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The Influence of the Executive Director Concurrently Serving as a Member of the Audit Committee on the Performance of the Internal Audit Duties

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Abstract—**In order to improve the management and guidance of the audit committee on internal audit and enhance the performance effect of internal audit, this paper first analyzes the current situation of executive directors concurrently serving as audit committee members from the perspective of the characteristics of audit committee personnel, and then discusses the impact of executive directors concurrently serving as audit committee members on the efficiency of internal audit, internal audit plans, internal audit objectives and the quality of financial reports. Finally, according to the above influences, the author puts forward specific suggestions in order to improve the performance effect of internal audit.**

Index Terms—**Executive director, the audit committee, internal audit**

I. Introduction

As the “third line of defense” of enterprise internal control, internal audit plays an important role in the effective corporate governance structure, and high-quality internal audit performance is the key to the effectiveness of internal governance. The performance effect of internal audit has an important relationship with its subordinate institutions (Zhou, 2021) . Early internal audit subordinate institutions have the financial director, The managers, the board of directors or the audit board, the board of supervisors, and the managers and the board of directors with the development of internal audit. According to the Interim Measures for the Administration of Internal Audit of Central Enterprises, relatively independent audit committee should be established in all state-owned holding enterprises and wholly state-owned enterprises with board of directors. Audit committee plays an increasingly important role in the internal audit management of listed companies in our country. In 2019, SASAC issued the “Implementation Opinions on Deepening the Internal Audit Supervision of Central Enterprises”, pointing out that central enterprises should effectively give play to the management and guidance role of the audit Committee of the Board of Directors in internal audit. The governance role of audit committees of state-owned enterprises is mainly reflected in the management and guidance of important matters such as internal audit plans, key projects of enterprises, rectification of audit results, etc., and the improvement of the quality of internal audit and financial reporting.

Most existing studies have discussed the governance effectiveness of the audit committee from the aspects of the characteristics of independent directors of the audit committee, including the research on the professionalism and independence of independent directors and the overlapping tenure of other special committees under the board of directors (Li and Sun,2021) Practice shows that the phenomenon of concurrent appointment of audit committee members is becoming more and more obvious (Xue *et al.*, 2021), while non-executive directors are more directly appointed by important shareholders or nominated by them, and the motivation to safeguard the interests of shareholders is stronger. Therefore, this paper discusses the phenomenon of executive directors concurrently serving as audit committee members. The dual role of executive directors as audit committee members is double-sided. On the one hand, it improves the information level of the audit committee, on the other hand, it damages the independence of the audit committee. Starting from the current status of non-independent directors in the audit committee, this study discusses the specific impact of executive directors concurrently serving as members of the audit Committee on internal audit performance

II. Current Status of Executive Directors Concurrently Serving as Audit COMMITTEE Members

A. *Status Quo of State-Owned Enterprises*

The enterprise system of our country has no clear requirements for the size of the audit committee, which is decided by the enterprise independently. Through the investigation of the tenure of the audit committee of state-owned enterprises, it is found that the audit committee of state-owned enterprises generally adopts the “2+1” “3+2” and other models in order to meet the requirements of “independent directors accounting for more than half of the audit committee”. With the inclusion of directors or senior executives within the audit committee, very few companies will choose the model of an all-independent board. The majority of independent directors in the audit committee are regulated by the system, while the rest are arranged by the enterprise itself. The survey shows that most of the non-independent directors in the audit committee are internal directors, general managers, financial directors and executive directors.

Through the investigation of the tenure track of the members of the audit committee of some enterprises, it is found that the executive directors who enter the audit committee will first serve as the general manager of the enterprise and then join the board of directors. In some

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enterprises, the proportion of executive directors in the board of directors is relatively high. Excluding independent directors, executive directors account for 1/3 and 1/2 of the remaining directors. In some enterprises, almost all of them are executive directors, and the proportion of executive directors on the board is relatively large.

B. Negative Impact of an Executive Director Being a Member of the Audit Committee

1) Impairs the independence of the audit Committee

Independence is the most essential feature of the establishment of audit committees. It is the key to the principal-agent issue of listed companies that audit committees perform their supervisory duties over directors and senior executives on behalf of shareholders (Wang and Feng, 2023). In order to ensure that audit committees perform their duties objectively, they should maintain independence from internal directors and senior executives. The multiple identities of executive directors can hardly guarantee the fairness of their performance after they join the audit committee. The executive Board of directors makes profits for itself by controlling key resources, hindering the normal performance of independent directors, which results in the loss of independence of the audit committee, which is controlled by the management, and makes the audit committee virtually useless.

2) Impairs the authority of independent directors

The executive director of the audit committee is easy to deprive the independent director of the right to restrict the internal personnel. As the core and key personnel of the audit committee, the director of the audit committee dominates the daily activities of the audit committee. However, because independent directors do not participate in the daily operation of the company and do not understand the operating conditions of the company, it is difficult to establish authority internally. Compared with independent directors, executive directors are more familiar with the company's operating dynamics and daily operation information, and have obvious information advantages. In the governance process of the audit committee, executive directors with information advantages obviously have a higher right to speak (Zhang and Huang, 2018). As executive directors with dual rights are likely to replace the chairman of the audit committee to lead the work process of the audit committee, which damages the authority of independent directors.

3) Impairs the enterprise supervision and balance mechanism

The existing corporate governance structure divides the decision-making power to the board of directors, the executive power to the senior management, and the supervision power to the board of supervisors and independent directors, which is the supervision and balance mechanism for the effective operation of enterprises. Directors and senior executives perform the duties of operation and management, while the audit committee performs the duties of supervision over directors and senior executives on behalf of shareholders. The duties of operation and management and the duties of supervision and governance are the relationship between supervision and the supervised. If the executive director concurrently serves as a member of the audit committee, the supervision and balance mechanism established by the enterprise will fail, and the members of the audit committee will be negligent in performing the supervision duties of the audit committee. Or use the identity of audit committee to make its self-interested behavior more hidden and rationalized, leading to the low efficiency of audit committee governance, and damage the interests of shareholders.

III. The Impact on Internal Audit of the Executive Director Being a Member of the Audit Committee

A. The Efficiency of Internal Audit is Affected

At the same time, internal audit serves the board of directors and the management to form different governance tasks, and different governance tasks correspond to different governance requirements. Different governance requirements will lead to role conflicts, thus reducing the work efficiency and performance of internal audit (Chen, 2018). Placing internal audit under the leadership of the board of directors or the audit committee under the board of directors avoids the influence of managers on the performance of internal audit. From the essence of the entry of executive directors into the audit committee, internal audit still serves the board of directors and the management, and the rights of executive directors are far greater than the rights of independent directors, which is not only detrimental to the establishment of a long-term cooperation mechanism between independent directors and internal audit, but also deepens the power erosion of management over the audit committee, which may further reduce the efficiency of internal audit.

B. Resulting in Unclear Internal Audit Objectives

The establishment of internal audit objectives will be affected by the scale of the enterprise, the external environment and the governance structure, and the internal audit objectives will also be affected by different governance levels within the enterprise. Foreign scholars pointed out that the greater the impact of independent directors on internal audit, the more likely internal audit will give priority to the activities concerned by independent directors. The greater the influence of the executive director on the internal audit, the more likely it is that the internal audit will prioritize the activities that the executive director is concerned about (Eulerich *et al.*, 2017). In practice, executive directors obviously have more information advantages and authority than independent directors. In the process of audit committee governance, executive directors with information advantages often have a greater say.

It is understood from the announcement of the independent director's work report and the prior opinion of the independent director issued by the listed company that the responsibilities of the independent director are: (1) to examine and approve the proposal to hire or replace the external audit institution of the company, and to express independent opinions thereon; (2) To review and comment on the company's financial reports; (3) Supervise and evaluate the company's internal control. In addition, independent directors need to review the daily related transactions of the enterprise, the use of raised funds, financial reports, internal control self-evaluation reports, etc. It can be seen from the above analysis that the management and guidance of independent directors on internal audit is mainly reflected in the "confirmation" activity of internal audit, that is, economic supervision. The relationship between the executive director and internal audit more reflects the "consulting" activities of internal audit. The executive Board believes that internal audit is the best assistant to help them improve the operating process and implement measures to save costs. As the executive director is responsible for the continuous operation and performance of the enterprise, the executive Board requires internal audit to audit specific businesses and activities. Internal control and risk management audits to achieve better business performance.

C. Affects the Formulation of Audit Plan

On the one hand, the executive director is also a member of the audit committee, and the excessive concentration of power makes a senior executive have greater power, which leads to the failure of the internal checks and balances mechanism of the management and the information asymmetry among the management. Under the incentive of mixed compensation, senior executives have more motivation to carry out earnings management and profit manipulation to increase their own compensation. Some studies believe that based on the identity of the director, the executive board weakens the tendency of opportunistic behavior that damages the value of the company (Wang and Sun, 2021), but the existing studies have not confirmed whether the executive director can still identify with his/her identity as a director if he/she becomes a member of the audit committee. In addition, internal auditors are mostly grass-roots officers who are easily restricted by the power of senior managers, while independent directors perform their duties as audit committees only when the audit committee meets, and internal auditors easily compromise with executive directors under the oppression of power. Therefore, this paper believes that the executive board interferes with the formulation of internal audit plan for self-serving purposes, which is manifested as the failure of internal control and risk management.

On the other hand, executive directors believe that internal audit is the best assistant to improve operational processes and implement measures to save costs. Therefore, internal audit is often assigned tasks by executive directors, requiring internal audit to audit specific businesses and activities to meet their own audit needs and affect the development of internal audit plans. Under the current governance mechanism, the audit committee is subordinate to the Board of directors, and the entry of executive directors into the audit committee will inevitably affect the formulation of internal audit plans, thus interfering with the performance of internal audit.

D. The Quality of Financial Report is Affected

Internal audit is closely related to the quality of financial reports. The internal audit is responsible for improving the quality of the financial report under the management and guidance of the audit committee, and the characteristics of the audit committee have a significant impact on the quality of the financial report. Wang Bing believes that the CFO who concurrently serves as a member of the audit committee has more power in corporate governance, and the more power the senior executives have, the worse the quality of accounting information disclosure. This means that executive directors have a greater right to speak, which will inevitably erode the power of independent directors and affect the management and guidance of independent directors on internal audit.

Internal audit, as the main source of internal information for independent directors in the audit committee, can help independent directors to carry out internal audit work, immediately grasp corporate information, and provide independent directors with the information they need to perform their supervisory duties. The entry of the executive director into the audit committee means that the audit results of the internal audit need to be shown to the executive director. Under the restriction of the internal power level, it is not conducive to exerting the supervision function of the internal audit and affecting the quality of the corporate financial report.

IV. Suggestions

A. Strengthen the Communication between the Independent Directors and the Internal Audit

In 2023, The General Office of the State Council issued the Reform of the Independent Director System of Listed Companies, pointing out that the responsibilities of independent directors should be positioned in the board of directors to participate in decision-making, supervision and checks, professional advisory roles, and promote the integration of independent directors and the internal decision-making process of enterprises. Both independent directors and internal audit belong to the supervision bodies of enterprises, while internal audit belongs to the grass-roots organizations, with obvious lack of internal personnel ability and experience, lack of overall perspective of operation and management, and lack of in-depth understanding of business. However, independent directors in the audit committee belong to the decision-making level of the company, and have very rich experience and strong professional ability. Therefore, on the premise of ensuring the independence of independent directors, enterprises should allow independent directors to participate in the internal decision-making of enterprises, strengthen the communication channels between independent directors and internal auditors, and make internal audit a qualified audit institution for independent directors, which can not only check the rights of non-independent directors of the audit committee, but also make up for the lack of ability of internal auditors.

B. Strengthen the Party's Leadership over Internal Auditing and Improve the Overall Supervision Mechanism

The participation mode of "two-way entry and cross-appointment" is a unique corporate governance mechanism of Chinese enterprises. Under the influence of this mechanism, members of the Party group enter the audit committee as non-independent directors, which on the one hand can realize the direct leadership of the Party over internal audit work and enhance the authority and corporate status of internal audit (Meng, 2020). On the other hand, the supervision mechanism can be improved. China has established a more complete supervision mechanism for the members of the Party group. Enterprises have internal audit, board of supervisors and independent directors, and state-owned enterprises also have the discipline inspection commission responsible for the party building work of state-owned enterprises (Hou and Teng, 2021). The relevant departments and personnel to investigate and deal with violations of discipline, play a role in preventing problems and preventing them from happening. The State-owned Assets Supervision and Administration Commission (SASAC) and the Audit Office supervise the enterprise externally. If the internal and external supervision mechanism is relatively perfect, the violation cost of members will be increased, thus promoting effective corporate governance.

C. Improve the Appointment Requirements of Audit Committee Members

At present, the relevant system of listed companies in our country only limits the professional and independence of independent directors to the audit committee members, ignoring the appointment requirements of non-independent directors. When an enterprise configures the members of the audit committee, it shall carefully select non-independent directors and try its best to avoid the appointment of executive directors or other personnel who may affect the performance of the audit committee.

D. Address the Audit Needs of Executive Directors

Executive directors enjoy both the decision-making power of directors and the operation and management power of senior executives. When participating in the operation of the company, the audit department needs to provide appropriate cooperation to assist the management team to implement effective control over the management process. The internal audit department should rationally allocate resources and utilize the existing human resources of the enterprise to achieve the goals or plans of stakeholders without affecting the independence of the internal audit. When necessary, it can recruit necessary human resources to solve audit problems that executive directors may encounter in daily operation, so as to avoid onerous tasks and task conflicts for internal auditors.

Conflict of Interest

The author declares no conflict of interest.

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