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Researching the Operating Principles of Internal Auditors in Internal Auditing at Vietnamese Enterprises

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Abstract

The 4.0 industrial revolution has been having a strong impact on the economy in general and the business community in particular. Corporate governance activities are receiving a lot of attention from businesses. Internal audit activities are also one of the issues that businesses focus on and flexibly improve. For internal audit activities to become an effective tool to help businesses manage and prevent

risks, businesses must be fully aware of and ensure good implementation of its principles. The survey of the theoretical system shows that the agency theory and positive accounting theory used to explain the operating principles of internal audit are appropriate. Research results show that internal audit contributes to increasing value and competitive advantage for businesses.

Keywords: Internal Audit, Agency Theory, Positive Accounting Theory

1. Overview of internal audit and operating principles of internal audit

1.1 Internal audit

According to the Association of Internal Auditors IAA (1999): Internal audit is an independent, objective assurance and consulting activity designed to add value to the organization and improve operational efficiency. Internal audit helps businesses accomplish their goals through methodical and systematic risk assessment, thereby improving the effectiveness of risk management activities as well as governance processes. Company. This concept emphasizes the importance of independence and objectivity of the internal audit function (Goodwin & Yeo, 2001).

Vietnamese businesses today all focus on and seriously consider the role and importance of internal audit principles so that they can build truly effective internal audits.

Internal audit is an independent appraisal function established within an entity to review and evaluate the entity's activities as an aid to the entity's administrators. Internal audit is understood as a department established within a unit to perform the function of examining, evaluating and independently verifying information about activities taking place within that unit.

Internal audit is considered an effective management tool and a necessary complement to the external audit work of external audit activities. Internal audit is an audit located at the base unit, so it has a great effect in early detecting, preventing and handling negative behaviors, fraud and errors in the management and operation of activities., contributing to improving the efficiency of using resources in the unit. It is the independent operation process of competent people in the Internal Audit department in a unit to collect evidence to check and evaluate economic, financial and other information. Other about the unit's operations; on compliance with State laws and unit regulations; about the economics, effectiveness and efficiency of operations in that unit. Thereby confirming and reporting to the unit's Board of Directors on the quality and reliability of audited information and at the same time making recommendations on solutions to correct, overcome and prevent the recurrence of errors., violations, contributing to improving the effectiveness of risk management, internal control and management activities of the unit, helping the unit achieve its set goals.

Internal auditors must be responsible for their confirmation and assessment opinions (which are the opinions of the intermediary between the unit's leaders and the audited department). The opinions and findings of the internal auditor in all cases are only intended to confirm the reasonable truthfulness of the information or consultation and do not convey any direct authority to take action. Specifically. Therefore, the work of the internal auditor must be separate from the activities being audited. If Internal Audit activities are temporarily suspended, the professional activities of each individual, each department

and the entire unit will still continue in the current way. However, without Internal Audit, there can be major risks during the unit's operations because the possibility of risks and ensuring the reliability of information cannot be identified by Internal Audit. The unit's leadership has made a wrong decision... Therefore, the unit should organize and maintain the activities of Internal Audit to enhance the effectiveness of control and management in the unit and especially contribute part to ensure reliable information to serve the decision-making of unit leaders.

The tasks of Internal Audit in the unit are:

- Check and evaluate the reliability, effectiveness and efficiency of the internal control system, risk management, and safety measures assets and use of resources of the unit;
 - Check and evaluate the authenticity and reliability of information in the unit; - Check and evaluate the unit's compliance with laws and internal regulations; - Check and evaluate the effectiveness, effectiveness of activities in the unit; - Recommend measures to correct and overcome errors and problems; handle violations; Propose measures to improve the internal control system and risk management system in the unit. In order for Internal Audit to perform the above tasks well, it is necessary to clearly define the powers of Internal Audit. Internal audit **has the following powers:**

- Proactively perform its tasks according to the audit plan approved by competent authorities in the unit;
- Request audited subjects to provide and explain information, documents and records necessary for Internal Audit work;
- Approach and interview officials and employees of organizations and units. members of the subject being audited related to the audit content;
- Attend and receive meeting minutes of the unit's Board of Directors related to the work of the Internal Audit;
- Independent in professional expertise, not influenced or interfered with when performing audits and expressing opinions in audit reports;
- Receiving unlimited information related to the unit's operations (such as being able to attend and be fully provided with meeting minutes of the Board of Directors and State legal documents, strategies, regulations, processes, professional instructions...) and be fully equipped Human resources, finance and other physical conditions to serve audit activities;
- Sign and confirm on Internal Audit Minutes and Reports and take responsibility according to assigned audit duties and powers.; Report audit results to the unit's Board of Directors in accordance with the law and internal regulations of the unit; Reserve opinions expressed in Minutes and Internal Audit Reports;
- Provide recommendations and suggest advice to the unit's Board of Directors in improving and perfecting management and operations unit's operations, preventing errors and fraud within the unit. Supervise, evaluate and monitor repair, remedial and improvement activities of leaders of units and departments for issues that Internal Audit has recorded and made recommendations;
- Refuse to implement Perform tasks that are not within the scope of Internal Audit operations. To perform well its duties, powers and functions, the Internal Audit department must be independent of the unit's Board of Directors and other departments. Functions and departments are audited to ensure independent

inspection and evaluation of the unit's activities, in accordance with the unit's charter. Currently, there are many units, such as Groups, Corporations, commercial banks... have increasingly attached importance to the role of Internal Audit. But the current state of Internal Audit operations in units is often not as effective as expected. In many units, Internal Audit does not have the cooperation of the audited departments. In many cases, Internal Audit work is still subject to the influence and intervention of managers at all levels. There are even cases where senior managers of the audited department react to the internal auditor's assessment, causing obstacles for Internal Audit. These people believe that Internal Audit activities have made it difficult for them to perform their duties and responsibilities. There are also many cases where internal auditors are not allowed to access books, employees and physical assets related to audit work, leading to limited audit scope. Or in some units, internal auditors concurrently hold other positions and professional jobs in the unit's operating apparatus, leading to internal auditors being unable to identify their profession. Objectively during audit activities as well as in evaluating and presenting opinions in audit reports. That situation leads to the fact that internal audit in these units is still formal, has not really become an effective management tool, and has not done a good job of preventing, detecting and handling negative acts. Extreme fraud and errors in the management and administration of economic and financial activities in the unit. There are many reasons leading to this situation. One of the important reasons is that the internal audit in the unit does not ensure independence. Independence is an important principle in audit activities. Internal auditors must ensure independence at the necessary level, enough so that they can perform audit work independently and draw objective conclusions.

1.2 Operating principles of internal audit

Operating principles of internal audit include the following elements:

- **Independence:** From the perspective of internal audit, independence refers to the ability to perform work freely and objectively without interference from managers or internal employees. Outside the organization. For example, internal audit having direct access to the Board of Directors, as well as reporting only to the Board of Directors, instead of reporting to management, both increase the independence of the audit function. Internally (Raiborn *et al.*, 2017)^[9]. In this study, internal audit independence is defined as the degree to which internal audit is not influenced or influenced by managers during the internal audit process of performing audit activities in the organization. Businesses as well as releasing internal audit reports (Ebissa, 2015)^[4].
- **Objectivity:** Objectivity is the unbiased attitude and avoidance of conflicts of interest of internal auditors. Therefore, when all compliance audit activities have been performed well, internal auditors can reduce the content and scope of quality monitoring activities (Fadzil *et al.*, 2005)^[5]. In the theoretical basis system, there is a consensus that objectivity is related to the

quality of assessments, judgments and decisions in internal audit activities. Specifically, objectivity is considered the opinions of individuals, not influenced by external factors in evaluation, judgment and decision (Stewart & Subramaniam, 2010)^[11].

- **Professionalism:** According to Kalbers & Lawrence (1995)^[8], the professionalism of internal auditing is reflected in the values and benefits they bring to the organization. An internal auditor is considered professional, in addition to ensuring sufficient knowledge and professional capacity, he must also possess necessary skills such as proficiency, caution and the ability to work in a team. Besides, the professionalism of internal audit not only brings better results at work, but also plays an important role in increasing the value of the business.

In Vietnam, on January 22, 2019, the Government issued Decree No. 05/2019/ND-CP regulating internal audit, which regulates internal audit at enterprises. Accordingly, for internal audit work for businesses, the following units must perform internal audit work: Listed companies; Enterprises in which the State owns more than 50% of charter capital are parent companies operating according to the parent company-subsidiary model; State-owned enterprises are parent companies that operate according to the parent company-subsidiary model.

Enterprises not falling into the above categories are encouraged by the State to carry out internal audit work. This Decree clearly stipulates the basic principles of internal audit including: Independence (Persons doing internal audit work are not allowed to simultaneously undertake tasks that are subject to internal audit. Unit must ensure that internal audit is not subject to any interference while performing reporting and evaluation tasks); Objectivity (Internal auditors must ensure objectivity, accuracy, honesty, and fairness in the process of performing internal audit tasks) and Comply with the law and be responsible before the law. Law on internal audit activities.

2. Overview of research on operating principles of internal audit

The authors' survey shows that the operating principles of internal audit are rarely mentioned in the theoretical basis system. However, recently, the operating principles of internal audit have begun to receive attention in a number of domestic and foreign studies. Stewart & Subramaniam (2010)^[11] conducted a study on the independence of internal audit and said that independence means not being influenced by an individual or group of people when encountering material conflicts or interests. May affect their objectivity.

In one of his studies, Ebissa (2015)^[4] identified the independence of internal audit as a fundamental factor for the reliability of internal audit reports. If internal audit staff do not have independence both internally and externally, internal audit reports will lose reliability and objectivity.

Goodwin & Yeo (2001) point out that businesses need to strengthen the independence and objectivity of internal audit. Among them, factors that can impact the objectivity of internal audit include: (1) The relationship between internal audit and the Board of Management, (2) Using internal audit as a method to train the management team in the future (For example: Recruiting new internal audit specialists and in the future can be promoted to management positions in the enterprise, or initially rotate employees

within the company). Businesses into internal audit positions and then bring them back to the old department with higher management positions). The professionalism of internal auditing is not only reflected in the benefits it brings to businesses., but also shows value in its links to job performance, job satisfaction, organizational commitment, and corporate revenue goals (Kalbers & Lawrence, 1995)^[8]. Through the above studies, the authors believe that the operating principles of internal audit are the basic foundation; serve as a basis for internal auditors to perform their work properly and reasonably. Internal auditors need to promote compliance with principles so that the enterprise's internal audit activities become more thorough and scientific.

3. Underlying theory explains the operating principles of internal audit

3.1 Delegation theory

The fundamental concern of corporate governance stems from the separation of ownership and control in modern public companies. This is the essence of the problem of representation raised a long time ago by leading scholars abroad. Specifically, delegation theory was first formulated by Ross (1973), later further developed by Jensen & Meckling (1976)^[7]. The content of this theory refers to the relationship between the principal and the authorized party through a contract. In this, the authorized party will perform a number of tasks on behalf of the principal, including delegating a level of decision-making authority to the authorized party.

Based on this, the responsibility of running the enterprise is given to the board of directors who represent the shareholders. The Board of Directors usually meets a few times a year to appoint managers, headed by a CEO, to manage the enterprise. At the same time, independent external auditors will provide assurance services to shareholders through assessing the quality of financial reports. Internal audit will provide assurance to the board of directors, through protecting corporate value; ensure businesses comply with the law, business ethics and internal regulations; Prevent risks and improve processes so businesses operate more effectively.

In this context, delegation theory can be used as a basis to explain the independence and objectivity of internal audit (Adams, 1994)^[2]. It is shown that internal auditors are the representatives of managers to carry out responsibilities according to the expectations of stakeholders as well as society. In particular, the management and control functions must be separated to ensure independence and not concurrent functions to maximize the role of internal audit.

The theory of delegation suggests that both parties (the principal and the delegate) want to maximize their benefits. Normally, the principal is expected to behave in a way that is in the principal's best interest, but the principals themselves also pursue their own interests.

Therefore, in this relationship there are always conflicts and this gives rise to an agency cost, which is classified into two types: The cost of investing in the control system necessary to minimize the lack of information of the principal and the cost of minimizing information risk through risk sharing with the principal through output-based incentives. However, according to this theory, internal audit (the authorized party) must carry out work clearly, fairly and minimize conflicts of interest. Therefore, thanks to

delegation theory, internal audit tends to behave objectively and adhere to its own interests. Since then, the role of internal audit in the operating process of enterprises has been emphasized.

3.2 Positive accounting theory

Positive accounting theory explains and predicts accounting activities that take place every day in reality. Positive accounting theory helps answer the question "what is happening every day, why do people prepare financial statements like that, what motivates them to do so?" (Watts & Zimmerman, 1978). Thus, positive accounting theory provides the opportunity to discover and explain phenomena that have never appeared or have appeared but accountants have not observed in the financial world and especially financial activities. Accounting activities (specifically internal audit activities).

Here, positive accounting theory is used to explain the professionalism of internal auditing. The value of internal auditing is expressed in carefully reviewing business activities, as well as auditing. Check compliance, check the correctness of financial reports... Valuable internal audit will also add value to businesses. That is, the more benefits internal audit brings to the business, the more the business value increases. This theory suggests that businesses need to pay more attention to improving the professionalism of internal auditing as a driving force for value enhancement.

4. Discussion

Internal audit is a key activity of businesses in risk management and prevention, but there are many threats to the independence, objectivity and professionalism of internal audit. Therefore, it is also necessary to be careful about the participation of internal audit in business activities. For example, a business is implementing a certain project and the internal auditor may have enough knowledge and special skills to carry out this project.

In this context, delegation theory can be used as a basis to explain the independence and objectivity of internal audit. It is shown that internal auditors are the representatives of managers to carry out responsibilities according to the expectations of stakeholders as well as society.

However, if internal audit is involved in this project, there may be potential compromise and collusion of internal audit with other members of the organization. Thus, the operating principles of internal audit will be significantly affected. The company must then accept a trade-off that is hiring outside experts at higher costs or hiring additional service providers to complete the project, instead of using internal audit to participate. Into the activities of this project to ensure independence is not violated (Stewart & Subramaniam, 2010) [11].

Regarding the relationship between the internal audit function and the management function, the factors that threaten the independence of internal audit mainly include: (1) enterprises use the internal audit function as a stepping stone to promotion into management positions; (2) The CEO or CFO approves the budget for the internal audit function and provides input to the internal audit plan.

According to Christopher *et al* (2009) [3], the threats to internal audit are: (1) Internal audit does not report to the

Board of Management in accordance with functional requirements; (2) The Board of Management does not have full decision-making authority in appointing, dismissing, and evaluating internal audit; (3) All members of the Board of Management or not at least one member has sufficient professional qualifications in accounting. Because if the internal audit does not perform its functions and tasks properly and the board of directors does not have any members knowledgeable in accounting, it will be difficult to evaluate the activities of the internal audit. At the same time, the Board of Management does not have full authority to appoint internal auditors, which will significantly affect the overall situation of the unit. Therefore, businesses should carefully consider the above conditions to limit bottlenecks in the internal audit implementation process.

Besides, after surveying the theoretical basis, the authors found that there is a relationship between internal audit activities and the effectiveness of the internal control system. Research in Malaysia by Fadzil and colleagues (2005) [5] suggests that internal audit activities impact the quality of the internal control system. The authors believe that professionally and competently managing the internal audit department and objectively evaluating internal audit activities can promote the "monitoring" component of the control system. Internal. The scope of audit work and the effectiveness of audit work affect the "information and communication" component of the internal control system.

Meanwhile, performing audit work competently, objectively and professionally has an impact on the "control environment". Manage the internal audit department, perform audit work, prepare audit programs and audit reports that impact the "risk assessment" component. Finally, performing audit work and preparing audit reports affects the "control activities" of the internal control system. Therefore, in order for internal control activities to maximize their role, businesses must seriously evaluate the functions and tasks of internal audit. From there, internal audit becomes a factor that promotes the effectiveness of internal control and contributes to helping businesses create competitive advantages.

5. Solution

Firstly, regarding organization: The internal audit department must ensure separation and independence from the units, operating and operating departments of the unit. The unit's internal audit committee must have a satisfactory position in the unit's organizational structure to be able to complete its audit tasks. That shows:

- Internal audit must have the support of the unit's Board of Directors so that they can have the cooperation of the audited departments and so that their work is not interfered with by management staff. Levels within the unit as well as within the audited department;
- The head of the internal audit department must be a person with sufficient authority to maintain independence and ensure overall audit coverage, fully review audit reports and take appropriate action on recommendations. Audit recommendations;
- The Head of the Internal Audit Department must be allowed to directly and regularly communicate with the Senior Management Board of the unit, creating conditions for the Head of Internal Audit Department and the Senior Management Board of the unit to be able to Exchange information about problems arising in the

unit that require appropriate and timely handling measures. It is necessary to clearly stipulate that the Head of the Internal Audit Department must report directly to the Board of Directors;

- The purpose, powers and responsibilities of the internal audit department must be clearly stated in official documents (such as regulations on internal audit activities, for example). In the operating regulations of internal audit, the status of the internal audit department must be clearly defined; Allow the internal audit department to access books, employees and physical assets related to audit work and clearly stipulate the scope of internal audit activities (so as not to be limited in scope). Micro audit). The internal audit department is only under the direct leadership of the unit's Board of Directors and not under the leadership of any other functional department in the unit. Every year, the Head of the Internal Audit Department must submit a summary of the audit program, personnel plan and budget to the unit's Board of Directors for approval. Periodically (or unexpectedly), the Head of Internal Audit must report to the unit's Board of Directors on important audit findings along with recommendations on changes and additions to audit plans and programs. Audit (if any) to be approved by the unit's Board of Directors, to avoid unexpected reactions from the audited departments... In case there is a reaction from the managers of the audited departments to the auditors internally, the unit's Board of Directors needs to carefully examine to make correct and timely decisions, ensuring that they do not hinder the operations of internal audit;
- Internal auditors are not allowed to concurrently hold other positions or professional jobs in the operating apparatus of the unit.

Second, regarding operations: The internal audit department must ensure independence from the daily operating activities of the unit and from the operations being audited. The internal audit department and internal auditors are independently evaluated and present opinions in the audit report. Internal auditors must not allow themselves to fall into a situation where they are unable to objectively assess their profession during audit activities, specifically:

- Internal auditors must have a fair attitude, without bias and avoid any conflicts of interest. Internal auditors have the right and obligation to report to the Head of the Internal Audit Department on all issues that affect their independence and objectivity before and while performing internal audit work;
- The head of the internal audit department must master, monitor and ensure the independence and objectivity of internal auditors. In case the independence or objectivity of the internal auditor is affected or may be affected, the Head of the internal audit department must report and propose solutions to the unit's Board of Directors for comments. Handle accordingly;
- Internal auditors do not participate in auditing activities that they were previously responsible for implementing or managing;
- Internal auditors are not allowed to audit a unit or department within three (03) consecutive years;
- Have inspection measures to ensure the independence and objectivity of internal audit right during the audit

process at the audited unit or department and during the preparation and submission of audit reports;

- Audit conclusions in the internal audit report must be carefully analyzed and based on collected documents and information to ensure objectivity and honesty;
- The performance results of the Head of the Internal Audit Department must be regularly inspected, reviewed and evaluated by the unit's Board of Directors. Above are some basic solutions to enhance the independence of internal audit in the unit so that internal audit operates effectively, is no longer just a formality, and truly promotes its supporting role for the organization. Administrator in controlling, managing and operating the unit.

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