

**UNIVERSITI TEKNOLOGI MARA**

**EFFECTIVE INTERNAL AUDIT:  
A PERFORMANCE INDEX**

**RAZIMAH BINTI ABDULLAH**

**Thesis submitted in fulfillment of the requirements  
for the degree of  
Master of Accountancy (By Research)**

**Faculty of Accountancy**

**April 2009**

## Candidate's Declaration

I declare that the work in this thesis was carried out in accordance with the regulation of Universiti Teknologi MARA. It is original and is the result of my own work, unless otherwise indicated or acknowledged as referenced work. This topic has not been submitted to any other academic institution or non-academic institution for any other degree or qualification.

In the event that my thesis be found to violate the conditions mentioned above, I voluntarily waive the right of conferment of my degree and agree be subjected to the disciplinary rules and regulations of Universiti Teknologi MARA.

Name of Candidate : Razimah Binti Abdullah  
Candidate's ID No : 2005100414  
Programme : AC780  
Faculty : Accountancy  
Thesis Title : Effective Internal Audit:  
A Performance Index

Signature of Candidate :  
Date : 24 April 2009

## ABSTRACT

Audits have been present since the Egyptian and Roman Empires in relation to the principal-agency relationship. Corporate governance is the way in which those managing an organisation (the agents) carry out their responsibilities towards their stakeholders (the principal). Agency problems mainly due to wealth maximization of agents result in agency costs detrimental to the principal. Internal audit acts as a monitoring mechanism within the organisation. Poor corporate governance has pointed to the ineffectiveness of internal audits to report on possible mismanagement, thus failing to give indications for preventive measures to be taken in due course by the management and stakeholders. World disasters like Enron, WorldCom and HIH group are classical cases in recent times. This calls for a measurement on the effectiveness of internal audits. The purpose of this research is to measure the effectiveness of internal audits conducted by internal auditors. The data were collected by way of questionnaire survey sent to internal auditors in Malaysian public institutions of higher learning and corporate members of the Institute of Internal Auditors Malaysia.

The study considers the internal audit activities from the planning stage to the follow-up of reported audit findings. Best practices in internal auditing have been reviewed taking into account activities within the audit process cycle.

Results suggest that the effectiveness of the internal audit can be measured by using a performance index and the indicators used provide reasonable insight into the internal audit activities assessed. The significant of deriving an internal audit index may serve as a benchmark of best practices in internal audit. The internal audit activities assessed in this study give some indication of areas for improvement to be considered in the management of the internal audit function. It is the novelty of this unidimensional measurement method where it can be further applied to all other institutions of higher learning to determine the effectiveness of their internal audit, hence useful for national benchmarking purposes.

**Keywords:** Internal audit, agency problem, corporate governance, performance measurement

## ACKNOWLEDGEMENTS

Grace to Allah for his blessings that enables me to complete this study. Special thanks to my family who has continued to embrace me with their love, patience and resilience. I could not have completed this work without the persevering encouragement of my husband, Mohd Saidfudin and my parents. Sadruddin and Sai'dah, my son and daughter, who are concurrently doing their MBA and MBBS, provide me with the inspiration to continue with my postgraduate studies.

Dr. Mohd Ismail Ramli and Dr. Roziah Janor have been more than advisors to me. Their mentorship and friendship have helped me grow professionally. I appreciate their steady wisdom and counsel and their continued insistence to complete this study in time.

I would like to thank Datuk Dr. Ir. Ahmad Darus, Dr. Mazlina Esa, Rozeha A. Rashid and the Centre of Teaching and Learning, Universiti Teknologi Malaysia for providing me with the project grants to partially complete my thesis.

I would like to thank to Dr. David Andrich and Dr. Barry Sheridan of RUMM Laboratory, The University of Western Australia, who gave excellent advice and hands-on guidance in the Rasch Measurement tutorial.

Dr. Trevor Bond, Rasch SIG Chair and Dr. John Michael Linacre of Rasch Measurement Transactions, for their continuous support and interest in my research. Their in-depth discussions on technicalities are of great help.

Dr. Magdalena Mo Ching Mok from The Hong Kong Institute of Education, from whom I benefited from her advices on the difficulty index and fit analyses in

Rasch measurement model during the week long Pacific Rim Objective Measurement Symposium 2007.

I would also like to thank Assoc. Prof. Rosmawati Abdul Halim, Fellow Institute of Quality and Knowledge Advancement, Universiti Teknologi MARA, for her excellent advice on statistical analyses.

I would like to specifically thank Dr Ooi Cheng Lee, Amargit Singh, Nur Hayati Baharuddin, Edward Creaney, Hazimi Kassim, Abdul Rahim Abdul Hamid and Nik Mohd. Hasyudeen Yusoff for their expert opinions and participation in this study.

This work is a collaborative achievement. There are also those who provided insights to this study in their respective professional capacities. Their wisdom is indeed of great help.

Lastly, I appreciate the efforts from the Dean and members of the Faculty of Accountancy, Universiti Teknologi MARA, in helping me step outside of my professional field and bring back insight into the academic world on how to approach research in a new way.