



شبكة المعلومات الجامعية
التوثيق الإلكتروني والميكروفيلم

بسم الله الرحمن الرحيم



MONA MAGHRABY



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شبكة المعلومات الجامعية التوثيق الإلكتروني والميكروفيلم



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جامعة عين شمس التوثيق الإلكتروني والميكروفيلم

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MONA MAGHRABY



Faculty of Business

Accounting and Auditing Department

**A Proposed Framework for Assessing and
Interpreting the Factors that Determine
the Effectiveness of Internal Audit**

"A Field Study"

**إطار مقترح لتقييم وتفسير العوامل المحددة
لفعالية المراجعة الداخلية (دراسة ميدانية)**

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Prepared by

Eman Reda Sayed

Supervised by

Prof.

Mohamed Abdel-Fattah

Mohamed

Professor of Auditing

Vice Dean for Undergraduate

Faculty of Business

Ain-Shams University

Dr.

Mohamed Mahmoud

Abd-Rabo

Associate Professor of Accounting

& Auditing

Faculty of Business

Ain-Shams University

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Researcher Name: Eman Reda Sayed Ahmed
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Examination Committee

Dr. Mohamed Mahmoud Abd El-Maguid **Chairman**
Professor of Auditing
Faculty of Business-Ain Shams University

Dr. Mohamed Zedan Ibrahim **Member**
Professor of Accounting
Faculty of Commerce-El Menofia University

Dr. Mohamed Abdel-Fattah Mohamed **Supervisor**
Professor of Auditing-Vice Dean for Undergraduate
Faculty of Business-Ain Shams University

Dr. Mohamed Mahmoud Abd-Rabo **Co-Supervisor**
Associate Professor of Accounting and Auditing
Faculty of Business-Ain Shams University

Date of Thesis Defense:

Approved by Faculty council on: / /

Approved by University Council on: / /

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Abstract

Due to the technological, Political, regulatory, economic changes that's have occurred during the last decades have significantly affected basic functions, operations of the companies. In this respect, the rise of business risks, the economic instability and the importance increase of financial fraud scandals have necessitated the use of internal audit for companies.

As the internal audit function has been constantly evolving in line with these changes in the business environment. Contemporary challenges in the environment are closely related to risk and associated corporate governance issues. Consequently, the effectiveness of internal audit lies in the auditor's ability to achieve the established goals and objectives within the organization and if there is any barrier to achieve these goals, it will affect directly negatively not only the effectiveness of internal audit but also on the organization as a whole.

Additionally, the internal audit surrounded by a group of threats that considered as obstacles toward ensuring its effectiveness. The ineffective internal audit will not be capable to effectively accomplish the organization's objectives and perform its significant role towards the improvement of governance and accountability.

As the research problem previously mentioned, there is a significant importance of investigating the factors that determine the effectiveness of internal audit. Hence, the research discussed these factors as follows; (Internal auditors' capabilities, characteristics of internal audit, Independence and objectivity of internal auditors, Effective audit committee and the reliance of external auditors on the internal auditors' work) in terms of the existence of an effective Control environment.

Questionnaire was used for the needs of this study and depicted the internal audit effectiveness. The questionnaire assessed the perception of the internal auditors and the external auditors regarding the main factors which determine the effectiveness of the internal audit. The population of this study was

made up of the internal auditors, the internal auditor director and the senior managers of manufacturing sectors, in addition to that, the external auditors from the auditing firms.

- The results of this study revealed that "the internal auditors' behavior" is sufficient to exist in affecting the internal audit effectiveness and the internal auditors suffer from the shortage of both participating in training courses for self-development and the existence of a group of procedures that are known for perpetrating unethical behavior or illegal acts from the perception of external auditors.
- Besides, the results of the study indicated that the internal auditors' proficiency as a significant factor to ensure the internal audit effectiveness especially participating in continuous courses and the internal audit department has the necessary skills to be more competent in performing the audit work regarding the communication skills, problem identification, Solution skills, and information technology.
- Also, the results revealed that the reliance of external auditors on the internal audit work is determined by selected criteria and the compliance of the IIA standards as an indicator that there is an effective internal control.

Keywords: Effectiveness of internal audit, Internal auditors' capabilities, Effective control environment, Ethical culture, Effective Audit committee, Internal auditors' behavior, Internal auditors' resources, Independence of internal auditors, Objectivity of internal auditors, Proficiency of internal auditors, Effective risk management.

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General Framework of the Research

1.1 Introduction:

As a result of a variety of many changes in the business environment such as the accounting scandals, organizations being declared bankruptcy in recent years and the rise of business risks, the management has to play a pivotal role in managing their companies to be more effective. Failing to do Therefore; great scandals of financial embezzlements and fraud might face the companies in various sectors.¹

The International professional Practice framework (*IPPF, 2013 p.2*) has stated that the effectiveness of internal audit help organizations to accomplish their business objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process. In accordance with a *survey by the Institute of Internal Auditors, 2010 (IIA)* which indicated that supporting the internal audit to be effective is considered an imperative requirement to meet the new challenges of today's business environment. In addition to that, the value of internal audit will be assessed by its ability to drive influential positive changes and improvements (*IIARF 2010a b; IIARE, 2011 a, b, c, d*).²

¹ Dhiaa Shamki, Thuraiya Amur Alhajri, Study, (2017): "Factors Influence Internal Audit Effectiveness" **International Journal of Business and Management, Canadian Center of Science and Education**, Vol. 12, No. 10, P.143.

² Suhaily Suhaily, Nurmazilah Dato'Mahzan, Norhayah Zulkifli. (2016): "Value-added Services of Internal Auditors: An Exploratory Study on Consulting Role in Malaysian Environment", **International Journal of Management Excellence**, Vol.7, No.1.

Moreover, the importance of improving the internal audit effectiveness has an effect on the corporate governance to assure its importance in the company and is considered to be the crucial contributor to effective financial reporting and corporate governance. The internal audit quality affects relationships with other participants of corporate governance (Executive management, Audit committee, and external auditor) and consequently, the quality of corporate governance. Hence, the continuous improvement of internal audit effectiveness has a positive effect on the internal audit quality, considering that effectiveness is the main indicator of quality *Vuko, Sarens, (2009) & Ernst & Young, (2010)*. Internal audit has been identified as the most effective mechanism to improve the performance of the companies *Gupta, (2001) as cited in Mihret, (2011), Samuel, (2008)*. Other studies were conducted in Europe. In the same vein, studies in Greece, *Baltaci and Yilmaz (2006), Jokipii, (2010); Theofanis, Drogalas and Giovanis, (2011), Vijayakumar & Nagaraja, (2012)* have revealed that the absence of an effective control environment will impact negatively on ensuring the effectiveness of internal audit because it considers as one of the infrastructures for the success of the organization. Consequently, it is better to improve the effectiveness of the internal control environment for improving good governance *Eko & Hariyanto, (2011)*.¹ Therefore, ensuring internal audit effectiveness has become the main challenge that internal audit should successfully overcome to be the key component of good governance.

Additionally, there is a value-adding role provided by internal audit to ensure its effectiveness and owing to this, it is necessary to examine the effectiveness of the internal audit to assess the value-

¹ Ivana Barisic, Boris Tusek, (2016): "The importance of the supportive control environment for internal audit effectiveness- the case of Croatian Companies, *Journal of Economic Research*, www.tandfonline.com, vol.29, No.1.

adding associated with it. A study in Italy by *Arena and Azzone (2009)* has stated that the importance of identifying the organizational drivers of internal audit effectiveness because of the challenges that internal audit is continuously facing in terms of its role. In addition to that, Internal audit is demonstrated its increased significance throughout the years owing to its association with the internal control-risk management system. *G. Mihret, James, & Mula, (2010).*¹

1.2 Research Problem:

A study by *Arel et al. (2012)* has indicated that the internal audit department suffers from the lack of management support which can be viewed as a situation where there is a weak ethical leadership which prompts auditors to have greater doubts as regards audit work process. Besides, the study has mentioned to the importance of exercising due professional care when performing the audit work because internal auditors are required to develop their skills, knowledge and other competencies to be able to assess the related risks in an effective manner and control mechanisms. The institute of internal audit *IIA, (2010)* has stated the importance of continuous professional training programs to arm auditors with the necessary skills to address ever more complex audit activities professionally otherwise; the risk will threaten their independence and even negligently dealing with inaccuracies *Satava et al. (2006).*²

¹Seif Obeid Alshbiel, Study, (2017): "Internal Auditing Effectiveness Success Model: A Study on Jordanian Industrial Firms" **Proceedings of the Second American Academic Research Conference on Global Business, Economics, Finance and Social Sciences (New York Conference, USA, 2017), P.4.**

²Yahel Ma'ayan, Abraham Carmeli, (2016): "Internal Audit as a Source of Ethical Behavior, Efficiency, and Effectiveness in work units", **Journal of Business Ethics**, vol.137.

Another deterrent toward ensuring the effective internal audit is the lack of sufficient audit staff which considered being a major impediment to ensure effective internal audit as the internal audit department has to be equipped with the appropriate, sufficient resources as presented by *Ahmed Othman & Josef, (2009)*.¹

Moreover, internal auditors should maintain their independence and objectivity when performing the audit work as stated by the IIA standards. According to many studies have mentioned that internal auditors are exposed to some circumstances that threaten their independence and objectivity. As a recent report from the *Institute of internal auditing (IIA)* which is called (The politics of internal Auditing) revealed that internal auditors are typically fraught with tension and many auditors are working under inappropriate pressure. For example, managers try to force internal auditors to omit or modify conclusions that are regarded as damaging or ignoring high-risk areas of the operations as described by this report. The report classified this as political pressure and some authors described this as “extensive and pervasive”. Therefore, maintaining independence and objectivity has become a bigger challenge toward ensuring the effectiveness of internal audit *Steve Giles, (2015)*.²

Because of the occurrence of the illegal behaviors perpetrated by internal auditors which reflects negatively on ensuring the effectiveness of internal audit, several studies argued the importance of the internal auditors’ awareness by the ethical culture in terms of the adherence of the internal audit department with the internal audit

¹ Aaron Cohen, Gabriel Sayag, (2010): “The Effectiveness of Internal auditing: An Empirical Examination of its Determinants in Israeli Organizations”, **Australian Accounting Review**, Vol.20, No.54, Issue 3.

² Rittenberg, Land Miller, (2015): ”Threats to Audit objectivity- And How to manage them” **The global body for professional accountants**.