

The role of internal auditors' independence in the effectiveness of internal audit disclosure: Evidence from Egypt

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Abstract

This research aims to examine the role of internal auditors' independence in the effectiveness of a voluntary forward-looking disclosure represented in internal audit disclosure IAD in the joint stock companies listed on the Egyptian Stock Exchange. This objective could be done by studying the obstacles and solutions related to internal auditors' independence and investigating its effect on the effectiveness of IAD. The research used the questionnaire method to collect the data required for testing the research hypotheses. The sample was selected from internal auditors, financial analysts, external auditors, accountants, and academics in accounting and auditing to collect the data needed. A total of (350) questionnaires were distributed, of which (273) questionnaires were completed and valid for the statistical analysis, representing (78%) response rate. The study found that there is a significant positive relationship between the solutions related to internal auditors' independence and the effectiveness of internal audit disclosure in the Egyptian joint stock companies. Whereas the obstacles to internal auditors' independence increase the obstacles to IAD.

Keywords: Internal auditors' independence, Internal audit disclosure, Voluntary disclosure, Corporate governance.

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دور إستقلالية المراجعين الداخليين في فعالية الإفصاح عن تقارير المراجعة الداخلية في مصر

المخلص

هدفت هذه الدراسة إلى معرفة دور من استقلالية المراجعين الداخليين في فعالية الإفصاح الخارجي عن تقارير المراجعة الداخلية في شركات المساهمة المدرجة بالبورصة المصرية. ويمكن تحقيق هذا الهدف من خلال دراسة معوقات وحلول إستقلالية المراجعين الداخليين ، وتأثيرها على فعالية الإفصاح الخارجي عن تقارير المراجعة الداخلية. تم استخدام أسلوب الاستقصاء لجمع البيانات المطلوبة لإختبار العلاقة بين إستقلالية المراجعين الداخليين وفعالية الإفصاح عن تقارير المراجعة الداخلية. تم اختيار عينة الدراسة من المراجعين الداخليين والمحللين الماليين والمراجعين الخارجيين والمحاسبين والأكاديميين في مجال المحاسبة والمراجعة لجمع البيانات اللازمة للبحث. وتم توزيع (350) استبانة ، تم استرداد (273) استبانة ذات بيانات كاملة وصالحة للتحليل الإحصائي ، تمثل نسبة استجابة 78%.

وجدت الدراسة أن هناك علاقة إيجابية ومعنوية بين الحلول المتعلقة بإستقلالية المراجعين الداخليين وفعالية الإفصاح عن تقارير المراجعة الداخلية في شركات المساهمة المدرجة بالبورصة المصرية. حيث أن معوقات إستقلالية المراجعين الداخليين تؤدي إلى زيادة عيوب الإفصاح عن تقارير المراجعة الداخلية في شركات المساهمة المدرجة بالبورصة المصرية.

الكلمات المفتاحية: إستقلالية المراجعين الداخليين ، الإفصاح عن تقارير المراجعة الداخلية ، الإفصاح الإختياري ، حوكمة الشركات.

1. Introduction:

Internal audit is one of the most important corporate governance mechanisms that its importance has been expanded after the occurrence of corporate failures in the USA (e.g., Enron, WorldCom). Otene (2014) stated that effective internal systems support a company's financial and corporate strategy, in which the internal audit plays a key role in increasing the reliability of internal control systems. Furthermore, an internal audit is an important element of an organization's corporate governance framework, which includes oversight efforts of the board of directors and audit committees to ensure that the financial reporting process is trustworthy (Public Oversight Board, 1994). Internal auditors are in a unique position as providers of both assurance and consulting services to managers. This dual responsibility has put internal auditors in a situation of conflict about their ability to exercise objectivity and independence as the enterprise's employees (Paape, 2007).

International Standards for the Professional Practice of Internal Auditing (ISPPA) established by (IIA, 2011) stated that the internal audit activity must be independent, and internal auditors must perform their work objectively. Kumaat (2011) put a definition to internal auditors' independence as an internal auditor alignment on factual truth. Independence has been described as "avoidance of situations which would tend to impair objectivity or permit personal bias to influence delicate judgment" (Carey & Doherty, 1966). Sawyer et al. (2005) indicated that an independent internal auditor is a professional auditor who is free to fulfill their professional obligations, express objective, unbiased, and unrestricted opinions, and report the problem objectively without taking orders from the executive or the agency. Internal auditors should not be put in a

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situation where their independence is in question or where they are unable to make objective judgement (Vanasco, 1994). Internal auditors should ideally be free to report matters as they are, with no outside influences (Sawyer & Dittenhofer, 1996).

Archambeault et al. (2008) argued that external stakeholders lack information on internal audit composition, responsibilities, and activities designed to provide assurance on related financial reporting, compliance, and operational matters, because there are no statutory requirements to disclose internal audit information. Holt & Dezoort (2009) indicated that external disclosure requirements are consistent with corporate governance mechanisms and that these requirements include the management report, the audit committee report, and the external auditor report. These requirements did not include the internal audit report, despite being an effective mechanism for achieving transparent corporate governance. Lapidés et al. (2007) reviewed the principles of corporate governance that enhance stakeholders' confidence in financial reports. One of these principles is to provide an internal audit report to external stakeholders which includes non-financial information about the nature of the internal audit function, internal control, the effectiveness of risk management, and governance processes.

Archambeault et al. (2008) proposed a framework for internal audit disclosure, suggesting that internal audit should report on their composition, responsibility, accountability, activities and resources. Holt & DeZoort (2009) stated that including an internal audit report in governance reports increases confidence in the information presented in the annual report. Coetzee (2015) stated that internal audit disclosure is a publishment of internal audit reports to stakeholders to rationalize their investment decisions.

2. Literature review

Literature review can be divided into two groups as follows:

2.1 Literature review related to internal auditors' independence:

Anggraini (2020) aimed to analyze the independence and competencies of internal auditors and their impact on the quality of audits. Whereas the company's wide scope restricts the board of directors from conducting direct oversight of the company's internal and external operational activities. Therefore, the board of directors need a task force with overseeing and examining the company's operating activities to improve internal control effectively and efficiently.

The study found that there are still many independence problems among the internal auditors due to the position of the internal auditor working for the company's management. the study concluded that there is an impact of independence and competence on the quality of internal audit processes.

Eiada (2019) aimed to find the factors affecting internal auditors' independence as well as the effect of such independence on increasing the value of companies' shares listed on the Egyptian stock market, and the effect of incentives and equity ownership on internal auditors' independence.

The study found that there is a strong positive relationship between internal auditors' independence and the increased value of company's shares. In addition, Internal auditors' competence and management intervention are the two most important factors affecting internal auditors' independence. Further, the internal auditors' independence creates value which leads to enhancing company's value and its shares.

Helmy (2018) aimed to illustrate the impact of internal auditors' independence, audit committee members, and

corporate institutional ownership on disclosure of internal control. The study used the internal control disclosure index to measure this disclosure in the industrial companies listed on Indonesia's stock exchange between 2014 and 2016.

The study found that both internal auditors' independence and corporate institutional ownership have a direct positive relationship with disclosure of internal control reports. The audit committee had no influence on this type of disclosure.

Nasvita (2016) examined the factors affecting internal auditors' independence, namely the competence of internal auditors, management intervention, employee participation and company's regulation.

The study found that all factors have influences on internal auditors' independence, simultaneously or partially. While auditor competence, employee participation, and company regulation have positive influence, management intervention has a negative influence on internal auditors' independence.

Lucas (2014) aimed at undermining the relationship between the independence of the internal audit process and the performance of stocks in the Nairobi stock exchange.

The study found that there was a strong positive correlation between internal audit independence and corporate equity performance and a strong correlation between evaluation rates (profit distribution) and equity performance.

2.2 Literature review related to disclosure of internal audit reports:

Ashfaq & Rui (2019) aimed to investigate the internal control disclosure (ICD) practices in South Asia and compare those disclosure practices across enforced setting (India) versus comply setting (Pakistan and Bangladesh).

The results showed that public sector companies in South Asia tend to disclose significantly more internal control information as compared to private sector companies. It was also found that board and audit committee characteristics and ownership by government have positive significant effect on ICD except representation of female or foreigner on audit committee which was found insignificant.

Aboul Gheit et al. (2017) aimed to determine the extent to which the Egyptian environment needs disclosure of internal audit reports and testing the acceptability of the proposed framework for such disclosure in the Egyptian environment.

The study emphasized the need for internal audit disclosure in Egypt for the following reasons: enhancing users' confidence in the reliability of reports, reducing information asymmetry, supporting corporate governance through increased transparency, improving the quality of internal and external audit and limiting profit management. The study also found that greater external outsourcing for preparing and disclosing IA reports enhances users' confidence in the independence of IA.

Khalil (2015) aimed to propose a framework for external disclosure of internal audit reports and its impact on meeting information needs of external stakeholders to improve corporate governance and reduce the gap in internal audit expectations.

The study found that disclosure of internal audit reports has several advantages, including eliminating information asymmetry, improving corporate governance, reducing the expectations gap for IAF, and improving the quality of IA.

Holt & Dezoort (2009) aimed to find the impact of external disclosure of the internal audit report on the reliability and credibility of financial reporting disclosed at year-end, as well as the impact of such disclosure on the perception and judgment

of investors on the company's organizational efficacy and on the investment decisions of external stakeholders.

The study found that disclosure of the internal audit report affects private investors' perception of the effectiveness of the institutional supervision and increases investors' confidence in the final financial reports. The study also revealed that internal audit reports have a strong impact on companies with high fraud risks than for companies with low fraud risks.

Archambeault et al. (2008) aimed to show how much external stakeholders need a report on internal audit and what impact this has had on increasing corporate governance transparency.

The study found that the disclosure of the internal audit report has a great impact on the information symmetry between internal parties and external stakeholders. the study stated that this disclosure is made by means of a descriptive report which consists of five sections, namely: the internal audit section, responsibility section, accountability section, the internal audit activities section and the section of financial resources.

By extrapolating previous studies, we find the following:

The research gap appears in the fact that there are no studies, according to the researcher's knowledge, that examined the role of internal auditors' independence in the effectiveness of internal audit reports disclosure in the Egyptian environment. Furthermore, it is noticed that the previous studies examined the internal audit disclosure without solving the problem of internal auditors' independence. The researcher believes that the factors supporting internal auditors' independence must be applied firstly before applying the external disclosure of IA reports, as the quality of such disclosure will be decreased in the event of the lack of internal auditors' independence.

3. Research Problem:

Internal audit profession faces many challenges within business organizations in Egypt, since many organizations tend to reduce the degree of internal auditors' independence, which in turn leads to the bias of internal audit reports in favor of the board of directors and/or executive management to which the internal auditor belongs functionally and administratively. This results in a reduction in the degree of trust, transparency, and relevance in internal audit reports, which influences the effectiveness of internal audit reports disclosure to external stakeholders (e.g., shareholders and investors).

It has been argued that an internal auditor cannot have complete independence due to being an employee of the organization (Mihret et al., 2010). Akharayi (2013) argued that internal auditors' independence is low, and in most cases, they are not objective in their opinions and recommendations simply because of the fear of losing their job (Okodo et al., 2019).

The benefit that external stakeholders derive from internal audit reports is closely associated to the extent of their confidence in the independence of the internal audit processes.

The problem can be summarized in the following questions:
The main question: What is the role of internal auditors' independence in the effectiveness of internal audit reports disclosure in the Egyptian listed joint stock companies?

Sub-questions:

RQ1. What are the obstacles to internal auditors' independence?

RQ2. What are the suggested solutions that support the internal auditors' independence?

RQ3. What is the impact of applying the solutions supporting the internal auditors' independence on the effectiveness of internal audit disclosure?

4. Research Objectives:

The main objective of the study is to determine the role of internal auditors' independence in the effectiveness of internal audit reports disclosure in the Egyptian joint stock companies. This can be done by studying the factors affecting the independence of internal auditors and the effect of applying these factors on the effectiveness of the external disclosure of internal audit reports, which improves the corporate governance for companies listed on the Egyptian Stock Exchange.

This main objective is obtained by achieving the following sub-goals:

- Determining the obstacles to internal auditors' independence.
- Determining the suggested solutions that support internal auditors' independence.
- Investigating the impact of the factors supporting the internal auditors' independence on the effectiveness of internal audit disclosure.

5. Research Importance:

1.5.1 The Scientific Importance of the study:

This study keeps pace with recent developments in the field of internal audit, which focus on internal auditors' independence and the disclosure of internal audit reports. Despite the importance of the independence of internal auditors and the external disclosure of internal audit reports, This research will be the first of its kind, according to the researcher's knowledge, that addresses the relationship between them and the importance of addressing the obstacles to internal auditors' independence and its impact on the effectiveness of the external disclosure of the internal audit reports.

1.5.2 The practical importance of the study:

The practical importance of this study lies in the necessity to find solutions to increase internal auditors' independence and solutions to increase the effectiveness of the external disclosure of internal audit reports. It is anticipated that the results of this research will help regulators in applying the factors that support internal auditors' independence and internal audit disclosure in case of generalizing the internal audit disclosure. The results will also help in finding the effect of applying these supporting factors on the effectiveness of internal audit disclosure and increase users' confidence in these reports.

6. Research Methodology:

6.1 Research Philosophy

As the study is quantitative in nature, so we adopt the positivism as a research philosophy. The positivist (deductive) approach is being appropriate for answering the study questions because the study answers only the measurable relationships.

6.2 Sampling Strategy and selection

The study used the probability sampling strategy because it involves a random selection of participants from a population. Therefore, the findings can be generalizable to a population. The study selects a sample of internal auditors, financial analysts, external auditors, accountants, and academics.

6.3 Data Collection and Data Analysis Methods

As the field study aims to collect quantitative data, therefore it is logical to use the questionnaire method (large-scale surveys) that produce large volumes of data related to the study.

The study used the descriptive statistics and inferential statistical techniques through using the Statistical Package for Social Sciences (SPSS) version 28 in testing the hypotheses.

Theoretical Study

1. Internal Audit: New Functions and Effectiveness

The Institute of Internal Auditors IIA (2011) defined internal audit as an independent, objective assurance and consulting activity established to add value and improve an organization's operations. It assists a company in achieving its goals by implementing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, controls, and governance processes. International Auditing and Assurance Standards Board IAASB (2012) defined Internal audit as a function that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control.

Soltani (2007) defined internal audit as "an appraisal activity established within a company as a service. Its functions include examining, evaluating and monitoring the adequacy and effectiveness of the accounting and internal control systems". In addition, Basel (2012) defined internal audit as an effective function provides independent assurance to the board of directors and executive management on the quality and effectiveness of the internal control, risk management and governance, thereby helping the board and senior management protect their organization and its reputation.

Internal audit plays a significant role in achieving company goals and putting strategies to achieve them (Ljubisavljević & Jovanović, 2011). Furthermore, internal audit is in charge of strengthening management and the audit committee (Hutchinson & Mat Zain, 2009). Internal audit determines the reliability, accuracy, and integrity of financial and operational information from various organizational units to make appropriate decisions at all managerial levels (Alflahat, 2017).

Chapman & Anderson (2002) argued that internal audit becomes a proactive consumer focused activity concerned with control, risk management and governance. Organizations have also experienced a rapid change in economic complexity, expanded regulatory requirements, and technological advancement (Hass et al., 2006).

In practice, internal audit is intended to add value and improve company's operations. As a result, Coetzee & Erasmus (2017) believe that IA supports some of the most powerful arguments for good governance and accountability. Otene (2014) stated that the internal audit activity assesses risk exposure related to the organization's governance, operations, and information systems in terms of operational effectiveness and efficiency, financial and operational information reliability and integrity, and compliance with regulations and contracts.

2. Internal Auditors' Independence

2.1 What is Internal Auditors' Independence

IIA (2017) distinguished between independence and objectivity of internal auditors. Independence is "the freedom from the circumstances that threaten the ability of the chief audit executive (CAE) and internal auditors to carry out their responsibilities in an unbiased manner. Objectivity is "an unbiased mental attitude that enables internal auditors to perform their tasks in a manner that makes them believe in the safety of work results and do not make any sacrifices at the expense of internal audit quality". Hence, the IIA's distinction between the two terms appears to be that objectivity is a state of mind, while independence is the state of affairs that permits an internal auditor to operate with an objective attitude.

Although the IIA standards (IIA, 2009) emphasize independence at the organizational level, the definition indicates

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that it is also important at the individual, engagement, and functional levels. The IIA's (2009) "Code of Ethics" consists of a set of basic principles, as well as rules of conduct that outline the expected behavior of internal auditors. The rules of conduct indicate that internal auditors:

- shall not participate in any activity or relationship that may impair their unbiased assessment.
- shall not accept anything that may impair or be presumed to impair their professional judgment.
- shall disclose all material facts known to them that may distort the reporting of activities under review.

Academic and practitioner research has supported the expanded role of internal auditors' independence. Mutchler et al. (2001) defined independence as "freedom from material conflicts of interest that threaten objectivity. In other words, it is a state where threats to objectivity are managed to the extent that the risks of ineffective internal audit services are acceptably controlled". Independence has been described as "avoidance of situations which would tend to impair objectivity or permit personal bias to influence delicate judgment" (Carey & Doherty, 1966). Independence has been termed as the building block of the auditing profession since it forms the foundation for the public's trust in the attest function of ascertaining whether the financial statement show a fair and true position of the financial status of an organization (Caswell & Allen 2001). Brinkley (2015) stated that independence and objectivity reflect an auditor who is self-sufficient, self-reliant, free of undue control, operationally autonomous, and thinking for oneself.

It can be concluded that internal auditors' independence is one of the factors that lead to internal audit effectiveness.

Internal audit function loses its effectiveness and quality without independence. It also a state of trust and neutrality that made internal auditors express their opinion about internal control and risk management and other internal audit activities apart from companies' management interests.

2.2 Importance of Internal Auditors' Independence

The importance of independence was discussed by Mutchler et al. (2001), who stated that as internal auditors' responsibilities grow, so does the demand for greater independence, objectivity and accountability. Internal auditor's independence was vital to the organization to help improving accountability and employees' performance. Independence of the internal audit profession and internal auditors is crucial based on the criterion of objectivity (Mutchler, 2003). Internal auditors should not be put in a situation where their independence is in question or where they are unable to make objective professional judgement (Vanasco, 1994). Internal auditors should ideally be free to report matters they audit as they are, with no outside influences (Sawyer & Dittenhofer, 1996).

Internal audit should be given appropriate organizational status so that it can function independently, and internal auditors act objectively. This is necessary because internal auditors are in a unique position as employees of an organization, responsible for assessing and monitoring management decisions, as well as advising management on the adequacy and effectiveness of internal controls (Sarens & Beelde, 2006).

Academic and practitioner research has supported the expanded role of internal audit and internal auditors' independence. There has been a significant shift in emphasis toward promoting and supporting effective organizational

governance (Ramamoorthi, 2003). Mautz & Sharaf (1961) stated that one of the most important characteristics of an auditor is independence, without which the audit report is not reliable.

The ISPPIA has identified internal auditor's independence as a most important criterion for effectiveness of the internal audit function. Internal auditors must therefore have a thorough understanding of the influences they face to act independently (Mutchler, 2003). George et al. (2015) argued the most important factors affecting internal audit effectiveness. These factors include independence of internal audit, internal audit quality, competence of internal audit team and management support. In accordance with independence of internal audit, Yee et al. (2008) stated that without independence, internal audit simply becomes a part of the management team, losing its ability to present a fresh perspective.

2.3 Obstacles to Independence of Internal Auditors

Internal auditors aren't always well-positioned to defend their independence (Al-Twaijry et al., 2004). Internal auditors are not seen as a proper profession by everyone, including some of their own company managers (Cooper et al., 1994). Internal auditors and management consultants acting as service providers rather than acting as independent appraisers (Brody & Lowe, 2000). DeZoort & Reisch (2000) found that incentives can also influence internal auditors, as internal auditors' independence may be harmed by incentive compensation based on overall company performance.

It has been argued that internal auditor, being an employee of an organization, cannot enjoy absolute independence (Mihret et al., 2010). Vanasco (1994) stated that internal auditors

develop personal relationships as a result of conducting internal audits over time.

While there have been a few attempts to put a framework around the identification of threats and safeguards of internal auditors, The Institute of Internal Auditors IIA (2001) has published a framework to guide internal auditors about independence and objectivity. Within this framework, independence is described as a situation in which threats to objectivity are addressed. Mutchler (2003) has summarized this framework in her discussion of research opportunities related to such framework. This framework discusses the following seven threats to internal auditors' objectivity:

- (1) Self-review, in which the internal auditor reviews his work.
- (2) Social pressure, as the internal auditor is exposed to pressure from the auditee.
- (3) The economic interest resulting from incentives or from reviewing a person who has the potential to influence the employment or salary of the internal auditor.
- (4) Personal relationship, in which the internal auditor is a relative or friend of the audited body.
- (5) Friendship resulting from a long-term relationship with the entity subject to review.
- (6) Cultural, ethnic, and sexual biases that arise in multinational organizations.
- (7) Cognitive biases resulting from the adoption of a certain psychological perspective.

Furthermore, In some companies, the position of chief internal auditor is rotated, with line managers taking on the role for a three-year period (PWC, 2000). While there are benefits to using the internal audit function as a training ground for future managers, there are also some risks. Chadwick (1995) has

stressed that it 'blocks independence', particularly when it involves senior internal audit personnel. Also, according to the World Bank (2009), "The chief internal auditor is to be appointed, reappointed, and dismissed by the chief executive officer (CEO) and not the board's independent audit committee as per good practice, and the chief internal auditor is to report directly to the CEO and not the board's independent audit committee". This implies that the CEO has complete control over the internal audit function and procedures.

Christopher, et al. (2009) discussed the extent to which the relationships between the internal audit, management and the audit committee create threats to independence. They put three threats to the independence which are the following:

1. the well-known practice of using the internal audit function as a stepping-stone for future managers.
2. The approval of the internal audit budget is the responsibility of the CEO or CFO.
3. The senior management being heavily involved in developing internal audit plan.

2.4 Addressing the Internal Auditor's Independence Gap

IIA (2017) stated that the organization should make efforts to overcome the obstacles of independence and objectivity, these efforts may include the following:

- Internal auditors must cease from evaluating the processes they previously supervised. The objectivity may be affected if he provides assurance services for activities, he was responsible in the previous year.
- Assurance engagements relating to functions under the supervision of the chief audit executive must be placed under the supervision of a party outside the internal audit.

The doubt about internal auditors' independence can be reduced through several methods as follows: (Kamal, 2012; Muhammad, 2011; Archambeault, D., et al., 2008; Issa, 2005)

- Outsourcing the internal audit is one of the most important factors that increase external users' confidence in the independence of internal audit.
- Obliging the management not to impose restrictions on the internal auditors to access records or contact the entity's employees, or to interfere in determining the audit scope.
- Reconsidering the authority that has the power to dismiss internal auditors, represented in BOD and AC. Giving this authority to the general assembly of shareholders makes less pressure and strengthens internal auditors' independence.

Goodwin & Yeo (2001) argued that when an organization hires professional internal auditors to staff the function, it appears that objectivity is enhanced. This is especially true if the chief internal auditor is a career auditor who is unlikely to be promoted to a line management position anytime soon. However, any threat to objectivity caused using the internal audit function as a management training ground could be mitigated if the internal audit is closely reviewed by a strong and independent audit committee.

3. Disclosure of Internal Audit Reports:

3.1 What is Internal Audit Disclosure?

Coetzee (2015) stated that internal audit disclosure is a publication of internal audit department reports to stakeholders to rationalize their investment decisions. According to Naseer (2019), internal audit disclosure indicates that companies publish a separate report to external parties that includes descriptive information about the formation, responsibilities, activities, and resources of the internal audit function, in

addition to information about the results of audit operations and the opinions of internal auditors on the effectiveness of the internal control system, risk management and governance.

Abdul Karim (2009) confirmed that internal audit disclosure is a type of voluntary disclosure that increases the confidence of various external stakeholders. Wahdan (2013) indicated that the external disclosure of internal audit reports is considered as a confirmation of actual practices, especially after the decrease of confidence in the external audit processes as a result of the major collapses which occurred to major companies such as Lehman brothers in the USA and Olympus corporation in Japan. In this context, Naseer (2019) stated that the internal audit report for external parties includes descriptive information about the structure of the internal audit function, and also includes the opinion of the internal auditor on the effectiveness of risk management, control and governance processes, which reflects the expanded role of the internal audit function.

Overall, the researcher concludes that internal audit disclosure is a voluntary disclosure tool in which companies can publish information to outside stakeholders to increase their confidence in the investment decisions and decrease information asymmetry that exists between internal and external stakeholders.

3.2 Internal Audit Disclosure's Benefits

There are many benefits for disclosure of internal audit reports, which satisfy the needs of many parties. These benefits can be clarified as follows: (Archambeault, et al., 2008; Holt & DeZoort, 2009; Muhammed, 2011; Aboul Gheit, et al., 2017)

3.2.1 Disclosure's Benefits for the entity:

Internal audit disclosure is expected to bring many benefits to the entity as follows:

- The disclosure of internal audit reports creates a new competitive advantage for the entity when compared with the rest of its competitors that have not disclosed.
- Improving the quality of the internal audit in the entity.
- Solving the problem of management's inability to meet the needs of users of different interests.
- Building good relations with shareholders and stakeholders.

3.2.2 Disclosure's Benefits for investors and financial analysts:

The disclosure can bring many benefits to investors and financial analysts as follows:

- providing investors and financial analysts with additional information.
- Increasing the confidence of investors and financial analysts in the effectiveness of the internal control system.
- Verifying that entity follows the professional standards.
- Reducing the problem of information asymmetry.
- Reducing the opportunistic behavior of management.

3.2.3 Disclosure's benefits for external auditors:

This disclosure can bring many benefits to external auditors, the most important of which are:

- Enhancing the quality of the external audit, giving more confidence to the results of the external audit evaluations.
- Reducing the burden on the external auditor, especially about internal control and governance.
- Strengthening the skills and the quality of IA, which is an essential for the external auditor who was granted the possibility of relying on the IA results (PCAOB, 2004).

3.3 Obstacles of internal audit disclosure

Despite the benefits of internal audit disclosure, there are some obstacles that must be taken into account when adopting this

disclosure. These obstacles can be summarized as follows: (Archambeault, et al., 2008; Al-Twaijry et al., 2003; Muhammed, 2011; Aboul Gheit, et al., 2017; Nasser, 2019)

3.3.1 Costs of disclosing internal audit reports

Costs of internal audit disclosure result from collecting and processing the data required by an enterprise. Usually, those costs are large and vary from one entity to another. Fees of those in charge of the internal audit are one of the elements that increase the costs of disclosing internal audit reports.

3.3.2 Lawsuit risks

Lawsuits costs emerge when internal audit reports contain predictions and future expectations, any external user who has been harmed because of his dependence on those predictions can sue the entity and internal auditor and demand exposure.

3.3.3 Lack of awareness about IA disclosure:

Considering that companies do not currently disclose IA reports, it can be said that the companies' failure to disclose the internal audit report may be due to non-realizing the importance of such disclosure to external stakeholders (Nasser, 2019).

3.3.4 Absence of an accounting regulation for IA disclosure:

Internal audit disclosure is not regulated, and the internal audit function lacks true independence (World Bank, 2009). It can be said that the absence of an accounting regulation regarding disclosure of IA reports may be the major reason for the companies' failure to disclose those reports.

3.3.5 Opportunistic behavior of management:

The management's opportunistic behavior is considered one of the most important obstacles to external disclosure of internal audit reports, as the management assumes that the evaluation of its performance and then its incentives are closely related to the disclosed information, so it may resort to misleading investors

and deceiving the market by sending certain signals to the market in order to influence the prices of shares in a way that achieves their interests (Aboul Gheit, et al., 2017).

3.3.6 The increased information burden.

Case (2006) claimed that disclosure of new reports increases the information burden and thus makes the external user consequently lose its value and does not pay any attention to it. As a result, this may tend to make wrong decisions. Limited experience leads to the use of financial analysts, thus increasing their fees.

3.3.7 Competitive disadvantage /cost of ownership:

Most entities believe that the expansion of disclosure may affect the competitive position of the entity and incur additional costs. some types of disclosure may damage the company's competitive position (Li, et al., 2018). Previous studies have provided evidence that the threat of competitors motivates companies not to disclose more information despite any benefit that disclosure can provide (Rezaee & Tuo, 2019).

3.3.8 Weaknesses on Internal Control Quality

Higher internal control quality ICQ may encourage managers to disclose more voluntary information about company's operations because they will receive better internal signals about the company's current state and future prospects (Khlif et al., 2019). According to Hu and Gan (2017), “a poor internal control system leads to poor accounting quality and less reliable financial information dissemination to outside investors.” Lower ICQ may impair timely disclosure (Feng et al., 2009).

3.3.9 The lack of Internal Auditors’ Independence:

Finally, it will be crucial to discuss the major obstacle of IA disclosure as suggested by the study which is the lack of internal auditors’ independence. To perform its expected role,

internal audit function must be effective. The lack of internal auditor's independence will negatively affect the accuracy of internal audit results, and thus external stakeholders are expected to lose their confidence in the audit results in case of internal audit disclosure. Similarly, World Bank (2009) stated that board members are frequently chosen by powerful CEOs for their loyalty rather than their skills and independence.

3.4 The role of internal auditors' independence in the effectiveness of internal audit disclosure.

For the internal audit disclosure to perform its expected role to outside stakeholders, it must be effective, and the internal auditor must be independent. The benefit of outside stakeholders and companies from internal audit disclosure is low in case of not addressing the internal auditors' independence gap. The benefit of external stakeholders from the internal audit reports is closely related to the extent of their confidence in the independence and objectivity of the internal audit processes that led to these reports.

The confidence of external stakeholders in the independence of internal audit is decreased due to the following reasons: (Kamal, 2012; Muhammad, 2011; Archambeault, D., et al., 2008; Issa, 2005).

1. The internal auditor, in the eyes of external users, is considered as an employee of the company, which reflects on their confidence in the results of his reports.
2. The internal auditors do not adhere to the behavioral standards for their operations.
3. The internal audit report may be a tool for management to achieve its opportunistic behavior.
4. If the authority to dismiss the internal auditor rests in the hands of the board of directors or the audit committee, the

external user will not expect disclosures will be in the interest of the establishment.

5. The internal auditor's loss of independence brings to mind the results of the external auditor's loss of independence and the consequent collapses that occurred in the financial markets and its consequences.

IIA (2017) stated that it is necessary to disclose the barriers and obstacles of independence or objectivity that may arise for the internal audit activities. From this point of view, the external user's confidence in the internal audit report is related to the extent of his confidence in the efficiency of the internal audit function. Hence, the lack of internal auditors' independence leads to bias in collecting evidence and preparing reports which is expected to result in external stakeholders losing confidence in the disclosed results.

The researcher believes that there is a necessity to apply the factors supporting the independence of the internal auditors before adopting the external disclosure of their reports. It can be stated that internal auditors' independence increases the reliability of internal audit reports, which in turn strengthens the effectiveness of internal audit reports disclosure for investors and other external stakeholders as follows:

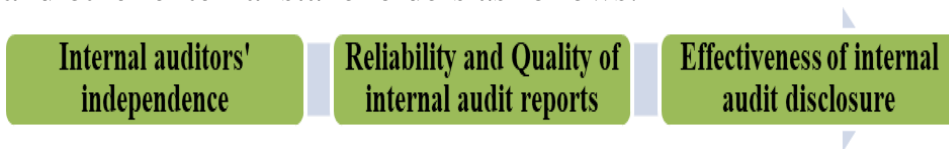


Figure (1): the relationship between internal auditors' independence and internal audit disclosure
(Source: prepared by the researcher)

The Field Study

1. Objective of the field study:

The field study aims to empirically test the hypotheses of the study about the role of internal auditors' independence in the effectiveness of the external disclosure of internal audit reports in the joint stock companies listed on the Egyptian Stock Exchange. This objective can be done through:

- Determining the obstacles to internal auditors' independence.
- Determining the suggested factors that support the independence of internal auditors.
- Determining the factors that increase the effectiveness of internal audit disclosure.
- Investigating the relationship between the factors supporting the internal auditors' independence and the effectiveness of internal audit disclosure.

2. Research Hypotheses:

Based on the research questions and to achieve the study objectives, the study hypotheses can be set as follows:

H0₁: There are no statistically significant differences between the respondents' categories about the obstacles to internal auditors' independence in the Egyptian listed joint stock companies.

H0₂: There are no statistically significant differences between the respondents' categories about the solutions related to increasing internal auditors' independence in the Egyptian listed joint stock companies.

H0₃: There are no statistically significant differences between the respondents' categories about the factors that increase the

effectiveness of internal audit disclosure in the Egyptian listed joint stock companies.

H04: There is no significant relationship between the solutions that support internal auditors' independence and the effectiveness of internal audit disclosure in the Egyptian listed joint stock companies.

3. Research population and Sample selection:

The study involves a random selection of participants from a population. Therefore, the findings can be generalizable to a population. The study selects a sample of internal auditors, financial analysts, external auditors, accountants, and academics to collect the data needed for the research.

4. Managing the Questionnaire list

A total of 350 questionnaires were distributed according to the equal distribution among the sample's categories. Data were collected from July to August 2022. From the total questionnaires distributed, 273 were returned with complete and valid data with a response rate of 78%. Table (1) summarizes the study sample according to respondent's category.

Table (1): distributed and responded questionnaires according to respondent's category

	Distributed questionnaires	Response with complete data	Response Rate
Internal Auditor	70	58	82.86%
Financial Analyst	70	55	78.57%
External Auditor	70	48	68.57%
Accountant	70	60	85.71%
Academics	70	52	74.29%
Total	350	273	78%

5. Designing the Questionnaire list

The questionnaire was divided into three main sections, where respondents were requested to indicate their opinion on a **five-**

point Likert scale ranging from strong disagreement to strong agreement (1= Strongly Disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree). The researcher divided the questionnaire into the following sections:

- 1) **The First Section:** This section aims to measure the obstacles to the independence of internal auditors.
- 2) **The second section:** This section proposes solutions to increase internal auditors' independence.
- 3) **The third section:** This section proposes solutions to increase the effectiveness of internal audit disclosure.

6. Reliability and Validity Coefficients

Reliability test was used to verify the reliability and validity of the questionnaire. Cronbach's Alpha test was used for estimating reliability, which means the degree to which questionnaire items are homogeneous. The findings of the reliability test are presented in the following table.

Table (3): Reliability and Validity Coefficients for the sample

Questionnaire Sections	Number of Questions	Reliability Coefficient	Validity Coefficient
1. The obstacles to internal auditors' independence.	10	0.687	0.829
2. The solutions suggested to increase internal auditors' independence.	8	0.722	0.850
3. The solutions suggested to increase the effectiveness of the external disclosure of internal audit reports.	14	0.845	0.919

It is noticeable that the reliability coefficient (Alpha Cronbach) for each variable is more than 0.5, which means that the questions are consistent.

Statistically, from the reliability coefficient, we can reach the validity coefficient for each variable which equals the square root of the reliability coefficient.

The validity coefficient for each variable is more than 0.5, which means that the statements for each variable are valid.

7. Statistical analysis and testing the hypotheses

The researcher discusses the results of the statistical analysis of the questionnaire elements through the application of some statistical methods using the statistical analysis program (SPSS) for each set of questions in the questionnaire list separately, to show the correctness or error of each hypothesis of the study.

7.1 Descriptive analysis for the data related to the obstacles of internal auditors' independence:

a) Descriptive analysis for the categories:

In the following table, the researcher reviews the results of the opinions about the questions related to the first hypothesis for each category, through statistical measures (arithmetic mean, and standard deviation).

Table (4): Descriptive statistics for the obstacles to internal auditors' independence

Section 1	Internal Auditor		Financial Analyst		External Auditor		Accountant		Academic	
	Mean	Standard Deviation	Mean	Standard Deviation	Mean	Standard Deviation	Mean	Standard Deviation	Mean	Standard Deviation
The obstacles to internal auditors' independence	3.97	0.399	3.97	0.437	3.99	0.677	3.97	0.471	4.06	0.323

✚ The table shows the following:

- The overall mean for each category about all statements is more than 3.4 which means that there is an agreement among all categories that the statements represent obstacles to internal auditors' independence that should be taken into consideration in the event of disclosing internal audit reports.

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- Academic has the highest overall mean score of (4.06) followed by external auditors with (3.99). Internal auditors, financial analysts, and accountants have the same overall mean score of (3.97).

b) Kruskal-Wallis Test for the categories:

The first hypothesis has been tested using Kruskal-Wallis Test.

The results were shown in table (5):

Table (5): Kruskal-Wallis Test to show the differences in respondents' opinions about the obstacles to internal auditors' independence

Statements	Kruskal-Wallis H	df	Asymp. Sig.
(1)	4.467	4	0.347
(2)	1.415	4	0.842
(3)	5.773	4	0.217
(4)	5.495	4	0.24
(5)	2.435	4	0.656
(6)	3.035	4	0.552
(7)	2.378	4	0.667
(8)	8.382	4	0.079
(9)	4.335	4	0.363
(10)	2.377	4	0.667

The table shows that the significance for each statement is more than (0.05). Therefore, the null hypothesis is accepted, and the alternative hypothesis is rejected which means that “**there are no statistically significant differences between respondents' categories about the obstacles to internal auditors' independence in the Egyptian listed joint stock companies**”.

7.2 Descriptive analysis for the data related to the solutions of internal auditors' independence

a) Descriptive analysis for the categories:

In the following table, the researcher reviews the results the questions related to the second hypothesis for each category, through statistical measures (mean, and standard deviation).

Table (6): Descriptive statistics for the solutions to increase internal auditors' independence

Section 2	Internal Auditor		Financial Analyst		External Auditor		Accountant		Academic	
	Mean	Standard Deviation	Mean	Standard Deviation	Mean	Standard Deviation	Mean	Standard Deviation	Mean	Standard Deviation
The solutions of internal auditors' independence	4.17	0.535	4.16	0.443	4.31	0.520	4.28	0.482	4.14	0.518

✚ The table shows the following:

- The overall mean for each category about all statements is more than 3.4 which means that there is an agreement among all categories that the statements represent solutions to increase internal auditors' independence.
- External auditors have the highest overall mean score of (4.31) followed by accountants with (4.28). Internal auditors, financial analysts, and academic have a close overall mean score with (4.17), (4.16), and (4.14) respectively.

b) Kruskal-Wallis Test for the categories:

The second hypothesis has been tested using Kruskal-Wallis Test. The results were shown in table (7):

Table (7): Kruskal-Wallis Test to show the differences in respondents' opinions about the solutions of internal auditors' independence

statements	Kruskal-Wallis H	df	Asymp. Sig.
(1)	1.656	4	0.799
(2)	3.157	4	0.532
(3)	8.075	4	0.089
(4)	5.457	4	0.243
(5)	3.116	4	0.539
(6)	3.812	4	0.432
(7)	3.995	4	0.407
(8)	8.482	4	0.075

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The table shows that the significance level for each statement is more than (0.05). Therefore, the null hypothesis is accepted, and the alternative hypothesis is rejected which means that “**there are no significant differences between respondents' categories about the solutions of internal auditors' independence in the Egyptian listed joint stock companies**”.

7.3 Descriptive analysis for the data related to the solutions of internal audit disclosure

a) Descriptive analysis for the categories:

In the following table, the researcher reviews the statistical measures related to the second hypothesis for each category.

Table (8): Descriptive statistics for solutions of the effectiveness of internal audit disclosure

Section 3	Internal Auditor		Financial Analyst		External Auditor		Accountant		Academic	
	Mean	Standard Deviation	Mean	Standard Deviation	Mean	Standard Deviation	Mean	Standard Deviation	Mean	Standard Deviation
solutions to increase the effectiveness of internal audit disclosure	4.12	0.555	4.18	0.510	4.08	0.520	4.20	0.561	4.08	0.430

✚ The table shows the following:

- The overall mean for each category is more than 3.4 which means that there is an agreement that the statements represent solutions to increase the feasibility and usefulness of the external disclosure of internal audit reports.
- Accountants have the highest overall mean score of (4.20), followed by financial analysts with (4.18). The other categories have a close overall mean score with (4.12) for internal auditors and (4.08) for each of external auditors and academic.

b) Kruskal-Wallis Test for the categories:

The sixth hypothesis has been tested using Kruskal-Wallis Test. The results were shown in table (9):

Table (9): Kruskal-Wallis Test to show the differences in respondents' opinions about the solutions of the effectiveness of IA disclosure

Statements	Kruskal-Wallis H	df	Asymp. Sig.
(1)	6.618	4	0.158
(2)	3.763	4	0.439
(3)	5.135	4	0.274
(4)	1.733	4	0.785
(5)	1.713	4	0.788
(6)	3.745	4	0.442
(7)	0.299	4	0.99
(8)	2.604	4	0.626
(9)	6.792	4	0.147
(10)	3.752	4	0.441
(11)	8.883	4	0.064
(12)	4.844	4	0.304
(13)	3.694	4	0.449
(14)	5.006	4	0.287

The table shows that the significance level for each statement is more than (0.05). Therefore, the null hypothesis is accepted, and the alternative hypothesis is rejected which means that **“there are no statistically significant differences between respondents' categories about the solutions to increase the effectiveness of internal audit reports disclosure in the Egyptian listed joint stock companies”**.

7.4 Testing the fourth hypothesis

The researcher explores the results of testing the fourth hypothesis which states that **“There is no significant relationship between the solutions of internal auditors' independence and the effectiveness of internal audit disclosure in the Egyptian environment.”**

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The variables of this hypothesis include:

Independent variable (x): **The solutions related to internal auditors' independence**

Dependent variable (y): **The effectiveness of internal audit disclosure**

Simple linear regression model was used to test the correlation between the solutions related to internal auditors' independence and the effectiveness of internal audit disclosure. Table (10) presents the Pearson correlation matrix.

Table (10): The correlation matrix of the hypothesis

The solutions related to internal auditors' independence	The effectiveness of internal audit disclosure	
	Pearson correlation	0.447
P-value	<.001	

From the above table, there is a direct positive relationship between the independent variable and the Dependent variable in which the correlation coefficient is (0.447) and the significance level is less than (0.001). thus, the null hypothesis is rejected, and the alternative hypothesis is accepted **“There is a positive and significant relationship between the solutions related to internal auditors' independence and the effectiveness of internal audit disclosure in the Egyptian environment”**.

Table (11) shows the simple linear regression that presents the correlation between the two variables.

Table (11): The simple linear regression model of the hypothesis

	B	T-test		F-test		R ²
		T	P-value	F	P-value	
Constant	2.184	9.162	<.001	67.759	<.001	0.2
the solutions related to internal auditors' independence	0.463	8.232	<.001			

From the above table, it is noticed that R^2 is 0.2 which indicates that the independent variable explains only 20% of the dependent variable, and the rest of the percentage may be due to other factors. Although the percent 20% might be a low explanatory power, it represents a high percentage concerning that there is only one explanatory variable, and it can be increased by including more independent variables.

Findings, recommendations and future research

A. Findings of the empirical study

- 1- There are no statistically significant differences between the respondents' categories about the obstacles to the internal auditors' independence in the Egyptian listed joint stock companies.
- 2- There are no statistically significant differences between the respondents' categories about the solutions to increase internal auditors' independence in the Egyptian listed joint stock companies.
- 3- There are no statistically significant differences between respondents' categories about the solutions to increase the effectiveness of internal audit disclosure in the Egyptian listed joint stock companies.
- 4- There is a positive and significant relationship between the solutions related to internal auditors' independence and the effectiveness of internal audit disclosure in the Egyptian environment.

B. Study Recommendations

1. The study recommends applying the proposed solutions for internal auditors' independence because these factors lead to increase the effectiveness of internal audit disclosure.
2. The most important solution suggested for internal auditors' independence is "Giving power and more responsibilities to

- the General Assembly of Shareholders to increase internal auditors' independence". Among these responsibilities are (the legal accountability of internal auditors - Appointment of internal auditors at the annual meeting - the power of the dismissal or remove of internal auditors - approving the IA budget - Determining the salary of internal auditors).
3. The study recommends applying the proposed solutions for increasing the effectiveness of internal audit disclosure in the Egyptian listed joint stock companies.
 4. The most important solutions suggested for increasing the effectiveness of internal audit disclosure, other than increasing internal auditors' independence are "Suggesting the setters of auditing standards to increase the accounting regulation about IA disclosure – Increasing the awareness about the importance of disclosing IA reports
 5. There should be a legal obligation for companies listed on EGX to form independent internal audit departments to help increase the effectiveness of disclosing IA reports if such disclosure is circulated in the future.

C. Suggestions for Future Research

The following are some ideas for future research:

1. Investigating the impact of internal audit disclosure on financial reporting quality.
2. Investigating the impact of internal audit disclosure on risk management.
3. Investigating the impact of external disclosure of internal audit reports on the value of stocks.
4. Examining the impact of internal audit disclosure on the quality of external auditing.
5. Suggesting a framework for internal auditors' independence in companies listed.

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Appendix: The Questionnaire

1- The First Section

This section aims to measure and identify the extent to which there are obstacles to the independence of internal auditors.

Statement	SD (1)	D (2)	N (3)	A (4)	SA (5)
1. The internal auditor, functionally and administratively, follows the board of directors and the executive management.					
2. There are roles and responsibilities for the Chief Audit Executive outside the scope of the department's work.					
3. The board of directors and/or the audit committee are responsible for the process of setting, developing and controlling the internal audit plan, and setting and accepting the internal audit budget.					
4. A conflict of interest may occur while the internal auditor performs his work, as there are personal relationships (relatives or friendship) between him and the employees in other departments.					
5. The internal audit function is often used as a starting point and training for future managers.					
6. It is possible that there is an economic interest for the internal auditor when reviewing the work of a person who has the ability to influence his employment or salary and financial incentives.					
7. The internal auditor's commitment to international internal auditing standards with regard to independence and objectivity decreases due to lack of knowledge and full awareness of the development of standards.					
8. The internal auditor is not held accountable by external parties. On the other hand, the external auditor is legally accountable if his report is biased towards the management of the company.					
9. The board of directors and/or the audit committee determine the salary and financial incentives for the internal auditor, and there is no interference by the general assembly of shareholders in these incentives.					
10. The board of directors and/or the audit committee have the power to appoint and remove the internal auditor.					

2- The second section

This section aims to propose solutions to increase the internal

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auditors' independence.

Statement	SD (1)	D (2)	N (3)	A (4)	SA (5)
1. The legal accountability of the internal audit work team by the general assembly of shareholders works to increase its independence and make his reports not be biased to the entity to which it is affiliated, represented in the Board of Directors and the Executive Management.					
2. Determining the remuneration and salary of the internal auditor by the general assembly of shareholders increases his independence.					
3. Obligating the company not to give responsibilities to the Chief Internal Audit Executive outside the scope of the department's work, working to increase his independence.					
4. Appointment and identification of the internal audit work team at the annual meeting of the general assembly of shareholders works to increase the independence of the team.					
5. Obligating the Board of Directors and the Executive Management by legal legislation not to conclude any external agreement unless a representative of the IA Department is present to protect the rights of shareholders from any possible manipulation.					
6. Reconsidering the entity entrusted with the dismissal of the internal auditor (currently represented by the Board of Directors and/or the audit committee) and giving it to the General Assembly of Shareholders, working to increase his independence in the performance of his work duties.					
7. Giving the responsibility for approving the internal audit budget to the general assembly of shareholders instead of the board of directors works to increase the independence of the internal auditor.					
8. Giving the responsibility of setting, developing and controlling the IA plan to the Chief Audit Executive, authorized by the general assembly of shareholders instead of the board of directors, working to increase Internal auditors' independence.					

3- The third section:

This section aims to propose solutions to increase the effectiveness

of disclosing internal audit reports.

Statement	SD (1)	D (2)	N (3)	A (4)	SA (5)
1) Internal auditors' independence helps in providing accounting information that is accurate, objective.					
2) Internal auditors' independence helps in increasing of users' confidence of the disclosed reports.					
3) Internal auditors' independence helps in improving the corporate governance and thus increasing the transparency of governance.					
4) The independence of the internal auditor helps in increasing the quality of IA reports and financial reports in general, and thus the possibility of external parties relying on them in making decisions.					
5) The independence of the internal auditor helps reduce the potential risks of fraud and manipulation from management in the event of disclosing the IA reports.					
6) The quality of IA reports helps increase quality of mandatory disclosure of financial reports.					
7) The quality of IA reports helps increase quality of the voluntary disclosure of the IA reports.					
8) The application of the proposed supporting factors for internal auditors' independence increases the usefulness of external disclosure of IA reports.					
9) The application of the proposed supporting factors to increase the quality of IA reports increases the utility of external disclosure of IA reports.					
10) Disclosure of applying the factors supporting internal auditors' independence and the factors supporting the quality of IA reports increases the users' confidence of these reports if they are disclosed.					
11) Suggesting the setters of auditing standards from professional societies to increase the accounting regulation regarding disclosure of IA reports.					
12) Suggest placing the costs of disclosure of IA reports within the budget of the IA department in the event of generalizing disclosure of IA reports.					
13) Awareness of the company and external parties must be increased of the importance of disclosing IA reports to reduce the information asymmetry.					
14) There should be a legal obligation for companies listed on EGX to form independent IA departments to help increase the quality and benefit of IA disclosure.					

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