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## THEORETICAL FRAMEWORK AND PROPOSED RESEARCH MODEL ON FACTORS AFFECTING THE EFFECTIVENESS OF INTERNAL AUDIT IN VIETNAMESE ENTERPRISES

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### ABSTRACT

Based on synthesizing foundational theories and inheriting results from related prior studies on the effectiveness of internal auditing, the article proposes a research model on factors influencing the effectiveness of internal auditing in Vietnamese enterprises, including 5 factors: the competence of internal auditors, the independence of internal auditors, the application of information technology, managerial support, and the relationship between internal auditing and external auditing.

**KEYWORDS:** Internal auditing, effectiveness of internal auditing, independence, competence of internal auditors, application of information technology.

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### 1. INTRODUCTION

In recent years, especially in Western countries, the role of internal auditing has become increasingly important. Companies are more proactive in identifying risks, especially significant risks, while also developing more effective methods, programs, and approaches to auditing. Saren (2009) raised the question, "When can we speak of effective internal auditing?" in presenting the future outlook of internal auditing research. Looking at existing literature, there are many suitable answers to this question. Different answers may lead to debate or intervention in establishing a common guideline for determining the effectiveness of internal auditing (Mihret&Yismaw, 2007; Arena &Azzone, 2009; Mihret et al., 2010; George et al., 2015). Previous researchers have established relationships between internal auditing and:

- ✓ Company environment, managerial support, internal auditor quality, and the quality of internal auditing work (Albrecht et al., 1988);
- ✓ Rank, behavior, and attitudes of managers within the organization (Yee et al., 2008);

- ✓ Collaboration between internal auditors and external auditors, managerial support, and organizational setup (Arena &Azzone, 2009);
- ✓ Expertise, objectivity, performance, and the application of information technology (Wubishet& Dereje, 2014);
- ✓ Internal auditing quality, internal auditing team competence, internal auditing independence, and managerial support (George et al., 2015) can be seen as lacking consistency among factors in determining the effectiveness of internal auditing.

Based on related theories and suggestions from previous studies, the article proposes a research model on factors influencing the effectiveness of internal auditing in enterprises, including 5 factors: internal auditor competence, internal auditor independence, application of information technology, managerial support, and the relationship between internal auditing and external auditing.

## **2. THEORETICAL FRAMEWORK**

### **2.1. Related theories**

Gill & Johnson (2002) define theory as a formula of cause-and-effect relationships between two or more varying quantities, which may or may not be testable. There are some existing research articles related to theories of internal auditing. A new approach by Endaya &Hanefah (2013) is to combine three theories: agency, institutional, and communication.

In this study, the authors combine three theories as a basis for analyzing and proposing factors influencing the effectiveness of internal auditing in Vietnamese enterprises. The agency theory is considered the most important premise of the study because it stems from the relationship between unit owners and top management.

#### **2.1.1. Agency Theory**

Agency Theory is all about the relationships between unit owners and top management (Adams, 1994). It is a theory of the positive camp (Changwony& Rotich, 2015; Adam, 1994). For organizations like companies, top management manages the entire organization on behalf of the unit owners as an entity. Therefore, top management may use their authority for personal purposes. Consequently, it is not debatable when companies need to hire an independent party (internal auditors) to oversee the organization's activities and protect unit owners from these frauds (Peurseem & Pumphrey, 2005). Internal auditors, in their role as experts, must perform their duties perfectly (Endaya &Hanefah, 2013). To fulfill their role professionally and perfectly, they must possess professional judgment, academic and professional qualifications, and experience to conduct an audit (Greenawalt, 1997; Mihret&Yismaw, 2007). Internal auditors with these qualities will increase the confidence of the Board of Directors and the company's management (Endaya &Hanefah, 2013).

The role of internal auditing is to reduce the volatility of company owners by controlling the activities of the company's senior management. Internal auditing is the functional body of the audit committee and the board of directors to evaluate the work of the board of directors and senior management (Endaya &Hanefah, 2013). However, internal auditors may have other motivations

(financial rewards from senior management, personal relationships with senior management) to act against the interests of the board of directors and the audit committee. This is a consequence of giving senior management authority such as deciding the future position of internal auditors or their salary (Endaya & Hanefah, 2013). Agency Theory is often used to argue and resolve issues between senior management and the organization's owners.

Therefore, internal auditing plays a significant role in companies by reducing arising issues and controlling management activities (Ramachandran et al., 2012). Agency Theory plays an important role in pointing out that organizational governance structure and control structures aim to meet the expectations of company owners. Xiangdong (1997) explained the role of internal auditing in the economy through Agency Theory. Similarly, Fadzil et al. (2005) also mentioned the costs incurred by the internal auditing department to achieve the organization's common interests through Agency Theory.

### **2.1.2. Institutional Theory**

Institutional Theory explains the institutional pressures affecting organizational structure and operations (Abu-Azza, 2012). Institutional pressures include both internal and external factors (Mihret et al., 2010; Zucker, 1987). According to DiMaggio & Powell (1983), institutional pressures consist of three elements: regulations, norms, and isomorphism. Similarly, Arena & Azzone (2007) identified institutional pressures affecting individuals and organizations as Law and regulations (regulations), the choices of other organizations (isomorphism), and the advice of professional bodies (norms). Regulatory processes can enhance the effectiveness of internal auditing activities within an organization. This is because of the similarity with typical units in their industry (DiMaggio & Powell, 1983). This similarity can facilitate companies in connecting with each other to attract qualified, recognized, and administratively compliant employees (Abu-Azza, 2012). Regulations exert pressure on the formation of the internal auditing department (Al-Twaijy et al., 2003).

Institutional Theory suggests that each unit is a member of a group of units or industries related to each other in some way. This relationship leads to units influencing each other (Mihret et al., 2010). Arena & Azzone (2006) pointed out that Institutional Theory provides a means to understand the regulations and legal processes affecting the development of internal control systems. Institutions are social structures that have achieved a high level of resilience (Changwony & Rotich, 2015). DiMaggio & Powell (1983) argued that institutions are the result of structure. According to Mihret et al. (2010), in addition to Gidden's work, 1984, structure includes regulations and personnel that initiate functions within the general system.

Norms are pressures arising within the company. Normative pressures have a proportional relationship with changes in regulations adhered to by the organization (Abu-Azza, 2012). There are two key aspects of normative resources (DiMaggio & Powell, 1983). First, formal training programs are developed by experts. In this regard, internal auditors must attend internal auditing courses organized by professional associations. Second, training programs are conducted by professional teaching organizations. Accordingly, internal auditors must achieve certifications such as Certified Internal Auditor (CIA) or become part of the IIA within their organization. Thus,

training sessions and courses from training centers are crucial in developing a department within the company like internal auditing.

There have been many studies on internal auditing that have approached Institutional Theory (Abu-Azza, 2012; Arena &Azzone, 2007; Changwony& Rotich, 2015; Mihret et al., 2010; Ramachandran et al., 2012; Al-Twaijy et al., 2003). Institutional Theory is suitable for these studies due to the following reasons. First, Institutional Theory includes the practical work of internal auditing as part of the company and facilitates discussions about organizational issues without being constrained by general objectives (Abu-Azza, 2012). Second, Institutional Theory is suitable for situations in countries with underdeveloped capital markets like Vietnam (Mihret et al., 2010). Therefore, this study relies on the similarity of regulatory and normative processes as mentioned in Institutional Theory to identify factors contributing to the effectiveness of internal auditing.

### **2.1.3. Communication Theory**

The International Institute of Auditors Standards (IIA Standards) and previous research have leaned towards studying IA within the framework of effective communication theory. Previous studies have emphasized the importance of communication skills within organizations, especially within the IA department (Golen, 2008; Hahn, 2008). Lack of effective communication skills can lead to improper information gathering or communication conflicts (Endaya &Hanefah, 2013). Whether minimal or significant, inappropriate information can hinder effective communication (Hahn, 2008). Effective communication skills for IA professionals entail efficient communication between IA professionals and auditees, independent auditors, and members within the organization, as well as among IA professionals themselves (Endaya &Hanefah, 2013). Communication skills are a necessary condition for IA professionals to conduct audits effectively, and this study has highlighted the role of communication skills through Communication Theory.

Traditional audit research has been conducted according to the standards of agency theory (Pilcher et al., 2011). However, Mihret et al. (2010) argued that classical economic theories, including agency theory, are primarily responsible for the limitations in IA research. Therefore, they explored institutional theory. Utilizing a combination of multiple theories has raised concerns about societal issues, behavioral aspects, and the scale of the economy. Many studies have approached both agency theory and institutional theory (Abu-Azza, 2012; Mihret et al., 2010). In this research, while agency theory primarily aids in identifying economic motivations - something IA professionals must detect behaviors aimed at achieving personal benefits even if it goes against the interests of the collective or even the common interest of the organization - institutional theory addresses the extent of adherence to the Standards of Professional Practice of Internal Auditing (ISPPA) and how this affects IA support for the company. Communication theory explains the importance of effective communication between IA professionals and auditees.

## **2.2. Studies on the Effectiveness of Internal Audit**

The IIA defines Internal Audit as follows: "Internal Audit 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."

Transparency, accountability, responsiveness, and effectiveness are four hallmarks of good governance (Belay, 2007). Effectiveness is the organization's ability to assess the output results of its operations based on various internal and external factors (Gregory & Ramnaravan, 1983). Effectiveness can also be understood as achieving operational goals through predefined measures (Ditternhofer, 2001). A similar interpretation can be applied to the effectiveness of Internal Audit (IA, 2010). Internal Audit activities have their own objectives, so achieving those objectives is influenced by various factors (Mihret A.G., 2011). Similarly, the effectiveness of Internal Audit is explained by Mihret & Yismaw (2007) as the degree to which the Internal Audit department achieves pre-established objectives. Furthermore, Internal Audit is effective when it provides on-demand services (Arena & Azzone, 2009; Mihret & Yismaw, 2007). According to Karapetrovic & Willborn (2000), effective auditing is the result of auditors' capability to conduct error-free audits, be ready to apply when necessary, and identify appropriate objectives.

Previous literature related to the effectiveness of Internal Audit has often focused on planning, execution, and reporting of results (Sprakman, 1997; Ditternhofer, 2001). Recent research highlights that Internal Audit is effective if it meets desired objectives (Mihret and Yismaw, 2007). Effective Internal Audit performs independent evaluations of financial information and activities, as well as systems and processes, to provide useful recommendations for improvements when needed (Van Gansberghe, 2005). Getie Mihret and colleagues' (2010) study provided the perspective that the effectiveness of Internal Audit is the expectation of achieving set objectives. Similarly, according to IA (2009), effective Internal Audit helps enhance and protect the organization's value. In conclusion, the effectiveness of Internal Audit lies in achieving established objectives and adding value to the organization by assisting management in evaluating and enhancing the effectiveness of risk management, control, and governance processes. Additionally, the effectiveness of Internal Audit is demonstrated through advising senior management to improve risk management activities, participate in goal setting, and policy formulation (Phan Trung Kien, 2013).

Previous studies have introduced various approaches and measurement techniques for assessing the effectiveness of Internal Audit. Some studies focus solely on compliance procedures, without addressing stakeholders' requirements (Hanim Fadzil et al., 2005; Ditternhofer, 2001). Other studies examine Internal Audit effectiveness by referencing the auditees' needs (Cohen and Sayag, 2010).

### **2.3. Studies on Factors Influencing the Effectiveness of Internal Audit**

In the world, there are quite a few studies concerned with the factors influencing the effectiveness of Internal Audit (IA) in various types of organizations.

Christopher et al. (2009) measured the independence level of the IA department in 34 Australian companies through the relationship between management and the audit committee. The survey was conducted via email sent to IA department heads, identifying risks affecting the independence of IA through the audit committee. These risks may include IA department heads not reporting timely to the audit committee, the audit committee not being responsible for appointing, supervising, and evaluating the results of IA, and audit committee members lacking financial accounting competence. Therefore, Christopher et al. assessed and measured the independence of IA based on surveys of enterprises, thus inferring the impact of this factor on the effectiveness of IA.



Alzeban and Gwilliam (2014) presented a model comprising five factors influencing the effectiveness of internal audit. The study data were collected by sending survey questionnaires to management personnel of audited departments in 79 public sector organizations in Saudi Arabia and to 396 internal auditors in the same audited organizations under the General Audit Bureau (GAB). The study provided evidence for identifying factors such as auditor competency, internal audit department size, top managerial support, the relationship between internal audit and external audit, and internal auditor independence for the functions of internal audit; the degree of impact on the effectiveness of internal audit in the public sector in Saudi Arabia. This study highlighted the role of management in supporting the effective implementation of internal audit functions.

Saidu Badara and Zabedah Saidin (2014) also developed a model of influencing factors in Malaysia with fewer but overlapping independent variables, yielding similar positive results, with internal auditor independence identified as the foundation and the most important factor.

JantipaDejnarok (2015) conducted a survey to identify factors influencing the effectiveness of IA in Thai companies. The author also conducted surveys using regression models and structural equation modeling (SEM). The results showed that the author identified three (3) new factors influencing the effectiveness of IA: (1) compliance with IIA principles, (2) IA based on risk identification, and (3) the presence of improvement and quality assurance programs. Through the study, JantipaDejnarok identified three additional factors influencing the effectiveness of IA, thereby proposing solutions to improve the IA department in companies.

Drogalas George et al. (2015) conducted a survey on 40 subjects, namely internal auditors of companies in Greece. The study identified four (4) factors influencing the effectiveness of IA in companies: (1) quality of work of internal auditors, (2) independence of internal auditors, (3) auditor competence, and (4) support from management. These results are consistent with previous studies in developing countries. Additionally, the authors provided recommendations to improve the quality of IA operations in these companies.

Another model with four influencing factors - the quality of internal audit, the competence of the internal audit department, independence, and managerial support - impacting the effectiveness of internal audit was conducted by Drogalas and colleagues (2015) with positive results in Greek companies.

Marius Gros et al. (2016) conducted a survey to measure the quality of IA in establishing and operating IA systems in German companies. Additionally, the study performed regression tests to measure the correlation of some IA quality characteristics affecting the quality of financial reporting in these companies. The results showed that IA systems operating effectively positively affect the preparation and presentation of financial reports in companies. This result supports the positive view of IA as an essential factor in effective corporate governance and plays a crucial role in financial reporting.

Samar Yousry El-Tahan (2016) conducted a thesis on Applying IA in developing countries: A case in the public sector in Egypt. The study measured the influence of IA in the public sector in Egypt.

The article also identified barriers to the application of IA and proposed appropriate recommendations to overcome these barriers. The study used qualitative methods through interviews with individuals operating in this field. The results indicated that the capacity and independence of IA in the public sector are not high. In addition, the role of IA is limited to auditing financial statements and compliance audits, while the modern definition of IA has highlighted the role of IA more in assessing the accuracy of financial reports than in typical financial reporting audits.

Khalid et al. (2017) presented a model of factors influencing the effectiveness of IA, including the competence and independence of IA, and managerial support. The authors all used empirical research by collecting detailed questionnaire data sent to IA and relevant stakeholders. The research models were conducted in different contexts and all yielded positive consistent results. Additionally, other studies proposed additional influencing factors such as the scale of the IA department (Alzeban and Gwilliam, 2014; Salehi, 2016); risk management factors and the effectiveness of risk management systems (Badara and Saidin, 2014), and the scope of IA work (Sakour and Laila, 2015; Salehi, 2016). Through experimental research and quantitative analysis, the authors also reached positive conclusions regarding these factors and the effectiveness of IA.

### **3. PROPOSAL FOR A RESEARCH MODEL ON THE FACTORS INFLUENCING THE EFFECTIVENESS OF INTERNAL AUDIT IN VIETNAMESE ENTERPRISES**

#### **3.1. Proposed research model**

Based on related theories and previous studies on Internal Audit, the author has selected the factors influencing the effectiveness of Internal Audit to be included in the research model in Vietnamese enterprises, including:

- The competence of Internal auditor affects the effectiveness of Internal Audit positively in Vietnamese enterprises.
- The independence of Internal auditor positively influences the effectiveness of Internal Audit in Vietnamese enterprises.
- The application of information technology positively influences the effectiveness of Internal Audit in Vietnamese enterprises.
- Managerial support positively affects the effectiveness of Internal Audit in Vietnamese enterprises.
- The relationship between Internal Audit and External Audit positively influences the effectiveness of Internal Audit in Vietnamese enterprises.

Therefore, the proposed model of factors influencing the effectiveness of Internal Audit is as follows:

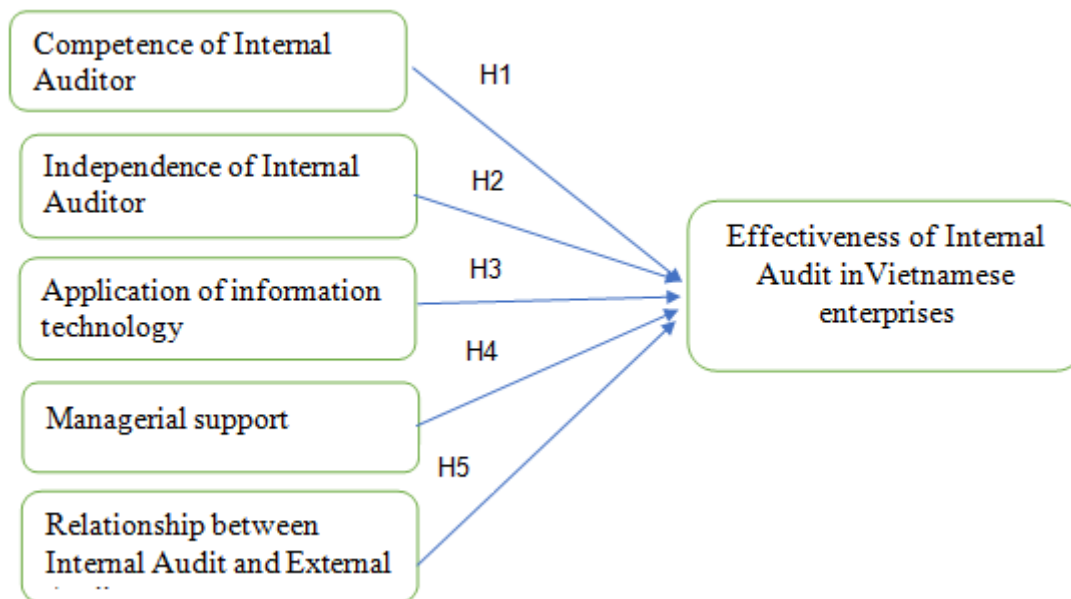


Figure 1: Proposed model

### 3.2. Research hypotheses

#### 3.2.1. Competence of Internal Auditor

The competence of Internal Audit is crucial for enhancing the effectiveness of Internal Audit. According to the International Accounting Standards (2011), Internal Auditors must acquire and develop knowledge, skills, and other professional competencies to carry out their duties. Moreover, Internal Auditors must perform operational functions alongside financial functions.

Previous studies have shown that competence plays a significant role in the effectiveness of Internal Audit. If an organization has competent Internal Audit staff, the following benefits will materialize within the company. Firstly, they can conduct efficient internal audits within the organization. Secondly, they assist in reducing audit costs as independent auditors utilize the results of Internal Audit. Thirdly, Internal Auditors can provide information for reports under ideal conditions. Therefore, the competence of the Internal Audit team is significantly related to the effectiveness of Internal Audit.

*H1: Competence of Internal Auditor positively influences the effectiveness of Internal Audit in Vietnamese enterprises.*

#### 3.2.2. Independent of Internal Auditor

Previous literature mainly focused on the independence of external auditors. However, nowadays, independence is also emphasized for internal audit. Independence is the cornerstone of the effectiveness of internal audit activities; the effectiveness of internal audit cannot be achieved without independence. Therefore, the position of internal audit in the organization is constrained, being a part of the company but having the autonomy and independence to carry out its activities properly. Independence is defined as follows by Abu-Azza (2012): "Independence is generally understood as the auditor's ability to perform an assessment and appraisal fairly and objectively without being influenced by any pressure that could affect their opinion."



Similarly, The Institute of Internal Auditors (IIA) standard 1100 on independence states that "Internal audit activity must be independent in performing its duties" (IIA, 2011). The standard explains each term regarding independence as follows: "Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner."

The IIA has issued numerous standards (IIA, 2011) and accompanying practice guides (IIA, 2009) related to independence. Regarding this issue, Standard 1130 state that "the necessity to disclose to appropriate parties any impairment to independence." Impairment here refers to evaluating the organization's activities at least annually, including personal conflicts of interest, limitations on scope and resources, constraints on access to information, personnel, and assets. Standard 1110 indicate that the head of the internal audit department must report directly to the company's board of directors (IIA, 2011; KPMG, 2003). According to the standard, the head of the internal audit department confirms the independence of the department's organization at least annually within the company's structure. Therefore, the internal audit department is responsible for reporting whether its activities significantly affect the independence and effectiveness of internal audit work. Thus, the independence of the internal audit department is crucially related to the effectiveness of internal audit activities.

*H2: The independence of the internal auditor department positively influences the effectiveness of internal audit in Vietnamese enterprises.*

### **3.2.3. Application of Information Technology**

Rezaee et al. (2001) stated that auditors can easily access all information with the assistance of deep search capabilities. According to Shaikh (2005), Information Technology (IT) is considered to provide an advantage for auditors in the auditing process. IT aids auditors in completing their tasks more efficiently and effectively, shortening the time required for content review during assessments and improving productivity. Chaveerug and Ussahawanitchakit (2009) suggested that the development of IT has influenced the internal audit and auditing processes within organizations. The use of IT in auditing can enhance the efficiency of auditing work. Some components include deep information search, transaction analysis remediation, comprehensive audit practice, continuous audit process improvement, and timely auditing report generation. According to Shaikh (2005) and Hall (2015), auditors use various software to access accounts and data stored in different formats in different locations such as cloud computing, cloud, hard drives, etc. This enables auditors to access clients' electronic data files and performs their tasks more efficiently, demonstrating that the advent of IT benefits auditors in the auditing process. Computer-assisted audit involves any use of technology to aid in assessment completion, including automated work papers and traditional document processing applications like computer-assisted audit (Braun & Davis, 2003). Audit standards also encourage auditors to use computer-assisted audit methods to check the accuracy of electronic files and perform selected procedures such as processing accounts receivable (Zhao et al., 2004). IT can help auditors shorten the time required for content testing in sampling procedures. Both statistical and non-statistical sampling methods are allowed for basic evaluations (Higgins & Nandram, 2009). Mustapha and Lai (2017) also suggest that the application

of IT in internal audit helps shorten the audit process timeline and complete their tasks more effectively.

*H3: The application of information technology positively influences the effectiveness of Internal Audit in Vietnamese enterprises.*

### **3.2.4. Managerial Support**

Managerial support is a determining factor in the effectiveness of internal auditing (Mihret&Yismaw, 2007; Mihret&Woldeyohannis, 2008). Due to the dynamic and supportive environment in which internal auditing operates, auditors expect support from management. According to SPPIA 1110 on organizational independence, for auditors to perform their tasks effectively, they should receive support from senior management such as executives and the coordination of the audit committee (IIA, 2011). Albert et al. (1988) identified four factors that enhance the effectiveness of internal auditing: managerial support, suitable organizational environment, high-quality internal auditors, and a conducive organizational environment. AbuAzza (2012) explains managerial support as the encouragement provided by the Board of Directors to internal auditors. According to Abu-Azza (2012), this encouragement involves organizing educational and training programs for the internal audit team; appropriate budget allocation for the internal audit department; bonuses and support for the internal audit team; and acceptance and implementation of internal auditors' recommendations. Therefore, managerial support has a significant relationship with the effectiveness of internal auditing.

*H4: Managerial support positively influences the effectiveness of internal auditing in Vietnamese enterprises.*

### **3.2.5. The Relationship between Internal Audit and External Audit**

Internal auditing, external auditing, audit committees, and senior management are considered the four fundamental pillars of corporate governance, with internal auditing and external auditing being the primary representatives of stakeholders in business (Gramling, 2004). Internal auditors and external auditors need to collaborate in their activities, respect each other, and leverage each other's capabilities (Sawyer, 2005). By improving coordination and cooperation between internal and external auditors, auditors can both enhance the effectiveness and efficiency of auditing activities and benefit from each other's work (Wood, 2004). When a company maintains effective internal auditing, external auditors can identify low control risks and reduce the scope of their testing. Based on the results of internal auditors' testing, external auditors can complete their audits in shorter time frames and at lower costs. Due to the benefits derived from effective collaboration between parties, audit costs, and therefore audit fees, will decrease when external auditors believe that benefiting from internal auditing activities is appropriate (Wood, 2004; Suwaidan &Qasim, 2010).

Furthermore, studies by Soh & Martinov-Bennie (2011); Abu-Azza (2012); Lenz et al. (2014) have identified that collaboration with external auditors enhances the effectiveness of internal auditing in privately held enterprises. Abu-Azza (2012) reported that the majority of internal audit managers in Libyan organizations believe that collaborating with external auditors is beneficial for internal auditing.

*H5: The relationship between Internal Audit and External Audit positively influences the effectiveness of Internal Audit in Vietnamese enterprises*

#### 4. CONCLUSION

Internal auditing plays a crucial role in helping businesses achieve their objectives when it is performed, operated, and managed effectively. Enterprises that effectively implement, operate, and manage internal auditing can identify business risks well and detect inefficiencies in the system in implementing corrective measures and improving internal auditing processes.

This article hopes to contribute to the progress towards a unified framework in researching and evaluating the effectiveness of internal auditing in Vietnamese enterprises by proposing a research model for future experimental studies. However, due to the complexity and specificity of internal auditing activities, the proposed research model needs to be validated by experimental studies. This is also a limitation and a direction for future research of the author of this article.

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