



Contents lists available at [Journal IICET](#)

JPPi (Jurnal Penelitian Pendidikan Indonesia)

ISSN: 2502-8103 (Print)ISSN: 2477-8524(Electronic)

Journal homepage: <https://jurnal.iicet.org/index.php/jppi>



Determinants of internal audit function on emerging markets: SEM-PLS approach

Ahmad Subaki^{*)}, Rachmawati Rachmawati, Wahyu Widarjo, Djuminah Djuminah

Sebelas Maret University, Indonesia

Article Info

Article history:

Received Feb 26th, 2022

Revised Jun 28th, 2022

Accepted Sep 10th, 2022

Keyword:

Internal audit function (IAF),
Level of internal risk,
External agency risk,
Corporate governance

ABSTRACT

The existence of an internal audit function (IAF) is very important to describe companies that follow the criteria of good corporate governance, so it needs to be investigated further because there is still a lack of research that discusses IAF. This research is a quantitative study using secondary data in the form of company annual reports included in LQ45 on the Indonesia Stock Exchange. Data processing is carried out with a different approach using SEM-PLS. The purpose of this study was to determine the effect of internal and external risk management on the internal audit function. So, from our findings, it can be concluded that the level of internal risk, external agency risk, and corporate governance is not significant to the internal audit function (IAF).



© 2022 The Authors. Published by IICET.

This is an open access article under the CC BY-NC-SA license
(<https://creativecommons.org/licenses/by-nc-sa/4.0>)

Corresponding Author:

Ahmad Subaki,
Sebelas Maret University
Email: achmad60subaki@gmail.com

Introduction

An internal audit is a monitoring activity by members within the company or organization whose function is to evaluate and assess control activities aimed at supervising all employees of the company or organization in carrying out their responsibilities effectively, accompanied by providing recommendations, reviews, and providing statements relating to the observed employee activities (Bastian, 2014). Previously, the role of internal audit (IA) only focused on compliance assurance, financial control, and asset security (Dellai & Omri, 2016). Over time, the function of an auditor began to shift to become an internal consultant who provided input on improvements to existing and running systems. The internal consultant function is a relatively new role that takes place and requires internal auditors to always increase their knowledge about the auditor profession and business aspects to be able to solve an existing problem (Nainggolan & Prabowo, 2019). This incident made IA one of the supporting factors towards good corporate governance. It greatly influenced the adoption and practice of internal audits (Endaya & Hanefah, 2016). Thus the internal audit function (IAF) became crucial (Ismael & Roberts, 2018)

Transparency is a powerful tool for influencing stakeholders' behavior. The information must be available, audited, and disclosed by applicable accounting standards. This is needed by stakeholders and potential investors who need access to company information that is regular, reliable, and can be compared in detail and accurately. Thus, they can assess the situation of the company's management to be used as a reference in making the right decisions. Companies worldwide are now trying to break out and join the international capital markets. Therefore, adequate and reliable disclosure of the information is needed (Albitar, 2015).

In short, the internal audit function is the foundation of good corporate governance that contributes to increasing productivity, efficiency, and company performance in both private and public sectors (Dellai & Omri, 2016). IAF can provide reasonable assurance regarding financial reliability reporting by detecting weaknesses of a company's financial controls ((Ashbaugh-Skaife et al., 2008) (Beasley et al., 2009)) and by detecting earnings management (Prawitt et al., 2009). All of the IAF governance roles discussed are summarized in the IIA's definition of internal audit:

“Internal audit is an independent and objective consulting and assurance activity created to add value and improve an organization's operations. It helps organizations achieve the goals by taking a systematic and disciplined approach to evaluate and improve risk management, control, and governance processes (Auditors, 2010)”

Nowadays, IAF remains a relevant issue on an ongoing basis. First, the role of a company's internal audit is considered important in corporate governance (Bostan & Grosu, 2010). Second, only a few studies have studied it worldwide, and several researchers have recommended the need for further research, especially in developing countries ((Mihret & Yismaw, 2007); (Yee et al., 2008); (Endaya & Hanefah, 2013); (Endaya & Hanefah, 2016)). Third, as previous studies have shown, to date, there is no consensus among researchers on either the influencing factors or the best framework for IAF ((Endaya & Hanefah, 2013); (Endaya & Hanefah, 2016); (Ismael & Roberts, 2018)). Therefore, this study intends to contribute more to research related to IAF.

(Sarens & De Beelde, 2006) analyze five case studies in Belgian firms, finding that senior management expectations significantly influence internal audit, and internal audit meets most of these expectations. NS research results also show that senior management expects the internal audit to: first, compensate for the loss of management control due to organizational complexity; second, maintain the corporate culture through personal contact with people in the field; third, to become a supporting function in monitoring and to improve both risk management and internal control systems; fourth, become a training ground for future managers; and fifth, cooperation between internal and external auditors increases audit coverage. On the other hand, internal auditors expect senior management to take the first step in formalizing the risk management system. They seek the overall support and acceptance of senior management.

(Mihret & Yismaw, 2007) identified factors that impact internal audit services effectiveness, according to a public sector higher education forum in Ethiopia. Their model consists of four interrelated factors: internal audit quality, management support, organizational setting, and auditee attributes. It is found that internal audits and management support quality largely determine internal audits' effectiveness. In contrast, organizational settings and auditee attributes do not strongly impact internal audit effectiveness. The researchers also suggest the need for future research to understand the effectiveness of internal audits using other variables.

(Arena & Azzone, 2009) investigated the effectiveness of internal auditing by dividing internal auditors into three different groups based on their opinions. The first group related internal audit effectiveness to the quality of internal audit procedures, the second group related internal audit effectiveness to the results of internal audit activities. Moreover, lastly, the third group associates it with the upcoming audit activity. Arena and Azzone (2009) measure internal audits effectiveness by the level of internal audit recommendations senior management runs.

(Endaya & Hanefah, 2013) argue about agency theory, institutional theory, and communication theory. These theories are appropriate for building a theoretical framework for internal audit effectiveness and suggest a model consisting of internal audit department characteristics and performance as factors that directly affect internal audit effectiveness and support members of the organization as senior management of moderating factors. They also suggest that the theoretical framework proposed in this study needs to be studied further in future research.

(Lenz & Hahn, 2015) provide a synopsis of internal audit effectiveness literature over the past decade and suggest a multifaceted example of macro and micro factors influencing internal audit effectiveness. Macro factors, in their example, consist of four key dimensions or categorical blocks: organizational characteristics, internal audit resources, internal audit processes, and internal audit relationships, and interim micro factors consist of the following three institutional strengths: compliance with laws and regulations (coercive power), consultancy or professional body (normative), strengths, and learning to copy the (good) practices and recipes of others from consulting firms (mimetic powers). The relationship between internal audit and senior management will continue to be a crucial research area.

(Endaya & Hanefah, 2016), who distributed a personally developed questionnaire to 114 members of the Libyan Association of Accountants and Auditors, found that internal auditors' characteristics significantly impact the effectiveness of internal audits senior management support has a moderating effect.

(Ismael & Roberts, 2018), who examined 332 UK non-financial companies listed on the Main Market of the London Stock Exchange (LSE), found that firm size, level of internal risk, agency problems between owners and managers, and the presence of an effective audit committee were associated with IAF presence. These results demonstrate IAF's importance as an internal corporate governance tool and the effectiveness of UK governance regulations in monitoring internal control system effectiveness. Thus, the need to have strong internal control, risk management systems, reduce internal and external agency costs drives companies to have IAF.

Method

The research method used in this study is explanatory, namely research that aims to mention the variables' position and the correlation between one variable and another (Ghozali & Latah, 2015). The independent variables (independent variables) in this study are the proportion of receivables and inventory, the proportion of cash flows from operations, the level of debt, the presence of an independent coordinator, the existence of an independent BOD, and IAF. The population in this study is LQ45 from 2017-to 2021. At the same time, the sampling technique used means purposive sampling, namely selecting a synchronous sample using criteria with the final result showing 116 observed data. The data collection method used in this study is secondary data, where secondary data is obtained from the financial statements of each sample used. This research uses panel data and regression using SmartPLS 3.0 software. This study refers to research conducted by Ismael & Roberts (2018), which uses a model such as:

$$\text{IAF Existence} = b_0 + b_1\text{RECINV} + b_2\text{OCF} + b_3\text{LEV} + b_4\text{INDCH} + b_5\text{INDDS} + e$$

Description:

IAF Existence	= 1 if the company has IAF (both in-sourced and out-sourced) and 0 if it is absent
RECINV	= receivables and inventories divided by total assets
OCF	= operating cash flows divided by total assets
LEV	= long-term debts divided by total assets
INDCH	= 1 if the Chairman is independent and 0 otherwise
INDDS	= percentage of independent BOD number

Result and Discussion

Table 1. Descriptive Analysis

	No.	Missing	Mean	Median	Min	Max	Standard Deviation	Excess Kurtosis	Skewness
RECINV	2	0	0.216	0.191	0.038	0.514	0.121	-0.996	0.284
OCF	3	0	0.113	0.097	-0.023	0.42	0.086	3.363	1.61
LEV	4	0	0.177	0.149	0	0.796	0.153	3.916	1.653
INDCH	5	0	0.043	0	0	1	0.204	18.909	4.537
INDDS	6	0	37.881	37.5	0	83.33	15.384	2.132	0.095
IAF	7	0	0.957	1	0	1	0.204	18.909	-4.537

Source: processed by the author, 2021

Table 2. Construct Reliability and Validity

	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
IAF	1.000	1.000	1.000	1.000
INDCH	1.000	1.000	1.000	1.000
INDDS	1.000	1.000	1.000	1.000
LEV	1.000	1.000	1.000	1.000
OCF	1.000	1.000	1.000	1.000
RECINV	1.000	1.000	1.000	1.000

Source: processed by the author, 2021

Based on Table 2, Cronbach's Alpha, rho_A, Composite Reliability, and AVE values for each variable meet the criteria, make indicators, variables IAF, RECINV, OCF, LEV, INDCH, INDDS, are formative indicators because it can stand alone and interpret construct variables (Hair et al., 2017). For Discriminant Validity, based on table 3 above, it meets the Fornell-Locker (FLC) criteria, namely the AVE value of the squared of each variable (1,000) is greater than the correlation between variables/constructs (0.045, 0.248, 0.241, -0.076, -0.413, 0.20, -0.044, 0.005, 0.232, 0.086, 0.488, -0.049, -0.324, -0.558, 0.195).

Table 3. Fornell-Locker (FLC)

	IAF	INDCH	INDDS	LEV	OCF	RECINV
IAF	1.000					
INDCH	0.045	1.000				
INDDS	0.248	0.020	1.000			
LEV	0.241	-0.044	0.086	1.000		
OCF	-0.076	0.005	0.488	-0.324	1.000	
RECINV	-0.413	0.232	-0.049	-0.558	0.195	1.000

Source: processed by the author, 2021

Table 4. Total Effects

	IAF	INDCH	INDDS	LEV	OCF	RECINV
IAF						
INDCH	0.139					
INDDS	0.313					
LEV	-0.082					
OCF	-0.170					
RECINV	-0.443					

Based on the Table 4, there are no significant variables. Furthermore, those have a negative coefficient on the IAF variable are the LEV, OCF, and RECINV variables. Meanwhile, the INDCH and INDDS variables have positive coefficients.

Table 5. R Square

	R Square	R Square Adjusted
IAF	0.260	0.226

Source: processed by the author, 2021

Based on Table 5, the R Square Adjusted value is 0.226, which means that the RECINV, OCF, LEV, INDCH, INDDS variables can explain 22.6% of the IAF variables, while other variables explain the rest.

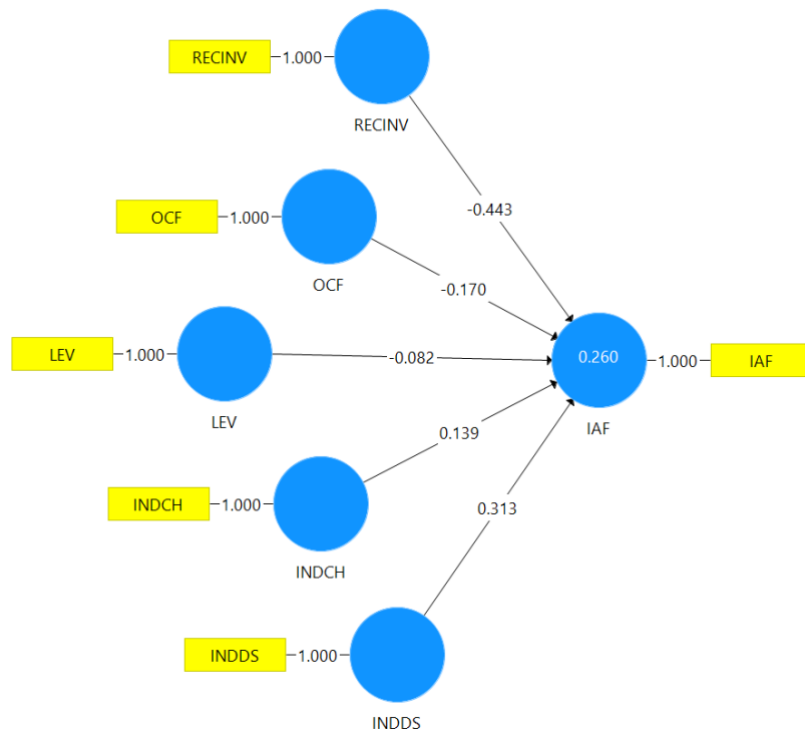


Figure 2. Final Model

This study is in line with research conducted by (Kurniawan, 2020) the internal audit function and auditor specialization, which cannot strengthen the negative effect of risk disclosure on information asymmetry. Audit

risk can be influenced by the ability of the auditor and also by the condition of good company management. A good company management environment will greatly assist external auditors in auditing, and external auditors with high independence and professionalism will not be affected by the company's condition.

Conclusion

Based on the data processing results, it can be concluded that internal and external risks and corporate governance do not affect the internal audit function (IAF). This is because the COVID-19 pandemic is a phenomenon that causes a global recession and worsens the economy. Developing countries, including Indonesia, are among those affected more broadly, thus the existence of the internal audit function itself does not significantly impact the company's internal and external risk management. In addition, the results of this study do not match previous studies due to the small number of samples. It is necessary to increase the number of samples used and add several variables related to the internal audit function (IAF) for future research.

References

- Albitar, K. (2015). Firm characteristics, governance attributes and corporate voluntary disclosure: A study of Jordanian listed companies. *International Business Research*, 8(3), 1–10.
- Arena, M., & Azzone, G. (2009). Identifying organizational drivers of internal audit effectiveness. *International Journal of Auditing*, 13(1), 43–60.
- Ashbaugh-Skaife, H., Collins, D. W., Kinney Jr, W. R., & LaFond, R. (2008). The effect of SOX internal control deficiencies and their remediation on accrual quality. *The Accounting Review*, 83(1), 217–250.
- Auditors, T. I. of I. (2010). *Professional practices framework (IPPF)*. www.theiia.org/guidance/standards-and-guidance/, <https://na.theiia.org/standardsguidance/mandatory-guidance/Pages/Definition-of-Internal-Auditing.aspx>.
- Bastian, I. (2014). *Sistem Pengendalian Manajemen Sektor Publik*.
- Beasley, M. S., Carcello, J. V, Hermanson, D. R., & Neal, T. L. (2009). The audit committee oversight process. *Contemporary Accounting Research*, 26(1), 65–122.
- Dellai, H., & Omri, M. A. B. (2016). Factors affecting the internal audit effectiveness in Tunisian organizations. *Research Journal of Finance and Accounting*, 7(16), 208–211.
- Endaya, K. A., & Hanefah, M. M. (2013). Internal audit effectiveness: An approach proposition to develop the theoretical framework. *Research Journal of Finance and Accounting*, 4(10), 92–102.
- Endaya, K. A., & Hanefah, M. M. (2016). Internal auditor characteristics, internal audit effectiveness, and moderating effect of senior management. *Journal of Economic and Administrative Sciences*.
- Ismael, H. R., & Roberts, C. (2018). Factors affecting the voluntary use of internal audit: evidence from the UK. *Managerial Auditing Journal*.
- Kurniawan, B. (2020). Pengaruh pengungkapan manajemen risiko terhadap asimetris informasi dengan kualitas audit dan fungsi internal audit sebagai variabel pemoderasi. *Jurnal Akuntansi Bisnis*, 13(1).
- Lenz, R., & Hahn, U. (2015). A synthesis of empirical internal audit effectiveness literature pointing to new research opportunities. *Managerial Auditing Journal*.
- Mihret, D. G., & Yismaw, A. W. (2007). Internal audit effectiveness: an Ethiopian public sector case study. *Managerial Auditing Journal*.
- Nainggolan, C. S., & Prabowo, T. J. W. (2019). Analisis determinan auditor internal pada efektivitas audit internal sektor publik (studi pada inspektorat provinsi DKI Jakarta). *Diponegoro Journal of Accounting*, 8(4).
- Prawitt, D. F., Smith, J. L., & Wood, D. A. (2009). Internal audit quality and earnings management. *The Accounting Review*, 84(4), 1255–1280.
- Sarens, G., & De Beelde, I. (2006). Internal auditors' perception about their role in risk management: A comparison between US and Belgian companies. *Managerial Auditing Journal*.
- Yee, C. S. L., Sujana, A., James, K., & Leung, J. K. S. (2008). Perceptions of Singaporean internal audit customers regarding the role and effectiveness of internal audit. *Asian Journal of Business and Accounting*, 1(2), 147–174.