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**An Examination of Internal Audit Compliance with  
International Standards for the Professional Practice of  
Internal Auditing:  
An Empirical Study of Saudi Joint Stock Companies**

**Saad M. Mariq, PhD<sup>1</sup>**

# **An Examination of Internal Audit Compliance with International Standards for the Professional Practice of Internal Auditing:**

## **An Empirical Study of Saudi Joint Stock Companies**

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### **Abstract**

The aim of this research is to determine whether the internal audit departments of Saudi joint stock companies comply with the International Standards for the Professional Practice of Internal Auditors (ISPPIA). The research is based on a survey of chief internal auditors of companies listed on the Saudi Stock Exchange as of February 2007. Seventy-four questionnaires were sent to directors of internal audit departments in Saudi joint stock companies listed on the Saudi Stock Exchange. The companies represent 8 sectors: banking, industrial, cement, services, electrical, telecommunication, insurance, and agricultural. Responses to each question were scored on a five-point scale ranging from a high score (Always) to a low score (Never). Thirty-six completed questionnaires were returned (48.6%). This study provides empirical evidence that the internal auditing practices of the Saudi joint stock companies comply with the ISPPIA. A significant percentage (89%) of internal audit department managers believe they are required to adhere to the

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ISPPIA submitted by The Institute of Internal Auditors (The IIA).

The present study found evidence that 78% of internal audit managers stated that there are no local or other standards to which they are required to adhere. In addition, the responses revealed that the purpose, authority, and responsibility of the internal audit activity are defined in a charter, are consistent with the ISPPIA and are approved by the board.

In all organizations studied, 84% believe that internal audit departments are independent. Moreover, the responses stated that internal auditing departments in Saudi companies are adequately staffed with competent personnel who possess the necessary skills and competencies to perform their individual responsibilities.

The survey revealed that internal audit managers report periodically to the board and senior management on the purpose, authority, responsibility, and performance of the internal audit activity.

This study notes that to provide valuable and important services, internal auditors should adequately follow recognized standards such as the ISPPIA. Moreover, a professional internal audit complying with the ISPPIA would support both the board and executive management in carrying out their responsibilities. One distinguishing feature of internal auditing as a respected profession is its commitment to professional standards such as the ISPPIA.

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The primary objective of the internal audit function is to provide assurance to the audit committee and management regarding the efficiency of controls, management of risk and effectiveness of corporate governance. They deliver value by facilitating operational improvement and promoting best practices across the enterprise. They create synergies with external auditors to avoid duplication of audit work and enhance controls. They build relationships with senior management to strengthen the commitment of the company to risk management improvements. They seek disciplined and talented internal audit professionals who embody integrity, (Roth, 2002; Carcello et al., 2005; ECIIA, 2005b; Vance, 2006). Carcello et al. (2005) added that the emphasis on internal auditing has increased markedly since 2001. In the aftermath of the large corporate failures such as Enron and WorldCom, regulators have taken steps to ensure that companies have internal auditing.

Internal audit is one of the cornerstones of corporate governance, along with the board of directors, senior management and

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external audit. It provides audit committee members with valuable assistance by giving objective assurance on governance, risk management and control processes. In order to do this effectively, an internal audit function must be adequately resourced, professionally staffed and follow the internationally recognised framework for internal auditing provided by The IIA (IIA-UK and Ireland, 2004).

Around the world, organizations face escalating financial, operational, strategic and physical risks that have been increasing steadily in terms of impact, likelihood and complexity. This should come as no surprise as the pace and complexity of change continues to accelerate regardless of geography. Corporate governance regulations and guidelines, financial reporting requirements, operational efficiencies, customer satisfaction levels – all these factors drive the internal audit functions of companies to add value beyond any standard that has been set in the past.

The IIA's definition of internal auditing reflects the broad duties of internal auditors in their organizations. The encompassing nature of the definition allows for future development of the role of the internal audit. The new definition is as follows: "Internal auditing 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" (IIA, 2007, p. 9).

The European Confederation of Institutes of Internal Auditing (ECIIA) recognises that, in order to fulfil this definition and, therefore, to address most effectively management objectives and stakeholder interests, a professional internal audit activity must comprise competent professionals working within an organisation in accordance with The IIA's International Standards for the Professional Practice of Internal Auditing (ISPPIA) (ECIIA, 2005a). The ECIIA added that a professional internal audit activity, meeting this definition and complying with the Standards, is a key component of any governance mechanism. Various government-mandated commissions in several European countries have supported this view.

One of the criteria usually considered necessary for a group to achieve professional status is a set of standards to guide the members of the profession in their rendition of services (Allan, 1991; Hooks, 1991). A genuine business profession is characterized by a dedication to craft, a sponsorship organization, a set of standards and ethical guidelines, a member certification programme that includes continuing professional education requirements, and a forum for ongoing discussion and continuing professional education. What differentiates internal auditing from most other professions, though, is the single, global nature of its standards. The internal audit profession is shaped and guided by the ISPPIA from The IIA; these standards engender quality and consistency for internal audit organizations throughout the world. Yet flexibility and adaptability underscore the Standards: as the internal audit profession continues to evolve, so does our

understanding of its parameters (Mautz and Sharaf, 1961; Goodwin, 2003; Pickett, 2005).

The ISPPIA were first published in 1978 and are recognised as the quality benchmark of the profession. They have been adopted by key standard-setting bodies in public and private sectors worldwide. The last changes to the Standards became effective in January 2007.

These standards are designed for all types of internal audits. The Standards consist of Attribute Standards, Performance Standards, and Implementation Standards. The Attribute Standards address the characteristics of organizations and parties performing internal audit activities. The Performance Standards describe the nature of internal audit activities and provide quality criteria against which the performance of these services can be evaluated. The Attribute and Performance Standards apply to all internal audit services, while the Implementation Standards apply to specific types of engagements (IIA, 2007).

The purpose of the Standards is to:

1. Delineate basic principles that represent the practice of internal auditing as it should be.
2. Provide a framework for performing and promoting a broad range of value-added internal audit activities.
3. Establish the basis for the evaluation of internal audit performance.
4. Foster improved organizational processes and operations.

The ISPPIA provide the basis for the guidance and evaluation of internal audit performance and outline the systematic methodology that will deliver objective assurance. Adherence to



the ISPPIA is mandatory for members of The IIA and its affiliates and for all qualified internal auditors. By requiring internal audit work to be performed in accordance with the Standards, the audit committee and the board gain additional assurance that the internal controls of their organisation are adequate, which should strengthen public trust in the financial reporting system (ECIIA, 2005a).

Fadzil et al. (2005) stated that one issue that has emerged related to internal auditing practices is “what is a proper and sound measurement of the internal auditing practices?” Fadzil notes, “effectiveness (of internal audit) can be described, but it is difficult to quantify and in the final analysis, effectiveness is determined by the perception of auditees.” In the company environment, the management is the most important auditee of the internal audit department since the effectiveness of the internal auditing practices can be described through the expectations thereof held by the management. The management will expect the internal auditors to perform their internal auditing practices to a certain level compliant with the Standards for the International Professional Practice of Internal Auditors (ISPPIA, now known as the Professional Practice Framework, PPF) since it can be easily described. Compliance with the SPPIA is therefore an indication of the effectiveness of the internal audit department.

The IIA was established in 1941 and currently represents 100,000 internal auditing professionals worldwide. All internal auditing professionals are required to adhere to The IIA’s Code of Ethics and to comply with the ISPPIA, which ensures that internal

audit work is performed by competent professionals in compliance with professional guidance and rules of conduct requiring objectivity, due professional care and periodic quality assessments (IIA, 2007).

To add value through internal auditors, it is important for them to comply with the Standards for the (ISPPIA) (Ridley & Chambers, 1998; Moeller & Witt, 1999). Paape et al. (2003) added that adherence to professional standards – such as those used by The IIA worldwide – is a prerequisite for undertaking effective internal audits. Organisations should ensure that this is one of the key benchmarks for any internal audit provision.

To the author's knowledge, research examining the role of internal auditors in risk management in Saudi companies is scant. Therefore, the main objective of this study is to determine whether the internal audit department of the Saudi joint stock companies complies with the ISPPIA.

This paper is structured as follows. The next section outlines the development of the ISPPIA. The third section focuses on a review of the literature. The fourth section explores the research method, with the fifth section reporting the results of the empirical study. The final section formulates conclusions and outlines some suggestions for future research.

## **Compliance with International Standards for the Professional Practice of Internal Auditing**

The year 1941 has been noted as being the year of the birth of internal auditing. Sawyer (1981) stated that modern internal auditing began to evolve in 1941 when the Institute of Internal Auditors was formed. International Standards for the Professional Practice of Internal Auditing were developed by the Professional Standards and Responsibilities Committee of the Institute of Internal Auditors in 1978. The purpose of this section is to provide a historical perspective of the development of the ISPPA. The remainder of this section will explore the advantages of complying with the ISPPA.

### **The Development of the ISPPA**

The role and professional status of the internal auditor began changing as businesses decentralized and expanded their operations. Although corporations, financial executives, internal and external auditors, and the academic community all talked about an expanded and professionalized role for the internal auditor, the changes were slow and did not gain significant momentum until The Institute of Internal Auditors (IIA) was formed in 1941 (Gupta, 1991; Rittenberg, 2001).

In September 1977, the draft of the ISPPA was finalised and proposed standards were published in December 1978; the subcommittee of the standards worked for thirty months preparing the exposure draft (IIA, 1978). The Standards are

subject to a systematic process of review and development. The Internal Auditing Standards Board engages in extensive consultation and discussion prior to the issuance of new versions of the Standards, including worldwide solicitation for public comment through the exposure draft process. The last changes to the Standards became effective in January 2007 (IIA, 2007). Chapman (2001) stated that these revisions to the Standards clearly demonstrate the progress of the internal auditing profession over the last 30 years. Internal auditors with vision and commitment can ensure that the history of the profession will continue its upward spiral.

Gupta (1991) added within a few years of its formation that The IIA had made remarkable progress, establishing itself as a legitimate body to oversee the professional interests of internal auditors. When The Institute issued the ISPPIA in 1978, it further broadened the scope of internal auditing by redefining it as "an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization." These Standards emphasize the role of the contemporary internal auditor as a service to the organization rather than only to the management.

Abrune (2004) stated that The IIA has traditionally been recognized as the standard-setting body for effective internal audit programmes. While IIA standards are not legally mandated, compliance with those standards instils a level of confidence among bank audit committees, management and the investing public in the quality and effectiveness of a bank's internal audit function.

Beelde (2002) and Abrune (2004) added that the International Standards and the Code of Ethics are followed by all IIA members and are the foundation of the profession of internal auditing. The International Standards are recognized as the quality benchmark of the profession. They have been adopted by key standard-setting bodies in the public and private sectors worldwide.

Rittenberg (2001) stated that the demands for professionalism, knowledge, integrity, and leadership have never been more stringent. To be effective, internal auditors must serve as objective assurance providers and advisors to management, the board of directors, and the audit committee; they must provide guidance on improving operational efficiency and control and educate personnel regarding control concepts. In addition, they evaluate risk and facilitate the improvement of risk and control processes within an organization. The boundaries of internal audit responsibility are as broad as today's business and the demand to add value requires a responsive and clearly articulated approach to the practice of internal auditing.

The Standards are a crucial part of the Professional Practices Framework (PPF), which includes the Definition of Internal Auditing, the Code of Ethics, the Standards, and other guidance. Guidance regarding how the Standards might be applied is included in Practice Advisories issued by the Professional Issues Committee. This framework was proposed by the Guidance Task Force and approved by The IIA's Board of Directors in June 1999. The Standards incorporate the guidance previously contained in the "The Red Book," recasting it into the new format

proposed by the Guidance Task Force and updating it as recommended in the report of the Task Force, "A Vision for the Future" (Abrune, 2004).

Whitley (2006) stated that whether regulatory requirements or awareness of the importance of internal controls is behind this initiative, the banking industry has led the pack in complying with the Standards and the related Practice Advisories.

### **The Standards**

The ISPPIA describe the nature of internal auditing and the characteristics of parties performing internal audit. They also provide quality criteria against which the performance of internal audit can be evaluated. Purpose, Authority and Responsibility: the purpose, authority, and responsibility of internal audit should be formally defined in a charter, consistent with the International Standards and approved by the board. Independence and Objectivity: the internal audit function should be independent and internal auditors should be objective in performing their work. Proficiency and Due Professional Care: all internal audits should be performed with proficiency and due professional care. Quality Assurance and Improvement Programme: the head of internal audit should develop and maintain a quality assurance and improvement programme, including internal and external quality assessments (Colbert, 2002; Chapman, 2001).

The ISPPIA consist of three sets of standards, all of which are mandatory (IIA, 2007):

1. Attribute Standards - cover the purpose, authority and responsibility of internal audit, its independence and

objectivity, proficiency and due professional care, as well as quality improvement programmes including both internal and external assessments.

2. Performance Standards - cover managing the internal audit activity (including developing risk-based plans), the nature of work (including risk management, control and governance), engagement planning, performing the engagement, communicating results, monitoring progress and addressing the acceptance of risks by the management.
3. Implementation Standards - apply the attribute and performance standards to specific types of engagement (for example, a compliance audit, a fraud investigation, or a control self-assessment project). There is one set each of attribute and performance standards; however, there may be multiple sets of implementation standards: a set for each of the major types of internal audit activity. Initially, implementation standards are being established for assurance activities.

Colbert (2002) pointed out that the internal auditor applies attribute, performance, and implementation standards when performing both assurance and consulting work. In an assurance engagement, the internal auditor provides an independent assessment of one or more aspects of risk management, control, or corporate governance. When planning a consulting engagement, an agreement is made with the client as to the nature and scope of the work to be performed, again, related to risk management, control, or corporate governance. The results

of assurance and consulting services help management achieve its objectives.

The purpose of the Standards is to:

1. Delineate basic principles that represent the practice of internal auditing as it should be.
2. Provide a framework for performing and promoting a broad range of value-added internal audit activities.
3. Establish the basis for the evaluation of internal audit performance.
4. Foster improved organizational processes and operations.

The ISPPIA are the criteria by which the operations of an internal auditing department are evaluated and measured and are intended to represent internal auditing practice as it should be. They are also meant to serve the entire profession of internal auditing in all types of organizations (Chapman, 2001).

### **Compliance with the ISPPIA**

Internal audit activities are performed in diverse legal and cultural environments, within organizations that vary in purpose, size, and structure, and by persons within or outside the organization. These differences may affect the practice of internal auditing in each environment. However, compliance with the ISPPIA is essential if the responsibilities of internal auditors are to be met.

The IIA was established in 1941 and currently represents 100,000 internal auditing professionals worldwide. All internal auditing professionals are required to adhere to The IIA's Code of Ethics and to comply with the ISPPIA, which ensures that internal



audit work is performed by competent professionals in compliance with professional guidance and rules of conduct requiring objectivity, due professional care and periodic quality assessments.

Rittenberg (2001) stated that the base of the hierarchy of the Professional Practices Framework (PPF) is its mandatory guidance, embodied in the Code of Ethics and the Standards. This foundation maintains the principles of auditing practice. One distinguishing feature of a respected profession is its commitment to ethical conduct that embraces integrity, honesty, and diligence; another is a commitment to provide the highest quality of service, as well as to guide practising professionals. The Standards form the second facet of the mandatory guidance of the PPF. Whether used when performing governmental audits, information technology audits, or consulting activities, they are uniform around the world.

Rittenberg added that standards and mandatory guidance are interesting concepts. By making them mandatory, the Standards must embrace fundamental concepts of internal auditing that are unambiguous and can be easily interpreted and applied anywhere. Developed to stand the test of time, the Standards set a baseline for measuring performance even though there may be a number of ways in which internal audit activities can be organized or carried out to be in compliance with them.

As mandatory sections of the PPF, the Code of Ethics and Standards should be incorporated into all aspects of an internal audit activity from staffing to assurance and consulting services. Because the fundamental principles are incorporated into every

facet of the internal audit function, the Standards are invisible on a daily basis. However, they should guide every aspect of internal audit activities. At least every five years, auditors should demonstrate adherence to the Standards through a quality assessment.

Overshadowed in 2002 by the widespread and strident introduction of the Sarbanes-Oxley Act and its related internal control requirements, The IIA introduced an enhancement — the addition of a quality assurance review (QAR) requirement — to its compliance standards. A QAR is an independent assessment of the internal audit function and activities of a bank. Under IIA standards, a QAR must be performed at least once every five years by a qualified, independent reviewer or review team from outside the organization. Why are the IIA standards receiving attention now? The compliance deadline for the 2002 standards was 1 January 2007. Only banks that did not have an internal audit function as of 1 January 2002 can claim an exemption. Banks that are not compliant as of the end of 2006 cannot, without meeting this quality assurance review requirement, claim their internal audit programme meets IIA international standards (Manohar, 2004).

Rittenberg (2001) stated that the benefits of applying the ISPPIA are illustrated by a WorldCom case study. The internal audit function at the US telecoms giant WorldCom acted effectively and efficiently when it detected the financial irregularities that led to the company's decline in 2002. But according to Dick Thornburgh, the former US Attorney General charged with investigating the WorldCom debacle, the narrow operational

focus of internal audit might have contributed to the organization failing to detect and address the improper accounting practices earlier.

In his 2003 report, Thornburgh found “a number of deficiencies in the operations of the audit committee and internal audit”. The report says that the audit committee appeared to have met the letter of its charter and acted in good faith to carry out its duties “on the surface” but the committee members rarely scratched below that level. For example, while most of the audit committee thought that internal audit reported to it, this was not in fact the case: internal audit reported to senior management both functionally and practically, allowing senior management to exert “unwarranted influence” on internal audit. With its independence compromised, internal audit was not able to provide the audit committee with the level of assurance necessary for good corporate governance.

Thornburgh found that the internal audit function was not fully supported by senior management at WorldCom. As a result, the head of internal audit attempted to gain acceptance by focusing the efforts of the team on audits that would be seen to “add value” by identifying revenue and cost improvements. This approach was in contrast to the IIA International Standards, which state that the internal audit plan should be risk-based.

The WorldCom audit committee reviewed the internal audit plan only as a formality and provided no real scrutiny or oversight of the function. If the WorldCom internal audit and audit committee had been committed to following the ISPPA, it is likely that many of these issues would have been corrected.

As a conclusion, when internal auditors comply with the ISPPIA they will deliver value to their organizations as one of the cornerstones of governance. Moreover, compliance with the ISPPIA is essential if the responsibilities of internal auditors are to be met.

## **Review of the Literature**

A review of the literature reveals that only a few empirical or archival research studies have touched on the issues of internal audit department compliance with the ISPPIA. A brief overview of this literature is presented below:

**Powel et al. (1992)** carried out a study to search for evidence of professionalism in the practice of internal auditing by 1104 internal audit members in eleven countries: Australia, Canada, France, India, Israel, Italy, Japan, New Zealand, South Africa, the United Kingdom, and the United States. A questionnaire survey investigated (1) the effectiveness of the professional culture of the internal auditor to achieve compliance with internal auditing standards, (2) the extent of the independence of the internal auditor from management, and (3) the scope of work performed by the internal auditor. They found an overall compliance rate of 82% with the ISPPIA. This high percentage prompted the authors to suggest that the ISPPIA provided evidence of the internationalization of the internal audit profession. The findings indicate that evidence of the elements of professionalism is present in the countries surveyed.

**Paape et al. (2003)** conducted a study to sketch in broad brushstrokes the relationship between the internal audit function (IAF) and corporate governance (CG) among the top listed companies in the European Union (EU). The groundwork for this article was laid in May 1998 when the European Commission (EC) initiated a discussion via its Committee on Auditing regarding the role and position of the statutory audit in Europe.

Seventy-two (72) per cent of the respondents said they were required to adhere to IIA standards. However, while in Finland, Ireland, Luxembourg, Austria and Sweden the response on this matter was almost 100%, in the other countries it swung wildly from 83% in Italy to 25% in Denmark. In total, 28% of the respondents stated that they did not require adherence to ISPPIA. As for obeying other standards, which could be national accountancy rules, 39% said they must adhere to them, and a massive 61% thought it was not necessary.

**Fadzil et al. (2005)** carried out a study of which the main objective was to determine whether compliance with the ISPPIA of the internal audit departments of companies listed on Bursa Malaysia would affect the quality of the internal control systems of the companies. They found that the management of an internal audit department, professional proficiency, objectivity and review significantly influence the monitoring aspect of the internal control system. The scope of the work and the performance of audit work significantly influence the information and communication aspect of the internal control system while the performance of audit work, professional proficiency and objectivity significantly influence the control

environment aspect of the internal control system. The study also showed that the management of an internal audit department, the performance of audit work, audit programmes and audit reporting significantly influence the risk assessment aspect of the internal control system. They also found the performance of audit work and audit reporting significantly influence the control activities aspect of the internal control system. The management of an internal audit department positively influences the monitoring aspect of the quality of the internal control system but it is negatively influenced by professional proficiency, objectivity and the review of the internal auditing practices. The information and communication aspect of the quality of the internal control system is negatively influenced by the scope of the work of the internal auditing practices but is positively influenced by the performance of audit work. The control environment aspect of the internal quality control system is positively influenced by the performance of audit work while it is negatively influenced by professional proficiency and objectivity. The risk assessment aspect of the quality of the internal control system is negatively influenced by the management of an internal audit department but is positively influenced by the performance of audit work, audit programmes and the reporting of the internal auditing practices. The control activities aspect of the quality of the internal control system is positively influenced by the performance of audit work and the reporting of the internal auditing practices.

Koutoupis (2005) assessed the current status of corporate governance, business risk management & internal audit in Greek

companies listed on the Athens Stock Exchange (ASE) after the introduction of several laws and regulations by the Greek state. Koutoupis also tried to identify their main weaknesses and possibilities to improve their service level by compliance with the ISPPIA, the implementation of international best practices and the possibility of adjustment to the local regulatory framework.

For the majority of cases, internal audit staff did not sign forms concerning their compliance with the ISPPIA. In addition, many internal auditors were not members of the Hellenic Institute of Internal Auditors so they were not obliged to comply with such standards. Koutoupis suggested that internal auditors should sign a form regarding compliance with the ISPPIA.

The above literature review shows that few of academic studies have investigated internal auditors' compliance with the ISPPIA. These studies took place in the UK, the US. To our knowledge, internal auditors' compliance with the ISPPIA in Saudi Arabian companies has not been the subject of any study. The literature reveals the importance of complying with the ISPPIA. Our study contributes to this emerging literature by examining the existing practices of internal auditors in relation to the ISPPIA in Saudi joint stock companies. The data for the research were obtained through a survey sent to the joint stock companies in Saudi Arabia. The next section explores the research method.

### **Research Method**

The prime purpose of this study is to determine whether the internal audit department of the Saudi joint stock companies

complies with the International Standards for the Professional Practice of Internal Auditors.

The questionnaire was developed based on a review of the ISPPIA literature. A questionnaire was mailed to internal audit department managers. Seventy-four questionnaires were sent to directors of internal audit departments in Saudi joint stock companies listed on the Saudi Stock Exchange as of February 2007. New companies established during 2006 were excluded. The companies were drawn from a variety of industries. Table 1 shows that this group of 74 companies represents 8 sectors: banking, industrial, cement, services, electrical, telecommunication, insurance, and agricultural. These companies were chosen because they are the most regulated companies in Saudi.

The survey instrument sent to the internal audit departments was designed to elicit responses to 20 questions related to the ability of each internal audit department to comply with the ISPPIA. As discussed earlier in section two, there are three general areas covered by the standards: attribute standards, performance standards and implementation standards.

Since the aim of this study is to consider overall general compliance with the ISPPIA rather than any other issues, the measurement of the degree of compliance concentrated on these three areas of the ISPPIA.

The responses to each question in the present study were scored on the following five-point scale ranging from a high score (Always) to a low score (Never):

1. Always



2. Very Often
3. Sometimes
4. Rarely
5. Never

The questionnaire was composed in English, translated into Arabic by the researcher and then checked by an academic professional. In order to ensure that the questionnaire was intelligible, the draft questionnaire was sent to academic colleagues of the researcher. This pilot test resulted in some minor textual alterations. To encourage responses, a stamped envelope addressed to the researcher was sent with the questionnaire. The final survey contained 20 questions, and the paper version was four pages long, with one of these pages left empty for the respondents to write any comments. Two mechanisms were used to gain a good response rate: first, the questionnaire was sent through the post to the address of each company; second, an e-mail reminder was sent twice to companies that did not respond to the first mailing. Thirty-six (48.6%) responses were received. Table 1 show the response figures.

**Table 1: Response figures**

	Distributed forms	Returned forms	Returned (%)
Banking	10	8	80%
Industrial	28	12	42%

	Distributed forms	Returned forms	Returned (%)
Cement	8	3	37%
Services	19	8	42%
Electrical	1	1	100%
Telecommunication	2	1	50%
Insurance	2	1	50%
Agricultural	2	1	50%
Total	74	36	48.6%

\* Questionnaires were not sent to new Saudi joint stock companies established during 2006.

### Attitudes towards the statements

This section addresses a five-point Likert scale with 0 representing "Never", 25 representing "Rarely", 50 representing "Sometimes", 75 representing "Very Often" and 100 representing "Always".

The sample size was 36; the attitudes of the respondents towards the 14 statements are given in the form of frequency and percentiles, along with the weighted mean and the standard deviation. The attitudes of the respondents were computed for the five-point Likert scale according to the following categories:

<b>weighted mean range</b>	<b>attitude</b>
<b>0 to 19.99</b>	<b>Never</b>
<b>20 to 39.99</b>	<b>Rarely</b>
<b>40 to 59.99</b>	<b>Sometimes</b>
<b>60 to 79.99</b>	<b>Very Often</b>
<b>80 to 1000</b>	<b>Always</b>

The results are summarized in the following table:

Table 3

Question No.	Statements (arranged)	Always		Very Often		Sometimes		Rarely		Never		Weighted Average	SD	Attitude
		Freq	%	Freq	%	Freq	%	Freq	%	Freq	%			
1	Does your internal audit department require adherence to the International Standards for the Professional Practice of Internal Auditing?	24	66.7	9	25.0	2	5.6	1	2.8	0	0.0	88.9	18.4	Always
3	Is the purpose, authority, and responsibility of the internal audit activity formally defined in a charter?	20	55.6	15	41.7	1	2.8	0	0.0	0	0.0	88.2	14.0	Always
14	Does the chief audit executive share information and coordinate activities with the external auditors?	20	55.6	13	36.1	3	8.3	0	0.0	0	0.0	86.8	16.4	Always
6	Do you feel that the internal audit activity is free from interference in determining the scope of internal auditing?	17	47.2	16	44.4	3	8.3	0	0.0	0	0.0	84.7	16.1	Always
5	Is the internal audit department independent?	16	44.4	19	52.8	0	0.0	1	2.8	0	0.0	84.7	16.1	Always
12	Does the chief audit executive communicate the plans and resource requirements of the internal audit activity to senior management and to the board for review and approval?	13	36.1	22	61.1	0	0.0	0	0.0	1	2.8	81.9	18.5	Always
11	Do the internal auditors report that	17	47.2	15	41.7	2	5.6	0	0.0	2	5.6	81.3	24.9	Always

	their activities are conducted in accordance with the International Standards for the Professional Practice of Internal Auditing?	12	33.3	16	44.4	7	19.4	0	0.0	1	2.8	76.4	22.3	Always
4	Is the purpose, authority, and responsibility of the internal audit activity consistent with the International Standards for the Professional Practice of Internal Auditing?													
19	Do internal auditors develop and record a plan for each engagement, including the scope, objectives, timing and resource allocations?	12	33.3	17	47.2	4	11.1	2	5.6	1	2.8	75.7	24.3	Very Often
13	Does the chief audit executive ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan?	13	36.1	12	33.3	8	22.2	1	2.8	2	5.6	72.9	27.6	Very Often
17	Does the internal audit use adequate criteria to evaluate controls?	10	27.8	20	55.6	1	2.8	2	5.6	3	8.3	72.2	28.5	Very Often
20	Does the chief audit executive establish a follow-up process to monitor and ensure that management actions have been effectively implemented?	4	11.1	23	63.9	6	16.7	3	8.3	0	0.0	69.4	19.0	Very Often

10	Is the quality of the internal audit department evaluated by a qualified, independent reviewer from outside the organization?	9	25.0	17	47.2	5	13.9	2	5.6	3	8.3	68.8	28.9	Very Often
15	Does the chief audit executive report periodically to the board and senior management on the purpose, authority, responsibility, and performance of the internal audit activity relative to its plan?	8	22.2	17	47.2	7	19.4	1	2.8	3	8.3	68.1	27.8	Very Often
9	Do internal auditors have knowledge of key information technology risks and controls and available technology-based audit techniques to perform their assigned work?	4	11.1	19	52.8	6	16.7	2	5.6	5	13.9	60.4	30.1	Very Often
7	Do internal auditors possess the knowledge and skills needed to perform their responsibilities?	10	27.8	15	41.7	0	0.0	2	5.6	9	25.0	60.4	39.4	Very Often
18	Does the internal audit assess and make appropriate recommendations for improving governance?	3	8.3	15	41.7	14	38.9	1	2.8	3	8.3	59.7	24.8	Sometimes
8	Do the internal auditors have sufficient knowledge to identify the indicators of fraud?	7	19.4	17	47.2	0	0.0	2	5.6	10	27.8	56.3	38.9	Sometimes
16	Does the internal audit activity assist	2	5.6	11	30.6	18	50.0	2	5.6	3	8.3	54.9	23.8	Sometimes

	<b>the organization in maintaining effective controls:</b>																				
<b>2</b>	<b>Are there any other standards you require adherence to?</b>	<b>0</b>	<b>0.0</b>	<b>0</b>	<b>0.0</b>	<b>0</b>	<b>0.0</b>	<b>8</b>	<b>22.2</b>	<b>28</b>	<b>77.8</b>	<b>5.6</b>	<b>10.5</b>	<b>Never</b>							
	<b>Total</b>	<b>221</b>	<b>30.7</b>	<b>308</b>	<b>42.8</b>	<b>87</b>	<b>12.1</b>	<b>30</b>	<b>4.2</b>	<b>74</b>	<b>10.3</b>	<b>69.9</b>	<b>11.4</b>	<b>Very Often</b>							

From the previous table, the following results can be noted:

- 1- Seven statements out of twenty (about 35%) elicited the attitude "Always"; the largest weighted mean (88.9) among this group was for the question "Does your internal audit department require adherence to the International Standards for the Professional Practice of Internal Auditing?" and the lowest weighted mean (81.3) for the question "Do the internal auditors report that their activities are conducted in accordance with the International Standards for the Professional Practice of Internal Auditing?"
- 2- Nine statements out of twenty (about 45%) elicited the attitude "Very often"; the largest weighted mean (76.4) among this group was for the question "Is the purpose, authority, and responsibility of the internal audit activity consistent with the International Standards for the Professional Practice of Internal Auditing?" and the lowest weighted mean (60.4) for the question "Do internal auditors possess the knowledge and skills needed to perform their responsibilities?"
- 3- Three statements out of twenty (about 15%) elicited the attitude "Sometimes"; the largest weighted mean among this group (59.7) was for the question "Does the internal audit assess and make appropriate recommendations for improving governance?" and the lowest weighted mean (54.9) for the question "Does the internal audit activity assist the organization in maintaining effective controls?"



- 4- One question out of twenty (about 5%) elicited the attitude "Never" with a weighted mean of 5.6: "Are there any other standards you require adherence to?"
- 5- No questions elicited the attitude "Rarely".

### **Reliability analysis**

Reliability analysis allows us to study the properties of measurement scales and the items that compose the scales. The reliability analysis procedure calculates a number of commonly used measures of scale reliability and also provides information about the relationships between individual items in the scale. Intraclass correlation coefficients can be used to compute inter-rater reliability estimates.

Cronbach's alpha models internal consistency based on the average inter-item correlation and ranges from 0 to 1. Cronbach's alpha for the twenty statements equals 0.683, which may be considered "moderate to high".

## Results and Discussion

The purpose of this section is to explore the findings of the study. The aim of this research is to determine whether the internal audit departments of Saudi joint stock companies comply with the International Standards for the Professional Practice of Internal Auditors. The statistical analysis presented in Table 3 reveals that internal audit departments of Saudi joint stock companies are in compliance with the ISPPIA. The ISPPIA set out measures to safeguard the independence of the activity, a systematic methodology for auditors to apply in performing their duties, and quality assurance requirements.

Responses to the first question reveal that a significant percentage (89%) of internal audit department managers believe that they are required to adhere to the ISPPIA. These results confirm Izzard's (1988) findings in a 1987 survey indicating that members outside of North America regard the ISPPIA as the international link in the internal auditing profession. Powel et al. (1991) stated that worldwide adherence to the ISPPIA would provide evidence of acceptance by the business community, a collective programming, and hence the existence of a professional culture. They added that the distillation of current and future practices into an acceptable theoretical framework requires intellectual maturity. The IIA fosters the individual and collective intellectual maturity of its members through its certification programme, standards, conferences, quality assurance reviews, research and other activities. If internal auditing is an emerging international profession, then The IIA

through its members must look beyond country boundaries and form a consensus on theoretical issues that will be truly acceptable by and applicable to the worldwide community. Upon arriving at a consensus, the newly developed framework would be taken into practice for examination by the international profession to confirm its relevance and reliability. This consensus would provide a basis for the examination of all proposed future standards in a self-regulating system

When asked whether there were any other standards to which they require adherence, a significant percentage (78%) of internal audit managers stated that there are no local or other standards to which they require adherence. The responses also reveal that the purpose, authority, and responsibility of the internal audit activity are defined in a charter. Moreover, the responses stated that the purpose, authority, and responsibility of the internal audit activity are consistent with the ISPPA and approved by the board.

Another important issue in the ISPPA is the independence of the internal audit. Respondents were asked about the status of the independence of the internal audit within their companies; they were also asked whether they felt that the internal audit activity was free from interference in determining the scope of the internal auditing. The results show a high percentage of respondents (84%) believe that internal audit departments are independent. Chambers (1994) stated that the independence of internal auditors contributes to the effectiveness of the audit services. Pickett (2005) added that the concept of independence is fundamental: internal auditing cannot survive if is not objective. All definitions of internal audit feature an element of

independence, although its extent and how it is achieved are topics in their own rights. The audit function must have sufficient status and must be able to stand back from the operation under review for it to be of use. If this is not achieved, it constitutes a fundamental flaw in the audit service and some internal audit functions may not be able to subscribe to the ISPPIA.

Gleim (1989) pointed out that independence connotes that internal auditors must carry out their work free from influence from the organization so they may render impartial and unbiased judgments. Standard 110 relates that a free flow of information between the internal auditors and the board of directors enhances independence.

Responses to another question from the survey shed further light on the knowledge and skills of internal auditors. Compliance with the ISPPIA requires that internal auditors should possess the knowledge and skills needed to perform their responsibilities. The responses stated that internal auditing departments in these Saudi companies are adequately staffed with competent staff who possess the necessary skills and competencies needed to perform their individual responsibilities.

In addition, in all the organizations studied, the respondents believed that the internal auditors have sufficient knowledge to identify the indicators of fraud. Under the ISPPIA, internal auditors are required to have sufficient knowledge to be able to identify the indicators of fraud but are not expected to have the expertise of persons whose primary responsibilities are detecting and investigating fraud.

Thomas and Clements (2002) stated that in general, internal auditors appear to be more agreeable to accepting an active role in the prevention, rather than in the detection, of fraud. They also appear to be willing to take a more active role in fighting fraud to the detriment of the organization (usually employee fraud) than fraud for the benefit of the organization (usually involving management).

Pickett (2005) added that the first thing that needs to be in place to ensure competent internal auditors is effective human resource policies and practice. The ISPPA insist that each internal auditor should possess certain knowledge, skills, and other competencies, such as proficiency in applying internal auditing standards and procedures and proficiency in accounting principles. Pickett added that internal audit is now a complete profession and features in larger organisations in all sectors.

Regarding the evaluation of the quality of the internal audit department by a qualified, independent reviewer from outside the organization, the ISPPA require that "external assessments, such as quality assurance reviews, should be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organisation." When questioned on this issue, the responses of the internal audit managers reveal that most of the internal audit departments are evaluated by qualified, independent reviewers. In the case of Saudi joint stock companies, the internal audit departments are evaluated by external auditors.

One of the important issues related to the ISPPA is the way internal auditing departments communicate with the board. Table

3 show that the managers of audit departments communicate the internal audit activity's plans and resource requirements of the internal audit activity to senior management and to the board for review and approval. In addition, Table 3 reveals that internal auditors report that their activities are conducted in accordance with the ISPPIA.

The ISPPIA require that the chief audit executive should ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan. The respondents agreed that the internal audit departments in Saudi joint stock companies have appropriate and sufficient resources. In addition, internal audit departments share information and coordinate activities with the external auditors.

The survey revealed that internal audit managers report periodically to the board and senior management on the purpose, authority, responsibility, and performance of the internal audit activity. Appropriate communication between senior management, the board of directors and internal auditors will improve the effectiveness of the internal audit process.

The most surprising finding is that when internal auditors were asked about their role in assisting the organization in maintaining effective controls, the responses, as shown in Table 3, indicated that internal audit department participation was low. They stated that they "Sometimes" assisted in maintaining effective control. The ISPPIA state that the internal auditor must be concerned about the state of the controls in the organisation. The performance standard goes straight to the point: the internal audit activities should assist the organisation in maintaining effective

controls by evaluating their effectiveness and efficiency and by promoting continuous improvement. International organizations such as The Committee of Sponsoring Organisation of the Treadway Commission (COSO) have contributed significantly towards the adoption of best practices concerning internal controls. Over the last four years, both the Securities Exchange Commission (SEC) and the New York Stock Exchange regulations have strengthened internal control systems with the adoption of extremely strict laws and regulations. The United States Sarbanes-Oxley law (especially sections 302 and 404) have forced publicly listed companies and audit firms to develop and maintain robust well developed methodologies for documenting and testing the adequacy of internal control systems. Finally, local corporate governance laws and regulations that have been developed by various countries as a means to protect the interests of shareholders and stakeholders have also added value to the respective internal control systems.

Campbell et al. (2006) added that in most organizations, internal audit (IA) groups are focused solely on their role as an independent reviewer and critical appraiser of the effectiveness of internal controls and the overall financial health of the company. Although IA still owns this responsibility, it has new opportunities under the Sarbanes-Oxley Act of 2002 to provide much greater value to the organization.

The responses also revealed that when internal auditors are involved in assisting the organisation to evaluate internal controls, they use adequate criteria to do so.

This study found that internal audit departments assess and make appropriate recommendations for improving governance. Internal auditors also develop and record a plan for each engagement, including the scope, objectives, timing and resource allocation, and establish a follow-up process to monitor and ensure that management actions have been effectively implemented.

## **Conclusion**

This study has used research questionnaires to determine whether the internal audit departments of Saudi joint stock companies comply with the International Standards for the Professional Practice of Internal Auditors. This study has revealed that Saudi joint stock companies are complying with the ISPPIA. The Standards promulgated by The IIA have given internal auditors their professional identity around the world (Izzard, 1988; Verschoor, 1988). The ISPPIA clearly outline what internal auditors need to do to be effective. Moreover, the literature review reveals the importance of the ISPPIA in ensuring that internal auditing is effective.

The factors leading to a high level of compliance by internal audit departments to the ISPPIA are firstly that the Standards describe the nature of internal auditing and the characteristics of parties performing internal audit activities. They also provide quality criteria against which the performance of internal auditing can be evaluated. The second factor is the role and importance of internal auditing as a cornerstone of corporate governance; because of the unique position of internal auditors within the organization, they provide the audit committee and the



board of directors with valuable assistance, especially in the areas of risk management and control processes. To provide such valuable and important services, internal auditors should adequately follow recognized standards such as the ISPPIA.

A professional internal audit compliant with the ISPPIA would support both the board and executive management in carrying out these responsibilities. The IIA - UK and Ireland (2004) stated that in organizations in which the internal audit activity complies with the ISPPIA, the audit committee would find it much easier both to comply with its own charter and regulatory requirements and to execute its oversight responsibilities effectively.

Another principal concern is the reporting line and the independence of internal auditing. The internal auditing position of Saudi companies in the organization is at a sufficiently high level and sufficiently detached from functional areas to guarantee its independence.

Future research possibilities exist in several dimensions. One of them is the applicability of ISPPIA to the Saudi environment and whether the accounting and auditing regulators in Saudi should promulgate customized internal audit standards. A cost/benefit study could also be conducted to evaluate the cost of complying with the ISPPIA compared to the benefit. Reducing the cost of external audits could be another area of study: internal audit compliance with the ISPPIA could reduce the cost of external auditors. Family-owned companies in Saudi represent a large sector in the business community; another study could investigate the impact of ownership structure on complying with the ISPPIA.

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