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HOW TO HANDLE INTERNAL AUDITOR'S INDEPENDENCE GAP?

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Abstract. This scientific article explores the concepts of objectivity and independence within the internal audit profession. We discuss the significance of the internal auditor's autonomy and impartiality for different stakeholders, both internal and external. Furthermore, we examine the factors that influence the independence of internal auditors and the challenges they face. Independence is a state of trust and fairness that allows internal auditors to provide their insights on internal control, risk management, and other internal audit operations, free from any influence from company management. Our research relies on the analysis of various scientific articles and papers related to the topic of internal auditor independence, covering its various aspects within organizations. Throughout this article, we employ general scientific methods of cognition, including analysis and synthesis. Finally, we present recommendations that can be implemented in firms to enhance the autonomy of internal auditors and mitigate threats to their independence.

Key words: internal audit, external audit, corporate governance, financial reporting, financial performance, audit, and analysis system.

Introduction

Internal auditors' independence is regarded as one of the most critical aspects in determining the success of internal audits within corporate governance standards, especially after the worldwide financial disasters that hit many different companies, like Enron, WorldCom, and most recently Lehman Brothers, the importance of it has grown significantly. It has been believed that the lack of independence maintained by internal auditors was considered as one of the main elements that contributed to the start of the financial crises. Therefore, it will be essential to do in-depth research on this topic.

Internal audits performed by independent internal auditors have the same effect as external audits in lowering management's opportunistic behavior, this is because internal auditors understand management's motivations and know how work is done in business organizations (Asare et al., 2008). Regarding internal auditors' independence, the International Standards for the Professional Practice of Internal Auditing (ISPPIA) indicated that internal audit actions must be independent and that internal auditors must do their work objectively. Whereas «independence» was defined as being free from things that would make it hard for the internal audit committee (AC) to do its job or for the chief audit executive (CAE) to do his or her job in a fair way, but now independence means more than that. Objectivity is defined as an impartial manner of thinking that authorizes internal auditors to do their jobs in a way that makes them feel confident in the safety of their work results and not make any sacrifices that hurt the quality of their work (IIA, 2017). As it relates to the credibility of the reports that the internal auditor releases, the internal auditor's independence is of the uttermost importance. Unless the essential independence along with credibility provided by the internal auditor, audit reports lose their credibility and value with investors and lenders.

The shareholders view the internal auditor's independence from the directors of the corporation as a crucial element in delivering high-quality audits. However, effective collaboration with the firm's board of directors (BODs) can be necessary for an audit. This powerful working relationship has prompted shareholders to query the perceived and real independence of auditors and to require more controls, safeguards, and standards to protect them (Otene, 2014).

It is argued that the level of independence granted to internal auditors is quite low. Furthermore, it has been shown that, in the majority of instances, internal auditors are not objective in their judgments and suggestions. This is caused by the simple fact that they are workers of the organization, which prevents them from enjoying complete independence.

There are many obstacles that internal auditors have to overcome within business organizations. Based on the fact that several businesses have a tendency to lessen the degree of independence that internal auditors possess. This, in turn, causes internal audit reports to be biased in support of the directors' board and executive management, to which the internal auditor is related functionally and administratively. This ends up with a decrease in the degree of confidence, transparency, value, and relevance in internal audit reports, which subsequently in turn effects the effectiveness of the disclosure of internal audit reports to external stakeholders (such as shareholders and investors). Therefore, researchers realized that it is important to analyze the gap concerning internal auditors' independence and try to solve this gap by implementing the elements that support independence.

Literature review

Due to the increased importance of this topic, it becomes a matter of interest for most researchers in the audit field, here we will discuss previous studies and researches that addressed internal auditors' independence from different aspects.

Anggraini (2020) aimed to examine the independence and abilities of internal auditors along with their effect on audit quality. While the company's expansive scope prevents the BODs from exercising direct supervision over either external and internal operational duties and functions of the organization. for enhancing internal control efficiently and effectively, an organization's BODs must appoint a task force charged with monitoring and examining the operations of the business. Due to the internal auditor's position as a member of the company's management, the research found that there are still many difficulties with independence among internal auditors. The study concluded that independence and competency have an effect on the integrity of internal audit operations.

Okodo et al. (2019) examined the internal audit reliability issues. It offers conceptual as well as practical insights into a number of consequential issues when evaluating the dependability of internal audit tasks. This study focused on four of these issues in particular: internal auditors' competency, the level of management support, their objectivity as well as independence, and regulatory issues. Accordingly, this study revealed that the four identified characteristics would most likely have an effect on the dependability of internal audits. Therefore, in addition to other policy consequences, the study suggests a conceptual research paradigm that will need to be empirically examined by other researchers.

Helmy (2018) attempted to demonstrate the influence which the internal auditor's independences, AC members, as well as institutional ownership of corporations have on the publication of internal control. The internal controls disclosure index was utilized in the research project in order to quantify this disclosure. The industrial enterprises that were listed on the Indonesian stock market between the years 2014 and 2016 availed as the basis for such analysis. According to the outcomes of the study, internal auditors' independence as well as the institutional ownership of corporations has a direct and positive association with the disclosure of information regarding internal controls. The AC was powerless to sway the decision to make the reports on the internal control and supervision public.

Dordevic & Dukic (2017) meant to bring attention to the issue of the objectivity and independence, which is particularly important considering the position and function of internal auditing within the framework of corporate governance as well as the efficiency and effectiveness of internal audit. The paper also highlights the obstacles that internal auditors encounter in achieving objectivity and independence in their job and highlights the difficulties that internal auditors face. According to the returns of the study, regulatory choices governing the status of internal audit in organizations provide important support for internal auditors, particularly orders to invest efforts and eradicate all threating variables that could compromise their objectivity and independence.

Abbott et. al. (2016) sought to establish a competent and independent internal audit function quality model as part of an interactive internal auditing function IAF. Taking into consideration the increasing significance of functions performed by internal audit unit as well as the confined archival information regarding the quality of the internal audit, the clear purpose of this study was to gain a deeper understanding of the factors that determine how effective the Internal Audit Function is as a financial reporting controller.

The study detected that the joint presence of competence and independence is a necessary criterion for effective IAF financial reporting monitoring. Also, findings concluded that the financial reporting quality depends on the internal auditor's independence (competence).

Nasvita (2016). The basic objective of this study was to examine the elements that influence internal auditor's independence. These factors include internal auditors' competency, intervention from management, participation from employees, and regulation from the organization. According to the feedback of this study, every aspect either fully or partially has effect on internal auditor's independences. These influences might occur concurrently or separately. Internal auditors' independence is negatively impacted by management intervention, despite the fact that auditor competency, employee participation, and business regulation all have a favorable impact on internal auditor's independences.

Dawuda et al. (2015) used descriptive research to examine Ghanaian local government internal auditors' organizational independence, the investigation found poor budget allocation, low status of internal audit departments, management control over internal audit activity due to lack of charter. Intimidation and familiarity are the biggest dangers to internal auditor independence. The study found local government internal auditors' organizational independence at risk.

Kassab (2015). This study aimed to identify the most influential factors that impact internal auditor independence, followed by the independence of the department of internal audit in corporations located in Saudi Arabia. The study confirmed that the managerial and functional subordination of the department of internal audit to the top authority in the business, which is the AC that comes from the BODs, makes internal auditors more independent. Some people have said that it would be better for independence to move that subordination to the general shareholder meeting. Also, an internal auditors' independence is strongly linked to their experience and qualifications, the lack of executive tasks, how effective is the AC, having an explicit internal audit charter that has been approved, and the internal auditor's hiring and firing.

Kimotho (2014). The target of this study was to characterize the factors that affect the independence of internal audits at the Mombasa Technical University as well as the many variables that impair it. A review of the relevant literature was performed on many independent factors that have an effect on the dependent factor. According to the study results, it is radical for the organization to maintain the independence of its internal auditing processes in order to facilitate increased employee accountability and performance within the organization.

Otene (2014). The aim of the study was to cast doubt on the idea that there is a connection among the independence of the internal audit procedure and the success of companies' stock performances on the Nairobi stock market. At the close of 2013, this study was approved for adoption. The study disclosed that there is a significant positive relation between the independence of the internal audit and corporate equity performance, as well as a significant connection between evaluation rates (such as profit distribution) and ownership performance. The research indicated that during the period of the last five years, there had been considerable increases in exchange rates for currencies, inflation rates, profit distribution, and income.

Stewart & Subramaniam (2010) aimed to give a clear review of the literature concerning the objectivity, internal auditors' independence, and address opportunities for future study. Five factors related to the objectivity and independence were examined at: the internal auditor's organizational position, the internal auditor's dual duty as a provider of assurance as well as consulting activities, the internal auditor's involvement in risk management, outsourcing of internal audit operations and the utilization of internal audit as a training activity for managers. The study summed up a set of concepts about the objectivity alongside independence of the internal auditor and found that a variety of these organizational and individual factors have the potential to affect and be affected by the independence as well as objectivity of internal audits.

Ahmad & Taylor (2009) aimed to come up with standards for how committed internal auditors are to being independent. It did this by taking a cognitive view of internal auditors' independence, role conflicts, and ambiguity in roles in the context of their work environment. This was done to show how role conflicts and ambiguity affect the internal auditor's commitment to being independent. The study indicated that internal auditors' ambiguity and conflict roles negatively affect independence. Ambiguity in the internal auditor's authority, time pressure, and discrepancy between their personal values and management's and their profession's requirements are the main factors that affect independence.

Christopher et al. (2009). The intention of this study sought to carry out a comprehensive investigation on the autonomy of the internal audit department in Australia by investigating how it interacts with the company's board of executives and the AC. The study confirmed there is an array of factors that pose a risk to the connection that is present between the role of internal audit and management. Among these are the following: using the duty of internal auditor as an entry-level position to other jobs; CEO or CFO of the company is the official who gives input on the internal audit strategy and authorizes the budget for the internal audit function. In terms of the connection with the auditing committee, the following threats were found: It is not required that the (CAE) submit to the Auditing Committee (AC), and AC is not solely responsible for staffing up, discharging, or evaluating the (CAE) . The members of the (AC) lack experience in accounting, and there is not even one person on the committee who has experience in accounting, either.

Goodwin & Yeo (2001) tested two aspects that have the potential to influence the independence alongside objectivity of internal audits. The AC relationship affects internal audit's organizational independence. Second is managerial training. There is a possibility that internal auditors will be afraid to confront the pressures brought on by an auditee that might pose a potential threat which may undermine objectivity. According to the outcomes of the study, there is a significant relationship that exists among the level of engagement between the AC and the internal audit team, was demonstrated to be greater when the AC was composed completely of independent members. significant number of companies in Singapore employ the management training ground based on internal audit section.

Materials and methods

The methodology used in this article depends on the theoretical review and analysis of scientific articles and works related to the internal auditors' independence gap, what threats that impact independence, what factors that manipulate the independence in order to obtain logical conclusions and summarize the whole topic in this article that help in the suggestion of a set of requirements to increase independence and objectivity. In addition, this article employs general scientific methods of cognition, including analysis and synthesis.

Discussion and results

Firstly, internal audit was described by the IIA in 1999 as an impartial, objective assurance along with consulting activity meant to provide value while boosting an organization's operations. It serves an organization in accomplishing its mission through organized, disciplined strategy for assessment and enhancement of the efficacy of supervision, in addition governance activities. Independence means the absence of conditions that could compromise objectivity as well as an appearance of objectivity these kinds of challenges to objectivity need to be controlled at every level – the individual auditor, the engagement, the functional, and the organizational. Objectivity means an objective frame of mind that enables internal auditors to execute engagements using a way that they have a sincere belief in the output of their labor and that non-significant goodness sacrifices are made.

Consequently, it seems that the difference between the two phrases is that objectivity refers to a state of mind, whereas independence refers to the state of events that makes it possible for an internal auditor to do their duties with an objective attitude.

Secondly, the significance of having independence was highlighted by Mutchler et al. (2001) who stated that the desire for more independence, objectivity, and accountability among internal auditors grows in tandem with the responsibilities of internal auditors, it is dignified for the company to maintain the independence of its internal auditors in order to assist in the improvement of employee performance and responsibility. So internal auditors shall operate honestly and independently, the role of internal auditing must have adequate organizational status, this is required since internal auditors are unique employees that evaluate and monitor management decisions and advise management on internal controls.

The Institute of Internal Auditors (IIA) published a number of attribute standards and practice advisories regarding independence and objectivity (IIA, 2009) emphasizing the significance of internal audit function's organizational independence as well as internal auditors' individual objectivity which are as follows (Table 1).

Table 1 – Standards as well as advisories for objectivity and independence (Prepared by researchers)

Standard	Explanation
Standard 1100 – Independence and Objectivity	Pointed out that internal auditing operations demanded to be independent and that internal auditors ought to be impartial in their work. The (CAE) must have to have unfettered involvement with senior management and the board in order to ensure the required level of independence; this can be done by having a dual reporting arrangement.
Standard 1110 – Organizational Independence	The (CAE) is required to furnish reports to an upper management level that enables the internal audit function to effectively discharge its duties. Annually, the CAE must attest to the board that the organization's independence that governs internal audit activity.
The related Advisory Practice No 1110-1	Ideally, the CAE ought to provide reports to both the company's board of executives and the CEO, encompassing administrative aspects, respectively. Administrative reporting ought to go to an executive with enough authority to foster independence, comprehensive audit coverage, adequate assessment of engagement communications, and suitable action on engagement recommendations.
Standard 1120- Individual Objectivity	Pertains to the individual's capacity for objectivity and demands on internal auditors to maintain a neutral stance, free from bias, and to steer clear of any possible and potential upcoming conflicts of interest
The related Advisory Practice No 1120-1	Emphasizes the necessity to prevent prospective and real conflicts of interest as well as bias at the personal level, and recommends that staff assignments be periodically rotated.
Standard 1130 – Impairment to independence or objectivity	Highlights the necessity of providing appropriate disclosure to the appropriate parties of any impairment to the independent or objective status of the firm An example of an impairment would be internal auditors evaluating activities for which they had been responsible in the past. Individual conflicts of interest, limitations on scope, resources, and constraints to access data.
The related Advisory Practice No 1130-1	Emphasizes the significance of avoiding taking payments, gifts, or amusement from audit clients and requires auditors inside firm to disclose any instances that involving actual or possible impairment to the CAE, also encourages internal auditors to report any events involving actual or prospective impairment.

Thirdly, there are some factors that impact on auditors' independence in company and applying those factors can improve auditors' independence, proposed by Kimotho (2014) which are the following: 1) The auditor must acquire a sufficient comprehension of the role of internal control and audit to identify pertinent internal audit operations for the company. 2) Managing internal audit operations and objectives with different assurance providers in order to minimize repetition of effort and departmental management burdens. 3) Requiring management to react to important findings from the audit in a formal and timely way by taking necessary corrective action in accordance with the recommendations of the audit. 4) Including in an audit charter a set of responsibilities and authorities for internal auditing that are crystal obvious and clearly stated. 5) Tracking to ensure that management executes agreed-upon control enhancements in a timely manner and that they are sufficient and efficient. 6) Evaluation the efficiency of policies that are currently in place and evolution of new ones. In addition, a wide range of concerns that impact on the internal auditor's impartiality and independence, such as **Organizational Independence**: which means functionally subordinating the CAE to the BODs ensures organizational independence. While the internal auditing process has to be allowed to determine its scope, perform its task, and report its findings. The CAE must notify the members of BOD about any interference. The CAE needs to directly communicate with the BOD. Also, **the role of the chief audit executive CAE outside the internal audit framework**: which means the CAE of internal audit must take efforts to protect independence and objectivity when he has or is expected to have roles beyond the internal audit framework. This has been determined as the CAE might have to fulfill additional roles beyond the internal audit structure, such as risk management, which may negatively impact compliance activities, organizational independence, governance practices and individual objectivity. Additionally, **Individual Objectivity**: which means internal auditors should be unbiased and equitable, and they must avert any possible conflicts of interest. The term «conflict of interest» has been defined as a scenario whereby the internal auditor, who is expected to be trustworthy, has competing either professional or private interests. These competing interests could render it challenging to the internal auditor to successfully carry out his responsibilities in a fair and impartial manner. Additionally, a conflict of interest could undermine trust in the internal audit's findings. A conflict of interest can also compromise an auditor's capacity to carry out his tasks and duties objectively.

Fourthly, threats to internal auditors' independence (independence gap) must be discussed to help determine the internal auditor's independence gap, which is of greater significance in this article. Incentives can also impact internal auditors, as incentive remuneration based on company performance as a whole may pose a threat to the objectivity accompanied by internal auditor's independences. In the same way. Internal auditors are less likely to report GAAP violations if incentive payments are related to share prices.

The IIA (2001) has released a framework for directing internal auditors in matters of independence and impartiality. In this scope, internal auditors' independence is characterized as a circumstance in which threats to objectivity (independence gap) are effectively addressed. Internal auditors have a duty to identify, evaluate, and manage any threats to the organization's objectivity, which includes the requirement to think about measures that can reduce threats drawbacks.

This framework examines seven internal auditor objectivity and independence threats: (Mutchler, 2003)

1) Self-evaluation, wherein the internal auditor evaluates his own work.

2) The internal auditor is subjected to social pressure by the auditee.

3) Economic interest that results from payment of incentives or appraising the duties of the individual who has sufficient authority to affect internal auditor's employment or compensation.

4) Personal connection, where an internal auditor is regarded as one of the members of the same family or is a personal acquaintance of the organization being audited.

5) Friendship and familiarity with the entity being assessed as a result of having maintained a longstanding relationship with the entity, including having performed work in the unit that is being reviewed.

6) In international firms, cultural, racial, and sexual prejudices can emerge when the person reviewing is biased or lacking an awareness of local customs and practices. This can lead to unequal treatment of employees from different groups.

7) cognitive biases coming from either the adoption of a given psychological perspective when carrying out the review or the existence of preconceived notions.

The degree to which interactions between management, the AC, and the internal audit present potential risks to the organization's independence was analyzed by (Christopher et al., 2009) and they identified three basic threats to independence as follows: 1) **practice to put future managers through their paces in the internal audit function, which serves as both a training ground and a stepping stone.** It is possible to claim, despite the fact that there are reasons to support this approach, that internal auditors are unlikely to be able to function independently because they would be dependent on the auditees they work for due to possible professional changes. 2) **Approval of internal audit budget**. The approval of the budget for the internal audit is often the duty of the Chief Executive Officer or Chief Financial Officer. Because the imposition of financial constraints is a powerful tool that management can use to minimize the scope and effect of the internal audit function, this can be considered as a substantial threat to internal audit process independence. **3) A significant amount of top management involvement is expected in the creation of the plan for the internal audit.** Even if the opinion of senior management is essential for determining the priorities of internal audits, the influence of this feedback should be kept under control by the CAE as well as the AC. Internal auditors are perceived as management advisors, which usually poses a challenge internal auditing department independence, if their requests are considered to be unconditional priorities. Internal auditors are frequently viewed as «partners» by staff members. This «partner role» exerts pressure on internal auditors to assume a subordinate management position, thereby endangering internal audit function independence.

Fifthly, in this part we will go over some ways in which the challenges to our objectivity and independence can be overcome, IIA (2017) confirmed that organizations ought to make attempts to overcome the challenges of securing its independence and objectivity which include the following:

– It is necessary for internal auditors to stop conducting audits of the procedures that they formerly oversaw. If an internal auditor delivers assurance services linked to an activity for which he was accountable in the preceding year, it is likely that his objectivity will be compromised as a result of this conflict of interest.

– Assurance engagements that pertain to duties that are supervised by the CAE are required to be put under the supervision of a third party that does not take part in the process of conducting internal audits.

– Also, there are a few different approaches that can be taken in order to cut down on the amount of uncertainty regarding the internal auditor's objectivity and independence, which are as follow:

– Numerous studies have demonstrated that one of the most prominent factors that shape a rise in the level of external users' trust in the independence of the entity's internal audit is the degree to which the processes of internal audit are outsourced.

- An obligation placed on management to refrain from interfering with the audit's scope determination or imposing restrictions on internal auditor's abilities to gain access to records or make contact with personnel of the organization being audited.

– Reviewing the authority that presently has the authority to fire the internal auditor, which is represented by the AC and the BODs. Providing this power to the shareholders' general meeting reduces the burden on internal auditors, enhancing their independence.

Sixthly**,** we will discuss factors that can decrease the threats to independence which are as follow: **1) Positioning of the Organization and Its Policies**: The internal auditor's organizational position and customer relations policy statements at multiple levels may improve the auditor's position and prevent audit clients from influencing or threatening auditors. Such procedures can shield staff from repercussions for alerting management. **2) Powerful Organizational Governance System/Environment**: A supportive internal audit function and company environment that supports learning and continual improvement may lessen the feeling of failure associated with suggestions and system implementation issues. auditors and audit consumers would be less fearful of bad results and reporting inaccuracies. An AC fosters support. Strong AC ensure auditor objectivity. **3) Rewards**: Threats against objectivity can be mitigated by instituting a structure of rewards along with disciplinary procedures inside the internal audit unit as well as within the organization itself. Encouragement toward objectivity can be found in environments that punish biased and prejudiced thought while rewarding critical and objective thinking. 4) **Utilization of Teams**: Having other people back up your assessments, choices, and judgments is an important part of being objective. Teams, not just people, can help reduce cognitive biases, being familiar, interpersonal connections, as well as self-review threats when providing assurance services. A team member will be afraid to say something that goes against what most of the team or a socially strong team member thinks because of social pressures risk. **5) Peer Review/ Supervision**: Audit studies show that performance rewards, justification requirements, as well as feedback can reduce biases in audit judgments. Expecting peer and supervisory evaluation may improve an auditor's self-awareness, helping them avoid biases and other challenges to neutrality. **6) Circumstances Alter/Passage of time**: The possibility of an auditor posing a threat to his or her own self-review decreases over the passage of time when the auditor examines the suggestions he or she has made during earlier audits. A longer period of time can also result in changes in the situations and employees in the audit client area, so lowering or removing potential dangers such as social pressure, as well as self-review. **7) Internal Consultations**: Two mitigating factors include the utilization of teams as well as supervision and peer review. When conducting an internal consultation, as opposed to an external one, the auditor handles potential threats to his or her impartiality by freely and of their own accord taking the initiative to do so requesting information or feedback from a professional colleague. Despite the process of consulting with an outside party. An informal procedure that defines criteria for when an internal auditor should seek assistance could be created by the internal audit unit as part of a formal process.

Conclusion

The independence of the internal auditor is absolutely necessary for the company in order to facilitate improvements in both employee performance and responsibility. Additionally, the independence of the internal auditor is essential to investors as well as other outside stakeholders in the event that the internal audit is disclosed.

This is done in order to assist investors in making decisions based on factual information. Without independence, an internal audit report can no longer be considered effective or of high quality. Because many companies have a tendency to lessen the degree of independence enjoyed by their internal auditors, those working in auditing roles within businesses confront a number of obstacles on the job such as self-evaluation, social pressure by the auditee, economic benefits that results from payment of incentives and salaries, personal relationships as the internal auditor is one of the employee of the organization, serving the firm for a long period makes him more familiar with the top level management and AC as well as Prejudices based on culture, ethnicity, and sexual orientation can threat the internal auditor independence , and to overcome all of those threats internal auditors must fully understand standards and associated practice recommendations pertaining to independence and objectivity that have been issued by the institute of internal auditors in 2009, internal auditors should not evaluate their former processes, the authority to fire the internal auditor has to be delegated to the general meeting of shareholders, thereby reducing the strain on internal auditors as well as outsourcing internal audit processes boosts external users' confidence in audit's independence.

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