

Evaluation of the performance of the internal audit function in Libyan banks: A study on Libyan commercial banks.

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Abstract:

This study aimed to evaluate the performance of the internal audit function in Libyan banks and to explore the role of demographic information in determining this evaluation. It provides an insightful look into the performance and this relationship through the opinions of the respondents. The study utilized a quantitative descriptive-analytical approach to collect data and answer the posed questions. The study population consisted of employees in the Libyan commercial banking sector. The study distributed 350 questionnaires to Libyan banks, and after about three weeks, 345 were collected, of which 333 were valid for analysis. Survey results indicated that respondents largely agreed that the performance of the internal audit function was high, as most scores were rated high. However, there were some items that respondents indicated as average, meaning they did not agree with their content. Hence, it should be noted that internal auditing should provide recommendations to improve the internal control system when necessary, tables of committee meeting agendas and related key information should be circulated before meetings, and the audit committee should monitor the selection of accounting policies and principles. The study also revealed that there was no statistically significant effect of demographic information on the evaluation of the performance of the internal auditor, with the exception of the age variable. Thus, the study recommends addressing the challenges faced in adopting the International Financial Reporting Standards (IFRS) by providing a high-quality set of internationally recognized accounting standards that achieve transparency, accountability, and efficiency for financial markets worldwide.

Keywords: Internal audit performance evaluation, Libyan banks, Independence, Effectiveness of internal auditing.

Introduction

The Internal Audit Function (IAF) has witnessed significant global developments, especially in recent decades. Initially, the typical internal auditor's role was limited to checking accounting records only twice (Kotb et al., 2020). However, as per Ahmad et al. (2009) and Alzeban (2010), duties expanded to encompass internal control and financial compliance. Subsequently, the environment in which internal auditing operates or is available experienced other substantial modifications (Ahmad, 2015). The Institute of Internal Auditors recently updated its definition of internal auditing as follows: "Internal auditing is a neutral, objective advisory activity intended to add value and improve an organization's operations, offering a systematic, disciplined approach to evaluate and enhance the effectiveness of risk management, control, and governance processes" (IIA, 2017).

This definition illustrates that internal auditing has shifted to offer a wide range of services, including auditing operations and assurance, as well as advising management on diverse topics to enhance organizational procedures. Effective internal auditing can provide value to an organization and has expanded the interest in the role of internal auditing alongside the focus on its effectiveness (Mihret, 2010). When correctly established, executed, and managed as per international standards interpretations, it plays a crucial

role in helping an organization achieve its goals and protect its assets (Gustavson, & Sundström, 2018). As a result, organizations eventually benefit from this auditor's role (Mihret & Yismaw, 2007).

Moreover, studies like Assakaf et al. (2018), Bou-Raad (2000), and Coram et al. (2008) indicate that internal auditors play a vital role in supporting management and shareholders in preventing fraud or potential financial misconduct. Consequently, internal auditing has become a vital function across all organizations, whether in the public or private sectors.

Research Problem

The internal auditor's capability to achieve set objectives determines the effectiveness of internal auditing (Badara & Saadin, 2014; 2012; Leung, et al., 2011). Additionally, effective internal auditing can be crucial in assisting management in preventing fraud or other infractions (Abu-azza et al., 2015; Betti, & Sarens, 2021). Therefore, the primary aim of this study emerges: evaluating the performance of internal auditing in Libyan banks, particularly Libyan commercial banks. How does demographic information play a role in assessing the internal auditing performance in Libyan banks?

Study Significance

The study draws its significance from:

- The vitality of its subject matter, as the topic of internal auditing performance is essential in accounting thought.
- Contributing to enriching the subject of internal auditing and its relation to financial information in the Libyan banking sector.
- Providing evidence for stakeholders on the importance of the internal auditing role in accounting disclosure quality.

Study Objectives

This study aims to achieve several objectives, most notably:

1. Evaluate the performance of internal auditing in Libyan banks.
2. Determine the role of demographic information in assessing the internal auditing performance in Libyan banks.

Theoretical Framework

Importance of Internal Auditing:

Previous studies have explored the factors that influence the effectiveness of internal auditing. Firstly, the effectiveness of internal auditing relies on the concept of internal auditing as proposed by the Institute of Internal Auditors (Mihret, 2010). A primary goal of internal auditing is to provide an independent and objective auditing and consulting function, designed to add value and improve an organization's operations. Internal auditing assists the organization in achieving its objectives by adopting a systematic approach to evaluate and enhance the effectiveness of risk management, control processes, and corporate governance (Walter, & Guandaru, 2012; Yee, et al., 2008).

Factors Influencing the Effectiveness of Internal Auditing:

Despite the emphasis on the significance of contributions made by account auditors, it's crucial to identify some factors that, according to studies, make internal auditing ineffective. In this context, (Ahmad et al 2009) found that reasons behind the ineffectiveness of internal auditing include:

- Lack of competence of internal auditors,
- Shortage of staff, management, and limited resources,
- Lack of independence,
- A negative perception of the role of internal auditing by auditors,
- Lack of support from senior management.

Similarly, (Alzeban & Gwilliam, 2014; Salehi, 2016) agreed that important factors leading to auditors' shortcomings include:

- Lack of support from senior management,
- Competence,
- Independence,

- Size of the internal audit department,
- Cooperation between internal and external auditors.

Among the most influential factors on the effectiveness of internal auditing (Alzeban & Gwilliam, 2014; Salehi, 2016; Sarens, 2009; Sarens, & De Beelde, 2006) are:

Planning Ability:

The strategic planning process involves the systematic and organized use of developing the internal auditing strategic plan:

- Understanding the objectives of internal auditing services,
- Considering the International Professional Practices Framework (IPPF),
- Understanding stakeholders' expectations and updating the internal auditing vision and mission,
- Conducting a SWOT analysis (Strengths, Weaknesses, Opportunities, Threats),
- Identifying critical success factors.

Developing Organizational Productivity:

The productivity of auditing is also vital due to the close relationship between performance and productivity. It's possible to align with operational standards but still not be productive. Productivity is related to outcomes and outputs, and performance metrics should be linked to effectiveness and efficiency alike.

Independence of the Internal Auditor:

Standard-setters and professional bodies have increasingly emphasized the importance of independence, despite the fact that an internal auditor is usually an employee of the organization (Alzeban & Gwilliam, 2014). This is due to their role within organizations, while independence is a fundamental pillar in defining Internal Auditor IA. This was confirmed by the Institute of Internal Auditors (IIA), stating that "the internal auditing activity must be independent, and internal auditors must be objective in performing their work" (IIA, 2017). Additionally, global professional standards suggest that appropriate independence can be achieved by reporting to levels within the organizations that enable the internal auditing function to fulfill its responsibilities without interference; having access to personnel, records, and departments; avoiding conflicts of interest; having a direct link with senior management or the board of directors; possessing the power to appoint and dismiss the Chief Internal Auditor without executive management interference; and not performing non-auditing tasks (Alzeban & Gwilliam, 2014).

Size of the Internal Auditing Department:

There's a clear need to equip the internal auditing office with sufficient resources to properly and effectively perform its duties and responsibilities (Alzeban & Gwilliam, 2014). Therefore, the International Standards for the Professional Practice of Internal Auditing (ISPPA), the "Resource Management Standard", stipulates that the Chief Audit Executive must ensure that the internal auditing resources are adequate to achieve the approved plan. In this context, the term "adequate" implicitly refers to the need for a sufficiently sized internal auditing department to perform its responsibilities or duties efficiently (Alzeban, 2010).

Research Methodology:

The study is based on the descriptive-analytical quantitative approach in data collection. Accordingly, the researcher used the descriptive method to deal with and categorize the data, describing the phenomenon and the researched community and the analytical part between them to obtain the results of the study questions and draw conclusions about evaluating the performance of the internal auditing function in Libyan banks: a study on Libyan commercial banks, and what is the role of demographic information in evaluating the performance of the internal auditing function in Libyan banks?

Scale Correction Method

A five-point Likert scale was adopted for correcting the study scales. Each item on the scale is given one out of its five grades (strongly agree, agree, neutral, disagree, strongly disagree), represented numerically as (1,2,3,4,5) respectively for the positive statements. The order was reversed for the negative statements in the scale, which are (24, 29, 34). The following scale was adopted for the purpose of analyzing the results, as illustrated by using the equation:

Upper limit of alternatives - Lower limit of alternatives / Number of levels

- First range: $(1 + 1.33 = 2.33)$, hence, a rating less than or equal to (2.33) indicates a low index.
- Second range: $(2.33 + 1.33 = 3.66)$, greater than (2.33) and less than (3.67) indicates a medium index.
- Third range: $(3.67 + 1.33 = 5)$, thus, a rating greater than or equal to (3.67) indicates a high index.

Study Results

The researcher distributed 350 questionnaires to Libyan banks. After approximately three weeks, 345 (98.57%) questionnaires were collected from the Libyan banks. Out of these, 12 were deemed invalid for analysis and were consequently excluded. Therefore, the effective response rate for the current study was (95.1%).

Table No. (1) Demographic information of the study sample.

%	Frequencies	
		Gender
81.4	271	Male
18.6	62	Female
		Age
20.1	67	Less than 35 years
27.3	91	Between 35-45 years
41.1	137	Between 46-55 years
10.8	36	More than 55 years
		Educational Qualifications
14.4	48	Diploma
65.2	217	Bachelor's degree
12.9	43	Master's degree
7.5	25	Doctorate
		Work Experience
29.4	98	Less than 5 years
38.7	129	Between 5-10 years
23.4	78	Between 11-15 years
8.4	28	More than 15 years
		Job Specialization
82.9	276	Audit Committee Member
12.6	42	Audit Department Manager
4.5	15	Head of Audit Department
		Number of Internal Auditors in the Department
45.3	151	1-5 Auditors
31.5	105	6-10 Auditors
13.8	46	11-15 Auditors
3.6	12	16-20 Auditors
5.7	19	More than 20 Auditors

The table above sheds light on the distribution of genders among the respondents. Out of the total, males constitute 81.4% with 271 respondents, while females account for 18.6% with a count of 62 respondents. This male predominance, as reflected in the table, can be attributed to the prevailing culture in our society. Many community members believe that men should play a dominant role in non-educational sectors, and that the best profession for women in our society is in the educational sector. This belief is supported by a study conducted by Abu Melhem (2017), which mentioned that the majority of working women in the Arab community are in the education sector.

As further elucidated in Table (1), 41.1% of the respondents were aged between 46-55 years (137 out of 333 respondents) - the majority demographic among the respondents. They are followed by the age group of 35-45 years, representing 27.3% (91 respondents), and then those under 35 years, at 20.1% (67 respondents). The least represented age group were those above 55 years, standing at a confusingly worded percentage of 2.510.8%. This distribution might hint that the majority of bank managers are from the more experienced age bracket of 46-55 years. Banks prioritize experience in leadership roles, always aiming for optimum performance to achieve a competitive advantage.

Table (1) also clarifies the educational qualifications of the respondents. A significant 65.2% (217 respondents) held only a bachelor's degree. This is followed by 14.4% (48 respondents) with a diploma, 12.9% (43 respondents) with a master's degree, and the least, 7.5% (25 respondents), held a Ph.D. degree. This data suggests that the majority of employees in commercial banking sectors hold bachelor's degrees, indicating the sector's preference for hiring graduates.

The table also categorizes the respondents based on their work experience, divided into four categories. The largest group, at 38.7%, had 11-15 years of experience (129 respondents), followed by those with less than 5 years at 29.1% (98 respondents). Those with experience between 5-10 years were 23.4% (78 respondents), and the least experienced group, above 15 years, represented 8.4% (28 respondents).

In terms of professional specialization, the table categorizes respondents into three categories. The largest group, at 82.9% (276 respondents), were members of the audit committee. This is followed by departmental audit heads at 12.6% (42 respondents), and the smallest group, at 4.5% (15 respondents), were audit department managers.

The table (1) also illustrates the number of internal auditors in each respondent's department, segmented into five categories. The highest, 45.3%, fall into the 1-5 auditors bracket. This is followed by 6-10 auditors at 31.5%, 11-15 at 13.8%, more than 20 auditors at 5.7%, and the least, 16-20 auditors, at 3.6%.

To address the primary research question, evaluating the performance of the internal auditing function in Libyan banks, particularly Libyan commercial banks, the study undertook descriptive statistics like mean and standard deviation.

Table (2) provides a descriptive statistical analysis of the planning capability paragraphs

The table above illustrates the mean and standard deviations for the paragraphs related to planning capability. The table indicates that the mean scores for all the planning capability paragraphs range between 4.26 and 3.92. Meanwhile, the standard deviation ranges from 0.838 to 0.636. The highest mean score is for the paragraph, "It's possible to audit and review every activity within the specified time and cover the planned scope of audit activities," with a mean score of 4.26 and a standard deviation of 0.636, which is high. The next paragraph, "Internal auditors' work plan is clear," had a mean score of 4.25 and a standard deviation of 0.753, which is also high. On the other hand, the paragraph with the lowest mean score is "Internal auditing reviews compliance with policies, plans, procedures, and regulations" with a mean of 3.92 and a standard deviation of 0.838, which is still considered high.

Table (3) Descriptive statistical analysis of paragraphs related to improving the organization's productivity

Degree	Standard deviation	Mean	Paragraphs of the variable 'Development of the institution's productivity	Rank
Improving the productivity of the institution				
High	1.059	4.23	Internal auditing provides adequate follow-up to ensure the adoption of appropriate corrective actions and their effectiveness	1
High	.780	4.02	Taking timely actions to implement the recommendations in the internal audit report	2

High	.793	3.97	Internal auditing works to improve the organization's productivity	3
High	.814	3.79	Internal auditing improves organizational performance	4
Medium	.815	3.66	Internal auditing provides recommendations to improve the internal control system when necessary	5

The table above presents the mean scores and standard deviations for the paragraphs related to the development of organizational productivity. The table shows that the mean scores for all these paragraphs range between 4.23 and 3.66, while the standard deviation ranges between 1.059 and 0.780. The paragraph with the highest mean score is "Internal auditing provides adequate follow-up to ensure appropriate corrective action effectiveness" with a mean score of 4.23 and a standard deviation of 1.059, which is high. The paragraph with the lowest mean score is "Internal auditing offers recommendations to

enhance the internal control system when needed," having a mean score of 3.66 and a standard deviation of 0.815, categorized as medium.

Table (4) Descriptive statistical analysis of the effectiveness of internal auditing paragraphs

Degree	Standard deviation	Mean	Effectiveness of Internal Auditing	Rank
Effectiveness of Internal Auditing				
High	1.071	4.09	Internal auditing reviews compliance with applied external laws and regulations.	1
High	1.117	3.91	Internal auditing determines the adequacy and effectiveness of the internal accounting systems and operational controls in the institution.	2
High	.949	3.89	Internal auditing reviews processes and programs to ensure results are aligned with defined objectives and goals.	3
High	1.055	3.89	Internal auditing reviews the economical, efficient, and effective use of resources.	4
High	1.024	3.86	Internal auditing reviews the means of asset protection.	5
High	1.025	3.86	Internal auditing evaluates and improves the effectiveness of risk management.	6
High	1.142	3.81	Internal auditing evaluates the internal control system.	7
High	1.122	3.80	Internal auditing reviews the accuracy and reliability of financial reports.	8

The table above displays the arithmetic means and standard deviations for the items related to the effectiveness of internal auditing. The table reveals that the mean scores for all items related to enhancing the institution's productivity range between 4.09 and 3.80, while the standard deviation for the scores varies between 1.142 and 0.949. The table further shows that the highest arithmetic mean was for the item "Internal auditing reviews compliance with applicable external laws and regulations," with an arithmetic mean of 4.09 and a standard deviation of 1.071, rated as high. This is followed by the item "Internal auditing determines the adequacy and effectiveness of the organization's internal accounting systems and operational controls" with an arithmetic mean of 3.91 and a standard deviation of 1.117, also rated as high. As for the items with a lower arithmetic mean, the statement "Internal auditing reviews the accuracy and reliability of financial reports" scored an arithmetic mean of 3.80 and a standard deviation of 1.122, rated as high.

Table (5): Descriptive statistical analysis for the items related to the role of the audit committee.

Degree	Standard deviation	Mean	Role of the Auditors' Committee	kRan
Role of the Auditors' Committee				
High	1.098	3.91	The audit committee assesses whether the management establishes the appropriate "control culture" by conveying the importance of internal control and risk management.	1
High	1.040	3.90	The audit committee reviews arrangements (such as the hotline) through which employees might raise concerns about potential violations.	2
High	.973	3.81	The audit committee reviews the clarity and completeness of financial statement disclosures, interim reports, and preliminary announcements.	3
High	1.015	3.80	The audit committee assesses the overall effectiveness of the internal control framework and risk management.	4
High	1.027	3.79	The audit committee understands the controls and processes implemented by management to ensure that the financial statements derived from the fundamental financial systems.	5
High	1.020	3.74	The audit committee shows interest in the company's ethical stance and its work conduct rules.	6
High	1.067	3.70	Committee meetings allow ample time for discussion and questions.	7
High	1.078	3.68	The audit committee reviews management's discussions and analysis, company earnings press releases, and earnings guidance provided to analysts.	8
Meduim	1.076	3.66	Committee meeting agendas and relevant primary information are circulated at least two days in advance.	9
Meduim	1.131	3.64	The audit committee monitors the selection of accounting policies and principles.	10

The table above illustrates the arithmetic means and standard deviations for the items related to the role of the audit committee. The table shows that the mean scores for all items pertaining to the role of the audit committee range between 3.91 and 3.64, while the standard deviation for the scores varies between 1.131 and 0.973. The table also reveals that the highest arithmetic mean was for the item "The audit committee evaluates whether management is instilling the appropriate 'control culture' by conveying the importance of internal control and risk management," with an arithmetic mean of 3.91 and a standard deviation of 1.098, rating it as high. This is followed by the item "The audit committee reviews arrangements (such as hotlines) through which employees can raise potential compliance concerns" with an arithmetic mean of 3.90 and a standard deviation of 1.040, also rated as high. As for the items with a lower arithmetic mean, the statement "The audit committee monitors the selection of accounting policies and principles" scored an arithmetic mean of 3.64 and a standard deviation of 1.131, rated as medium.

Table (6): Descriptive statistical analysis for the items related to independence.

Degree	Standard deviation	Mean	Independence	Rank
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Independence				
High	.607	4.41	The Board of Directors (President for governmental entities) approves the appointment and replacement of the Chief Internal Auditor.	1
High	.681	4.17	Internal audit staff have sufficient independence to perform their duties and professional obligations.	2
High	.597	4.12	The Chief Internal Auditor presents his reports to a level within the institution that allows internal auditing to fulfill its responsibilities.	3
High	.694	4.03	The internal audit management has direct communication with senior management, excluding the financial manager.	4
High	.754	3.98	Internal audit staff are not asked to perform non-audit related functions.	5
High	.857	3.92	Internal audit staff have the freedom to access all departments and employees within the institution.	6
High	.955	3.82	The Chief Internal Auditor has direct communication with the Board of Directors (to the head of governmental institutions).	7
High	.893	3.71	Internal auditors rarely face intervention from management while performing their duties.	8
Meduim	.865	3.66	There's seldom a conflict of interest in the work of internal auditors.	9

The table above illustrates the arithmetic means and standard deviations for the items related to independence. The table indicates that the mean scores for all items of independence range between 4.41 and 3.66, while the standard deviation for the scores varies between 0.955 and 0.597. The table further reveals that the highest arithmetic mean was for the item "The board of directors (or president for governmental entities) approves the appointment and replacement of the head of internal audit," emphasizing the importance of internal control and risk management, with an arithmetic mean of 4.41 and a standard deviation of 0.607, rating it as high. This is followed by the item "Internal audit staff possess sufficient independence to perform their duties and professional responsibilities" with an arithmetic mean of 4.17 and a standard deviation of 0.681, also rated as high. As for the items with a lower arithmetic mean, the statement "Conflicts of interest in the work of internal auditors are rare" scored an arithmetic mean of 3.66 and a standard deviation of 0.865, rated as medium.

To answer this question and determine the role of demographic information in evaluating the performance of the internal audit function in Libyan banks, a multiple linear regression test was conducted between the demographic information and the performance of the internal auditor, which includes the following dimensions (planning ability, enhancing the productivity of the institution, independence, effectiveness of internal audit, size of the internal audit management).

Table (7): Multiple linear regression test of demographic information and the performance of the internal auditor within Libyan commercial banks.

		Unstandardized Coefficients		Standardized Coefficients	Value (t)	Statistical function
		Value (b)	Standard Deviation	Beta Value		
1	(Constant)	4.155	.171		24.299	.000
	Age	-.129-	.063	-.158-	-2.061-	.040
	Gender	.044	.243	.022	.179	.858
	Educational	-.153-	.082	-.146-	-1.872-	.062

	qualification					
	Number of internal auditors in the department	.019	.045	.027	.409	.683
	Practical experience	.102	.081	.121	1.253	.211
	Job specialization	-.070-	.196	-.046-	-.355-	.723
Variable: The function of the variable for the entity						

From the table above, it is evident that there is no statistically significant relationship at the significance level ($\alpha \geq 0.5$) between gender, educational qualification, the number of internal auditors in the department, practical experience, job specialization, and the evaluation of the performance of the internal auditor role, as the statistical value was greater than (0.05). However, when considering the relationship between age and the evaluation of the performance of the internal auditor, it was found that there is a statistically significant relationship, as the statistical value came out to be (0.040), which is less than (0.05).

Conclusion

The survey results showed that respondents agree that the performance of the internal audit function is high, as indicated in tables (2,3,4,5,6), which show that most scores were rated high. However, there are still some items that respondents indicated were average, meaning they did not agree with their content. Therefore, the following should be noted:

- Internal auditing should provide recommendations to improve the internal control system when necessary.
- Tables of committee meeting agendas and related key information should be circulated before meetings.
- The audit committee should monitor the selection of accounting policies and principles.

As the study suggests, the following should be considered:

- Challenges facing the adoption of International Financial Reporting Standards (IFRS) should be addressed by providing a high-quality set of internationally recognized accounting standards that achieve transparency, accountability, and efficiency for financial markets worldwide.
- Given that IFRS standards achieve transparency by enhancing international comparability and the quality of financial information, and enable investors and other market participants to make informed economic decisions, all sectors in Libya should expedite the adoption of such standards.
- IFRS standards should enhance accountability by narrowing the information gap between capital providers and those entrusted with their money. Our standards provide the necessary information to hold management accountable as a source of globally comparable information. IFRS standards are also crucial for regulatory bodies worldwide.

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