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**The Contemporary Role of Internal Audit and Its
Effect on the Credibility of Financial Reports**

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Abstract:

The purpose of this study is to study the contemporary role of the internal audit and measure the impact of this role on the credibility of financial reports.

The contemporary role of the internal audit is that internal audit has become an added source of value through giving value to the business (and its stakeholders) by providing objective and relevant assurance, as well as by contributing to the effectiveness and efficiency of governance, risk management, and control procedures through assurance and advisory services.

The credibility of financial reports is the degree of accuracy in the data of financial reports that allows a competent user to draw correct conclusions about the results of the activities of economic entities on their basis and to make decisions based on these conclusions.

The research was conducted using the following methodology: To test the study's hypotheses, the researcher chose a sample of 136 internal auditors, 24 external auditors, 169 managers and 14 faculty members to conduct a field study in order to achieve this goal. Data was analyzed by using descriptive and inference statistics analysis.

The results of the research concluded that there is a positive effect of the added value of internal auditing on the credibility of financial reports.

-key words: Contemporary Role of Internal Audit, internal audit added value, the credibility of financial reports.

الملخص:

تهدف هذه الدراسة إلى دراسة الدور المعاصر للمراجعة الداخلية وقياس أثر هذا الدور على مصداقية التقارير المالية.

يتمثل الدور المعاصر للتدقيق الداخلي في أن المراجعة الداخلية أصبحت مصدرًا ذو قيمة مضافة من خلال إعطاء قيمة للأعمال (والمساهمين فيها) من خلال توفير تأكيد موضوعي وذو صلة، وكذلك من خلال المساهمة في فعالية وكفاءة الحوكمة وإدارة المخاطر والرقابة من خلال خدمات التأكيد والاستشارات.

مصداقية التقارير المالية هي درجة الدقة في بيانات التقارير المالية التي تتيح للمستخدم المختص استخلاص استنتاجات صحيحة حول نتائج أنشطة الكيانات الاقتصادية واتخاذ القرارات بناءً على هذه الاستنتاجات.

منهجية الدراسة: ولتحقيق هذا الهدف استخدم الباحث الدراسة الميدانية لاختبار فرضيات الدراسة، حيث قام الباحث باختيار عينة مكونة من 136 مراجع داخلي، 24 مراجع خارجي، 169 مديراً و14 عضو هيئة تدريس. وتم تحليل البيانات باستخدام التحليل الإحصائي الوصفي والاستدلالي.

وقد خلصت نتائج البحث إلى وجود تأثير إيجابي للقيمة المضافة من المراجعة الداخلية على مصداقية التقارير المالية.

-الكلمات المفتاحية: الدور المستحدث للمراجعة الداخلية - القيمة المضافة من المراجعة الداخلية - مصداقية التقارير المالية.



Chapter one

1.1 The general framework of the research

1.1.1 Introduction and research problem:

The concept of internal audit has developed as a result of the development in the surrounding environment in order to suit the multiple and new changes in the world of business to turn into the value-added approach. The value-added internal auditing is to create value for stakeholders to contribute to achieving the organization's strategy as a whole. The internal audit is no longer a "control-based audit", but rather became a "risk-based audit", which is considered (a change in the basis), and in addition to the change in the term expressing the internal audit to become the "activity" of the internal audit, instead of the "department" of internal audit (Khalil M.A.I., 2014, P.342). Ascertaining the role of the internal auditor in achieving this value and achieving the credibility of financial reports necessitates the existence of a measure of the value - added resulting from the advanced internal audit services. Therefore, the researcher used the balanced scorecard (BSC) as a functional tool for controlling and carrying out the plan.

1.1.2 Study Importance and objective:

The importance of research comes from: the scarcity of scientific studies that dealt with the subject of the study, this research is one of the relatively few studies (within the limits of the researcher's knowledge) that deals with the subject of the effect of measuring the added value of the internal audit on the credibility of financial reports. Measuring the added value of the internal audit will increase the confidence of the beneficiaries of the company's financial reports, such as (investors and creditors) in the information published by the firm.

1.1.3 Study hypotheses:

H01: There is no statistically significant effect of measuring the internal audit added value on the credibility of financial reports.

H02: There are no statistically significant differences to measure the internal audit added value using the perspectives of the balanced scorecard as an independent variable due to the difference in the demographic variables of the sample (job position, years of experience).

H03: There are no statistically significant differences to measure the credibility of financial reports using the qualitative characteristics of financial reporting information as a dependent variable due to the difference in the demographic variables of the sample (job position, years of experience).

1.1.4 Research structure:

Based on the objective, importance and what the researcher seeks to achieve, the study will be structured as follows:

Chapter one: The general framework of the research

Chapter two: Theoretical Background of the contemporary role of the internal audit.

Chapter three: Theoretical Background of the credibility of financial reports.

Chapter four: The field study

Conclusion, References.

1.1 Literature review

1.2.1 Jiyane N. (2019)

The purpose of the study is to identify the added value of internal auditing in South Africa. The legislation and frameworks that formed the theoretical basis for the study included the Municipal Finance Management Act, the King Report on Corporate Governance, the Committee of Sponsoring Organizations (COSO) and International Professional Standards for Internal Auditing.

The study concluded that annual reports in South Africa revealed that internal audit performs a wide range of activities to fulfill its value-adding role and also concluded that there is a relationship between the financial performance of



municipalities and the disclosed performance of the IAFs of the respective municipalities.

1.2.2 Xiaolong Qu. and others (2020)

The study aims to determine the influences of the corporate operating environment, institutional function orientation in internal auditing, corporate internal duty segregation, concern from management and the competence of auditors on value-added internal audit.

The study concluded that Based on the assurance and consultation function of internal audit, internal audit creates value for corporates by exerting deterrent function and providing management consultation suggestions.

1.2.3 Azizan S.B. (2018)

This study explores the relationship between corporate citizenship performance and pricing decisions made by investors and auditors to determine whether it affects how credible financial reporting information is perceived.

The study comes to the conclusion that the greater the corporate citizenship performance, the lower the inherent uncertainty in the firm's or managers' credibility as a source of financial reporting information.

1.2.4 Chukwu N. and others (2019)

This study aims to evaluate the impact of basic forensic accounting skills viz: communication skills, technical & analytical skills, accounting & auditing skills and psycho-social skills on the financial reporting credibility of listed organizations in Nigeria.

This study concludes that there is a strong and significant association between these various skills and financial reporting credibility.

1.2.5 Grace O.O. and others (2021)

The goal of the study is to ascertain how income smoothing and earning management the credibility of the financial data provided by Nigeria's publicly traded manufacturing organizations.

According to the study's findings, income smoothing and earnings management had a positive impact on the credibility of the financial reporting.

Chapter two: Theoretical Background of the contemporary role of the internal audit.

2.1 The stages of internal audit

The internal audit has witnessed many developments in its stages until it reached its current value-adding form, as the emergence of internal auditing as an idea began in the thirties, but the trend towards the necessity of recognizing internal auditing as a profession with its components began in the forties, then the IIAs was established in 1941.

The researcher (Serag A.A.E.& Daoud M.M.,2021, P.P. 12-14) divided the stages of internal audit into 3 stages: the financial audit stage, the processes audit stage and the value-added stage.

2.1.1 The Financial Audit Stage:

It was crucial to audit a representative sample of transactions without fully analyzing the internal control and management systems (Tubek B., 2021, P.139). It is noted that this type at this stage was the internal audit dealing mainly with accounting and financial matters. The role of internal auditing in this phase was concentrated only on:

- 1) reviewing and assessing the internal control system.
- 2) preserving the company's assets.
- 3) auditing the financial operations.



2.1.2 The Processes Audit Stage:

Instead of merely concentrating on the financial audit during this phase, the internal audit also focused on evaluating the different activities within the organization.

2.1.3 The value-added Stage:

In this stage the scope of internal audit grows to consider the following (Chambers A.D.& Odar M., 2015, P.P. 46-47):

- 1) internal governance.
- 2) information presented to the Board and Executive Management for strategic and operational decision-making.
- 3) the determination of risk appetite and adherence to it.
- 4) the risk and control culture of the organization.
- 5) risks of bad customer service leading to conduct or reputational risk.
- 6) capital and liquidity risks.
- 7) key corporate events.
- 8) outcomes of processes.

2.2 The internal audit and risk management

The IIAs has issued Standards No. 2120 and No. 2006 on the role of the internal auditor in risk management. The role of internal auditors to add value is to evaluate the effectiveness of risk management through: (Ben-Ataf W., 2021, P. 132-133), (Ackermann C.& Marx B., 2016, P. 46) and (Abdelhamid S., 2020, P.P. 1170- 1172)

- 1- ensuring that risks are properly assessed.
- 2- determining the materiality of the identified risks.
- 3- identifying potential risk.
- 4- giving an organization's management an unbiased and independent assessment of whether risks are being managed at a level that is acceptable.
- 5- mitigating risk exposure to an acceptable level.
- 6- supporting the risk report.
- 7- Developing a comprehensive risk management strategy.

2.3 The internal audit and corporate governance

The role of internal auditors to add value is to evaluate the effectiveness of corporate governance through: (Maklad M., 2018, P.P. 37-39), (Koutoupis A. and others, 2018, P. 1009), (Grant D., 2017, P.P. 6-7), (Jiyane N., 2019, P. 42) and (Yushen Ma., 2021, P. 122)

- 1. helping employees form a good professional ethics and quality.**
- 2. pushing the business to develop a high-spirited organizational culture and harmonious working atmosphere.**
- 3. identifying potential problems in the internal control system and assess the various risks faced by internal and external organizations.**
- 4. assessing operational performance.**
- 5. reviewing the financial reporting process to ensure the quality and integrity of producing reliable, useful and transparent financial information for relevant decision making.**
- 6. ensuring accountability, preventing, detecting and correcting fraud and errors.**
- 7. Supervising the organization's social responsibility.**

2.4 The internal audit and internal control

The IIAs has issued Standard No. 2130 on the role of the internal auditor in internal control. The role of internal auditors to add value is to evaluate the effectiveness of internal control through: (Boulifa H., 2018, P. 13, 18), (Bou Omar N.& Sidhom A., 2015, P.P. 15-17), (Barbah B.& Bazag M. 2022, P. 344) and (Oussii A.A& Boulila N., 2018, P. 457)

- 1. determining whether control activities are adequate and recommending to improve the control tools.**
- 2. ensuring that all procedures, regulations and policies that have been established by the administration are implemented.**
- 3. ensuring the accuracy of the financial statements data provided by the accounting system.**
- 4. verifying that there are no fraud, manipulation or irregularities.**
- 5. helping maintain the organization's activities.**



6. helping discover strengths and weaknesses and give possible solutions and suggestions.
7. alerting management of future risks that the organization may face.

2- Using the balanced scorecard to measure the contemporary role of the internal audit.

The IIA- Australia in 2019 defined a Balanced Scorecard for Internal Audit as a way assist in managing and measuring internal audit performance through KPIs used to evaluate success of the internal audit function. It may also assist in linking the organization's overall strategy and the internal audit plan and help to translate strategy into action.

Table (1) Examples of internal audit added value Key performance indicators included in balanced scorecard methodology

Balanced scorecard perspective	Examples of internal audit added value KPIs
Financial perspective	<ul style="list-style-type: none">-The quantity of audits finished in relation to the plan.-The quantity of internal audit reports.- Costs of the audit fell within, below or actual to budget.
Customer perspective	<ul style="list-style-type: none">- Management satisfaction survey rating.-Audit committee satisfaction survey rating.-External auditor satisfaction survey rating.-The number of services that have been fulfilled for internal and external beneficiaries from the internal audit to the total number of services requested.

<p>Internal business process perspective</p>	<ul style="list-style-type: none"> -Performance relative to the budgetary budget for internal auditing. -Percentage of risk coverage. -The contribution of internal auditors to the application of corporate governance. -Projects finished by the predetermined timeframe. -Budget to actual audit times. -Cycle time from start of fieldwork to final report.
<p>Learning & growth perspective</p>	<ul style="list-style-type: none"> -Internal auditor workforce satisfaction. -The percentage of the quantity of internal auditors who have long experience in the field of internal audit to the total quantity of internal auditors in the organization. -Maximizing new methods and internal audit resources use. -Percentage of surprise risk events. -The percentage of the quantity of internal auditors who obtained a professional certificate to the total quantity of internal auditors in the organization. -Accomplishment of goals set forth in the professional development plan. -The percentage of the quantity of training courses for internal auditors to the total quantity of annual training courses in the organization. -The percentage of the quantity of training hours of internal auditors to the total quantity of training hours in the organization.

(Source: (IIA-Australia, 2019, P.P. 5-6), (Eulerich M.& Lenz R., 2020, P.P. 33-34), (Bagaga S.S., 2013, P.P. 19-21), (Baiden J.N. and others, 2016, P.P. 83-86)).



Chapter three: Theoretical Background of the credibility of financial reports.

The researcher (Bokandora A.&Babnat A., 2018, P. 11) defined the credibility of financial information as the ability to adopt financial and accounting information by its users with the least possible degree of fear, and this is achieved by the availability of (representation, verifiability and impartiality).

3.1 The importance of financial reporting credibility

The credibility of financial reports is not only important for external users of these reports, but it is also important for internal users. For internal users, it is important to determine good projects which will ultimately boost investment effectiveness and share values. For external users: it helps corporate lenders in evaluating the credit quality, and capital providers are better able to evaluate their investment returns as a base for more investment or divestment (Chukwu N. and others, 2019, P. 1).

3.2 The measurements of credibility of financial reports

(Fakhr, 2015, P. 586) has measured the financial reporting credibility by detecting the financial reports' errors and discovering the practice of profit management and limitation methods and trying to limit it.

(Liudmyla L. & Maria K., 2022, P. 148) stated that the disparity in valuation methodology and the unequal evaluation outcomes are the product of different approaches to defining the studied concept of financial reporting quality, so he uses a specific list of qualitative characteristics and divided them into:

- 1. Fundamental qualitative characteristics – relevance and fair representation (reliability).**
- 2. Enhancing qualitative characteristics– comparability, verifiability, timeliness, clarity.**

Finally, the researcher concludes from the above that there is no agreement between literature review on one measure of the credibility of financial reports, but the most common of

them is the qualitative characteristics of accounting information, which is what the researcher will rely on in his current study which can be illustrated in the following figure.

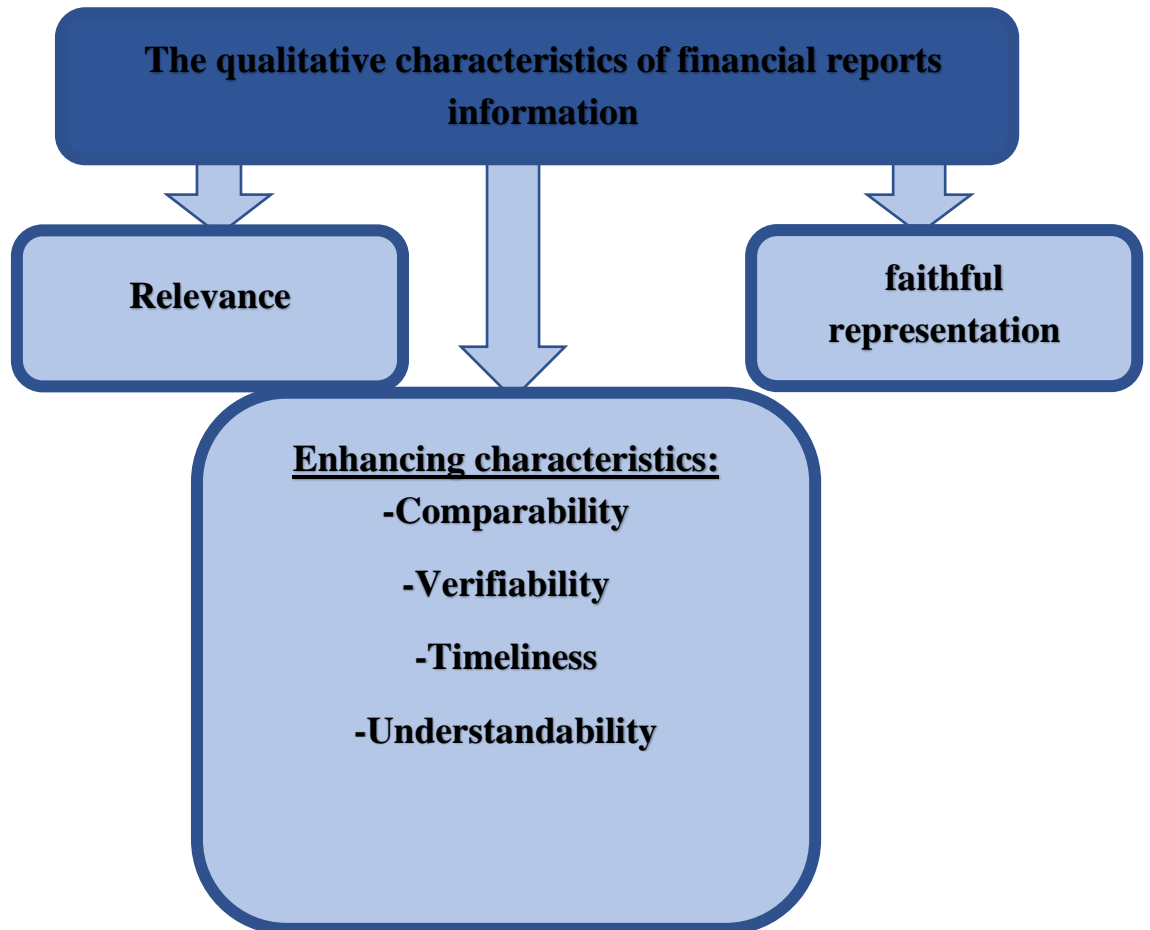


Figure (1) The qualitative characteristics of financial reports information

(Source: prepared by the researcher)



Chapter four: The field study

4.1 Introduction and the objective of the study:

In order to test the study's hypotheses, a field study was conducted in this chapter to learn what the study's sample thought about all the topics covered in the theoretical portion in the context of Egypt. The researcher selected a sample of 136 internal auditors, 24 external auditors, 169 managers and 14 faculty members. Data was analyzed by using descriptive and inference statistics analysis.

4.2 Hypotheses testing and discussion of findings:

The results of the field study provided the followings:

- 1- there is a statistically significant effect of measuring the IAAV on the credibility of financial reports, and included a strong correlation between measuring the IAAV as an independent variable and measuring the credibility of financial reports as a dependent variable.**
- 2- There are no statistically significant differences to measure the IAAV using the perspectives of the balanced scorecard as an independent variable due to the difference in the demographic variables of the sample (job position, years of experience)".**
- 3- There are no statistically significant differences to measure the credibility of financial reports using the qualitative characteristics of financial reporting information as a dependent variable due to the difference in the demographic variables of the sample (job position, years of experience)".**

Conclusions:

- 1. Internal audit departments that are well-run and efficient enable organizations to better realize their full potential in terms of goal achievement.**
- 2. the key role models of internal audit as a value adder, a trusted and reliable advisor and a governance, risk management, and internal control (GRC) partner.**
- 3. Highly credible financial reports are crucial to all parties and will only be achieved through the combined efforts of all parties concerned with those reports.**
- 4. there is a statistically significant effect of measuring the internal audit added value on the credibility of financial reports, and included a strong correlation between measuring the internal audit added value as an independent variable and measuring the credibility of financial reports as a dependent variable.**



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