internal audit functions to close the assurance gap are: to provide reliable assurance, high efficiency and make an impact on the business, by focusing on root causes, proven methodology and tools and innovative ways to provide assurance for critical issues (Spencer Picket, 2011).

**The internal audit function and the audit committee**

The audit committee is another cornerstone in the corporate governance process; therefore, it is necessary to establish the relationship between these two parts of corporate governance. The existence of audit committee is a protection for the shareholders (Haron et al., 2012). Members of audit committee must have the skill, experience, and the ability to evaluate and monitor internal control systems (Haron et al., 2012).

Garcia et al. (2012) defined effective audit committee as the one that “has qualified members with the authority and resources to protect stakeholder interest by ensuring reliable financial reporting, internal controls, and risk management through its diligent oversight efforts” (p, 308). Their results indicated that audit committees are more effective if they are composed of independent directors.
The Sarbanes–Oxley Act (2012) recommends a minimum of three members. It is necessary to mention that more members do not necessarily mean more assurance, because smaller committees are usually better coordinated (García et al., 2012). Having more members on the audit committee may increase the opportunity to discuss relevant issues, but having too many members can result in a biased opinion (García et al., 2012). Another important note was made, that more frequent committee meetings are more effective; therefore it is suggested that audit committee should meet at least four times per year (Anderson et al. 2012; Sarens and De Beelde, 2006).

Common sense and objectivity are stated to be two essential attributes of members of the audit committee (IIA, 2009). Moreover, in order to properly assist and advise, it is essential for at least one member to have the necessary financial expertise. Ideally, the audit committee should contain a majority of non-executive directors, because it should help obtain honest feedback on the performance of financial management, whereas the presence of executive directors may inhibit discussion of sensitive issues.

Good relationship between internal auditors and the audit committee is necessary for effective internal control assurance and can in turn improve the quality of financial statements (García et al., 2012). In other words, the internal audit function and the audit committee should work together as complements to each other to ensure effectiveness.

The board of directors is responsible for making sure that the company fulfils its statutory duties, the main of them being the preparation of the accounts and reports. To fulfil its formal task, the board must make sure control is working. A part of the board, an audit committee, is mainly responsible for reviewing the external audit process (even though an external auditor is not accountable to the board); considering the adequacy of systems of internal control and risk management; appointment of internal auditor and assurance that internal audit function operates within the standards – in other words, internal audit oversight. This mandates the audit committee to have an in-depth understanding on how the organization’s internal audit is functioning and what are the best practices of the internal audit function. Overall, the responsibilities of the audit committee include monitoring and oversight over the entire audit process, which includes internal audit activities.

Although, in general, the audit committee is expected to have a stronger focus on risk than management (Sarens and De Beelde, 2006), the standards of IIA indicate that the chief internal auditor should communicate their internal audit budget and plan to the audit committee for review and approval (IIA, 2009). The study of Anderson et al. (2012) has discovered that internal audit function’s size is positively associated with better audit committee governance, the size of audit committee, the frequency of meetings with the chief internal auditor and the oversight role, when it comes to approving the internal audit budget. Moreover, Regoliosi and d’Eri, (2012) argue that the internal audit’s budget mostly depends on the size of the organization, the degree of leverage, finance-related and accounting-related variables and whether the accounting committee is responsible for the supervision of the internal audit function.

Therefore, audit committee’s oversight provides an important monitoring function regarding the resources needed and activities that internal auditor intends to perform. It has been found that the internal audit budget tends to be larger when it is reviewed by the audit committee (Anderson et al.
Both audit committee and management are often seeking for more than financial statement compliance, and those internal audit functions that respond to it are in turn rewarded with more resources, most likely because it is perceived that they would deliver more value (Anderson et al. 2012). Limited resources are major constraints for internal auditor’s possibility to play a significant role and ability to work thoroughly (Sarens and De Beelde, 2006).

Strong audit committee (one that asks hard and important questions; raises issues) contributes to effective internal audit (Peursem, 2005). Moreover, IIA believes that effective audit committee allows internal auditors to maintain their independence and objectivity (Norman et al. 2011). But the relationship between internal audit and audit committee is not ‘one-way’. Norman et al (2011) state that chief internal auditor also has the capacity to influence audit committee’s decisions. Spencer Pickett (2011) also mentions that chief internal auditor can help the audit committee to understand the use and design of control models through which audit committee then base their view on internal controls, which will later be recommended to the board.

The role of audit committee (in relation to internal audit) is to appoint the chief internal auditor and to ensure that internal audit function operates accordingly to professional standards, performs well and discharges its responsibilities under audit plan and strategy (Spencer Pickett, 2011). Another responsibility of audit committee is to provide an oversight of the corporate governance process and to have a direct line to the shareholders; seek to ensure that management is equipped to install effective risk management and controls within the company. Clearly, one of audit committee’s mechanisms for corporate accountability is a co-operative relationship with internal auditors. Furthermore, the Sarbanes – Oxley act requires internal controls to be assessed and audited. Thus, audit committee appoints internal audit to do so and there is an increasing reliance on internal auditing as a key aspect for the corporate governance solution (Spencer Pickett, 2011).

According to Abbot et al (2010) investigation, audit committee’s oversight can affect the focus of internal audit activities through several mechanisms:

- During the review of internal audit function’s program and budget, audit committee can voice concerns over the amount of hours allocated to internal controls activities.
- Audit committee can request the internal audit function to take actions to improve existing internal control structure or increase the amount of coverage on higher-risk areas.
- Chief internal auditor can communicate audit committee’s internal control concerns to CFO and CEO.

Prescriptions calling for a strengthening of audit committee’s role seem to be irrelevant for Tremblay and Gendron (2011). Authors state that mandatory changes superficially implemented and do not shift members thinking or doing. There are gaps between meanings of prescriptions when interpreted by agents versus instigators. Members of audit committee are generally confident about the effectiveness of the committee on which they sit. Moreover, the effective audit committee is described as one where members are not afraid to raise serious and important issues: I am going to ask that question even if I think you are the most honest CEO in the world (Tremblay and Gendron, 2011). This denial of new prescriptions for the audit committee leads Anderson et al. (2012) to a question whether regulators over-react. They might, but there is a pressure on regulators
when scandals happen: if they do not do anything it would mean that there is no reaction to the scandals what so ever. However, regulations should not over-complicate processes because e.g. longer audit committee meetings usually become counterproductive (ibid). Making system more complex reduces transparency, which is not a goal to be set.

Sarens and De Beelde (cited in Mahzan et al., 2012, p. 76) state that the audit committee should value internal audit function’s independence and promote it, thus strengthening internal audit as a profession (Tremblay and Gendron, 2011). Without an effective audit committee and accountability to them, internal audit function would be a consulting activity and a partner of the management.

**The internal audit function and management**

Finally, the relationship between the fourth corporate governance cornerstone, management, and internal audit is as important as the previous one. The management (as an agent of the board) should live up to the demands of their defined responsibilities: supervise and manage the performance of staff; developing strategies for improvement, for internal control, etc.; acting in accordance to achieve company’s goals, visions and objectives; organize and control recourses and expenditures (Christopher et al., 2009). According to Lee et al. (2008) the responsibility for preventing and detecting fraudulent activities should be vested in the management through the systems of internal control. Therefore, management is responsible for risk management and maintenance of internal controls.

The essential role of management is to implement good controls by determining the needs for controls; designing suitable controls; implementing it; checking its correct application; and maintaining and updating the control system (Spencer Pickett, 2011). Responsibility for control within the organization is vested in both the board and the management (Christopher et al., 2009).

An effective manager is one who is not afraid of the internal auditor to identify issues in operations. Christopher (2012) states that managers should instead encourage a proactive culture in their internal audit and not focus on whether the issue will be reported. What is important is to show that actions have already been taken after the issue was found (ibid.).

The role of internal auditor is to assist both the management and the audit committee by examining, evaluating, reporting, and recommending improvements for effectiveness of management’s risk processes. Internal auditors also should encourage adherence to procedures and standards of a professional manner and keep the high ethical standards of the profession (Haron et al., 2012).

Some authors prefer to promote the consulting side of internal auditing. Alič and Rusjan (2009) argue that with the help of strong management’s support it is possible to change the internal audit function from sole check for compliance to searching for improvements. In other words, authors state that internal audit’s inspection focus should be shifted to a preventive focus resulting in continuous improvement. Hutchins (cited in Alič and Rusjan, 2009) sees internal audit as a problem solving tool and an advising activity that is independent and unbiased and is intended to improve business by improving effectiveness of internal controls and in turn decreasing risks. Properly supported internal audit function can help managers attain organization’s objectives.
The value that internal auditors can add in the form of advising the management depends on the defined purpose of internal audit function within the organization and on management’s expectations and support. Alić and Rusjan (2009) state that in order to turn an internal audit function into an effective managerial tool, it has to be properly integrated within the organization’s strategic management system. According to the authors, organizations often do not exploit possible opportunities from internal audit function that help achieve benefits, mostly because they are afraid to diminish internal auditor’s independence.

However, Mahzen et al. (2012) state that in order for internal auditors to perform their roles effectively, they need independence from the management, and that the internal auditor cannot become a managerial tool. Authors motivate this statement by arguing that “management is more likely to comply with internal auditors’ recommendations if there is authority” (p. 71) in case internal auditors press for action.

Management’s call for assistance in Section 404 (a section in the Sarbanes – Oxley act of 2002, “Management assessment of internal controls”) has caused a shift of internal auditor’s higher focus on financial reporting (Sarens and De Beelde, 2006). Internal auditors assist management by fulfilling risk assessment responsibilities. Their acting in a consulting role can assist the organization in identifying, evaluating, and implementing risk management methodologies in order to address those risks. Internal audit provides management with genuine assurance that adequate controls are in place, that they are being performed as intended, and that any failures are investigated and remedied on a timely basis (Christopher et al, 2009).

Management is responsible for the creation of internal control system. Whereas, the internal auditor is responsible for objective assessment of internal control system (assessing effectiveness and maintaining it). Therefore, internal auditor has to take into consideration everything that allows risk assessment and guarantees efficient control; accordingly he/she gives recommendations to the management on how to strengthen internal control system (Christopher et al., 2009). It is important to make a distinction that internal auditor is not making a decision, nor creating risks. He/she is giving assurance to the board while also helping out others in the organization. In other words, internal auditor is like a ‘co-driver in a car’: he/she does not drive the organization but comes in when there are big turns, big risks and gives advice or tells the management to be careful. Internal auditor needs to ensure that there is a good strategic planning process without creating it him/herself. Thus, internal audit function needs the following safeguards (Spencer Pickett, 2011):

- Clearance that management is responsible for risk management (not managing it for them). If internal auditor is responsible for any part of risk management there appears an impairment of objectivity and there is a need to engage other assurance providers.
- Document risk responsibilities of internal auditors in the audit charter.

In other words, internal audit should also avoid setting risk appetite; imposing risk management processes; being the sole source for management’s assurance that risks are effectively managed; taking decisions on risk responses; and implementing risk responses on management’s behalf. These are management’s responsibilities and should not be implemented by internal auditors.
Alić and Rusjan’s (2009) findings state that management should stimulate internal auditors, support their training and development, enable good working conditions, maintain correct and professional relations and acknowledge their contribution to organization’s goals, but treat their results seriously.

To conclude, in theory it seems quite clear that the internal auditor and management’s responsibilities differ, but in practice management has quite a big influence on the internal audit function, which raises issues. Difficulties appear because of senior managers positions of influence, power in the audit appointment and the need to assume honesty of senior managers. Thus, there is a risk that senior managers may override internal control by considering it as a managerial tool (Lee et al, 2008). According to Mahzan et al. (2012) today management relies on internal audit not just to cut costs or improve operations, but also to provide confidence, assurance and trust that internal controls are effective and that the whole organization is working efficiently.

**Independence, objectivity and recommended reporting lines**

It is still an on-going discussion on the reporting roles for the internal audit function. Some authors suggest that in order to secure internal auditor’s independence it is best to give the entire reporting role to the audit committee (Abbott et al., 2012; Haron et al., 2012), but IIA’s definition includes consulting and adding value because internal auditors can help the organization to reach the goals (Alić and Rusjan, 2009).

IIA (2009) listed the main stakeholders of internal audit function: Board of Directors; Audit committee; Senior management; External auditors; Shareholders; Oversight organizations; Middle management and other employees; Regulators and government agencies. Shareholders are mainly interested in formal aspects, such as objectivity and independence, whereas senior management’s main interest is performance-related aspects of internal audit function. As far as the formal point of view is concerned, many authors (Regoliosi and d’Eri, 2012; Abott et al., 2010; 2012; Sarens et al., 2012) believe that the independence issue together with the hierarchical position and reporting lines are fundamental to understand the ability of the internal audit function to effectively pursue its mission.

The conflicting incentives and ways of securing the internal audit’s independence still is an on-going discussion in the academia and practical application (Abbott et al., 2010). Many academics questioned if internal audit function can effectively serve both the audit committee and the management, arguing that previously this function was solely under management’s supervision and managers may be reluctant to relinquish the ability to direct the function (ibid).

The audit committee’s oversight can affect internal audit activities through a number of mechanisms (ibid.): the review of internal audit plan and budget; review of internal audit’s results (audit committee can then request internal auditors to take actions towards internal control improvement); and when internal auditor negotiates budgetary restrictions with management, audit committee’s internal control concerns can be used as a bargaining tool to influence CFO’s/CEO’s decisions.
The problem occurs because even though there is an official oversight of internal audit function by the audit committee, there is a great variety in the nature of active oversight by the audit committee and unofficial oversight by the management (Abbott et al., 2012). Internal auditor’s objectivity is a direct function of their organizational status, because it relates to how strong is the oversight relationship between the internal audit function and the audit committee (ibid.). IIA’s Standard 1100, “Independence and Objectivity”, requires internal auditors to be objective when performing their work. Plus, internal audit activity must be independent.

Independence is defined as the freedom from any conditions that threaten the ability of the internal audit function to carry out its responsibilities in an unbiased manner. More so, it must be free from interference when determining its scope, performing work and communicating its results (IIA, 2009). In order to be able to effectively carry out responsibilities, the chief internal auditor needs to have a direct and unrestricted access to senior management and the board. Further, internal auditors must abstain assessing operations for which they were responsible in the past, but they may provide any consulting services that relate to operations for which they had previous responsibilities.

As stated in the IIA’s Standard 1100, “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” (IIA, 2012a, p. 3). It is presumed to be impaired if internal auditors provide assurance services for any activity for which they had responsibility within the previous year.

The question of independence also comes up from the IIA’s definition of internal audit function, where the internal auditor is both an independent and objective assurance of the internal control’s effectiveness as well as a consulting activity designed to add value to organization’s operations (Ahlawat and Lowe, 2004). Internal audit function is put among conflicting motivations: to please the management, to please the audit committee and to promote reliable financial reports (Norman et al., 2011).

Objectivity is more on the individual level and is achieved by appropriate mind-set and ethical conduct, although Ahlawat and Lowe (2004) argue that objectivity in practice is a myth for individuals facing economic and other pressures. However, independence is established by a proper positioning of internal audit function within the organizational structure and reporting structure. As Peursem (2005) states, it is up to the board to decide what they want from internal auditor. Establishing correct reporting relationships is a crucial component to safeguard independence.

In other words, if there is no objective internal check of reports, the board cannot trust it. Thus, it is important for internal auditors to show their independence. The internal auditor has to be completely detached from operational function – it has to be a separate function (there cannot be members of internal audit staff running the operations). The internal audit function needs to be independent but the auditors themselves cannot be independent from the entity – from the employer – because they need to understand e.g. the risk appetite, against which the significance of risks is then measured (Savčuk and Tamošiūnienė, 2007a). As it was mentioned in the article by Peursem (2005) “I am not independent of the organization, I am independent of the activities here”. Thus, it is very important to be an expert in what you do – it is the provisional value that is important. It cannot be spontaneous, it has to be systematic and disciplined approach. Just following standards
and being ethical is not enough. Independence comes from the fact that nobody can make the internal auditor do something, it is his/her independent judgment that is made; his/her integrity.

**Independence threats from the management** (Christopher et al, 2009; Abbott et al., 2010):

- Internal auditor’s position used as a training ground or a stepping stone for the future (managers become possible future bosses; therefore reporting ‘bad’ things on them might be very risky and unwanted);
- Considering internal audit to be a partner;
- When CFO/CEO approves the internal audit’s budget (budgetary restrictions can result in reduced control activities – management may be reluctant to approve additional resources that would not generate immediate cost savings);
- When the management has the sole responsibility to appoint, dismiss and evaluate chief internal auditor.
- When senior management is too involved with internal audit planning (they might steer the internal audit function towards becoming a managerial tool, more consulting focus);
- Management might view internal audit function as a means of generating cost savings and achieving operational goals.

**Independence threats from the audit committee** (Christopher et al, 2009):

- When the audit committee approves internal audit’s budget (budgetary restrictions can steer internal audit’s activities to solely assurance provision);
- Composition of audit committee (not having all or at least one member qualified in accounting – not secured independence of audit committee members makes the independence of internal audit function also questionable);

**Internal auditor’s reporting lines**

Internal audit profession is very challenging as there is a thin line between dual reporting lines. There is a threat to objectivity and independence impairment due to inappropriate reporting relationships. The study conducted by Holt (2012) found that perceived disclosure credibility is significantly higher when the chief internal auditor is reporting functionally to the audit committee and administratively to the CEO (or the management), comparing to cases when both reporting lines are set for the CEO.

It is necessary to establish proper reporting lines because it gives the internal audit function the authority, which according to Mahzan et al. (2012) in turn has the most pervasive influence upon the clarity of internal auditor’s role. Authors also note that the lack of authority affects internal auditor’s role clarity and effectiveness. Thus, IIA has released the best practice guidelines where reporting lines are established as follows (Mahzan et al., 2012; Abbott et al., 2010; 2012; IIA, 2009):

- Functional reporting line to the **audit committee** (and the whole board):
  - Audit committee approves the internal audit charter (does not make it, but approves it);
  - Approves internal audit risk assessment and audit plan;
o Receives reports of the activities (including private meetings);
o Receives annual confirmation of independence of the function;
o Approves decisions on performance evaluation, appointment and removal of chief internal auditor;
o Approves the remuneration of chief internal auditor (salary, bonuses etc.);
o Inquires the management and the chief internal auditor to determine any limitations on audit scope or budget.

• Administrative reporting to the management:
o Budgeting (determines and approves internal audit department’s budget)
o Human resource administration (including evaluation and remuneration);
o Internal communication and information flows;
o Administration of the internal audit function’s policies and procedures.

It is important to note that these reporting lines and relationships are only recommendations and currently there is no mandated form of internal audit – audit committee relationship (Abbott et al., 2012). Therefore, the oversight roles often vary from organization to organization depending on their corporate governance structure and organizational culture.

The functional reporting line is argued to be the ultimate source of authority and independence (Rolandas, cited in Mahzan et al., 2012, p. 77). However, Abbott’s et al. (2010) findings suggest that audit committee is a near equal partner with the management. Regulatory organizations (such as the Institute of Internal Auditors and the Public Company Accounting Oversight Board) mostly emphasize the benefits of audit committee’s oversight of the internal audit function, but Abbott et al. (2010) points out the lack of research and discussion about anticipated outcomes that such oversight brings out.

Abbott’s et al. (2010) empirical findings led to the conclusion that when the budget oversight lies with audit committee vis-à-vis management, it is in most cases steering internal audit function towards more internal-controls-oriented activities. Management, on the other hand, may endeavour internal audit for more attention to operational audits and other consulting-related activities (Abbott et al, 2010) and that is a serious threat for internal auditor’s independence. Moreover, the internal auditor perceives more personal threats when reporting high levels of risks directly to audit committee relative to management. This leads the internal auditor to reduce assessed levels of fraud risk when reporting to the audit committee. Independence of internal audit is critical when it comes to fraud detection. Due to concerns of over-reaction of audit committee, internal auditors tend to work-out issues with the management before meeting the audit committee (Norman et al 2010), which is not a bad thing as long as internal auditor still reports it to the audit committee if the management is not willing to accept recommendations. Additionally, private contacts allowing chief internal auditor raise matters affecting management without its presence are also an effective way to guarantee independence (Christopher et al, 2009).
Another issue is that management does not always appreciate the need of independence. In some of their minds, internal auditor works for them and reporting to the audit committee is just a formality to satisfy requirements, whereas the audit committee values internal audit function’s independence (Christopher et al, 2009). Audit committee and management should have similar incentives and this would in turn promote internal audit’s independence, but in practice it is not always possible.

The guidelines promote the need of audit committee having sole responsibility for internal audit function, a complete control of it, but internal audit should still report to both. However, there is a problem if audit committee controls the budget and the entire internal audit function – it may become more external and there might be less access to the management’s information (perceiving internal auditor as a spy). On the other hand, if the management has control over internal audit function – the audit committee might trust it less. This conflict of incentives between the audit committee and the management is only obvious when assuming that audit committee is mainly focused on internal controls and the management is mainly focused on cost cutting (Abbott et al., 2010).

In the end, if there were a simple way to solve this issue it would have been done already. Whichever way the organization chooses there is still at least a suspicion that internal auditor may be too close to the decision making to remain independent. Therefore, success is achieved where internal audit function remains reasonably independent and accountable to the governing authority despite their management consulting activities – participant role and closeness to the management (Peursem, 2005).

THE RESEARCH QUESTION

To clearly define the research question I come back to the problem that internal auditors are faced with: how to overcome the tension of working together with management while at the same time remaining sufficiently distant and independent from management in order to report on their performance. As discussed in the previous section, opinions on a proper internal audit positioning in the organizational structure and proper reporting lines differ among researchers and there is no consensus reached yet. The provided guidelines from the IIA are only recommendations but not obligations for the organizations. Therefore, every organization has to choose or come up with their own way to solve this problem.

Moreover, as the theoretical review has revealed, today internal audit is often seen as one of the cornerstones of corporate governance. Putting my focus on Lithuanian commercial banks, my research question is formed as follows:

*How is internal audit function in Lithuanian commercial banks positioned in the organizational structure and is it considered as one of the cornerstones of corporate governance?*
INTERNAL AUDIT IN LITHUANIA: development, importance of the function and the current state

Internal audit in Lithuania appeared quite recently and is still a relatively new profession (Rupšys, 2012). This can be explained by the fact that it has only been slightly more than 20 years since Lithuania regained its independence and the transformational process from the team-control system to the market economy has not been fully established in all industries (Makara, 2005). Lithuanian companies do not have such strong and deep internal audit traditions as other western countries (Rupšys, 2012). To make it easier to follow all the regulatory changes, table 1 provides the timeline of changes in Lithuanian laws, considering the internal audit function.

Table 1: The timeline of important laws and events for internal audit in Lithuania (created by the author)

<table>
<thead>
<tr>
<th>Year</th>
<th>Law, resolutions and important events</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>“Procedures of internal audit function in commercial banks”</td>
</tr>
<tr>
<td>1997</td>
<td>Registration of Lithuania’s Internal Audit Association</td>
</tr>
<tr>
<td>2000</td>
<td>Resolution No. 127 “For internal audit in state-owned enterprises and institutions”</td>
</tr>
<tr>
<td>2001</td>
<td>“Internal audit requirements” approved by the government</td>
</tr>
<tr>
<td>2002</td>
<td>“Internal control and internal audit act”</td>
</tr>
<tr>
<td>2003</td>
<td>“Best practice audit methodology” and “Professional ethics rules for internal auditors”</td>
</tr>
<tr>
<td>2004</td>
<td>Bank of Lithuania released “General provisions for internal audit organization in banks”</td>
</tr>
<tr>
<td>2005</td>
<td>All banks are obliged to establish the audit committee</td>
</tr>
<tr>
<td>2006</td>
<td>Corporate Governance Code</td>
</tr>
<tr>
<td>2008</td>
<td>Law of the Republic of Lithuania on Audit obliged the establishment of the audit committee</td>
</tr>
</tbody>
</table>

According to Lakis (2002) the very beginning of internal audit in Lithuania is the year 1995, when the board of the Bank of Lithuania approved the “Procedures of internal audit function in commercial banks” and obliged Lithuanian commercial banks to establish an internal audit function. Oddly, internal audit establishment in state-owned institutions was only a second step following commercial banks. Another version is given by Mackevičius (2002), who claims that internal audit in Lithuania was established in 1997 with a registration of Lithuania’s Internal Audit Association (Lietuvos Vidaus Audito Asociacija). The author also evaluated Lithuania’s internal audit level in 2000 by comparing it to the level that was reached by western countries (such as UK, Germany and France) already in 1950-1960.
The change in laws, acts and resolutions for internal audit shows that the emergence of internal audit function in Lithuania was a difficult process. Makara (2005) presented a historical development of internal audit in Lithuania. In 2000 the government accepted the resolution No. 127 “For internal audit in state-owned enterprises and institutions”. In 2001 the government approved “Internal audit requirements” and recommended those to all internal audit departments. In 2002 the government signed the “Internal control and internal audit act”, which established main internal control and internal audit functions. In 2003 the government accepted “Best practice audit methodology” and “Professional ethics rules for internal auditors”, which provided these professional ethics principles: integrity; objectivity; confidentiality; competency and professionalism. In 2004 the government accepted the resolution “General provisions for bank’s internal audit planning”. Worth mentioning, that all the above mentioned acts and resolutions were prepared in accordance with U.S. requirements and acts on internal audit, which shows that Lithuanian government is following the steps of U.S. acts and laws.

In line with the 8th EU Company Law Directive on Statutory Audit (Directive 2006/43/EC - article 41) the Law of the Republic of Lithuania on Audit (Article 52) states that all public-interest entities must have an audit committee. The audit committee, together with other responsibilities, must monitor the effectiveness of the company's internal control, internal audit and risk management systems (Pedersen, 2011). In Lithuania all chief internal auditors must provide an annual written report to the board of directors (to the audit committee in case it is established within the organization) and to the Ministry of Finance, which then summarizes the results and provides the government with the report on how internal audit departments are functioning in public entities. However, it only mentions the overall state of internal audit functioning and states its compliance with regulations and does not give any informative insight over specific sectors.

An empirical study done by Makara and Palubinskienë in 2004 revealed that back then not everyone understood what the functions of internal audit were and how they differed from external auditors. However, an empirical analysis revealed that 100 per cent of the respondents saw the internal auditor as a helper for the organization and not a ‘policeman’ looking for defects; 50 per cent believed that internal auditors must be independent from the activities they audit. Nevertheless, 67 per cent thought that there is a lack of information about internal audit, its importance and possibilities in Lithuania. Interestingly, most of the companies did not plan on establishing internal audit function because of ineffective internal controls, motivating their opinion as already being disappointed with internal controls and not believing that internal audit could possibly solve their problems. Another reason, why internal auditors were refused before, was the thought that it was enough to properly manage accounts with the help of computer accounting programs and smaller companies did not need internal auditors.

In addition, the study revealed that 76 per cent of the internal audit functions were subordinate to the CEO and only 14 per cent were subordinate to the audit committee (Makara and Palubinskienë, 2004). This might be explained by the fact that all Lithuanian listed companies were obliged to have an audit committee only in 2008. Since then, internal auditors should functionally report to the auditing committees and this should ensure their independence and efficiency. Thus, I want to analyse if this is actually a case in Lithuanian commercial banks.
The empirical study in 2006 (Savčuk and Tamošiūnienė, 2007b) showed that in 300 biggest Lithuanian companies none had an audit committee. This shows that companies were not keen on establishing audit committees voluntarily. The situation started changing in 2006 when Lithuanian Securities Commission issued Corporate Governance Code to improve governance of Lithuanian listed companies (Savčuk and Tamošiūnienė, 2007b). Following this in April 2007 the draft Lithuanian Law on Audit was provided for analysis with the aim to oblige listed companies establish audit committees till July 1, 2008. The changes were approved.

Lithuanian banks faced this transition earlier than other institutions. In 2004 the Bank of Lithuania released General Provisions for Internal Audit Organization in Banks. To be able to understand corporate governance processes in Lithuania properly it is necessary to mention that in most Lithuanian organizations (as in some other European countries) the corporate governance model has a dual board system. This means that there is a separation of supervisory and executive functions: accordingly there is a Board (hence, executive function) and a Supervisory Council (hence, supervisory function).

However these General Provisions for Internal Audit Organization in Banks and the Corporate Governance Code are silent about the role, duties and responsibilities of internal auditors; hence it creates ambiguity and also causes misunderstandings about the role that internal auditors need to play in the organization. Thus internal auditors in Lithuanian commercial banks might vary in their roles depending on the organization they are employed by.

The code defines the Supervisory Council as a collegial body entrusted with the power and authority to act on behalf of the company. It is responsible for appointing the Board to create an effective internal control system and follow its effectiveness. The Board has an overall responsibility to ensure that risks are managed and in practice the Board will usually delegate the operation of risk management to the management team (Savčuk and Tamošiūnienė, 2007a). Moreover, the Supervisory Council also appoints the audit committee. Since 2005 the audit committee is a mandatory body in all Lithuanian banks and must report to the Supervisory Council at least once a year. CEOs cannot be members of the audit committee, but at least one member of the Supervisory Council has to be in the audit committee. Further, the audit committee must meet at least twice a year and participants, who can attend those meetings, include: internal audit staff; Board members and CEO. The internal audit function reports directly to the audit committee and provides annual reports (the Bank of Lithuania, 2004). There is also an addition for foreign capital banks, which must report to their mother bank’s internal audit department.

The major description of internal audit function in the above mentioned provisions and the corporate governance code are for the audit committee to review the adequacy of functions, scope and resources and, among other duties, to consider major internal investigation’s findings and management’s response to it. This implies that internal auditors may not fully understand the appropriate authority for their work.

Staliūnienė (2009) suggested that in order for Lithuanian companies to properly entrench in the European Union audit activities, it is necessary to prepare a concept for Lithuanian Audit development. However, since then no actions have been taken to address this issue.
In 2012 Deloitte conducted a survey on internal audit in Lithuanian companies, which revealed that all internal audit departments operate in accordance with the standards of the Institute of Internal Auditors (IIA). However, inconsistent with the best practices provided by the IIA, in 70 per cent of the companies the chief internal auditors reported directly to the CEO and only in 10 per cent of the companies the reporting line was the audit committee. Unfortunately, the survey does not distinguish between industries.

RESEARCH METHOD: sampling, validity and the method explanation

Generally studies concerning internal audit have focused on country-specific analysis (Sarens and De Beelde, 2006; Mahzan et al., 2012; Regoliosi and d'Eri, 2012). The reason for that is that cross-country analyses have major downsides, because of the differences in social, legal and regulatory contexts. Thus, this study focuses on commercial banks in Lithuania. Currently, there are seven commercial banks in Lithuania and four out of seven are foreign capital banks. Lithuanian-capital commercial banks are: AB “Šiaulių bankas”, AB bankas “Finasta” and UAB “Medicinos Bankas”. Foreign-capital banks are: AB “Citadele” bankas, AB “Swedbank”, AB “SEB” bankas and AB “DNB” bankas. All of them have both audit committees and internal audit departments (The Bank of Lithuania, 2012; Deloitte, 2012). Therefore, the sample is very suitable for this study.

Since the research question is complex and needs to be open to interpretations, I used the qualitative research method, which is usually concerned with words rather than numbers, putting an emphasis on the point of view of the participants (Saunders et al., 2009). Author also explains that one of the most difficult obstacles to overcome is getting research access within the organization. The biggest limitation in this study was the confidentiality of internal audit reports, thus I was not able to get them from any Lithuanian commercial bank. Therefore, I had to limit my analysis to the relationships between internal audit department and formal corporate governance structures as they are described in publicly available information and interviews. Organizational documents are likely to be authentic and meaningful, but at the same time they may not be an accurate representation of how different actors perceive particular situation (ibid.). Different sources let me triangulate the information, which increases the likelihood of finding a more truthful picture of internal audit in Lithuanian commercial banks. I have analysed audited financial reports (for 7 commercial banks in the period of 2008-2011 (hence, 28 financial reports), because the establishment of the audit committee in Lithuanian banks became obligatory in 2008); organizational statute and all available public information.

As it was mentioned already, internal audit is often seen as one of the four cornerstones of corporate governance, together with the management, the board (including the audit committee) and external auditors (Gramling et al. 2004; Holt, 2012; IIA, 2003; Mahzan et al. 2012; Sarens et al., 2012; García et al., 2012). When analysing my data I looked for significant information to find out if internal audit function is considered as a part of corporate governance structure in Lithuanian commercial banks. Furthermore, when analysing organizational statute I looked for the responsibilities of the internal audit function, the audit committee and management, which were related to internal audit.
According to Anderson et al. (2012) organizations with more foreign subsidiaries have more expansive operations. Agency problems increase risks, which then leads to a greater need for effective internal audit function to manage these risks. Therefore, I have also put my focus on any differences in internal audit department size depending on the origin of bank’s capital.

Best practise of audit committee oversight over the internal audit function suggests that an audit committee should be composed of three to five members to be able to fulfil its governance obligations and it should also meet at least quarterly (Anderson et al. 2012; IIA 2012b; Sarens and De Beelde, 2006). Moreover, in order to properly assist and advise, it is essential for at least one member to have the necessary financial expertise (not secured effectiveness of audit committee members makes the effectiveness of internal audit function also questionable) (Christopher et al, 2009; IIA 2012b). Therefore, I analysed audit committee’s structure and frequency of their meetings in all seven commercial banks of Lithuania, in order to find out any threats that their structure might raise for internal audit’s effectiveness and independence.

This method was also chosen because of the possibility to use less structured interviews than the ones in the quantitative approach and according to Saunders et al. (2009) it maximizes the reliability and validity of measurement of key concepts.

According to Maxwell (2008) most sampling in qualitative research is neither convenience sampling nor probability sampling. It falls into a third category: purposeful sampling, in which particular settings, persons, or events are deliberately selected for the particular information they can provide. I chose to interview chief internal auditors for few reasons. First of all, they are the ones who have the highest level of responsibility over the entire internal audit process. Also, they report directly to a designated body and attend (or can attend) the audit committee meetings. Therefore, their established relationship with other governing bodies in the organization is much stronger than for other internal audit staff.

In order to achieve the objectives of this research, I decided to utilise surveys as a means of getting the general perception from internal auditors within Lithuanian commercial banks on matters relating to their role and authority, which in the process turned to email-interviews with the heads of internal audit departments (chief internal auditors) in all 7 banks (hence, 7 respondents) to find out:

- how big the internal audit department is in comparison to the total number of employees and what drove the decision on the size of the department;
- if internal audit staff works full-time or not;
- their personal views on objectivity and independence (personal code of ethics);
- personal reasons to become an internal auditor (to find out if they interested in the profession itself or if it was a good stepping stone into the organization);
- functions performed;
- whether chief internal auditors participate in audit committee’s meetings;
- who approves their budget and audit plan;
- who approves their remuneration.
The respondents were free to depart significantly from the questions being used to get the rich and detailed answers. Moreover, interviewees were interviewed 2-3 times each. Hence, the analysis part is treated as something that must itself be designed. According to Maxwell (2008) this allows to progressively focus on interviews and observations, and to decide how to test emerging conclusions. After the first round and tentative conclusions, theoretical approach was redesigned and therefore new questions arose. The third time was needed in cases, when the questions were not understood clearly (which was the case with AB “Šiaulių bankas” and UAB “Medicinos bankas”).

As Maxwell (2008) puts it, validity in qualitative research is the result not of indifference, but of integrity. Interview data enhances construct validity by studying phenomena in their natural context. For this reason all interviews were conducted in Lithuanian language (which is a native language for all participants), to rule out the possibility of misinterpreting the meaning of both questions and answers and the perspective they have on what is going on.

All interviews and archival documents were summarized for each bank in order to get an overview of the most remarkable insights. Then the comparison of all 7 commercial banks was made in order to discover certain patterns, differences and similarities and reassure that conclusions from one bank were not idiosyncratic. In addition to differences between all the banks, another distinction was inspected, between foreign-capital and Lithuanian-capital banks, to find out if the origin of the capital makes any significant influence on the internal audit function.
DATA ANALYSIS

Even though Deloitte’s conducted survey in 2012 showed that in only 10 per cent of Lithuanian companies reporting line was the audit committee and in 70 per cent of the companies chief internal auditors reported directly to the CEO, commercial banks are operating under the laws and regulations of the Bank of Lithuania. Since having an audit committee and an internal audit function became obligatory for Lithuanian banks, their statutes and financial reports all mark that chief internal auditor reports directly to the audit committee. In other words, officially their functional reporting line is the audit committee.

In general all 7 Lithuanian commercial banks have almost identical statutes, which describe corporate governance structure consisting of:

- General meeting of shareholders;
- Supervisory Council (varying from 3 to 7 members);
- Board of directors (varying from 3 to 7 members);
- CEO.

The supervisory council meets at least quarterly and has an oversight role over the board and the CEO; therefore, the supervisory council approves board members. In turn, the head of the board is also the CEO of the bank. The board meets at least once every month.

In addition to this, every bank has established an audit committee, which is also a part of the corporate governance structure (appointing and remuneration committees can also be a part of it, but are not mandatory). The supervisory council must ensure the existence of effective internal controls and thus appoints the audit committee, approves its members and its charter. Audit committee must ensure internal audit’s independence and is responsible for internal control system’s strengthening; effectiveness of internal audit function; determines internal audit operating procedures; approves annual internal audit plans. At the same time audit committee plays an intermediate role between corporate governance bodies and internal audit function. However, in both foreign-capital and Lithuanian-capital commercial banks internal audit function is not considered to be a part of corporate governance structure, which is quite a different situation from e.g., Malaysia (Mahzan et al., 2010), Spain (García et al., 2010) and Italy (Arena and Azzone, 2007), where empirical findings show that internal audit function is considered as one of the cornerstones of corporate governance.

While analysing audited financial reports of all banks most of the important information was found in the external auditor’s notes. If the bank showed and explained how they comply with the Corporate Governance Code (issued in 2006 by the Lithuanian Securities Commission) in financial reports, external auditors also evaluated the internal audit function and its effectiveness. This shows that external auditors only thought of internal audit function as an important one if the bank showed it to be significant. However, these compliances only appeared in financial reports of AB “SEB” bankas; AB “DNB” bankas and AB “Šiauliu bankas” - the first two being foreign-capital banks and the last one being Lithuanian-capital bank. Therefore, there is no significant difference, concerning internal audit function’s importance, depending on the origin of bank’s capital.
Table 2: Important numbers of Lithuanian commercial banks in 2013

<table>
<thead>
<tr>
<th>Origin of capital (L - Lithuanian; F - Foreign)</th>
<th>No. of Supervisory Council members</th>
<th>No. of Board members</th>
<th>No. of audit committee members</th>
<th>No. of financial experts in the audit committee</th>
<th>No. of audit committee meetings per year</th>
<th>Total no. of employees</th>
<th>No. of internal audit staff</th>
<th>As a % of total employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>AB “Šiaulių bankas”</td>
<td>L</td>
<td>7</td>
<td>7</td>
<td>4</td>
<td>1</td>
<td>5-6 times</td>
<td>494</td>
<td>3</td>
</tr>
<tr>
<td>AB bankas “Finasta”</td>
<td></td>
<td>4</td>
<td>4</td>
<td>3</td>
<td>1</td>
<td>4-5 times</td>
<td>150</td>
<td>3</td>
</tr>
<tr>
<td>UAB “Medicinos Bankas”</td>
<td></td>
<td>4</td>
<td>5</td>
<td>3</td>
<td>1</td>
<td>4-5 times</td>
<td>489</td>
<td>4</td>
</tr>
<tr>
<td>AB “Citadele” bankas</td>
<td>F</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>1</td>
<td>4-5 times</td>
<td>329</td>
<td>4</td>
</tr>
<tr>
<td>AB “Swedbank”</td>
<td></td>
<td>5</td>
<td>5</td>
<td>3</td>
<td>1</td>
<td>4-5 times</td>
<td>1249</td>
<td>7</td>
</tr>
<tr>
<td>AB “SEB” bankas</td>
<td></td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>2</td>
<td>4-5 times</td>
<td>1955</td>
<td>7</td>
</tr>
<tr>
<td>AB “DNB” bankas</td>
<td></td>
<td>4</td>
<td>7</td>
<td>3</td>
<td>2</td>
<td>4-5 times</td>
<td>1481</td>
<td>12</td>
</tr>
</tbody>
</table>

Table 3. Matters concerning reporting lines in Lithuanian commercial banks in 2013

<table>
<thead>
<tr>
<th>Origin of capital (L - Lithuanian; F - Foreign)</th>
<th>Functional reporting line</th>
<th>Who approves internal audit function’s annual plan?</th>
<th>Who approves internal audit function’s budget?</th>
<th>Does chief internal auditor attend audit committee’s meetings?</th>
<th>Who decides on chief internal auditor’s remuneration?</th>
</tr>
</thead>
<tbody>
<tr>
<td>AB “Šiaulių bankas”</td>
<td>L</td>
<td>AC</td>
<td>AC</td>
<td>CEO</td>
<td>Yes</td>
</tr>
<tr>
<td>AB bankas “Finasta”</td>
<td></td>
<td>AC</td>
<td>AC</td>
<td>CEO</td>
<td>Yes</td>
</tr>
<tr>
<td>UAB “Medicinos Bankas”</td>
<td></td>
<td>AC</td>
<td>AC</td>
<td>CEO</td>
<td>Yes</td>
</tr>
<tr>
<td>AB “Citadele” bankas</td>
<td>F</td>
<td>AC</td>
<td>AC</td>
<td>AC</td>
<td>Yes</td>
</tr>
<tr>
<td>AB “Swedbank”</td>
<td></td>
<td>AC</td>
<td>AC</td>
<td>AC</td>
<td>Yes</td>
</tr>
<tr>
<td>AB “SEB” bankas</td>
<td></td>
<td>AC</td>
<td>AC</td>
<td>AC</td>
<td>Yes</td>
</tr>
<tr>
<td>AB “DNB” bankas</td>
<td></td>
<td>AC</td>
<td>AC</td>
<td>AC</td>
<td>Yes</td>
</tr>
</tbody>
</table>
AB “Šiaulių bankas” is the only Lithuanian commercial bank that has a separate section for internal audit function and their working principles, in their financial reports, which shows the significance of internal audit department in the bank. The other banks do not stress the importance of this function too much throughout the years 2008-2011:

- In UAB „Medicinos bankas“, AB “DNB” bankas and AB bankas “Finasta” internal audit function appears only in 3 short lines of the report, describing the function very briefly, stating that the chief internal auditor discusses the assessment made with management and then reports to the audit committee.
- AB “Citadele” bank does not mention neither the audit committee nor the internal audit function in their financial reports. However, the email-interviews revealed that the audit committee approves almost everything for this function: audit plan, budget, charter, and functions. The audit committee has one independent member and the others are from the mother bank.
- Both AB “Swedbank” and AB “SEB” bankas only start mentioning internal audit in their financial reports of 2010. The audit committee defines internal audit responsibilities and functions, approves the internal audit charter and approves the chief internal auditor, who reports directly to the audit committee.

All banks have an in-house internal audit function, which according to Arena and Azzone (2007) is the most common case in banks. These in-house departments mainly focus on operational audits: reviews functioning of operational procedures and management’s activities and there is a clear functional reporting line to the audit committee, who approves internal audit’s annual plan. However the administrative reporting line to the management differs among the banks. It is mainly established through the budget approval, human resource administration and remuneration of chief internal auditor.

Although the statute states that in all banks audit committees only give recommendations on selecting chief internal auditor and approving internal audit department’s budget, the interviews revealed a somewhat different situation. As it is shown in table 3, in all Lithuanian-capital commercial banks it is the CEO (hence, the management) who approves internal audit’s budget – this is in line with the suggested best practise from the Institute of Internal Auditors. In contrary, in all foreign-capital commercial banks it is the audit committee who approves internal audit’s budget. This refers to Abbott’s et al. (2012) raised problem that even though there is an official oversight by the audit committee, there is a variety in the nature of active oversight by the audit committee and unofficial oversight by the management.

Both of these choices create possible threats for internal audit’s independence, which were discussed by Christopher et al. (2009) and Abbott et al. (2010). When CEO approves the budget, restrictions can result in reduced control activities – CEO may be reluctant to approve additional resources that do not generate immediate cost savings. On the other hand, when the audit committee approves the budget, there is the threat that resources will be allocated solely on assurance activities. Further research would be needed to find out the reasons for this distinction, but for this study it is clear that there is a distinction, based on the origin of the capital.
Coming back to the administrative reporting line, it always exists at least for the reason that the management is responsible for the remuneration of other employees of the internal audit department. However the main difference was found when it comes to the remuneration of the chief internal auditor. According to the suggested best practise guidelines, it is best when the audit committee approves the remuneration of the chief internal auditor. This is the case only in AB bankas “Finasta”, UAB “Medicinos bankas” and AB “DNB” bankas. In the other four banks it is the management who approves the remunerations of the chief internal auditor: the CEO in AB “Citadele” bankas and the remuneration committee in AB “Šiaulių bankas”, AB “Swedbank” and AB “SEB” bankas. Worth mentioning, that where remuneration committee is established, it consists of one member from the supervisory council and the rest are employees of the bank. However, this distinction cannot be justified by the difference in the origin of bank’s capital.

The email-interviews also revealed that all internal audit staff in all 7 banks work full time. Moreover, all chief internal auditors justified the reason to become an internal auditor, by stating that the profession itself appeared to be very interesting and challenging. These statements mitigate the threat that internal auditor’s position in Lithuanian commercial banks might be used as a training ground or a stepping-stone for the future.

The composition of the audit committee appears to be in line with the conceptual framework: as it is suggested by Christopher et al. (2009) and the IIA (2009), the audit committees in all 7 Lithuanian commercial banks have 3-4 members and at least one member has a necessary financial expertise (two members are financial experts at AB “SEB” bankas and AB “DNB” bankas). Moreover to secure effectiveness of audit committees, they are meeting 4-5 times per year (5-6 times at AB “Šiaulių” bankas). All these numbers mitigate the threat for internal audit’s effectiveness and independence that might come from possible ineffectiveness of the audit committee.

There are no requirements for the size of the internal audit department, because it alone cannot justify the effectiveness of the function. Therefore, the size differs among the banks. As it is shown in the table 2, when the total number of employees is less than 1000, banks have chosen 3-4 employees for their internal audit function. Further, the last three banks in the table have between 1000 and 2000 employees, therefore the number of internal audit staff is accordingly higher. What comes out a bit strange is that AB “SEB” bankas have the most employees, but the percentage of internal audit staff is the lowest. Moreover, AB “DNB” bankas have a significantly higher number of internal audit staff in comparison with other banks, which might only be a coincidence but can also imply that this bank might face a larger number of complex risks (a conclusion made by the IIA (2009) concerning the size of the audit department). All of this leads to the conclusion that the size of the company is not a deciding factor when it comes to the size of the internal audit function. Moreover, email-interviews did not reveal any implications that might have influenced the size of the internal audit department and the origin of the capital does not justify the difference in the size of internal audit either.
CONCLUDING REMARKS

The need for improved controls is a very important issue in the public debate regarding corporate governance in European listed firms, including Lithuanian commercial banks. Internal auditors are expected to provide both assurance and consulting services and maintain their independence at the same time. The valuable knowledge spill-over effect to the assurance role outweighs the potential loss of independence, which can arise as a consequence of internal auditors’ involvement in consulting activities. On the other hand, objectivity impairments due to consulting activities may undermine monitoring benefits that internal auditors provide.

The position that internal auditors are put in nowadays is very challenging and organizations handle it differently. Therefore, the aim of the study was to find out how Lithuanian commercial banks position the internal audit function within organizations in order to overcome the tension of working together with management and keeping the distance at the same time to be able to assure the board that the management is working in the best interest of the organization. And the research question accordingly was: how is internal audit function in Lithuanian commercial banks positioned in the organizational structure and is it considered as one of the cornerstones of corporate governance?

Data analysis lead to the conclusion, that the internal audit function in Lithuanian commercial banks is not considered as one of the cornerstones of corporate governance. This function only comes into the picture of corporate governance through the audit committee as an assurance providing body, but is not considered as one of the most important bodies within the organization. Internal audit function has a clear functional reporting line to the audit committee that is set in the bank’s statute; all internal audit departments are in-house and put their main focus on operational audits; all interviewed chief internal auditors always attend audit committee meetings. The need for ensured independence seems to drive internal audit function away from consulting activities. Even though collected data did not show that, this could also be explained by the possible presence of other parties providing consulting services to the organization. Given responsibility to the audit committee to appoint and dismiss the chief internal auditor and to approve the annual audit plan mitigates independence threats from the management. The composition of the audit committee (having at least one financial expert in the committee) also mitigates independence threats from the audit committee.

Furthermore, because the sample could have been divided into two groups of Lithuanian-capital and foreign-capital commercial banks, it provided a ground to inspect any patterns, caused by the differences in the origin of the capital. The only clear distinction concerning the origin of the capital was witnessed in the approval of the budget: the CEO approves internal audit function’s budget in Lithuanian-capital banks and the audit committee in foreign-capital banks. However, this difference can also be just a coincidence, because no other factors showed any distinction based on the origin of the capital. There is no clear pattern or clear distinction between internal audit positioning in foreign-capital and Lithuanian-capital banks.
**Discussion, Limitations and Suggestions for future research**

Information on internal audit function, their produced reports, clear objectives, audit plans, etc. is not publicly available; therefore, this does not allow getting all the needed answers and forms a big limitation to this study. Another limitation was formed by the disability to interview other team members of internal audit function, which might have brought up somewhat different results.

It would be very valuable if internal auditors were more eager to participate in these kinds of studies, because it can actually benefit their effectiveness. In my opinion, reputation of this profession within a country influences every internal auditor and if these kinds of studies can result in some kind of assurance that in general internal audit function is effective – every professional can benefit from it. Internal audits should be seen as an important enabling and motivating factor, which provides a chance for improvement. In order to achieve this, trust can be gained by making internal audits as non-threatening as possible. The transfer of know-how among employees helps detect good practises and implement them inside the company.

The reason for a lack of research concerning the relationship between internal audit and corporate governance factors is threefold: a lack of public information on internal audit’s activities within the organization; lack of theoretical support with regard to the existence of the internal audit function within organizations; and the progressive evolution of capital markets that results in differences among countries.

The contribution of this paper is opening a somewhat different discussion. Academics, such as Mahzan et al. (2012), Abbott et al. (2010 and 2012), and the Institute of Internal Auditors have argued that the best way to overcome the tension of working with management and keeping the distance at the same time is to establish proper functional and administrative reporting lines. However, findings and especially limitations of this study imply that in practice positioning of internal audit function within the organizational structure does not solve the problem. Instead, difficulties to gain access to internal audit reports and internal audit function in general create a very secret bubble around this function. Thus, maybe the way internal auditors solve the tension is secrecy?

Since the banking sector appears to be very secretive, other sectors might be more open. Therefore, a suggestion for further research would be to investigate other sectors in Lithuania. Moreover, it would be interesting to see an investigation whether the found distinction between the responsibility to approve internal audit function’s budget can in fact be influenced by the origin of bank’s capital. Another suggestion would be to examine external auditors on matters relating to the internal audit function in Lithuania. It is interesting to know if external auditors trust internal audit reports, if they work together to provide assurance or is it the other way around, when internal audits are critically inspected and evaluated. These kinds of studies are very beneficial to a small country like Lithuania, where internal audit profession is still quite young, especially since two banks went bankrupt in the last two years. There is a possibility that if internal auditors were more important in Lithuanian commercial banks, considered as one of the cornerstones of the corporate governance, those two bankrupt banks would still be functioning.
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