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   REVIEW OF LITERATURE

   NEED/IMPORTANCE OF THE STUDY

   STATEMENT OF THE PROBLEM

   OBJECTIVES

   HYPOTHESES

   RESEARCH METHODOLOGY

   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

   CONCLUSIONS

   SCOPE FOR FURTHER RESEARCH

   ACKNOWLEDGMENTS

   REFERENCES

   APPENDIX/ANNEXURE

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- Hunker, H.L. and A.J. Wright (1963), "Factors of Industrial Location in Ohio" Ohio State University, Nigeria.

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- Sharma T., Kwatra, G. (2008) Effectiveness of Social Advertising: A Study of Selected Campaigns, Corporate Social Responsibility, Edited by David Crowther & Nicholas Capaldi, Ashgate Research Companion to Corporate Social Responsibility, Chapter 15, pp 287-303.

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- Garg, Sambhav (2011): "Business Ethics" Paper presented at the Annual International Conference for the All India Management Association, New Delhi, India, 19–22 June.

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WEBSITE

Garg, Bhavet (2011): Towards a New Natural Gas Policy, Political Weekly, Viewed on January 01, 2012 http://epw.in/user/viewabstract.jsp

THE RELATIONSHIP BETWEEN THE INTERNAL AUDIT FUNCTION AND CORPORATE GOVERNANCE: EVIDENCE FROM JORDAN

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ABSTRACT
This study aims to analyze the relationship between internal audit function and corporate governance. The sample was selected randomly, Results based of responses from questionnaire sent to chief audit executives, internal audit supervisors, internal auditors, assistant auditors. With respect to the internal audit function's relationship with corporate governance, threats identified include: using the internal audit function as a stepping stone to other positions; having the chief executive officer (CEO) or chief finance officer (CFO) approve the internal audit function's budget and provide input for the internal audit plan. With respect to the relationship with the audit committee, significant threats identified include CAEs not reporting functionally to the audit committee; the audit committee not having sole responsibility for hiring, dismissing and evaluating the CAE; and not having all audit committee members or at least one member qualified in accounting; audit committee not holding the required number of meetings, according to the instructions of governance in Jordan. Also the study found that internal auditors in Jordan did not do professional development; as stated in the standard -1230 professional development and they have lack of knowledge about the standards and raising the threat of the internal audit function.

KEYWORDS
Audit committees, corporate governance, internal audit, Jordan.

INTRODUCTION
Internal auditing is one of the cornerstones of corporate governance, along with the board of directors, senior management, and external auditing. Because of internal auditors' unique position within the organization, they provide audit committee members with valuable assistance by giving objective assurance on governance, risk management, and control processes. The Institute of Internal Auditors (IIA) defines internal auditing as follows: "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve the organization's operations. It helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance process", and the IIA defines Objectivity as: An impartial, unbiased mental attitude and avoidance of conflicts of interest, allowing internal auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made " (IIA, 2011). The increased importance of the internal audit function in enhancing corporate governance also has been reinforced indirectly through legislation, such as the Sarbanes Oxley Act (2002) in the USA and the Corporate Governance Code for Shareholding Companies Listed on the Amman Stock Exchange (2004) in Jordan . Although this legislation does not specifically address the corporate governance role of the internal audit function, it provides for the expanded accountability requirements of stakeholders, like the board (including the audit committee) and management. This, in turn, would suggest an expanded role for the internal audit function given that it comprises an integral component of the network of parties having corporate governance responsibilities (Al Kashef, 2000).

OBJECTIVE OF THE STUDY
The objective of this study is to draws on both agency and institutional theory to examine the independence of the internal audit function in relationship to the audit committee (as a sub committee of the board) and management, so the study seeks to answer the following questions:
Q1: **To what extent is the relationship between internal audit function and corporate governance in Jordanian companies?**
Q2: Does the relationship between the audit committee and the internal audit function in Jordanian companies provide for independence of internal audit?

LITERATURE REVIEW
The much publicized corporate collapses of the past few years have focused global attention on the needed for strong corporate governance. Simultaneously, the Sarbanes-Oxley Act of 2002 and the new expanded role of internal audit preoccupied researchers and scientists. Paape et al. (2003), explores the relationship between internal audit and corporate governance. The survey data are collected from the largest companies of 15 European Union countries. To accomplish the survey 332 questionnaires were sent; of which one hundred and five were answered (response rate 32%).The basic result of this research is the differences during internal auditors work and the perception of the role of internal auditors to corporate governance by country. Hence, it is a fact that there is lack of internal audit and audit committee on 50 companies and business managers are unaware of the recommendations and regulations on corporate governance. Finally, compliance with regulations and procedures viewed as the main purpose of internal audit, while the implementation of operational controls is considered as the main contributor of internal control. Research on the relationship between audit committee and internal audit was conducted by Goodwin (2003). The survey used questionnaire, addressed to internal auditors of financial institutions (public and private sectors) from Australia and New Zealand, who were members of the Institute of Internal Auditors. More precisely, 370 questionnaires were sent and 120 responses were received, giving an overall response rate of 32%. Of the responses, it is concluded that independence and accounting experience have a complementary impact on audit committee relations with internal audit. Hence, the differences observed between the two countries and the private and public sectors are stressed. One year later, Leung et al. (2004), investigated the role of internal audit in corporate governance in Australia. Questionnaires were sent to internal auditors and directors of Australian financial institutions. Research objectives were the identification of internal audit's objectives, the determination of the internal control' nature and the importance of corporate governance within the economic units. The main output from their research was the fact that the culture and the support of the Board of Directors are key factors that directly affects internal audit's effectiveness. In this context, Gramling et. al. (2004) explored the relationship between internal audit and corporate governance. The most important finding of this study was the catalytic role of internal auditing in the effective corporate governance. More recently, Christopher et. al. (2010) presented a critical analysis of the independence of the internal audit function through its relationship with management and the audit committee. Results are based on a critical comparison of responses from questionnaires sent out to Australian chief audit executives (CAEs) versus existing literature and best practice guidelines. With respect to the internal audit function's relationship with the audit committee, significant threats identified include CAEs not reporting functionally to the audit committee; the audit committee not having sole responsibility for appointing, dismissing and evaluating the CAE; and not having all audit committee members or at least one member qualified in accounting. In the same period, Sarens and Christopher (2010) explored the association between corporate governance guidelines, risk management and internal control practices. Data for the study were collected through a questionnaire that was sent out to chief audit executives in Australia and Belgium. The paper finds that the weaker focus of the Belgian corporate governance

guidelines on risk management and internal control is associated with less developed risk management and internal control systems in Belgian companies than in Australian companies. Finally, Ibrahim El-Sayed Ebaid (2011) explore the nature and characteristics of internal audit function in Egyptian listed firms and assess its ability to fulfil its role in corporate governance. The study has been carried out through a questionnaire survey. The results showed that internal audit function in Egyptian listed firms, in its current status, faces many difficulties that affect negatively its effectiveness in corporate governance. Therefore, extensive efforts should be made to enhancing the internal audit profession in Egypt.

HYPOTHESES OF THE STUDY

The first hypotheses: To what extent is the relationship between internal audit function and corporate governance in Jordanian companies?
The second hypotheses: Does the relationship between the audit committee and the internal audit function in Jordanian companies provide for independence of internal audit?

METHODOLOGY

DATA COLLECTION AND SAMPLE

A questionnaire was used to collect data; it was pre-tested by a number of colleagues for review and approval before distribution. The questionnaire comprises of questions including closed, open ended questions and yes, no questions. The sample was selected randomly, The sample was employed 150 respondents in different sectors (Jordanian Companies was available from the Amman Stock Exchange as of 11 march 2012) and a total of 121 responses were received from 67 company, representing a rate of 80.6 percent.

SAMPLE PROFILE

The following table 1 gives a general overview of the sample surveyed in term of the demographic information**.**

TABLE1: DEMOGRAPHIC INFORMATION

Demographic object	The valid items	Frequency N=121	Percent
Qualifications	PhD	0	0%
	Master degree	2	1.7%
	Bachelor's degree	116	95.9%
	Others	3	2.5%
Total		121	100%
Professional certificate	CIA	3	2.5%
	CPA	2	1.7%
	CMA	3	2.5%
	JORDAN CPA	4	3.3%
	OTHERS	0	0%
	WITHOUT CERTIFICATION	109	90%
Total		121	100%
Functional level	Chief executive auditor	67	55.4%
	Internal audit supervisor	32	26.4%
	Internal auditor	14	11.6%
	Assistant auditor	8	6.6%
Total		121	100%
Experience	1-5 years	64	52.9%
	6-10 years	46	38%
	More than 10 years	11	9.1%
Total		121	100%

Table 1 provides the number of respondent holding Master degree 2 of the sample and none of the respondent holding PhD Degree; this indicates that the companies are discouraging the employees to have a high degree of qualification. The majority of respondents have professional certificate CIA with a percentage of 2.5 %, CPA holders 1.7 %, this indicates that the companies don't care about the professional certifications. **In other words**, corporate **governance** or audit committee should reconsider the method of appointment , as we see most of the respondents is a chief executive auditor or internal audit supervisor with a percentage 55.4% and 26.4% respectively, this indicates unmindful of companies to have qualified employees in the internal audit department .A large number of respondents experience less than five years with a percentage 52.9% , this maybe indicates a cause weakness in the internal audit department .

ANALYSIS AND DISCUSSIONS

ANALYSIS PROCEDURE

The major statistical tools which were used in this study are central tendency (mean), percentage analysis.

RESULTS

TABLE 2: TO WHOM DOES THE CAE/INTERNAL AUDIT DIRECTOR REPORT?

	Functionally		Administratively	
	Responses	*Response Percent*	Responses	Response Percent
Audit Committee (AC)	65	53.7%	21	17.4%
AC and CEO	26	21.5%	11	9.1%
AC and CFO	11	9.1%	41	33.9%
AC, CEO and CFO	7	5.8%	9	7.4%
AC, CEO,CFO and BOD	9	7.4%	3	2.5%
CEO Only	3	2.5%	34	28.1%
Others	0	0.0%	2	1.7%
Total	121	100.0%	121	100.0%

Table 2 provides an overview of the reporting relationships of the responding internal audit functions. It is shown that, in only 53.7 percent of cases, the internal auditor function reports functionally to the audit committee, as recommended by the IIA. 28.1 percent of the respondents indicated an administrative reporting relationship with the CEO only. About 33.9 percent of the respondents indicated that they report administratively to the audit committee and CFO. It should be noted that there is no consensus as to whether reporting administratively to the audit committee or CFO threatens the internal audit function's independence. These results indicate that best practice guidelines in this regard are not being applied consistently. Table 3 shows that, consistent with recommended best practices, in over half of the cases (66.1 and 53.7 percent) respectively, the audit committee is mandated to appoint, dismiss and evaluate the head of the internal audit function, while a further 33.8 and 46.3 percent indicated that the audit committee carries out these duties in conjunction with the CEO, CFO or board of directors. Nevertheless, in 33.8 and 46.3 percent of companies, this responsibility lies with the CEO and/or CFO, which is a significant threat against the independence of the internal audit function. One could question whether the internal audit function could be independent if the continuity of the CAE's position is significantly determined by senior management. If there is a significant risk of being dismissed, it is reasonable to assume that the CAE would be biased towards management and would avoid sensitive issues in audit reports.

TABLE 3: WHO IS RESPONSIBLE FOR?

	Hiring, dismiss the CAE?		Evaluating the CAE performance?	
	Responses	Response Percent	Responses	Response Percent
Audit Committee	80	66.1%	65	53.7%
CEO	17	14.0%	34	28.1%
CFO	16	13.2%	18	14.9%
Others	8	6.6%	4	3.3%
Total	121	100.0%	121	100.0%

As shown in Table 4, all respondents reported that their internal audit function was placed at the corporate/group level, as opposed to being placed at the intermediate or local level. This is in line with best practice guidelines. While this indicates that, in practice, internal audit functions are well placed in the hierarchy with respect to maintaining independence.

TABLE 4: WHAT IS THE HIERARCHICAL LEVEL OF YOUR INTERNAL AUDIT FUNCTION?

	Responses	Response Percent
Corporate group level	121	100%
Intermediate level	0	0
Local level	0	0

As shown in table 5 when asked if it is common for internal auditors to move to other functions within the company, 72 percent of the respondents stated that there is a culture within the organization for internal audit staff to move to other management functions within the organization. This is corroborated by 87 percent (55%, 32%) of the respondents as shown in table 6 indicating that, on average, internal auditors stay between two and four years in the internal audit function, a long-term commitment was rare; in 61 percent of the companies, internal auditors stay less than four years. These results confirm that the internal audit function often is used as a training ground or a stepping stone for future managers to further their careers. An argument for this practice is that it also can be seen as an added value of the internal audit function. Internal auditors often are well-trained people, having a profound understanding of the different functional domains within the company. Therefore, it is not surprising that they are viewed as potential candidates for management positions. What is of concern, however, is the effect that this might have on the independence of the internal audit function, as it raises the question as to whether the internal auditor can raise reports against management independently and objectively, knowing that he or she is dependent on management for future career moves. It is reasonable to assume that internal auditors, to some extent, will be biased when performing an audit engagement in which the auditee is their potential future boss, given that they already have specific career plans in mind.

TABLE 5: IS IT COMMON FOR INTERNAL AUDITORS TO MOVE TO OTHER FUNCTIONS WITHIN THE COMPANY?

	Responses	Response Percent
Yes	87	72%
No	34	28%
No Comments	0	0%

TABLE 6: ON AVERAGE HOW MANY YEARS DOES AN INTERNAL AUDITOR STAY WITHIN YOUR INTERNAL AUDIT FUNCTION?

	Responses	Response Percent
Less than 2	7	6%
Between 2-4	67	55%
Between 5-7	39	32%
Between 8-10	5	4%
More than 10	3	3%

Another noted potential negative influence as shown in table 7 on the independence of the internal audit function is the possibility for management to influence the budget of internal audit function. In 32.2 percent of the companies, only the audit committee or the board of directors approves the internal audit budget. According to IIA Standards, this should be the best way to guarantee the independence of the internal audit function. On the other hand, in 36.3 per cent of the companies, the CEO or CFO is responsible for approving the internal audit budget. The internal audit function's independence is threatened in these companies. It can be assumed that CEOs or CFOs who do not want the internal audit function to focus on specific areas in their company (e.g. areas in which they know there are control deficiencies or, even worse, in which they want to hide fraud) have the power to impose significant budget constraints on the internal audit function, thus forcing it to reduce its auditing scope.

TABLE 7: WHO APPROVES THE INTERNAL AUDIT BUDGET?

	Responses	**Response Percent**
AC	**31**	**25.6%**
BOD	**8**	**6.6%**
CEO	**17**	**14.0%**
CFO	**27**	**22.3%**
AC & CEO	**16**	**13.2%**
AC & BOD	**6**	**5.0%**
AC & CFO	**12**	**9.9%**
BOD & CFO & CEO	**4**	**3.3%**
Corporate secretary	**0**	**0.0%**
Others	**0**	**0.0%**
Did not respond	**0**	**0.0%**
TOTAL	**121**	**100.0%**

It is recommended that input from the CEO and CFO be solicited, given their ability to identify high risk areas in which audits are warranted, the CAE and the audit committee should have sufficient autonomy to determine final priorities. As soon as the CEO and CFO become too heavily involved in determining the orientation of the internal audit function, its independence is indirectly threatened. In this study, the survey results indicate that, in 80.9 and 82.6 percent respectively of the cases, the CEO and/or CFO provide input for the internal audit planning. The results suggest that, in almost approaching to half of the cases, both CEO and CFO (42.1 percent) have a strong impact upon the planning. This would indicate a threat to the internal audit function's independence, especially if combined with other indirect threats, like the CAE and audit committee not having the independence to determine final priorities.

TABLE 8: WHO GIVES INPUT FOR THE INTERNAL AUDIT PLANNING?

	The CEO		The CFO	
	Responses	Response Percent	Responses	Response Percent
Strongly agree	51	42.1%	51	42.1%
Somewhat agree	47	38.8%	49	40.5%
Neither agree or disagree	9	7.4%	7	5.8%
Strongly disagree	6	5.0%	5	4.1%
Somewhat disagree	5	4.1%	4	3.3%
No response	3	2.5%	5	4.1%
Total	121	100%	121	100%

As shown in table 9 it was found that, in more than half of companies (49.6 percent), people within the organization perceive internal auditors to be partners. A sufficient degree of acceptance and appreciation of the internal audit function is crucial to allow for internal audit findings and recommendations to have an impact. Nevertheless, it can be argued that a culture in which the internal audit function is considered too much a "partner" may put additional indirect pressure on internal auditors to work closely with management to achieve a "common goal" rather than to act as an independent body providing assurance on risk management, control and governance.

TABLE 9: People within the organization perceive internal auditors as their partners?

	Responses	Response Percent
Strongly agree	11	9.10%
Somewhat agree	49	40.5%
Neither agree or disagree	33	27.3%
Strongly disagree	19	15.7%
Somewhat disagree	9	7.40%
Total	121	100%

Aspects relative to the composition of the audit committee were examined. Table 10 and Table 11 shows that all responding companies have an audit committee. According to Table IV, audit committee membership ranges from 3 to 9 members, with a mean of 3.8 (standard deviation 1.51). On average, 59 percent of the audit committee members are independent (standard deviation 1.25). In addition to the independence of audit committee members, prior research has identified that member backgrounds are of importance. It was found that, on average, 53 percent of the audit committee members have an accounting background (standard deviation 0.44). It is worth mentioning that over half of the members have an accounting background. These results indicate that, while there is a trend towards moving to best practices that promote independence, with regards to having suitably independent and qualified members on the audit committee, this is not consistently applied.

TABLE 10: DOES YOUR COMPANY HAVE AN AUDIT COMMITTEE?

Yes	121	100%
No	0	0

TABLE 11: INFORMATION ABOUT AUDIT COMMITTEE?

questionnaire items	Min	max	mean	st.dev
Number of audit committee members (n=121)	3	9	3.8	1.51
Independent audit committee members (n=121)	2	6	2.06	1.25
Audit committee with accounting background (n=121)	1	2	1.23	0.44
Audit committee time spent on internal audit topics (n=121)	8	85	21.9	14.36

Except for one case, all CAEs are invited regularly to audit committee meetings TABLE 12. These formal contacts enable them to present and discuss the internal audit plan, results and recommendations, as well as the follow-up of agreed action plans. It should be noted that this is a basic condition for the independence of the internal audit function.

TABLE 12: IS THE CAE REGULARLY INVITED TO THE AUDIT COMMITTEE MEETINGS?

Yes	116	95.9%
No	5	4.1%
	121	100.0%

In a large majority of cases (81.8 percent), as shown in table 13 the audit committee seems to provide input for the planning of the internal audit function. We can assume that, this input is quite significant. Compared to the input given by management, the audit committee's involvement strengthens the independence of the internal audit function. This is especially true given the (more or less) independent status of the audit committee and its growing monitoring responsibilities. A close relationship with the internal audit function would benefit both parties. On one hand, it strengthens the internal audit function's independence; on the other hand, it provides audit committee members with the necessary support to fulfill their responsibilities.

TABLE 13: THE CAE HAS REGULAR PRIVATE CONTACTS WITH THE AUDIT COMMITTEE (CHAIR OR INDIVIDUAL MEMBERS)

	Responses	Response Percent
Strongly agree	54	44.6%
Somewhat agree	45	37.2%
Neither agree or disagree	7	5.8%
Strongly disagree	9	7.4%
Somewhat disagree	6	5.0%
	121	100.0%

TABLE 14: THE AUDIT COMMITTEE (AC) GIVES INPUT FOR THE INTERNAL AUDIT PLANNING

	Responses	Response Percent
Strongly agree	53	43.8%
Somewhat agree	58	47.9%
Neither agree or disagree	2	1.7%
Strongly disagree	3	2.5%
Somewhat disagree	4	3.3%
No response	1	0.8%
TOTAL	121	100.0%

CONCLUSION

This study critically examined the relationship between the internal audit function and corporate governance in Jordan, using data collected from internal auditors on the Jordanian companies. More specifically, this study analyzed to what extent the relationships between the internal audit function and corporate governance body creates threats to independence. In addressing the first research question, potential independence threats stemming from the relationship with management were examined. The first independence threat refers to the well-known practice of using the internal audit function as a training ground and stepping stone for future managers. Although there are arguments supporting this practice, it can be argued that internal auditors will not be able to operate objectively and independently when they are dependent upon their auditors for future career moves. The second independence threat identified refers to approval of the internal audit budget. This study revealed that Jordanian companies exist at which the CEO or CFO is responsible for approving the internal audit budget. This may be considered a serious threat to the independence of the internal audit function, as imposing budget constraints is a powerful tool with which management can reduce the scope and impact of the internal audit function. The third independence threat relates to senior management being heavily involved in developing the internal audit plan. While senior management's input is essential for setting internal audit priorities, the CAE and audit committee should monitor the impact of senior management's input. If their requests are considered unconditional priorities, internal auditors are viewed as management consultants, which invariably threaten the independence of the internal audit function. Thus threatening the independence of the internal audit function. While some of these individual threats may not necessarily create a major threat to the internal audit function's independence on their own, the collective effect of these practices has the potential to significantly threaten independence. Based on a global score, taking into account all threats discussed, it can be concluded that the majority of the internal audit function in this study are confronted by a combination of indirect independence threats resulting from their relationship with management. In addressing the second research question, potential independence threats stemming from the relationship between the internal audit function and the audit committee were examined, and a number of independence threats resulting from this relationship identified. The first independence threat relates to non-compliance with best practices recommending the internal audit function to report functionally to the audit committee and administratively to the CEO. It was found that this practice is not applied consistently and, hence, can be considered a potential independence threat.

LIMITATIONS

The research is restricted to Amman city which is Jordan's capital , the results are not applicable to other State or Country**.**

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