

Factors Affecting the Effectiveness of Internal Audit

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Abstract

Internal audit (IA) is a vital management technique for ensuring that corporate controls are effective. Additionally, IA is an effective instrument for strengthening governance, increasing operational efficiency, increasing the unit's worth, and promoting public services. As a result, it is necessary to study and evaluate the elements affecting IA effectiveness, particularly IA independence, prior to establishing and operating IA in order to accomplish IA objectives. The purpose of this essay is to examine the aspects that affect the effectiveness of IA. By analyzing, reviewing, and synthesizing prior research, the article synthesized and proposed factors affecting the effectiveness of internal audit, including: IA independence; internal auditor capacity; management support for IA; the quality of IA; the use of information technology in IA; the size of the internal audit department; the relationship between internal and external audit; and the audit committee.

Key words: Internal Audit (IA), effectiveness, factors

1. Introduction

Internal audit is defined as “an independent, objective assurance and consulting activity designed to feature value and improve an organization's operations” (IIA, 2018). The IA can support the company in attaining its objectives by assessing and improving the effectiveness of its risk management, control, and governance procedures through the use of a scientific, principled methodology (IIA, 2018). IA ensures the organization's strategic procedures, management, and risk management, as well as supporting the business in accomplishing its strategic, operational, and financial objectives. IA takes place in a range of cultural and legal contexts; in organizations with a range of organizational aims, sizes, and structures; and by a range of internal and external stakeholders. Historically, the responsibility of the IA was restricted to financial forecasting and control oversight. However, companies that are forced to use the IA have greatly increased its role in recent years (Burnaby and Hass, 2011). This is because technological, political, regulatory, and economic variables have dramatically altered the core tasks and operations of organizations during the previous few decades, as well as increased company risks, economic instability, and financial fraud scandals (Bekiaris et al., 2013; Vinary and Skaerbaek; 2014; Tsipouridou and Spathis, 2014; Gbadago, 2015).

IA began to take shape and develop in the world in the 1940s, both conceptually and practically. On October 28, 1997, the Ministry of Finance published Decision No. 832-TC/QD/CDKT on enterprise-specific IA laws, which is widely regarded as Vietnam's first legal document on the subject. However, due to a lack of understanding and opposing perspectives at the time, this text was not taken seriously. After nearly two decades of disregarding flaws in the inspection and control of state financial activities, corporate finance, and the requirements of economic integration, a market economy, and internal control, the IA has added legal provisions in the amended Accounting Law 2015. On January 22, 2019, the Government released Decree No. 05/2019/ND-CP governing IA, including some legislation pertaining to IA at businesses, and the Ministry of Finance would issue more thorough guidance documents by 2020. Certain businesses, especially well-known corporations or banks, have begun to efficiently employ IA, such as the Bao Viet Group, Vinamilk, Thanh Cong Tay Ninh Sugar Joint Stock Company, NoVa Real Estate Investment Group Joint Stock Company, and Licogi 16 Company, among others, while the remainder do not (Hong Anh Nguyen, 2016). The situation in Vietnam illustrates that numerous instances of self-interested Board of Directors (BOD) acts have resulted in grave implications for the company's shareholders, although there was no warning voice until the case was identified. The most egregious example is a series of high-ranking Ocean

Bank officials embezzling and misusing their right to appropriate property. This is because the majority of business owners in Vietnam are unaware of the role, responsibilities, and functions of information assurance professionals in corporate business operations. The IA's position is rather vague, in part because Vietnam does not have a corporate governance system. IA has failed to attract highly competent human resources; it has been inadequately trained; and it has failed to adhere to the professional ethical norms of IA independence and objectivity... As a result, quality control becomes challenging (Thanh Hoai Nguyen, 2020).

Earlier research has examined and evaluated the elements affecting the success of IA using a variety of methodologies (Arena and Azzone, 2009). However, no consensus on the optimal framework for effective IA has been reached to yet (Endaya and Hanefah, 2013). The article's major objective is to uncover the factors that contribute to the efficacy of IA. Numerous research have been conducted over the years that point to several aspects affecting the performance of IA, including the following: Alzeban (2014) conducts research on the elements determining the effectiveness of IA. The findings indicate that management support for IA, experienced employees with enough resources, and an independent IA department all have an effect on the success of IA. George D., Theofanis K., and Konstantinos A. (2015) investigate many indicators of IA performance in the Greek corporate environment, including the IA's independence, management support (or lack thereof), the IA's capacity, and the IA's quality. They believe that the IA's independence is the most important factor affecting the IA's performance. Additionally, this article demonstrates how factors such as the capacity of IAors, the size of the IA department, the interaction between IAors and external auditors, and management's support for IA all influence stakeholders' perceptions (opinions) of IA's success. These factors were determined through a review of previous studies (Salehi, T., 2016; Alzeban & Sawan, 2013; Soh & Bennie, 2011; Ahmad et al., 2009; Mihret & Yiamaw, 2007; Ali et al., 2007; Sarens & Beelde, 2006; Carcello et al., 2005; Brierley et al., 2001, 2003), as well as an examination.

2. Literature review

2.1. IA effectiveness

The effectiveness of an internal audit is a complicated issue that receives scant attention in accounting and auditing papers. According to Dittenhofer (2001), IA effectiveness is defined as the accomplishment of IA objectives. The ultimate purpose of IA, according to the official definition (IIA, 2018), is to add value to the company. According to some past research, effectiveness IA is intended to bring value to the business by assisting the BOD in evaluating and improving the effectiveness of risk management, internal control, and management processes (Gramling et al., 2004; Yee et al., 2008). Al-Twajry et al. (2003) established that IA can provide value by assisting companies in achieving their economic objectives through the application of IA suggestions. Additionally, Tamosiuniene & Savcuk (2007) suggested that IA can help a business increase its competitive edge by assuring high-quality financial reporting and streamlining governance operations. Simunic (1984), Wallace (1984), and Xiangdong (1997) stated that internal auditing adds to the organization's compliance with current rules and regulations by setting favorable conditions for external auditors' work. While Sawyer (1995) contended that IA identifies flaws in business operations, Kinney (2000, 2001) stated that IA provides an objective assessment of company activities and procedures. In short, the efficacy of IA is determined by its ability to accomplish its ultimate objective, which includes adding value and enhancing the organization's performance.

2.2. Factors affecting the effectiveness of IA

We assembled the elements based on available documentation and the perspectives of reputable professional bodies, particularly the Institutes of internal auditor (IIA). The documents cited illustrate the critical aspects affecting the success of IA: Internal audit independence; internal auditor capability; management support for internal audit; application of information technology in internal audit; size of the internal audit department; combination of internal audit and external audit; audit committee

2.2.1. Internal audit independence

Throughout the years, specialized agencies and standards-setting bodies have stressed the critical nature of the auditor's independence and objectivity to the quality of IA, even when the auditor is an employee of the organization. Independent means that there are no dangers to the IAor his or her ability to complete the

activities objectively; in other words, the IA is self-sufficient when completing his or her duties, unaffected by familiar or economic considerations. Independence is frequently synonymous with objectivity. ISPPIA 1100 (2017) demonstrates how independence and objectivity can be achieved by reporting at multiple levels: providing services to management, reporting to the audit committee, and ultimately to the chief executive officer (CEO) or board of directors (BOD) for the achievement of the organization's goals and use of its resources... This enables the IA or to carry out their responsibilities freely and without interference from third parties; it enables the IA department to avoid all conflicts of interest and maintain direct communication with managers; it enables the IA to have unrestricted access to the activities of employees and departments; it enables the IA to replace the head of the IA department without direct management intervention; it enables the IA department to determine its own scope of work; it enables the IA department to avoid all conflicts of interest; it Several studies have been published on this topic (Yee et al., 2008; Subramaniam and Stewart, 2010; Alzeban and Sawan, 2013).

Independent assessment is critical when determining the efficiency of an IA (Mutchler, 2003; Zhang et al., 2007; Ahmad et al., 2009; Cohen and Sayag, 2010; Al-Akra et al., 2016). According to several researches, the more autonomous the IA department, the more effective the IA (Kaboi et al., 2018; Dellai and Omri, 2016). Alizadeh (2011) shown that IA independence is one of the five critical elements affecting the efficacy of IA in Iranian businesses. Alzeban and Gwilliam (2014) concluded that IA independence has a favorable association with IA effectiveness in Saudi Arabia.

Other studies have demonstrated that a lack of independence is a significant impediment to the IA's effectiveness. Ahmad et al. (2009)'s research focused on the absence of independence in the practice of IA, raising worries about how the lack of IA independence would harm the department's strength. Mustika (2015) concludes that a lack of independence and objectivity in IA, as well as involvement by audit stakeholders, results in bias in the collection, appraisal, audit recommendations, and reporting of evidence. Without independence, IA becomes a member of the management team, losing its ability to give objective, correct advice or promised services (Yee et al., 2008).

2.2.2. Internal auditor capability

Internal auditors must possess the necessary knowledge, skills, and other abilities to do their work efficiently. Internal auditors should possess the essential knowledge to detect and analyze risk or fraud, albeit they may not be expected to possess the same dexterity and proficiency as those responsible for fraud detection. If the internal auditor lacks the essential knowledge and abilities to conduct all or a portion of their assurance services, the leader of the IA department should hire experts to compensate. Capacity for IA is a critical factor in determining its success (Al-Twajjry et al., 2003; Van Gansberghe, 2005; Cohen and Sayag, 2010; Alzeban & Gwilliam, 2014). The International Standards for Professional IA Practice (ISPPIA) emphasize the need of an IA team that possesses the essential knowledge, skills, and other competences to carry out their obligations (ISPPIA, Standard 1210). Additionally, external auditors view the internal auditor's capacity as the primary factor in determining whether to rely on the internal auditor's performance (Al Twajjry et al., 2003).

Indeed, an internal auditor must possess the necessary education, credentials, experience, and training in order to contribute to and improve an organization's performance (Mihret & Woldeyohannis, 2008; Ali & Owais, 2013). Additionally, internal auditors must possess strong communication, persuasion, cooperation, and critical thinking abilities in order to properly fulfill their jobs (Fanning & Piercey, 2014). Consistent with ISPPIA, Mousa (2005) emphasized the internal auditor's competency and competence as a critical component of the IA. Turley and Zaman (2007) claim that communication between members of the audit team has a favorable effect on the audit's outcomes when analyzing the elements determining the effectiveness of IA efforts. Arena and Azzone (2009) also highlight the group of IA as a factor determining the effectiveness of IA. The IA team's capacity must be sufficient to enable them to provide high-quality services. They should hold qualified information assurance certificates issued by authorized authorities. Mihret et al. (2010) assert that both expertise and continual training are required to enhance the effectiveness of IA.

Several other studies have demonstrated that a lack of capacity for IA is impeding the effectiveness of IA efforts in a number of African nations (Onumah & Yao Krah, 2012; Walter & Guandaru, 2012). When Ali et al. (2007) and Ahmad et al. (2009) investigated the importance of IA in the Malaysian public sector, they discovered that the fundamental conditions for professional expertise were not met, as well as that

continuing to accumulate knowledge and skills in IA has a detrimental effect on the effectiveness of IA activities; they recommended training as a necessary component of developing IA activities in Malaysia. Brierley et al. (2001, 2003) shown that the inadequate quality of the IA is a factor restricting the IA department's success. Numerous studies have indicated that low-quality internal auditing is a factor in the demise of the internal auditing department (Mihret & Yismaw, 2007); thus, if internal auditors lack the necessary education but are professionally trained, they will be able to improve their working capacity and capacity.

2.2.3. The management's support for IA

Additionally, it has been demonstrated that management support and dedication have an effect on the effectiveness of IA operations. Indeed, the effectiveness of IA is contingent upon management's cooperation throughout the audit process. It is critical for management to recognize that IA is just as critical as any other activity carried out in the organization. Without management commitment, IA operations can fail, wasting valuable resources (money and time).

As a result, management support is critical for the adoption and evaluation of IA's efficacy within an organization. With management assistance, IAors can obtain additional resources to carry out their responsibilities, and the IA department can recruit competent employees, train them, and ultimately increase their capabilities and job performance (Alzeban & Sawan, 2013). According to ISPPA, IAors require top management and the Board of Directors' support in order to carry out their duties and fulfill their responsibilities. This will assist in reaffirming the function and value of information architecture within the enterprise. This assistance will assist the IA department in meeting its promises and duties. ISPPA highlights the critical nature of communication between IA and senior management, as well as the role of governance in assisting IA. The IA Department must give top management with comprehensive and credible reports on completed work, conclusions, and suggestions. In nations where internal auditing is conducted, the head of the audit office is required to present management and the senior audit committee with regular reports on the audit's objectives, dependability, and associated performance (ISPPA, Standard 2060).

Previous research has established that effective IA requires the support of managers at all levels (Mihret and Yismaw, 2007; Cohen and Sayag, 2010). According to Van Gansberghe (2005), in order to be effective, the IA department must win management support and demonstrate an appreciation for the participation and value that IA can bring to the firm. Ahmad et al. (2009) discovered that, after the IA's capacity, the managers' assistance (support) is the second most important factor of the IA's efficacy. They have demonstrated that with management support, the IA suggestions can be executed and that the IA department is adequately resourced in terms of staffing and financial resources. Cohen & Sayag (2010) discovered that management support is significantly associated with three characteristics of audit effectiveness in Israel organizations (audit quality, audited entity assessment, and value of IA contributions). According to Alzeban and Gwilliam (2014), management support is the most critical factor determining the efficacy of IA in Saudi Arabia's public sector organizations. They add that increasing the efficacy of the IA requires recruiting skilled and experienced employees and providing sufficient resources.

Mihret and Yiisma (2007) shown that a lack of management support results in a negative attitude toward the IA, which has a detrimental effect on the IA department's performance because it is not a high priority for top management. Support from management may also be eroded if management fails to execute the IA recommendations. Such apathy can mitigate some of the effectiveness of IA (Van Gansberghe, 2005).

2.2.4. The application of information technology in IA

Technology has advanced at a breakneck pace in this century. In the future, an increasing number of organizations will manage and undertake audit work through the use of technology. For example, Krishna et al. (2011) concluded that "*successful use of technical tools in auditing is critical to the success of the audit activity*" implying that this will undoubtedly increase the quality of IA and, in turn, its efficacy. This covers the availability of technology, including human resources and information technology infrastructure (Ahmi and Kent, 2013). Through automated processes, real-time data, and integrated IA, new IT systems enable IA to offer management with more relevant information at a cheaper cost and with less delay (Shin and associates, 2013; Sobel and Kapoor, 2012). As a result, IT will undoubtedly have a significant impact on the effectiveness of IA.

2.2.5. *The size of the IA department*

To carry out its responsibilities appropriately, the IA department must be adequately resourced. The ISPPA's resource management requirements state that an administrator must operate the IA to ensure that the resources supplying the IA are appropriate and adequate, and that they are used efficiently. One of the audit committee's roles is to advise top management of any deficiency of information assurance resources (ISPPA, standards 1409 and 1609). As a result, it is critical to have a sufficient number of internal auditors and to continue educating them on a continual basis to assure their professional capacity. Previous research indicates that when a significant number of staff is employed, the quality of IA is likely to improve. According to Ali et al. (2007), the primary challenge for IA is addressing the shortage of skilled personnel. According to Ahmad et al. (2009), "IA inadequacy" was the primary cause for the failure of IA in Malaysian government organizations. They argue that with strong management support, the IA department should be entitled to adequate human and other resources to enable personnel to carry out their responsibilities. Other studies have demonstrated a correlation between the number of internal auditors and the ability of the IA department to carry out its responsibilities (Mihret & Woldeyohannis, 2008; Brierley et al., 2001, 2003); thus, if the IA department is severely understaffed, the auditor will restrict the IA department's ability to carry out its responsibilities.

2.2.6. *The combination of internal audit and external audit*

Internal auditors and independent auditors must have a positive professional relationship. Coordination and cooperation between the internal auditor and the internal auditor have a significant impact on the quality audit report's creation. Coordination and cooperation might take the shape of planning, exchanging information, opinions, and reports in order to avoid duplication of effort and promote successful audits. The relationships between internal auditors and external auditors have been evaluated according to professional standards. According to the ISPPA, both auditors should build a professional working relationship, communicate information, and coordinate audit activities, thereby assisting the internal auditor in accomplishing their objectives and providing the organization with superior services (ISPPA, 2050). From the external auditor's perspective, the data gathered by the internal auditor can assist in forming an informed audit opinion and enhancing the audit opinion's quality.

Numerous academic studies demonstrate that good collaboration improves the audit's economics and effectiveness and enables managers to make higher-quality management decisions. According to Ali et al. (2007), more than 80% of internal auditors work with the internal auditor, and more than half of internal auditors from audit units report having a close relationship with the internal auditor. The strained connection between internal and external auditors has an effect on the audit's nature. Brierley et al. (2001) and Almohaimeed (2000) have established this.

2.2.7. *Audit committee*

More precisely, Zhang et al. (2007) evaluated the relationship between the audit committee's quality, the auditor's independence, and the disclosure of internal audit issues following Sarbanes-Oxley adoption. The audit committee is also considered a factor in determining the efficacy of internal audits. The results of the analysis of 208 organizations indicate a significant correlation between the quality of the audit committee's work, the auditor's independence, and internal audit shortcomings. Similarly, Arena and Azzone (2009) demonstrate that the structural characteristics of IA can affect its performance in an investigation of 364 enterprises in Italy. Additionally, the results indicate that when the audit committee is active in the internal auditors' operations, the effectiveness of the internal auditors increases.

3. **Conclusion**

IA makes recommendations to improve an entity's effectiveness and efficiency based on the study and assessment of its business data and processes. IA that is committed to honesty and accountability as an independent source of counsel adds value to the units' senior management. As a result, if IA operations are ineffective, they will squander resources, degrade the quality of IA activities, and eventually lose the trust of business management. The paper concentrated on synthesizing and highlighting the primary theoretical elements determining the success of IA operations. However, the article's drawback is that the precise influence of these characteristics on the effectiveness of IA activities in practice has not been tested. The

authors intend to increase the research objectives and scope in the future, as well as to employ more appropriate research methodologies, in order to obtain more accurate assessment results.

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