
Internal auditing quality in the banking sector of Kosovo

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Abstract

Among the factors affecting the quality of internal auditing in banks are the auditors' competence, objectivity and performance. In order to verify this assertion, the authors have reviewed the relationship between the internal auditor's competence, objectivity and performance and the quality of internal audit in the commercial banks of Kosovo. To reach the research objectives and test the hypotheses, a questionnaire was compiled, which was sent to internal auditors of all Commercial Banks of Kosovo. The results of this research provide evidence that the internal auditors in Kosovo's commercial banks consider the objectivity, competence and performance as major factors that affect the quality of the internal audit (IA) function. Based on these papers results the authors recommend that Kosovo's commercial banks should ensure the availability of main resources to achieve a better functioning of the internal audit department and its function.

Keywords: internal auditing, characteristics of the auditor, internal audit quality, internal control system, Kosovo

JEL Classification: M41, M42

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1. Introduction

The *Internal Audit Department (IAD)* is an important part of the corporate governance structure within the bank. The Corporate Governance includes those supervisory activities performed by the Board of Directors and the Audit Committee to ensure the integrity of the financial reporting process and the achievement of the objectives set out by the management.

The corporate governance body of knowledge has set out four monitoring layers which exist in every corporate entity: External Audit, Internal Audit, Board of Directors, as well as the Audit Committee¹. The functioning of *internal audit* can be seen as *the first line of defence* for preventing bad corporate governance and inadequate financial reporting in the banking sector. With the right support from the Board of Directors and the Audit Committee, *the internal audit staff* may be in a better position to gather information on inappropriate accounting practices, inadequate internal control and inadequate corporate governance². Therefore, it can be argued that the more objective, competent and efficient in performing its duties, the internal audit staff is, the better it serves its defensive role within the bank.

The research studies of *internal audit quality and factors affecting its effectiveness*, especially in banking sector, are not much investigated in the Western Balkan countries. This research, aims to review the major factors that have an impact on the quality of internal audit in the banking sector in Kosovo. Factors such as: objectivity, competence of internal audit staff and their performance have been put into test, in order to find out if there is any relationship between these major factors and the quality of internal audit function in the banking sector in Kosovo.

2. Literature review

This part deals with the literature review in the area of internal audit function related to the topic of this research.

The research paper of Gramling et al. (2004)³ examined the literature on the role of internal audit in corporate

governance. The findings from this review are that the analysis of the role of internal audit function in corporate governance uses the quality assessment by the external auditors, and the factors of this support decision, the scope and nature of its work are supported by the external auditors.

Through his research paper, Hermanson (2006)⁴ explained the importance of focusing on the proper functioning of the internal audit for fraud detection and risk management. As a requirement, internal auditors should consider four key areas: assessing modern business trends, information technology, risk management, and contributing to the growth of the company. The findings from this research are that the internal audit function has expanded from its traditional role as a financial audit to a new role as a management audit focusing on adding value to the company, reflected in the risk management and the implementation of the risk-based approach to auditing; and the quality of the internal audit function plays an important role in the realization of this new role. Eisa's research paper⁵ determined the factors that affected the quality of internal audit functionality to improve the quality of corporate governance. The author revealed that enhancing the appropriateness of internal auditors through increasing the level of education, increasing the level of professional experience, and increasing the level of training would **lead to increased internal audit quality**. Also, increasing the objectivity of internal auditors through increasing the level of independence leads to increased internal audit quality.

In addition, the authors Ahlawat and Lowe (2004)⁶ through their research paper came to the conclusion that the functioning of internal audit was changed from the traditional oversight function into a function that consisted of a large number of activities that added value to the entity organization.

Author AbdulAziz Alzeban (2013)⁷, through his study of 239 internal auditors, investigated the factors affecting

¹ The IIA (2003a) "Simply, Good Business" – High Tone, August 2003.

² R. I. (Bob) Tricker, Robert Ian Tricker, "Corporate governance: Principles, policies, and practices", 2015, UK.

³ Gramling, A.A, Maletta, M. J, Schneider, A. and Church, B. K. (2004). 'The Role of Internal Audit in Corporate Governance', *Journal of Accounting Literature* – Volume 23: Page. 194-244.

⁴ Robert D. Allen, Dana R. Hermanson, Thomas M. Kozloski, and Robert J. Ramsav (2006). Auditor Risk Assessment: Insights from the Academic Literature, *Accounting Horizons*: June 2006, Vol. 20, No. 2, pp. 157-177.

⁵ Eisa, S.K (2008). 'Determinants of Internal Audit Quality to Improve Corporate Governance Empirical Study', *Journal of the Faculty of Commerce for Science Research*, Publication 45, no. 1. gif.1-57.

⁶ Ahlawat, S.S. and Lowe, J (2004). 'An Examination of Internal Auditors' Objectivity' *Auditing: A Journal of Practice & Theory*, Vol.23 Nr. 2, p.147-160.

⁷ AbdulAziz Alzeban, (2013). "Factors affecting the internal audit effectiveness: A survey of the Saudi public sector", *Journal of International Accounting, Auditing and Taxation*, Volume 23.

mostly the quality and effectiveness of internal auditing. The study suggests that the management support for internal audit quality drives the effectiveness of internal audit function. The study also suggest that competence is a major factor affecting the quality of internal auditing.

Another study conducted by Drogalas George (2015)¹ on the internal audit quality and the factors affecting it, finds out that the main factors affecting internal audit effectiveness are: (1) quality of internal audit, (2) competence of internal audit team, (3) independence of internal audit and (4) management support. The results of his research also reveal that the independence of internal audit is the foundation of the internal audit effectiveness, as it is the most crucial factor in their model.

3. Conceptual framework

3.1. Concepts

Internal audit is defined as the independent, objective and advisory security, designed to add value and improve the organization's operations. Internal Audit helps an organization meet its objectives by bringing a systematic, disciplined approach to assessing and enhancing the effectiveness of risk management, control and governance processes (IIA, 2011)².

The internal audit, as a process, is influenced by the Board of Directors, Management and other staff, which are designed to provide reasonable assurance on achieving the organization's objectives in different categories and also, the internal audit is a key element of the financial reporting reliability, effective and efficient organization operations, and compliance with applicable laws and regulations (COSO-Internal Control³).

It can be argued that the review of the quality of internal audit in a bank requires internal audit activities. Therefore, although internal audit and internal control

should be assessed separately, they should also be evaluated on a complementary basis. The function of internal audit can assess and review the appropriateness and efficient internal controls in the banking environment. Hence, the internal auditors are primarily responsible to offer the audit committee and board of directors of the bank with the information about the efficiency and effectiveness of internal control within the bank operations. The internal audit activities can be considered as a first line of defence and an important internal control activity with its role in detecting fraud and error, which reflect the loss of revenue and assets.

Among the most important factors that determine the effectiveness of internal audit function in a bank are: the current "position/placement" of the internal audit function within the bank; the purpose of its operation; the authorized access to each type of information, documentation, notes and records; independence and objectivity; competence; oversight and monitoring of internal audit professionals; and the compliance of internal auditors with the international standards on internal audit as issued by the Institute of the Internal Auditors (The IIA). In the recent years, the Internal audit function has changed its 'idea' as not being an only internal control tool, but a 'wider' and more comprehensive one. Based on the findings of the very well-known authors Staciokas & Rupsys⁴, the internal auditors' role has been enhanced to include also assessing the future risks the bank may face, by consulting senior management in this regard. The authors also found out that all the internal parties within the bank (top management, board of directors and audit committee) must have adequate knowledge about the internal audit function.

3.2. Internal Audit Quality (IAQ)

The International Standards for Auditing (ISA) and the International Standards for Internal Audit (ISIA), for both internal and external auditing, have identified the factors needed to ensure the quality of internal audit functionality. Based on the AICPA standard nr. 65, the quality factors of internal audit functionality include (AICPA, 1991)⁵:

¹ Drogalas George, (2015) "Factors associated with Internal Audit Effectiveness: Evidence from Greece", *Journal of Accounting and Taxation*, Volume 5. 2015, Article Number: 9A5352054234.

² Institute of Internal Auditors (IIA), (2011). 'International Standards on Professional Practice of Internal Auditing', obtained from the URL: <http://www.theiia.org/guidance/standards-and-guidance>.

³ Committee of Sponsoring Organizations of the Treadway Commission (COSO), Internal Control— Integrated Framework: Volume I, Executive Summary, pp 500 – 501.

⁴ Staciokas, R, and Rupsys, R. (2005). 'Internal Audit and Its Role and Its Role in Organizational Governance'

⁵ American Institute of Certified Auditors (AICPA) – 'Internal 'Internal Auditors' Auditing of Financial Statements' Standard no. 65, New York, 1991.

- (i) Competence; measured by the level of education and professional designations the auditor has achieved during his career.
- (ii) Objectivity; measured by the parties to whom the internal audit department is accountable to and to whom they report on a regular basis;
- (iii) The quality of performance of duties; which is measured by the accuracy and appropriateness of the audit programs, and the scope of the audit.

Similarly, based on the Standards of the Institute of Internal Auditors (IIA, 2003b¹) there are identified the factors of the quality of internal audit functionality, which are:

- (i) Capacity,
- (ii) Independence and
- (iii) Objectivity

The audit committee and the external auditor (based on the International Standards of Auditing) should evaluate the quality of internal control including the assessment of the quality of the internal audit function within the entity. It should be added that the Standards of the Institute of Internal Auditors (the IIA) require that the head of internal audit department improve the quality of internal audit functionality, which includes the periodic assessment of the quality of internal audit functionality².

4. Research

4.1. Research methodology

This scientific research is conducted according to the statistical analysis methods, content analysis, and to achieve its research objectives it is based on primary data and secondary data. The secondary data for this research is provided through references, similar research published by other universities and international internal auditing standards issued by the IAASB and the IIA. The primary data are provided through the questionnaire, which is designed and compiled in order to fit all the elements described in the previous sections.

To achieve the objectives of this paper, we applied the descriptive statistics technique along with the content

¹ IIA (2003b), "Survey results: Impact of Sarbanes-Oxley Act on Internal Audit," February 25, 2003

² International Standard of Internal Auditing No. 1300 – Quality Assurance and Improvement Program, including sections 1310 and 1311.

analysis. The questionnaire consists of two parts, the first part includes demographic characteristics, while the second part includes the attitudes of respondents regarding each element examined in this research, and it was adapted from the author Ghassan. F. Al Matameh (2011)³. We applied the five-degree LIKERT system, which represented the most used and appropriate method for statistical analysis of data obtained through the questionnaire. Each answer was allocated a weight starting from (5) for the answer to 'fully agree', (4) 'agree', (3) 'neutral', (2) 'disagree', and (1) completely disagree'. This questionnaire was sent to all internal auditors of the commercial banks in Kosovo, including the Central Bank of Kosovo (CBK). During the part of statistical data analysis, the arithmetic mean, standard deviation and percentages were used.

4.2. Research Hypotheses

Therefore, based on the conceptual framework and the theory regarding the internal auditing quality (IAQ) discussed in section 3.2, we developed the following hypotheses:

H1: *There is a correlation between the competence and the quality of internal audit.*

H2: *There is a correlation between the objectivity and the quality of internal audit.*

H3: *There is correlation between the quality of internal audit performance and the audit quality.*

4.3. The sample of Internal Auditors and the regression model

The comprehensive population of this research includes all internal auditors in the commercial banks in Kosovo, including the Central Bank of Kosovo (CBK). The questionnaire was sent electronically and out of a total of 23 auditors (100% of the population), the number of valid questionnaires for analysis is 17. Therefore, the total percentage of the population involved in this research is 74%, which is enough to extrapolate the findings for the entire population for the Kosovo banking sector. The small number of internal auditors can be considered as a limitation of this study and the findings should not be generalized to other Western Balkan countries.

³ Ghassan. F. Al Matameh, Factors Determining the Internal Audit Quality in Banks: Empirical Evidence from Jordan, 2011.

To analyse the factors affecting the internal audit quality we applied this statistical model known as the multiple regression model, which was used by multiple authors (i.e. Eisa 2008¹; Suwaidan and Qasim 2010²)

$$QIA = \beta_0 + \beta_1KO + \beta_2OB + \beta_3PE + e$$

Where:

QIA – Quality of Internal Audit;

β_i – Regression coefficient, $i = 0, 1, 2, 3$;

KO – Competency;

OB – Objectivity;

PE – Performance;

e – error;

Independent Variables:

- Competence: measured with the attributes set out in Table no. 2.
- Objectivity: measured with the attributes set out in Table no. 3.
- Performance: measured with the attributes set out in Table no. 4.

Dependent Variables:

- Quality of internal Audit: measured with the attributes set out in Table no. 5.

5. Research results

5.1. Research methodology

Based on the data obtained from the first part of the questionnaire we noticed (Table no. 1) that 6 or 33% of respondents had completed the bachelor level, while 11 or 64.7% had completed the master level. Regarding the field of study, the vast majority of respondents have specialization in accounting (8 or 47.1%), while 6 or 35.3% of them have specialization in finance, and the rest of 17.6% has other specializations such as Banking, Retail and Technology Management. From the table it can be seen that the vast majority of respondents, 52.9%, have had an audit experience for more than five years. This fact *adds credibility to findings* of this research. So, we conclude that based on this information or these features, respondents were qualified to respond to the research questions and we could rely on the answers received from them to reach our conclusions on the research objectives.

Table no. 1. Qualification, Specialization and Experience of IA

Variable	Categories of the variable	Frequency in number	Frequency in percent (%)
Qualification	High School	0	0.0%
	Bachelor level	6	35.3%
	Master level	11	64.7%
Specialization	Accounting	8	47.1%
	Finance	6	35.3%
	Other	3	17.6%
Experience in internal audit	Less than 5 years	5	29.4%
	From 5 to 10 years	9	52.9%
	From 10 to 15 years	4	17.6%
	From 15 to 20 years	0	0.0%

Source: Own projection

¹ Eisa, S.K (2008). 'Determinants of Internal Audit Quality to Improve Corporate Governance – Empirical Study', *Journal of the Faculty of Commerce for Science Research*, Publication 45, no. 1 .gif.1-57.

² Suwaidan, M.S., and Qasim, A (2010), 'Supporting external auditors in internal audits and their impact on audit fees – Empirical Case', *Managerial Auditing Journal*, Publication. 25, Nr. 6, page. 509-525.

5.2. Descriptive statistics

The internal auditor's competence (Table no. 2):

Five factors were used regarding the qualification and education of the auditors. Based on the results of the study, most of the internal auditors emphasized the following important elements: the level of education, the

practical work and the knowledge of the internal policies and procedures of the bank, the level of professional designation, the level of technical expertise and continuous professional education (CPE). The simple mean of respondents' responses in this category is high, reaching 4.5122, while the standard deviation is 0.3215.

Table no. 2. Competence of internal audit staff

Paragraph	Mean	Standard deviation
– The internal auditor education	4.7160	0.4891
– Professional experience in internal audit and knowledge of processes, procedures they operate	4.8111	0.3616
– Level of professional certification (eg, Certified Auditor, Certified Internal Auditor, and similar)	4.4215	0.7312
– The internal auditor's preparation and technical training	4.2516	0.6126
– Updating and ongoing training	4.3612	0.4145
Total	4.5122	0.3215

Source: Own projection

Objectivity of the internal auditor (Table no. 3):

Six factors were used regarding the objectivity of the auditors. Based on the results of the study, most of the internal auditors emphasized the following important elements: direct linkage with top management; assignment, promotion, remuneration and dismissal of internal auditors from the audit committee; the freedom of auditors to have access to

all departments of the bank; the independence of the internal audit department; the freedom of internal auditors to carry out all necessary internal audit procedures; the existence and accessibility of the audit committee without interference. The simple mean of respondents' responses in this category is high, reaching 4.1778, while the standard deviation is 0.4812.

Table no. 3. Determining factors of objectivity in internal audit

Paragraph	Mean	Standard deviation
– The IA communicates directly with top management of the bank.	4.7870	0.4940
– Assignment, promotion, remuneration and termination of internal auditors from the Audit Committee or management.	3.9120	1.2210
– The freedom to have access to all departments of the bank.	4.1550	0.8616
– The independence of IA staff from other departments of the bank.	3.7220	1.1051
– The freedom provided to IA to carry out all necessary internal audit procedures.	4.2110	0.5622
– -The existence of the audit committee and access to it without interference.	4.2800	0.7291
Total	4.1778	0.4812

Source: Own projection

Performance of the internal auditor (Table no. 4):

Six factors were used regarding the performance of the auditors. Based on the results of the study, most of the

internal auditors emphasized the following important elements: the completeness and appropriateness of the internal audit working papers; the completeness and appropriateness of the scope of the internal audit work;

the level of internal auditors' care in carrying out audit procedures; support of auditors by management; assessing the performance of quality by outsiders from those who have practical experience in this field. The

simple mean of respondents' responses in this category is high, reaching 4.5969, while the standard deviation is 0.3215.

Table no. 4. Determining factors of performance in internal audit		
Paragraph	Mean	Standard deviation
– The completeness and appropriateness of internal audit programs.	4.5911	0.5121
– The completeness and appropriateness of scope of internal audit work.	4.8812	0.4451
– The level of internal auditor's care when carrying out audit procedures.	4.5517	0.6912
– Support of auditors from management.	4.7712	0.4312
– Evaluating the performance of quality by outsiders from those who have practical experience in this field.	4.2155	0.7791
– Ensure asset protection from errors, irregularities, and ensure accurate, inclusive and timely annual reports.	4.5712	0.7812
Total	4.5969	0.3215

Source: Own projection

Quality of internal audit (Table no. 5):

Six factors were used which reflected the quality of an internal auditor. Based on the results of the study, most of the internal auditors emphasized the following important elements: ensuring the protection of assets from misappropriation and misuse; providing accurate, inclusive and timely annual reports; providing the

necessary information to external auditors, management and related committees; the application of international accounting standards (IAS) and international financial reporting standards (IFRS). The simple mean of respondents' responses in this category is high, reaching 4.5501, while the standard deviation is 0.2891.

Table no. 5. Quality factors of IA		
Paragraph	Mean	Standard deviation
– Providing asset protection from errors and irregularities.	4.5591	0.5151
– Ensure accurate, inclusive and timely annual reporting.	4.8124	0.4102
– Provide the necessary information to external auditors, management and related committees.	4.6122	0.6851
– Focus on completing the audit and implementation of audit approach according to risk principle.	4.3157	0.6216
– Application of IAS and IFRS.	4.5891	0.5155
– Assessing the administrative performance and its plans to achieve the objectives of the organization.	4.4124	0.5712
Total	4.5501	0.2891

Source: Own projection

5.3. Testing the hypotheses

In this part of the research, the results of testing the hypotheses are reported using the statistical model explained in section 4. We also tested the correlation between all the elements specified in the previous section and the quality of internal audit in the commercial banks in Kosovo. Based on the results

presented in Table no. 6, with regard to "Competence", the calculated value of "B" is 0.455 at the level of significance of 0.00, while the calculated value "T" is 4.251, which is higher than the indexed value of 1.96, which implies the viability of the model. The value of the standard "Beta" regression coefficient is 0.521, indicating that the change of a single independent

variable value leads to the change of the dependent variables to 0.521. Based on the beta coefficient, we

accept as scientifically proven the first hypothesis.

Table no. 6. Statistical analysis results

Independent variables	"T"	"B"	"Beta"	"Significance"
Competence	4.251	0.455	0.521	0.000
Objectivity	4.663	0.315	0.550	0.000
Performance	7.315	0.661	0.739	0.000

Source: Own projection

In addition, with regard to "Objectivity", the calculated value "B" is 0.315 at the level of significance of 0.00, whereas the accrued value "T" is 4.663, which is higher than the indexed value of 1.91, which means the model's eligibility. The value of the standard "Beta" regression coefficient is 0.550, which indicates that the change from one point of the value of Objectivity leads to the change of the dependent variable in the value of 0.550. Based on the beta coefficient, we accept as scientifically proven the second hypothesis.

In addition, with regard to "Performance" variable, the calculated value "B" is 0.661 at the significance level of 0.00, while the calculated value "T" is 7.315, which is higher than the indexed value of 1.96, which implies the viability of the model. The value of the standard "Beta" regression coefficient is 0.739, indicating that the change of a single independent variable scale leads to a

change in the dependent variable in the value of 0.739. Based on the beta coefficient, we accept as scientifically proven the third hypothesis.

Table no. 7 – "Regression results" – presents the research outcome following the application of independent regression variables in the dependent variables. The results are highly significant (Value F = 20.314, P = 0.000) with a corrected R² of 0.538, which means that 53.8% of the changes in the internal audit quality can be explained through three independent variables included in this model that we researched. The coefficient of the variables is positive, thus highlighting a *positive relationship between the quality of the internal audit and the independent variables*. Based on the information analysed above we can summarize that there is a straight-line correlation between the competence, objectivity, performance and the quality of the internal audit.

Table no. 7. Regression results

	"R"	"R ² "	"R ² corrected"	"F"	"Significance"
IAQ	0.742	0.550	0.538	20.314	0.000

Source: Own projection

Conclusions

The results of the research suggest that the internal auditors of the banks in Kosovo consider the *competence, objectivity and performance* of internal auditors as important factors that affect the *quality of internal audit*. It was identified that "Performance" had the highest average value of 4.5969, followed by "Competence" with an average value of 4.5122 and "Objectivity" with an average value of 4.1778. The regression results point out that the internal audit performance is the crucial variable which affects the dependent variable quality of the internal audit of 68.4%

(adjusted R²), competence is the second variable with 45.1% (adjusted R²) and objectivity is the lowest factor which determines the quality of internal audit with 33.7% (adjusted R²).

The small number of internal auditor responses can be considered as a limitation of this study and the findings should not be generalized to other Western Balkan countries. The sample size, even though it covers 74% of all internal auditors working in the banking sector of Kosovo, is considered low from the statistical point of view.

Based on the research we recommend to the commercial banks of Kosovo to work on a continuous basis to ensure the availability of resources in order to

achieve the quality of the internal audit function. In addition, we propose them to perform external and internal assessments of the internal audit function as foreseen by the International Standard of Internal Auditing No. 1300 – Quality Assurance and Improvement Program, including sections 1310 and

1311, as issued by the Institute of Internal Auditors (the IIA).

Future research can be aimed at investigating a much higher number of internal auditors working in the banking sector from all the Western Balkan countries, and to compare the results.

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