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INDEPENDENCE OF CORPORATE AUDITORS IN GCC COUNTRIES

Key Words

Internal Auditing; Corporate Auditors; Internal Auditor; Corporate Governance; Independence; GCC Countries,

Abstract

The aim of this research is to investigate the extent of the independence of internal auditors in the Arabian Gulf region (GCC countries) and to identify factors restricting internal auditors' independence in the region. Findings of this study suggest that in more than half of the surveyed companies, neither the board of directors nor the audit committee were involved in the appointment or removal of the director of an internal audit department. Similarly, the recipient of the internal audit final report in the majority of the companies surveyed was neither audit committees nor the board. This situation is expected to have a strong negative effect on the independence of the internal audit profession. Also the undertaking of non-audit activities by members of the majority of internal audit departments in the region is presumed to impair audit objectivity. The statistical analysis of the data collected showed that in banks, in large internal audit departments, and in the departments whose leaders were members of the IIA or familiar with its standards, independence was significantly higher, and that internal audit departments maintaining professional terms of references were found to achieve significantly better independence.

Introduction

The recent IIA definition of internal auditing reads "*Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, con-*

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trol, and governance processes." (IIA, 2003). As can be noticed in the above definition, the first adjective used to describe internal auditing is *independent*, implying that any impairment of the autonomy of internal auditing results in reducing the value added by the function.

Since the existence of audit profession, independence was seen as an important theme affecting its practice. Sawyer *et al.* (2003, p. 1305) stated, "Independence has been an issue ever since the practice started." The independence of auditors is a major aspect of their effectiveness and is seen by Cosserate (2000, p. 75) as the cornerstone of the profession of auditing. Concerns about external and internal auditors' independence are remarkably similar (Fern, 1985). Although there is extensive literature focussing on the independence of external auditors (i.e. Taylor *et al.*, 2003; Cushing and Gilbertson, 2002; AAA, 2001; Canning and Gwilliam, 1999; Beattie, Brandt, and Fearnley, 1999; Kinney, 1999; Hasani, 1999; Elliott and Jacobson, 1998; Evans and Nobes, 1998; Jeppesen, 1998; Lee and Gu, 1998), little could be found on the independence of internal auditors. Research with relevance to internal auditing in developing nations is limited, and few studies discuss auditors' independence in developing countries. The majority of such studies have focussed on governmental or external auditors.

The standards on external auditing in various countries (i.e. Canada, France, Japan, Mexico, the U.K., the U.S.A.) focus on the importance of the auditors' independence (Hayes, 1999, pp. 82-83). The international internal auditing standards as promulgated by the international Institute of Internal Auditors (IIA) also laid down the necessary aspects for internal audit to be independent. In fact "Independence" was the first standard (Standard No. 100) of the 1997 edition of the Standards of Professional Practice of Internal Auditing (SPPIA).[1]

In reference to the Arabian Gulf region, several studies were directed towards independence of external auditors (see for example Al-Meghames, 1997) but only one article, Al-Bassam and Shahin, 1984, was found to be about the independence of internal auditors, and it focused on the petroleum sector of Kuwait.

Therefore, this paper endeavours to investigate the extent of the independence of the internal audit func-

(1) It should be noted that in the current release of the SPPIA, independence was discussed in Attribute Standard 1100 (Independence and Objectivity), Attribute Standard 1110 (Organizational Independence), Attribute Standard 1120 (Individual Objectivity), and Attribute Standard 1130 (Impairments to Independence or Objectivity).

tion in the corporate sector in the Arabic Gulf region of six countries: Saudi Arabia, Kuwait, United Arab Emirates, Qatar, Bahrain, and Oman. These countries share many similarities such as language, religion, economics, politics, and culture.

Historical Development of the Profession and its Standards

Although forms of the internal audit may be traced far back in history, the internal audit, as we know it today, is very much a phenomenon of the twentieth century. Sawyer and Vinten (1996) note that the roots of both internal and external auditing can be found deep in antiquity and trace forms of the audit back to Mesopotamian society circa 3600 BC. However, as economies developed in the eighteenth and nineteenth centuries, the internal and external audits, both in the public and private sectors, achieved greater prominence. In terms of the development of the internal audit, U.S. railroad companies employed "travelling auditors" as a form of internal audit, and in Germany, the Krupp Company produced an audit manual in 1875 (Flesher, 1991).

The first forty years of the twentieth century saw major changes in the commercial environment in Europe and most notably in the U.S.A. These reflected advances in technology, for example the development of the gasoline engine and electricity (Cochran, 1972), which in turn impacted upon economic growth, the size of business entities, their management systems and internal and external accountability (Flesher, 1991). Changes in management techniques, for example the adoption of scientific management practices and a greater focus on the role of management *per se* were one facet of this environmental change (Johnston, 1982), and a gradual improvement in the extent and nature of external disclosures (Hawkins, 1963) was another.[2] In this period, the increasing size and scale of operations of both commercial entities and the public sector and the development of more formalised management structures saw the emergence of the internal audit as part of the mechanism of internal control in some of these entities,[3] most notably the railroads (Lamperte and Thurston, 1953; Sawyer, 1981; Flesher, 1996) and banks in

(2) The crises of 1929-1933, which included worldwide stock market collapses, the failure of many banks, and the worldwide depression in industry, may also have acted as a spur to the development of the internal audit profession.

(3) O'Regan (1999) notes that, although the U.K. saw the first establishment of formalized procedures for the external audit, almost all the developments in the internal audit originated in the U.S.A.

the U.S.A. Although the internal audit function was developing in this period, its profile was still low as compared with, for example, the external, independent audit (Lamperte and Thurston, 1953) and associated documentation and literature were sparse. Nor was there any overarching professional body as there is today, acting as a standard setting organization (Flesher, 1991).

The foundation of the Institute of Internal Auditors (IIA) in 1941 was a milestone in the development of the internal audit function and the internal audit profession. The membership of the IIA, just 24 in 1941, grew to 3,000 in 1955 and 6,000 by 1965. By 1987, the membership had reached 27,000 (Chambers *et al.* 1987, p. 3), and it rose to exceed 93,000 members from 160 countries by the middle of the 2004.[(4)]

Whereas previously North America membership had been preponderant, in 1998 for the first time, membership from outside North America comprised more than half the membership (*Internal Auditor*, Feb. 1998, p. 84). The first local chapter (New York) was formed in December 1942. By the end of 1947, there were nineteen such chapters in North America, and 1948 saw the first chapters formed outside North America, in London[(5)] and Manila (Flesher, 1991). Nevertheless by the end of June 2004, more than 240 organizations (chapters and national institutions) were affiliated to the IIA across more than 90 countries.[(6)] The year 1944 saw the launch of the *Internal Auditor* journal under the auspices of the IIA.

Although the first full standards were not promulgated until 1978, as early as 1947, the IIA adopted a "Statement of Responsibilities of the Internal Auditor" which dealt with the nature, objectives, scope, responsibility, and independence of internal auditing.

The 1950s and 1960s were a period of almost unbroken economic expansion in the US and Europe, and this period also saw the widespread introduction of mechanised and computerised information systems. A "Code of Ethics" was adopted by the IIA in 1968. The most notable changes in the development of internal auditing were the 1974 introduction of the examination process designed to lead to the award of the title, Certified Internal Auditor (CIA), and the 1978 promul-

(4) as of the 25th of June 2004.

(5) In 1975, the five then existing chapters in the U.K. merged into an affiliated national institute, now known as IIA-UK. (Ridley and Chambers, 1998, p. 4).

(6) WWW.theiia.org as of the 25th of June 2004.

gation by the IIA, of the "Standards for Professional Practice of Internal Auditing" (SPPIA).[7] The SPPIA was an important step toward the professionalization of internal auditing. These standards consist of five general standards and twenty-five sub-standards. The perceived importance of these standards is seen in the foreword to the current edition of the standards:

- Standards, as used in this document, mean the criteria by which the operations of an internal auditing department are evaluated and measured. They are intended to represent the practice of internal auditing as it should be. The Standards are meant to serve the entire profession in all types of organizations where internal auditors are found.

These standards have received widespread acceptance and have been translated widely into various languages[8] and are in use in thousands of organizations worldwide across private and public sector (Ridley and Chambers, 1998).

Until recently (2003) and since 1978, the underlying framework to this standard has remained essentially unchanged, but the IIA has issued eighteen further statements, "Statement on Internal Auditing Standards" (SIAS), that have served to add to and clarify or to address particular internal audit issues of the existing standards. These statements are now integrated into the main framework of standards. The recent change to the framework of SPPIA resulted in a reorganization of the standards and their categorization into two main groups: Attribute Standards and Performance Standards. However, there have been no substantial changes to the core of the guidelines of the independence standard (the focus of this paper).

Although the development and establishment of the standards have been recognised as a major achievement of the IIA, there is a realization that the continual change in the global commercial environment calls for revision and updating of the standards (Miller, 1999). Garitte (1998) suggests, "Within the global family of internal auditing, we must also respect differences in our cultures, religions, languages, and levels of professional development." Currently, there is an IIA Guidance Task Force (GTF) charged with examination of the framework of standards for the purpose

(7) Ridley and Chambers (1998) suggest that internal auditing was the first profession to establish international standards for its professional practices.

(8) Domestic language versions are available in the following countries: Argentina, Belgium, Canada, Czech Republic, Egypt, Finland, France, Germany, Italy, Japan, Lithuania, Malaysia, Mexico, People's Republic of China, Portugal, Russia, Slovakia, Spain, and Taiwan (IIA 1998).

of recommending areas of change. This task force is responsible, too, for considering issues relating to compliance with such standards. IIA members are required to comply with these standards, but by comparison with financial accounting standards and those relating to external auditing, enforcement procedures are vestigial (Lower, 1998).

Independence is the first standard (Standard No. 100), and it encompasses two specific sub-standards: Organizational Status (110) and Objectivity (120). A number of studies have focused specifically on this standard in which the duty of objectivity is codified. The standard requires, *inter alia,* that:

The organisational position of the internal auditing department is designed to allow direct communication with the top management of the organization.

Previous Research

The independence of the internal auditor has to be demonstrated in both the organizational structure and practice. This was tested by Knight and Tominson (1976), who found that the auditor must not be involved in the day-to-day accounting duties and reports of the findings should be submitted directly to the entity's top management. Brown (1983), too, highlighted the significance of the organizational status of the internal audit function as an indicator of its objectivity. Abdel-Khalik, Snowball, and Wragge (1983) also found that the level of management that receives the internal audit reports is a major factor in determining the extent of reliance placed on their work by external auditors.

Clark, Gibbs, and Schroeder (1981) examined the dimension of objectivity and found that the most important criterion for the independence of the internal audit department was the level of administration to which internal audit staff reported. The potential threats to the objectivity of the internal auditor were examined by Plumlee (1985), who focused in particular, on whether participation in the design of an internal control system influenced judgments on the quality and effectiveness of that system. Plumlee found that such design involvement resulted in biases in both memory and attribution, biases that could eventually threaten the internal auditors' objectivity.[9]

The relationship between the company management and internal auditing in more general terms is clearly an

(9) It should be noted that such a task would not be permitted by guidelines of the internal audit practice.

important element in affecting the objectivity of that internal audit function. In research based on case study, Harrell *et al.* (1989) noted that perceptions of the desires of management could have strong impact on the performance and judgement of internal auditors. This study also showed those internal auditors who were members of the IIA as less likely to be influenced by such pressure.[(10)] The researchers conclude that the IIA has succeeded in educating its followers on the significance of maintaining professional objectivity.

Pei and Davis (1989) examined how the organizational structure can affect the perceptions of the internal auditor of both role stress and organisational-professional conflict (OPC). Five variables were used to measure the organizational structure characterizing the internal audit department: organizational status, audit authority, organizational support, formalization of audit policies and procedures, reporting levels, and service scope. A questionnaire, which contains status variables that are specified in the IIA standards, was distributed to forty-five internal auditors working in seventeen firms. The findings showed that the organizational status of the internal audit development was indeed an important source variable for both OPC and role stress, and the results suggested to the authors that "organizations which follow guidance from the IIA standards in structuring their internal audit department may get certain side benefits in personnel retention and job satisfaction."[(11)]

Ponemon (1991) tested whether or not the internal auditor will, in reality, appropriately report sensitive issues discovered during the course of the audit work. A case study that involves a discovery of fraud by an internal audit was used to investigate this issue. The participant internal auditors were asked whether they thought that the fraud problem would be reported by the internal auditor(s). The results of this research suggested to the author that the following three factors do affect the internal auditor's objectivity: the internal auditor's social position in the organization, his or her relationship to the management, and the existence of a communication channel to report wrongdoing.

Although in general terms, internal auditing is performed via employees within the organization (the internal audit unit), internal auditing can be outsourced. Many writers and researchers, e.g. Courtemanche (1991), Lampe (1993), James (1994)

(10) Professional autonomy achieved when the practitioner is able to make his decision without external pressure (Hall 1968).

(11) The results of this study provided empirical support for the IIA standards

and Gavin and Matherly (1997), have discussed the possibilities, advantages and difficulties of outsourcing the internal audit function. One of the advantages of audit outsourcing is the increase in the independence of the staff doing the audit. However, this might affect the independence of the external audit firm that may also do the financial statement auditing (the external audit) as supported by Lowe *et al.* (1999). They investigated the loan officers' perception of auditor independence when performing both internal and external auditing and found that the loan officers perceive auditor independence to be impaired in this situation.

In a recent study, Paape *et al.* (2003) studied, among other things, the degree of independence of the internal audit function in EC top listed corporations (105 respondents = 32% response rate). The results showed that only about half of the responding Chief Audit Executives (CAE) reported to the Audit Committees (ACs) and ACs are not always involved in the appointment or removal of directors of IAF. In a similar study, IIA (2003) revealed, based on a survey of 1650 CAEs (response rate = 23%), that 55% of the responding CAEs report to ACs.

Al-Meghames (1997) studied the independence of the external auditor in Saudi Arabia, Kuwait, and United Arab Emirates. The results of this study suggest that no significant differences on the perception of impairment of audit independence occur amongst CPAs and financial analysts in these countries.

With reference to the Arabian Gulf region,[(12)] Al-Bassam and Shahin (1984) studied the independence of internal auditor in the oil sector in Kuwait. Four corporations were included in the study in addition to the Kuwaiti Petroleum Inc. Two methods were used in collecting the research data: interviews with directors of the internal audit departments or financial managers (total interviewees are 8 persons) and survey of the relevant law and regulations. The results of this study indicate that the organizational status of the internal audit department is high. However, the major concern of the audit is to detect mistakes. This concern may influence the objectivity of internal auditors. This article recommended that internal audit department not be involved in any operational duties and that it not be connected to the board of directors. One aspect that may limit the benefit of this study is its being focused only on one sector.

(12) This is the only study found relevant to this research subject.

A number of studies (Abbott and Parker, 2000; Raghunandan *et al.* 2001; Carcello and Neal, 2003a; and 2003b; Goodwin, 2003) focussed on issues relating to the independence of audit committees. For example, Raghunandan *et al.* (2001) and Goodwin (2003) studied the influence of the independence of the audit committee on the internal audit performance and found a strong correlation between the level of independence of audit committees and its interaction with chief internal auditor.

Background of Field Study

Arabian Gulf countries (Saudi Arabia, Kuwait, United Arab Emirates, Qatar, Bahrain, and Oman) share similar economic, social and religious circumstances, and economic links amongst these states are strong.(13) Since the Gulf Cooperation Council's formation in 1981, its member countries have sought to extend economic cooperation and harmonization across a wide range of fields, including accounting and auditing. At the ninth meeting of the commercial cooperative committee held in 1987, an outline of intent to harmonize regulations of accounting and auditing was agreed (Al-Faisal, 1992 & Alshammiry, 1994).

At its 1998 meeting, the commercial cooperative committee of the GCC did discuss a recommendation to establish an overarching Gulf accounting and auditing organization and the possibility, thereby, of bringing about unified accounting and auditing standards (Almuhasabah, 1998). Consequently in December 1998, this organization was established and named the "GCC Accounting and Auditing Organization" (GCCAAO). However the first meeting of the GCCAAO was not held until May 2001 (Almuhasabah Walmuraja'ah, 2003). Similar proposals for setting up a single professional body for the purpose of improving accounting and auditing practice in the Gulf countries emanated from the first regional (GCC) accounting conference organised by the University of Kuwait in December 1996 (SOCPA, 1997). In the auditing context, against the background of the failure to develop common standards, a number of the GCC countries have chosen to adopt the auditing standards issued by the Saudi Arabian Ministry of Commerce (Al-Faisal, 1992).

Interviews in this study evidenced that the development of internal audit in the Gulf business environment had been a recent phenomenon and one

(13) Alshammiry (1994) identifies and discusses the similarities in the environmental circumstances among the Gulf countries.

supported by a very sparse framework of regulation or professional organization. The early development of the internal audit in the business sector took place in banks and very large corporations. The first IIA chapter was formed in Saudi Arabia (Dhahran Chapter) in 1982. The Dubai Chapter, which is considered an active organisation, formed in July 1995, and recently (in 2000), an IIA chapter was formed in Riyadh. Documentation of the development of the internal audit is scarce, but the interview evidence suggested that in many companies, the internal audit as a function in its own right was established only during the last two decades.

- Of the total sample of 250 companies selected, 177 companies responded (or contacted). 61 (34%) of them did not have an internal audit function. If the non-respondents are assumed to be less likely to possess an internal audit department, this might suggest that less than half of the companies had an internal audit function. This would bear out the perception that the internal audit is relatively underdeveloped in the GCC countries. This lack of acceptance of internal audit function in the Gulf countries was referred to by the 1998 president of the Dubai Chapter:

- In the absence of any legislation requiring internal audit, the biggest challenge faced by the profession is to have to constantly prove to business owners that internal audit is a value-adding function.

Meanwhile, the Chairman of the IIA Chapter in Saudi Arabia (Dhahran Chapter) noted:

- Previously internal auditing in the business sector was not considered as important because the businessmen and the managers were not aware of its advantages. Lately, they have found that internal audit is amongst the practices that benefit both their employees and profitability

Interview evidence suggests that:

1. There is no real development in this profession in the Gulf and its scope is not clearly defined.
2. There is a shortage of qualified personnel.
3. There are problems with independence since directors of internal audit do not report to the senior management, and internal auditors are mostly involved in ordinary, daily non-audit work.
4. Internal auditors may not be given full access or management does not listen consciously to their recommendations.

Research Method

Since the internal auditing function is most likely to be found in large companies, the sample of this study includes all Saudi joint stock and large companies (157) and the largest (turn-

Table 1
Distributed and Collected Questionnaires of Directors of Internal Audit Departments and Response Rates

Location of Companies of the Study Sample	No. of Companies in the Sample	Returned Questionnaires	
		No.	%*
Saudi	157	78	72%
Kuwait	27	15	75%
UAE	31	9	32%
Qatar	11	7	70%
Bahrain	13	6	50%
Oman	11	1	10%
Total	250	116	61%

* It should be noted that these percentages are of the questionnaires sent since some of the companies in the sample were excluded because the researcher had discovered that such companies did not have internal auditing at the time of the questionnaire distribution.

over in excess of SR 20m) joint stock companies operating in the other GCC countries (93). Both the questionnaire and interview methods of data collection were employed. Thomas (1996, p. 119) notes that a good survey design frequently encompasses different modes of enquiry such as the questionnaire and the interview, and it is contended in this study that they complement each other and enhance the reliability of the conclusions reached. The interviews were conducted with ten directors of internal audit departments and chairmen of the IIA Dhahran Chapter and Riyadh Chapter. Both the development of IAF and its independence were the focus of the interviews. The primary purpose of the questionnaire was to collect data as to the independence of internal audit in the Arabian Gulf companies. The data in turn could be used to evaluate the compliance of the internal audit function in those companies with the Independent General Standard (Standard No. 100) of the Standards for the Professional Practice of Internal Auditing (SPPIA) issued by the IIA.(14)

After excluding companies without internal audit function (22 companies) as found by the researcher before dispatching the questionnaires, a total of 228 questionnaires were sent out, and during or after the distribution of the questionnaires, it was found that in 39 instances the companies did not have an internal audit function. 116 usable responses were obtained from the remaining 189 questionnaires (response rate of 61%). Table (1) categorizes the responses received by country.

(14) The 1997 issue of the "Standards for the Professional Practice of Internal Auditing," The Institute of Internal Auditors, Florida, U.S.A.

Table 2
Educational Qualifications of Directors of IADs

Educational Degree	Frequency	Percent	Cumulative Percent
PhD	2	0.02	0.02
Master	16	0.14	0.16
Bachelor	87	0.75	0.91
Less than university degree	11	0.09	100.00
Total	116	1.00	

Scoring and Weighting

Other than demographical items, the questions asked (22 questions) were taken from the guidelines that accompany the IIA Independent Standard (Organizational Status = 13 Q, Objectivity = 9 Q). These questions require a Yes/No answer with *Yes* scoring one (full compliance) and *No*, zero (no compliance).(15) However, with regards to the other questions, the responses (which scored between, and including, 0 and 1) could imply complete conformance with the issue being asked about (if 1), no conformance at all (if 0), or an intermediate level of conformance (if > 0 and < 1). On occasion when deciding the conversion, it was necessary to use judgement. After scoring the responses they were weighted depending on the expected level of strength to the Organizational Status sub-standard (the 13 questions) and the Objectivity sub-standard (the 9 questions).

IIA considered each sub-standard (Organizational Status and Objectivity) to be of equal importance in determining compliance with the Independent Standard and so each sub-standard takes a minimum number of zero and maximum of ten, and the overall Independent Standard score is between (and including) zero and twenty (by adding up the calculated scores of the two sub-standards). The overall outcome was a score for compliance with the Independent Standard of the SPPIA for each company in the range 0-20, with zero indicating no compliance and 20 indicating full compliance.

Demographical information

The questionnaire contains several questions seeking demographical information about the internal audit departments (IADs). Table (2) represents the educational qualifications of the directors of IADs.

(15) For example, one question asks whether the terms of reference of the internal auditing department were formally set out. An answer of Yes meant that the internal audit department complies with this specific issue and an answer of No means the opposite.

Table 3
IA Experience of Directors in Audit Departments

	Less than one year	1-5 years	5-10 years	More than 10 years	No response	Total
Frequency	11	49	32	21	3	116
Percentage	9%	42%	28%	18%	2%	1.00
Cumulative %	9%	51%	79%	97%	100%	

The great majority (91%) of the respondents had at least a bachelor degree and a significant proportion (16%) had a higher degree. Although the respondents were not asked to specify their degree type, the interview feedback suggested that most of the degrees were obtained in accounting, business, or related subjects. The age profile of the directors showed that almost half of them were between 40 and 50 years old, and 20% were over 50. Table (3) sets out the extent of the respondents' experience in their present department.

The figures suggest that directors of IADs did not have long experience in the present internal audit department, where 42% of the respondents had less than 5 years tenure. A significant proportion (37%) had previously worked for other department(s) within their present company. Nearly three quarters (76%) had experience in working as an auditor other than in their present company, and 53% had experience in working for another company but not in an audit capacity.

In contrast to the high proportion who held degrees, the proportion of directors of internal audit departments who held relevant professional qualifications was much lower, 60% of the directors had no such qualifications (see Table 4).

Only 27 (23%) of the directors of the responding IAD were actually members of the IIA.

The personnel of internal audit departments surveyed ranged from one to seventy-three individuals. In total, there were 750 employees (including the direc-

Table 4
Professional Qualifications of Directors of IADs

Professional qualifications	No.	Percentage of total qualifications	Percentage of total directors of IADs
CPA	21	45%	0.18
CIA	5	11%	0.04
Others	21	45%	0.18
Total	47	100%	0.40
(5 of the directors have 2 certificates)			

Table 5
Professional Qualifications Held by Staff of IADs

Professional Qualifications	No.	%
Certified Internal Auditor (CIA)	42	17
Certified Public Accountant (CPA)	94	39
Certified Management Accountant (CMA)	18	7
Certified Data Processor (CDP)	19	8
Others*	41	17
Unidentified	29	12
Total**	243	100

* The most mentioned of these different professional qualifications are CA, QCA, CISA, and Indian Chartered.

** In all the responses, 209 individuals possessed a professional qualification with thirty-four of those possessing more than one qualification.

tors) working for the responding companies. The majority of these departments were small (73% consist of not more than five auditors), and only seven (6%) of the internal audit departments surveyed consisted of over twenty auditors. A high proportion of the staff in the departments surveyed (80%) were educated to a degree level, and 62% had at least five years experience in an internal audit capacity. 209 (28%) of the staff of the IAD held professional qualifications. Table (5) provides details of the nature of the qualifications held.

This low level of professional qualification contrasted with the situation in more advanced countries. For example, a survey of internal audit departments in U.S. municipalities showed that 25% of the staff held a CPA qualification, and no less than 50% were CIA qualified (Montondon, 1995).

Independence

Commentators and standard setters identify independence as being a key attribute of the audit, whether internal or external.(16) The SPPIA refers to the independence of internal auditors in the following terms:

- Internal auditors are independent when they can carry out their work freely and objectively. Independence permits internal auditors to render the impartial and unbiased judgments essential to the proper conduct of audits (SPPIA, 1997, p. 11).

The SPPIA suggests that such independence can be gained by means of organizational status and objectivity. It describes these factors accordingly:

- The organizational status of the internal auditing department should be sufficient to permit the accomplishment of its audit responsibilities (p. 11).

(16) For example, CIPFA (1994) describes the independence of internal auditors as the most significant characteristic of internal audit.

Table 6
Coverage of Submitted Annual Plan

	Department's audit work schedules	Staffing arrangements	Financial budget
Covered	94%	79%	74%
Not covered	6%	21%	26%

- Objectivity is an independent mental attitude which internal auditors should maintain in performing audits. Internal auditors are not to subordinate their judgment on audit matters to that of others (p.15).

Terms of Reference and Responsibility

In more than three quarters (78%) of the companies surveyed, there was a written document defining the purpose, authority and responsibility of the internal audit department. In the great majority, the terms of reference of the internal audit department had been agreed by senior management(17) (90%) and had identified the role of the IAD in the organization as well as its rights of access to individuals, records, and assets (95%), and the scope of internal auditing (86%).

Respondents were asked to assess the extent to which the relevant document complied with the specific requirements of the SPPIA.(18) Full compliance with the SPPIA was claimed by 47% of the respondents from companies where such a document existed. 28% considered their document to be partially consistent. In total, in more than 40% of the companies surveyed either no such document existed (22%) or the respondent was not aware whether the document complied with the SPPIA (20%).

Planning

The IIA standards suggest(19) that one aspect of independence is the submission to senior management of an audit plan. In a significant proportion (34%) of respondent companies, no such plan was submitted. The SPPIA identifies audit work schedules, staffing arrangements, and the financial budget as falling within the scope of this plan. Table (6) represents the percentage of respondent companies (which did submit such a plan to senior management) in which the plan incorporated these individual elements.

(17) Lower (1998) emphasises the importance of approval of these terms of reference by the board of directors and audit committee.

(18) SPPIA (1997). Ridley and Chambers (1998, p. 132) note that the charter of an internal audit unit must adhere to the professional standards and code of ethics and Moeller and Witt (1999) emphasize the importance of an internal audit charter being consistent with the SPPIA.

(19) SPPIA 1997, p. 12.

Table 7
Appointment, Removal and Reporting

		Board of directors	Audit committee	General manager*	Others (lower in positions)
Authority to appoint or remove director of internal audit department	Frequency	36**	17	55	8
	%	0.31	0.15	0.47	0.07
	Cumulative	0.31	0.46	0.93	1.00
To whom internal audit department ultimately reports	Frequency	35	17	53	11
	%	0.30	0.15	0.46	0.09
	Cumulative	0.30	0.45	0.91	1.00

* In some companies, he is called president and in some others chairman.
** This number includes the companies that identify owners as the answer to the question.

As can be seen, although the great majority included work scheduling in the scope of the plan, in more than 20% of the plans submitted, either staffing arrangements or the financial budget were not covered.

Lines of Authority

Professional standards imply that independence is enhanced where the board of directors concurs in the appointment or removal of the director of the internal audit department,[(20)] and also that the director of the internal audit department should be responsible to an individual of suitable seniority within the organisation.[(21)] The importance of both these factors has been emphasised in a number of academic studies, for example Vanasco (1996), Liu *et al.* (1997), and Ziegenfuss (1994).

Table (7) shows the authority to appoint or remove the director of internal audit department in the respondent companies and also the level to which the internal audit department reports.

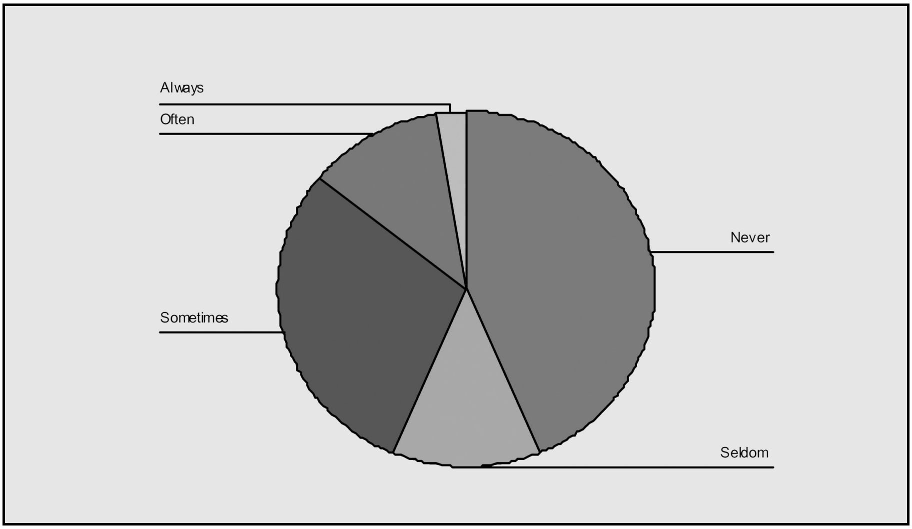
It is noticeable that in more than 45% of the respondent companies, responsibilities both in respect to appointment and removal and in terms of the receipt of internal audit reports lay with an individual who was normally the general manager. Mondonton (1995) notes that this could negatively affect the independence of internal audit function: "If the internal auditor reports solely to that individual, the appearance of tampering the internal audit findings is present and is possibly harmful to the internal auditors' perceived independence."[(22)] This problem was also noticed by the interviewees:

(20) SPPIA 1997, p. 12.

(21) SPPIA 1997, p. 11.

(22) Ridley and D'Silva (1997) suggest that for best practice internal auditing should be accountable to the full board for the services it provides.

Figure 1
The Frequency of an IAD Member's Attending Board of Directors' meetings



1. In most GCC country companies, internal auditors report to the general manager. This is not right since the internal auditor must report to the board of directors or the owner(s) of the company.
2. Because it does not report to the board of directors, the internal audit function in many companies is not independent.
3. One of the internal audit problems in the GCC countries companies is that it does not have a contact with the top management.

The SPPIA identifies the beneficial effects of regular communication with the board of directors:

- The director should have direct communication with the board. Regular communication with the board helps assure independence and provides a means for the board and the director to keep each other informed on matters of mutual interest (SPPIA 1997, p. 11).

Such a view was also supported by Liu *et al*. (1997), who stated "the right of direct access to top or senior managers is critical to the success of the [internal audit] department." Figure (1) depicts the frequency with which a member of the internal audit departments of the respondent companies in the Gulf region attended meetings of the boards of directors.

In almost half the companies, members of the IAD never attended board meetings, and in only two companies did such a thing take place on a regular basis.

Freedom of Enquiry

Unrestricted access to documentation and unfettered powers of enquiry are essential factors of the independence and effectiveness of internal auditing. Lower (1998, p. 28) suggests "the effectiveness of the internal audit function is dependent on its ability to have access to all documents, personnel and properties and to audit all areas of the organisation." However, the survey responses revealed that no less than 40% of the respondents believed that they did not, in fact, have full access to all necessary information. Furthermore, a considerable proportion of the respondents (15%) did not see themselves as free to report faults, frauds, wrongdoing or mistakes in all instances. A slightly higher proportion (21%) thought that their internal audit function did not always receive consistent support from senior management.

Non-Audit Activity

The professional standards identify the design, installation and operating of systems as "non-audit functions" and suggest that the performance of such activities is "presumed to impair audit objectivity."(23) More generally, Ridley and D'Silva (1997) and Ridley and Chambers (1998) suggest that the participation of internal auditors in decision-making and non-audit activities is likely to jeopardise their independence because of the existence of conflicts of interest.

Respondents were asked how often management requested the assistance of the internal audit department in the performance of non-audit duties, whether operational or financial.

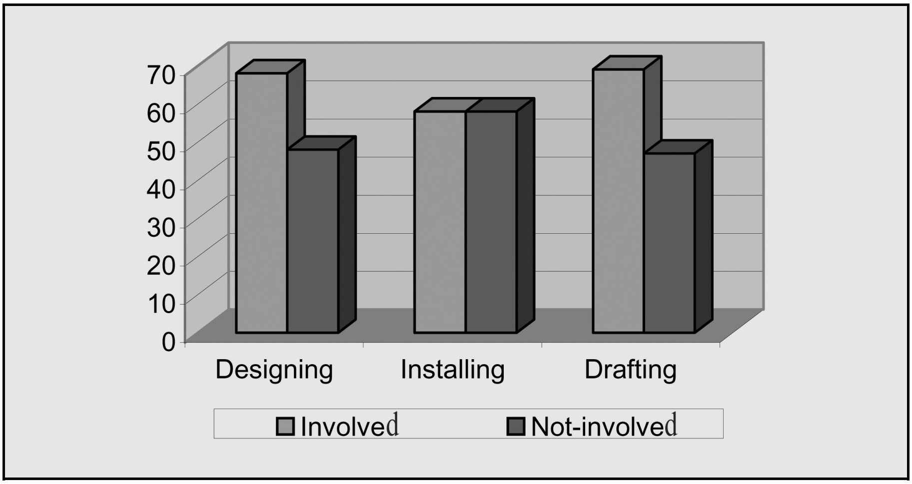
The responses set out in Table (8) show that in more than half the companies surveyed (54%), such requests were not uncommon and only 31% of the internal audit departments never participated in such non-audit activ-

Table 8
Assistance in Performance of Non-Audit Functions

Frequency	Percent of Total	Cumulative Percent
Always	0.07	0.07
Often	0.08	0.15
Sometimes	0.39	0.54
Seldom	0.15	0.69
Never	0.31	1.00

(23) SPPIA 1997, p. 16.

Figure 2
IAD's Involvement in System Design and Installation



ities. In some organizations, internal audit staff members were regularly used to cover staff shortages in other departments. Here are three respondents' comments:

1. "Whenever there is a shortage of employees in the other departments, they (the management) take from the internal audit department to fill such need."
2. "Sometimes they return those employees back to the audit department, and sometimes they do not."
3. "Currently, I help endorsing the cheques and banking papers, since the one who was responsible for this duty is absent."

In terms of specific participation in the design and installation of systems of control and drafting of systems procedures, Figure (2) depicts the active involvement of the majority of the internal audit departments surveyed in the design of systems (59%), in their installation (50%), and in the drafting of relevant procedures (60%).

Statistical Analysis

In this section, we are investigating the effect of specific variables on compliance with the Independent Standard and its specific sub-standards. These variables are company specific (size, industry classification, legal form), and correlate with the size of internal audit unit and the characteristics of its director, the terms of reference, and the internal audit procedures.

Three proxies were employed to indicate the firm size: total sales, total assets, and total number of employees.

Pearson Correlations between the three size measures and conformance with both specific standards (Organizational Status and Objectivity) and overall were run individually. The results indicate that there are significant statistical associations ($p < .05$) between all the size proxies and Objectivity although the correlation coefficients are not particularly high. Nevertheless Organizational Status is positively and significantly ($p < .05$) correlated with assets. Organizational Status also has a significant statistical association ($p < .01$) with the general Standard "Independence". However, the latter has a lower significant correlation ($p < .10$) with the sales proxy.

Since the risk of transaction and thus the internal control system are expected to be more important in some industries (such as banks), the internal audit function in the companies of these industries should be stronger and thus more likely to comply with Independence general and specific Sub-standards than the companies in the other industries. The overall mean of compliance achieved by the banks(24) (16.00) is noticeably higher than that in the other industries (12.53), and this difference is statistically significant at the 1% level of significance.

The results also suggest that internal audit compliance with the Independent Standard is greater in manufacturing firms than in non-manufacturing ones. The statistical results suggest that there are only trivial differences between the means of the two groups (manufacturing and non-manufacturing) in Organizational Status and in Objectivity as well as the overall score, and this is confirmed by the absence of any statistically significant differences ($p > .50$). From this finding, it might be inferred that the independence of internal auditing in the manufacturing industry does not significantly differ from the other industries collectively.

In some states, such as Saudi Arabia, joint stock companies are required by law to have audit comm-ittees which should seek to both monitor and empower the independence of internal audit function. If this is correct, then the compliance with the Independent Standard will be greater in these companies. However, although there are marginal differences between the means when comparing joint stock companies to non-joint stock companies, these are not statistically significant.

On the other hand, the size of the internal audit department and the role of

(24) Out of the sample of 116 companies, 31 operate in the banking sector.

its director could have some influence on the level of independence of internal auditing. The difference-of-means test proved that internal audit departments with more than five staff members (large size > 5 staff and small size < = 5 staff) exhibits significantly greater conformance to both Organizational Status ($p < .01$) and Objectivity ($p < .02$) and Overall ($p < .000$). Similarly, the size of the budget of the internal audit department has a positive, significant association with the Independent Standard. Departments with a budget of more than 500,000.00 Saudi Riyals achieved better compliance with Organizational Status ($p < .01$) and Objectivity ($p < .01$) and Overall ($p < .000$).

The director of the internal audit department is an important figure who could enhance the level of compliance with Independence Standard. To investigate this possibility, we used the correlation tests to see if there is any univariate association between (1) the age, experience, academic and professional background, and the director's knowledge of the IIA internal audit and (2) compliance with Independence General Standard and its substandards. Both age and educational background have no significant statistical association with Organizational Status, Objectivity and Overall. Similarly, the director of the internal audit department's experience in the audit department and as an auditor outside the current firm has no significant influence on the compliance with Independence Standard and its specific standards. However, it is interesting to know that the internal audit department director's experience in other department(s) within the same company and his experience in other auditing outside the current firm both have a significant negative correlation with Independence.

The level of knowledge acquired by the director of internal audit unit of the IIA and their standards is likely to positively influence compliance with Independence. For example, it was found by Harrel *et al.* (1989) that the management's ability to bias the internal auditor's objectivity is significantly affected by whether that internal auditor is a member of IIA or not.

Three factors have been chosen in this regard: general knowledge about the IIA, familiarity with the Internal Audit Standards and Code of Ethics issued by the IIA, and membership in the IIA. The regression results suggest that the mean of scores of compliance with the Independence Standard and its sub-standards: Organizational Status and Objectivity is significantly ($p < .01$ in eight cases and $p < .07$ in one case) higher when the director of internal audit department is a member of the IIA, familiar with the Internal Audit

Standards and Code of Ethics issued by the IIA, or knows about the IIA.

Also one might expect that, when the internal audit department has a formal charter, the level of compliance with the Independence Standard is higher. The mean tests showed that the internal audit departments which had formal terms of reference exhibited far higher compliance with the Independence Standard (and sub-standards) than those that did not ($p < .000$). The extent to which the charter is consistent with those set down by the SPPIA was also highly and significantly ($p < .01$) associated with enhanced compliance with Independence (Organizational Status and Objectivity). The internal audit departments that have written policies and procedures to guide the audit staff comply with the Independence Standard better (significant at 5% or 10% levels) than those which do not have such procedures.

Since, as discussed before, the member countries of the Gulf Cooperation Council (Saudi Arabia, Kuwait, United Arab Emirates, Qatar, Bahrain, and Oman) share many similarities, we expect no significant differences among these countries in regard to conformance with the Independence Standard of the SPPIA. The ANOVA test proved this conclusion and suggested that, although there are some differences in the means of compliance with the Organizational Status sub-standard among the six States, these differences are not statistically significant at conventional levels of significance. Similarly, the mean compliances with the Objectivity sub-standard neither statistically nor significantly ($p > .35$) differ among the Gulf States. In consequence, the Independence of internal audit departments holds a similar status in the entire Arabian Gulf region.

Conclusion

The internal audit profession and internal auditing in the Arabian Gulf Region are still in their early stages and not yet well recognized. One of the great problems contributing to this situation is the lack of an effective independent body focusing on the development of internal auditing and the internal audit profession. Such a body, if existing and operating as it should be, would be expected to strengthen the independence of auditors. This strengthening would consequently enhance the audit performance.

One of the significant findings of this study is that in more than 50% of the surveyed companies, the line of authority concurs in appointment or removal of staff, and the recipient of the report of the director of internal audit department is neither the board of directors nor the audit committee, and this does strongly and negatively affect the independence of the internal audit profession in the area. The undertaking of non-audit activities by the majority of internal audit departments in the region is expected to impair auditors' objectivity.

It was also found that in banks, in large internal audit departments, and in those departments whose leaders were members of the IIA or familiar with its standards, independence is significantly higher. In addition, internal audit departments that maintain professional terms of reference were found to achieve significantly better independence.

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الملخص

استقلالية مراجعي الشركات في دول مجلس التعاون الخليجي

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تهدف هذه الدراسة إلى التعرف عن قرب على درجة الاستقلالية التي يتمتع بها المراجعون الداخليون في دول مجلس التعاون الخليجي، وعلى معوقات الاستقلالية. وقد اتضح من خلال تحليل الردود الواردة من ١١٦ شركة خليجية، أن الجهة المسئولة عن تعيين وفصل رئيس قسم المراجعة الداخلية في غالبية هذه الشركات ليست مجلس الإدارة ولا لجنة المراجعة. كذلك لا يُرفع تقرير المراجعة النهائي في غالبية الشركات إلى إحدى تلك الجهتين اللتين تعدّان قمة التنظيم: مجلس الإدارة و لجنة المراجعة. كذلك مما يؤثر سلباً في موضوعية المراجعين الداخليين في دول الخليج قيامهم بأعمال تنفيذية غير المراجعة. من خلال تحليل الارتباطات في بيانات العينة، اتضح أنه في أقسام المراجعة الداخلية في البنوك، وكذلك في أقسام المراجعة الداخلية الكبيرة، وأيضاً حينما يكون رئيس قسم المراجعة الداخلية عضواً في معهد المراجعين الداخليين فإن المراجعين الداخليين في هذه الحالات يكونون أكبر استقلالاً من نظرائهم في الأقسام الاخرى.

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