

The impact of internal audit independence on internal audit effectiveness: A case study of Vietnam

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Abstract: Internal audit is a crucial instrument for achieving efficient business oversight and adding value. Assessing key factors influencing its effectiveness, including independence, is therefore paramount for organizations aiming to maximize the internal audit's contribution. This study investigates the impact of internal audit independence on internal audit effectiveness. Drawing on primary data, a survey was administered to 265 internal auditors and managers working in corporations with established internal audit functions across Vietnam. Descriptive statistics, including a frequency table, mean, and standard deviation, provided preliminary insights, while inferential statistics, including Pearson's correlation analysis and regression analysis, utilizing SPSS 22, were employed to test the hypothesized relationship. The empirical findings demonstrate a robust and statistically significant positive influence of internal audit independence on the perceived effectiveness of internal audit activities. These results conclusively highlight independence as a critical determinant of internal audit effectiveness ($\beta = 0.569$, $p\text{-value} = 0.000$). Based on this evidence, the study provides actionable recommendations aimed at internal audit departments, senior management, and relevant regulatory bodies in Vietnam to strengthen internal audit independence and enhance their overall contribution to organizational governance.

Keywords: Effectiveness, Independence, Internal audit (IA).

1. Introduction

Internal audit (IA) is defined as “an independent, objective assurance and consulting activity designed to feature value and improve an organization's operations” [1]. In 2020, the Institute of Internal Auditors (IIA) updated IA's definition to reflect these transformations as following: “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” [2]. The aforementioned description indicates that IAs have been modified to improve and add value to an organization's operations by providing a wide range of services, including operational consulting and audit services. IA can enhance the organization's ability to attain its objectives by employing a systematic and principled methodology to evaluate and refine the efficacy of its risk management, control, and governance processes [1]. IA guarantees the organization's strategic processes, governance, and risk management, facilitating the attainment of its strategic, operational, and financial objectives. IA activities occur across various cultural and legal contexts, within organizations that possess diverse objectives, sizes, and structures, executed by distinct internal or external entities. Previously, the IA's responsibilities were limited to financial estimation and oversight of control measures. In recent years, the significance of IA has been markedly emphasized by companies compelled

to utilize it Burnaby and Hass [3]. This results from technological, political, regulatory, and economic changes over recent decades that have profoundly impacted corporate functions and operations, heightening business risks, economic volatility, and financial fraud scandals [4–6].

IA began to form and develop in the world both in theory and practice in the 1940s of the last century. In Vietnam, on October 28, 1997, the Ministry of Finance issued Decision No. 832-TC/QĐ/CDKT on regulations on IA applicable to enterprises, which is considered the first legal document of Vietnam on IA. However, due to insufficient awareness and inconsistent viewpoints, at that time, this document was not seriously implemented. After nearly 20 years, before the inadequacies in the inspection and control of state financial activities, corporate finance, and the requirements of international economic integration, a market economy, internal control, IA has officially included legal provisions in the revised Accounting Law 2015. In particular, on January 22, 2019, the Government issued Decree No. 05/2019/ND-CP regulating IA, including some regulations on IA at enterprises, and by 2020, the Ministry of Finance had issued more detailed guidance documents. Some businesses, mostly well-known enterprises or banks, have started to effectively use internal audit, including Bao Viet, Vinamilk, BIDV, Vietcombank, ..., the rest do not have an IA [7]. The situation in Vietnam shows that many cases related to self-interest actions of the Board of Directors (BOD) have caused serious impacts on the interests of the company's shareholders, but there is no warning voice until the case was discovered. The most typical example is the embezzlement and abuse of the right to appropriate property of a series of high-ranking officials at Ocean Bank. The reason is that most of the business owners in Vietnam are not properly aware of the role, duties, and functions of internal audits in the business operations of enterprises. The role of the IA is rather fuzzy, partly due to the lack of a corporate governance system in Vietnam. IA has not attracted highly qualified human resources; has not been properly trained, does not ensure professional ethical principles of IA independence and objectivity... so it is difficult to control quality [8].

The new role of IA has increased the effectiveness of IA in risk management, corporate governance, and internal control. Both public and private sectors are interested in IA independence as a key factor that affects IA effectiveness in evaluating and appropriately managing for organizational goal achievement [9, 10]. While IA is playing its rightful role in developed countries, the pace of its adoption in developing countries has been slow, and there is little information showing how internal audits may effectively be implemented in these countries [11]. Therefore, there are few studies have been conducted on independence affecting IA effectiveness in developing countries and the public sector. This situation has led to growing concern and a need for answers to questions about the effect of IA independence on the effectiveness of IA. This study aims to assess the impact of IA independence on its effectiveness within the context of Vietnam. The research findings serve as the foundation for recommending enhancements to the independence and effectiveness of the IA.

2. Literature Reviews

2.1. Internal Audit Effectiveness

The efficacy of AI is a multifaceted concept that is scarcely examined in accounting and auditing literature. Dittenhofer [12] posits that the effectiveness of internal auditing is defined by the attainment of its objectives. According to the official definition of IA [22], the primary objective of IA is to generate value for the organization. Prior research indicates that the effectiveness of IA is focused on enhancing organizational value by assisting the Board of Directors (BOD) in assessing and refining the effectiveness of risk management, internal control, and management processes Budiandru [13]; Gramling, et al. [4] and Yee, et al. [14]. Al-Twaijry, et al. [15] established that the IA can enhance organizational value by facilitating the attainment of economic objectives through the execution of IA recommendations. IA can enhance a company's competitive advantage by ensuring superior financial reporting and refining governance processes [16]. IA facilitates adherence to existing laws and regulations within the organization, thereby establishing conducive conditions for external auditors' work [5, 17]. While Sawyer [18] contended that IA identifies deficiencies in business processes, [19]

asserted that IA offers an independent evaluation of business activities and procedures. The efficacy of IA is focused on attaining its primary objective, which encompasses generating value and enhancing organizational performance.

2.2. Internal Audit Independence

Over the years, specialized agencies and standards-issuing bodies have emphasized the importance of auditor independence and objectivity for the quality of IA, even though these auditors may be employees of the organization. The internal auditors' independence has been known as the foundation of the IA definition and a critical factor in the IA effectiveness. This definition is derived from the IIA, which stated that: "*the IA activity must be independent, and internal auditors must be objective in performing their work*" [20]. Independence means there are no threats that affect the internal auditor's ability to perform tasks objectively; in other words, the IA is independent when executing their work, unaffected by factors such as personal or economic interests. Independence is often linked with objectivity. International Standard for the Professional Practice of Internal Auditing (ISPPIA) [21] indicates that independence and objectivity can be achieved through reporting at different levels: providing services to management, reporting to the audit committee, and ultimately being accountable to the chief executive officer (CEO) or Board of Directors (BOD) for achieving its goals and utilizing its resources. This structure enables the internal auditor to carry out their responsibilities freely without interference from other parties, allows the IA department to avoid conflicts of interest, maintains direct communication with management, grants the IA unlimited access to employees' activities and departmental operations, provides the right to change the head of the IA department without direct management intervention, ensures freedom in scope determination, enables IA budget approval solely by the board, and prohibits the performance of non-audit work ... [2, 9, 14, 22].

Independence is a major factor in evaluating the IA's effectiveness. Researchers have found that the greater the independence of the IA department, the more effective the IA. [2, 9, 10, 14, 23, 24]. Other studies have shown that the lack of independence is a major obstacle to the effectiveness of the IA. The research of Ahmad, et al. [23] focused on the lack of independence in the practice of IA, thereby raising concerns about whether the lack of IA independence can affect the strength of the IA department. Mustika [25] concludes that a lack of IA independence and objectivity or interference by audit stakeholders results in bias in evidence collection, evaluation, audit recommendations, and reporting. Without independence, IA simply becomes part of the management team, losing the ability to provide accurate, objective advice or guaranteed services [14].

Based on previous studies, authors measured the IA independence through the scope of work, reporting levels, unrestricted access to all departments and employees, and performing non-audit services.

2.3. Scope of Work

The audit's scope is constrained when, for any reason, the IA is hindered from examining a critical aspect of the entity due to restricted access to records, information, or accountability [26]. Consequently, International Standard for the Professional Practice of Internal Auditing (ISPPIA) [21] mandates that an IA function must operate autonomously in defining its functional scope, executing its mandate, and reporting outcomes. In the event of any interference, the chief audit executive (CAE) must report the issue to the board, emphasizing potential ramifications. This standard delineates the extent to which the internal auditor's independence is compromised, thereby impacting effectiveness in instances of scope limitation. Conversely, research by Hellman [27] indicates that financial directors frequently attempted to influence the determination of the IA scope, resulting in diminished independence and efficacy of the IA. Sakour and Laila [28] contended that the autonomy of internal auditors influences the effectiveness of IA by enabling them to independently determine the scope of their work, audit duration, the breadth of audit procedures, the incorporation of significant audit findings in the audit report, and direct reporting to the audit committee. The scope of IA must encompass the entire

organization to allow the board to fulfill its legal and functional responsibilities [29]. The function should autonomously determine its scope or assignments for all work aspects.

2.4. Reporting Levels

Institute of Internal Auditors (IIA) [1] contended that to maintain independence, the Chief Audit Executive (CAE) should report directly to the board, which, through the IA charter, should approve the risk-based IA plan, receive updates from the CAE regarding IA's performance of the plan, and sanction decisions concerning the appointment and dismissal of the CAE. To institutionalize the independence of IA, the CAE reports functionally to the highest level of the organization to execute obligations impartially [21]. Furthermore, the CAE must annually confirm in writing to the board the organizational independence of the IA unit. Aluvala [30] contended that internal auditors require the requisite authority to maintain their independence, thereby delineating the scope of work, facilitating effective communication, and ensuring adequate implementation of audit recommendations.

According to Lawrence [31] in countries where the role of IA is highly valued, functional reporting by IA has shifted from senior officers in organizations to audit committees of the boards. Aluvala [30]; Alzeban and Gwilliam [22]; Salehi [32] agree that to build an appropriate level of independence for IA effectiveness, the CAE should report administratively to the senior executives and functionally to the board. Similarly, Zhang, et al. [33] identified IA reporting levels as significant criteria in influencing IA independence and ultimately IA effectiveness.

2.5. Unrestricted Access to All Departments and Employees

Arens and Loebbecke [34] asserted that to guarantee adequate independence and improved efficacy of the audit function, it must be granted perpetual access to accounting records, financial statements, information, and explanations. To enhance independence for IA effectiveness, there must be direct interaction or access between the internal auditor and the organizational board [21]. The CAE must have unrestricted and direct communication and interaction with the board. Restrictions on access to records, personnel, properties, and auditing resources will undermine the internal auditor's independence and, consequently, its effectiveness. A consensus exists in the study conducted by Aluvala [30].

2.6. Performing Non - Audit Services

Some researchers believe that auditor independence will be affected when the audit firm provides additional non-audit services to the client [3]. To build up sufficient independence for the IA effectiveness, [29] recommends separating internal auditors from providing non-audit services, including design, selection, or implementation of internal control. Kimotho [26] argues that the performance of non-audit services by internal auditor erodes and impairs their independence and objectivity, and is a recipe for familiarity and self-review threats to independence. This is the responsibility of entity executives to avoid a self-review threat to independence. When auditors are prohibited from providing non-auditing services, independence will be maintained at a high level [30].

DeFond, et al. [35] asserted that the evidence from their study did not substantiate the notion that the provision of non-audit services compromised the independence of the IA function. The research conducted by Zhang, et al. [6] concluded that the provision of non-audit services by auditors does not result in a loss of either independence of mind or appearance.

3. Research Method

3.1. Research Model

The research model was developed by building upon prior studies regarding the impact of IA independence on its effectiveness (Figure 1).

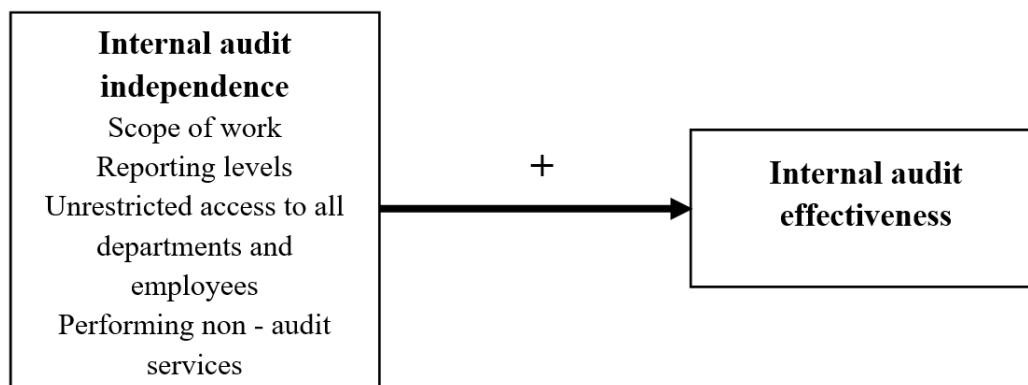


Figure 1.
Research Model.

The study encompasses the variables and their corresponding indicators in Table 1.

Table 1.
The variables and indicators.

Variables	Indicators	Sources
Internal audit independence (DL)	DL1 - Scope of work: The internal audit possesses the autonomy to determine the scope, timing, and extent of audit procedures by audit standards and organizational policies. DL2 - Reporting levels: The internal audit function operates and communicates findings directly to the audit committee. DL3 - Unrestricted access to all departments and employees: Internal audit has the authority to access all necessary documents, information, and data of the organization when performing the audit. DL4 - Performing non - audit services: Internal auditors are not obligated to provide non-audit services.	Kimotho [26] and Sakour and Laila [28] Aluvala [30]; Alzeban and Gwilliam [22] and Salehi [32] Arens and Loebbecke [34] and Yousif, et al. [9] Kinney Jr [19] and Zhang, et al. [6]
Internal audit effectiveness (HH)	HH1: Internal audit helps the organization achieve its goals HH2: Internal audit helps to evaluate and improve the effectiveness of risk management HH3: Internal audit provides recommendations for improving the internal control. HH4: Internal audit helps to improve the organization's operational efficiency	Al-Twajry, et al. [15]; Dittenhofer [12]; Gramling, et al. [4]; Yee, et al. [14]

Source: Compiled by author.

3.2. Sample and Data Collection Method

The survey subjects of this study are internal auditors and managers, mainly from companies listed on the Vietnam stock market, using a convenience sampling method. The data collection is done through survey questionnaires. The questionnaire included Likert-type items (ranging from 1= “strongly disagree” to 5 = “strongly agree”).

Based on the study of Hair, et al. [36] and Tabachnick and Fidell [37] the minimum sample size is 100. Thus, the total number of votes issued via email and Google Docs in the study was 300, and the number of valid votes was 265 (accounting for 88.33%).

3.3. Data Analysis Method

After collection, the data from the respondents were coded, cleaned, and analyzed through several steps, including reliability assessment of the scales using correlation analysis, and linear regression analysis by SPSS 22 to test the research hypotheses.

4. Results and Discussion

4.1. Descriptive Analysis

Of the surveyed subjects, the percentage of internal auditors (including CAEs) was 62.4%, while managers (including heads of the department) was 37.6%.

As shown in Table 2, DL3 (IA has the authority to access all necessary documents, information, and data of the organization when performing the audit) was rated highest with a mean score of 3.79 (SD = 0.997) followed by DL1 (the IA possesses the autonomy to determine the scope, timing, and extent of audit procedures by audit standards and organizational policies) and DL2 (the IA function operates and communicates findings directly to the audit committee) with a mean score 3.65 and 3.51 (SD = 0.989 and 0.934). DL4 (Internal auditors are not obligated to provide non-audit services) had a mean score of 3.24 (SD = 0.925).

Table 2.

Descriptive Statistics of Internal audit independence.

	N	Mean	Std. Deviation
DL1: the internal audit possesses the autonomy to determine the scope, timing, and extent of audit procedures by audit standards and organizational policies	265	3.65	0.989
DL2: The internal audit function operates and communicates findings directly to the audit committee	265	3.51	0.934
DL3: Internal audit has the authority to access all necessary documents, information, and data of the organization when performing the audit	265	3.79	0.997
DL4: Internal auditors are not obligated to provide non-audit services	265	3.24	0.925
Valid N (listwise)	265		

Source: Compiled by author

As shown in Table 3, HH4 (IA helps to improve the organization's operational efficiency) was rated highest with a mean score of 3.68 (SD = 0.622) followed by and HH2 (Internal audit helps to evaluate and improve the effectiveness of risk management) and HH1 (IA helps the organization achieve its goals) with a mean score 3.55 and 3.37. HH3 (IA provides recommendations for improving the internal control) had a mean score of 3.34 (SD = 0.684).

Table 3.

Descriptive Statistics of Internal audit effectiveness.

	N	Mean	Std. Deviation
HH1: Internal audit helps the organization achieve its goals	265	3.37	0.651
HH2: Internal audit helps to evaluate and improve the effectiveness of risk management	265	3.55	0.638
HH3: Internal audit provides recommendations for improving the internal control	265	3.34	0.684
HH4: Internal audit helps to improve the organization's operational efficiency	265	3.68	0.622
Valid N (listwise)	265		

4.2. Pearson's Correlation Coefficient Analysis

After Descriptive analysis, the research team used Pearson's correlation coefficient to check the correlation between IA independence and IA effectiveness. The result in Table 4 shows that the correlation coefficient was 0.569; the Sig. value is 0.000, less than 0.01, so the independent variable (IA dependence) has a linear relationship (positive) with the dependent variable (IA effectiveness).

Table 4.
Correlation Coefficient.

		IA effectiveness (HH)	IA independence (DL)
IA effectiveness (HH)	Pearson Correlation	1	0.569**
	Sig. (2-tailed)		0.000
	N	265	265
IA independence (DL)	Pearson Correlation	0.569**	1
	Sig. (2-tailed)	0.000	
	N	265	265

Note: **. Correlation is significant at the 0.01 level (2-tailed).

4.3. Regression Analysis

To examine the impact of an independent variable (IA independence) on the dependent variable (IA effectiveness), the study performs linear regression analysis. The results in Table 5, 6 indicate a positive and significant relationship between the scope of the audit, reporting level, unrestricted access to all departments and employees, and performing non - audit services and IA effectiveness. The R - squared (R^2) value of 0.324, F-test (ANOVA) represents the significance level = 0.000; therefore, the regression model is suitable, about 32.4% of the effectiveness of IA in Vietnam companies is explained by IA independence. The remaining 67.6% is explained by other factors, not in the model. Table 6 presents the result of the linear regression as follows: IA independence had a positive and significant effect on the effectiveness of IA in Vietnam with $\beta = 0.328$ at p-value 0.001 (<0.01). The indication was that as the IA independence is enhanced by one unit, IA effectiveness increases by 0.328.

Table 5.
ANOVA.

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	25.028	1	25.028	126.023	0.000 ^b
	Residual	52.231	263	0.199		
	Total	77.259	264			

Note: a. Dependent Variable: F_HH

b. Predictors: (Constant), F_DL

Table 6.
Regression Output.

		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
Model		B	Std. Error	Beta		
1	(Constant)	2.087	0.128		16.363	0.000
	DL	0.394	0.035	0.569	11.226	0.000

R = 0.569, $R^2 = 0.324$, Adjusted $R^2 = 0.321$, Std Error = 0.44564, F = 126.023 and Sig = 0.000

5. Conclusion

The results show that IA independence had a positive and significant effect on the effectiveness of IA in Vietnam, with $\beta = 0.569$ at p-value = 0.000. The results are consistent with the previous views, such as Ahmad, et al. [23]; Aluvala [30]; Alqudah, et al. [2]; Yousif, et al. [9] and Ta and Doan [10]. At the same time, the findings also support [19] whereby, to be effective, IA must be independent and internal auditors must be objective in performing their work. The findings show that to be able to increase IA effectiveness, IA independence needs to be ensured. So, companies have to perform the following:

Firstly, should come up with a policy to ensure that auditing staff can access relevant information they deem necessary without restriction and should be autonomous;

Secondly, the IA department should be adequately resourced with a budget passed directly by the board.

Thirdly, the IA department should continuously document threats to independence and recommend safeguards.

This study has several limitations. The study target was a census of all the 265 responses received. Therefore, the sample size in this study may be adjusted to be small. To this extent, the results may suffer from small sample bias. The study focused on some large companies in the Vietnam stock market, so the results may not be applicable to other firms in other sectors of the economy. These limitations will be overcome by extensive research in the future.

Transparency:

The authors confirm that the manuscript is an honest, accurate, and transparent account of the study; that no vital features of the study have been omitted; and that any discrepancies from the study as planned have been explained. This study followed all ethical practices during writing.

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