Determinant of effectiveness of internal audit in Commercial Banks of Ethiopia: The case study of Wegagen Bank Share Company

A Thesis: SUBMITTED TO THE DEPARTMENT OF ACCOUNTING AND FINANCE, COLLEGE OF BUSINESS AND ECONOMICS, ADDIS ABABA UNIVERSITY, IN PARTIAL FULFILLMENT OF THE REQUIREMENT OF MASTER OF SCIENCE (MSC) IN ACCOUNTING AND FINANCE

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Acronyms

BOD.........Board of Directors
CIA..........Certified Internal Auditor
CAE.........Chief Audit Executive
CEO.........Chief Executive Officer
ECBs........Ethiopia Commercial Banks
IA ..........Internal Audit
IAF ..........Internal Audit Functions
IFAC.........International Foundation of Accountants
IAD..........Internal Audit Department
IIA..........Institute of Internal Audit
IIRF.........Institute of Internal Audit Research Foundation
IPPF.........International Professional Practice Framework
ISPPIA......Institute of Standards on the Professional Practice of Internal Audit
OECD........Organization for Economic Cooperation Development
NBE..........National Bank of Ethiopia
RBIA..........Risk Based Internal Audit
Statement of Declaration

I undersigned declare that the ideas contained in this study are my original work, except all the materials used for this study have been duly acknowledged. I also certify that the work is original and has not been submitted for any other award.

Name: Negasi G/Aregawi Desta

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Date: December 20, 2019
Statement of Certification

This is to certify that Ato Negasi G/aregawi has carried out this research thesis on the topic entitled “Determinant of effectiveness of internal audit in Commercial Banks of Ethiopia: the case study of Wegagen Bank Share Company” in partial fulfillment for the award of Masters of Science (Msc) in Accounting and Finance under my guidance and supervision. I certify that this research work is original in nature and has not presented in any means and to any award.

Advisor: Abebe Yitayew (PHD)

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Abstract:
As internal audit plays a vital role in internal control, risk management and corporate governance of organizations, it is important to study factors that enhance effectiveness of internal audit. The main objective this study is to identify the determinants of effectiveness of internal audit in Commercial banks of Ethiopia. Therefore, it investigates the relationship between effectiveness and contributing factors. This research was conducted on Wegagen bank Share Company by collecting primary and secondary data. Questionnaires were constructed using likert scale and distributed to 190 internal auditors of Wegagen bank and analyzed using Stata statistical software. Moreover, interview with the bank’s internal audit director and documents review was made. Accordingly, the result of this study proved that competence of internal auditors, independence of internal audit activity, board and management support as well as methodology/process of internal audit have plays a vital role for effectiveness internal audit in Commercial banks of Ethiopia. The research recommended that Commercial banks of Ethiopia should give more attention to the factors mentioned above to enhance their internal audit department efficiency and effectiveness so as to play value adding role in risk management, strengthening internal control and corporate governance. The researcher also recommend further research to be carried out on other factors that could contribute a value for effectiveness of internal audit function of banking industry in Ethiopia.

Key words: Internal audit, determinants of internal audit effectiveness, Commercial banks of Ethiopia.
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Chapter one: Introduction

1.1. Background of the study:

Internal control is defined as “a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations (COSO, 2012).

Risk management and internal auditing are both elements in the five interrelated components of the internal control system in organizations; those are control environment, risk assessment, control activities, information and communication, and monitoring (COSO, 1994). On the other hand, COSO internal control framework organized an integrated relationship between all internal control elements as well as their activities. Consequently, the internal audit activity relies on the monitoring component, and its goal is reviewing and assessing the compliance with established internal control components. Accordingly, internal auditing and risk management each cover different specific purposes in the internal control system (COSO, 1994). Internal audit is an important part of internal control structure within an organization which includes those oversight activities undertaken by the board of directors and audit committee to enhance the integrity of financial reporting process. The internal audit activity adds value to the organization when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management, and control processes. In addition, a strong internal control system, including an independent and effective internal audit function, is part of sound corporate governance (the Basel committee, 2012).

Thus the definition of internal auditing demonstrates the new role of internal auditing, the ‘Risk Based Audit’, that links internal auditing to an organization’s overall management framework. Moreover, discussing the risk-based audit plan with the risk management provides insight garnered from different perspectives on organizational governance and enterprise oversight.
1.2. Statement of the problem:

The role of Commercial Banks is essential for the development of an economy. Commercial banking in Ethiopia has witnessed a significant expansion over the last few years. Such growth should be matched to strong risk management practices. In contrary, excessive, poorly managed risk can lead to distresses and failures of banks (NBE guideline, 2010). Similar talking, as banks play an essential role in the economy and mobilize the public money, they required to implement well establish effective risk management framework so as to protect the public interest. Hence, an internal audit function provides vital assurance to a bank’s board of directors and senior management as to the quality of the bank’s internal control system (the Basel committee, 2012). Moreover the IIARF (2011), internal auditing core role in relation to ERM should be to provide assurance to management and to the board on the effectiveness of risk management. However, limited studies have been conducted on factors that determine effectiveness of IA function. Mihret and Yismaw (2007) found significant relationship between Board and management support and effectiveness of internal audit. Wubshet & dereje (2014) indicate that both the technical competence and continuous training are essentials requirements for effectiveness of internal audit functions.

Thus, examining factors affecting internal audit effectiveness in commercial banks of Ethiopia can contribute to have strong internal control system in Commercial banks. In order to understand those factors, Wegagen bank Share Company was selected as the case study. This study, therefore, will try to identify and examine determinants of effective internal audit and its roles on internal control, risk management and corporate governance process in Wegagen bank Share Company.

1.3. General Objectives of the Study:

The main objective of the study is to identify and examine determinants of effective internal audit practices in Commercial banks of Ethiopia and underline the roles of internal audit in internal control, risk management and corporate governance process.
1.4. Specific Objectives

The researcher will try to achieve the following specific objectives related with the research questions.

✓ To examine the extent of internal auditors’ competency to the effectiveness of internal audit practice in Wegagen bank Share company;

✓ To examine the extent of internal audit activity independence to the effectiveness of internal audit in Wegagen bank Share company;

✓ To measure the extent Board and management support for internal audit in Wegagen bank Share Company;

✓ To examine the extent of risk-based internal audit approach in Wegagen bank Share Company;

1.5. Research Hypotheses:

Based on the literatures review, the researcher tried to test factors such as Competence of internal auditors, Independence of IA activity, Board and Management supports, the methodology internal audit function are determinant factors for the effectiveness of internal audit activity.

i. Competence of internal auditors

The findings of the study of Wubishet & Dereje (2014) and Tadiwos M (2016) indicated that technical competence is the most important factor for effectiveness of internal audit function. Based on these evidences, the researcher hypothesizes that:

H 1: Competence of internal auditors is positively associated with the effectiveness of IA.

ii. Independence of internal audit activity

Study result indicated that independence of internal audit activity is the key element of the effectiveness of the internal audit function (Abreham Y, 2015 & Tadiwos M, 2016). Based on these empirical evidences, the researcher hypothesizes that:
**H 2:** Independence of IA activity is positively associated with the effectiveness of IA.

iii. Board and management support

Management support in terms of providing resources, giving trainings, introducing with new technologies, providing enough facilities and encouraging the internal audit process contributes for the IAE (Abreham Y, 2015 & Tadiwos M, 2016). Based on these empirical evidences, the researcher hypothesizes that:

**H 3:** Board and Management supports are positively associated with the effectiveness of IA.

iv. Methodology/process of internal audit

The chief audit executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization’s goals and the plan must consider the organization’s strategies, objectives, and risks relevant to the engagement (ISPPIA, 2017). Benchmarking this internal audit standards, the researcher hypothesizes that:

**H 4:** The methodology or process internal audit function is positively associated with the effectiveness of IA.

1.6. Significance of the Study:

The study identified the factors that contribute for the effectiveness of internal audit in business risk management, corporate governance and internal control in Commercial banks of Ethiopia, taking Wegagen bank Share Company as a case study. It is believed this study will benefit the bank under study and similar parties in the following ways:

- The study expects to extend internal audit theories and to interpret the determinants of the effectiveness of internal audit in Commercial banks of Ethiopia.
- It will help Wegagen bank Share Company and other commercial banks in the country with same settings to evaluate effectiveness their internal audit department.
- It enables the supervisory body; i.e. NBE, to evaluate effectiveness of internal audit of Commercial banks.
The study is very important to the academicians and researchers who can use it as a reference for other researches/studies to examine other factors affecting effectiveness of internal audit.

1.7. Scope and Limitation of the Study:

1.7.1. Scope of the study:

This study with a focus area of determinant for effectiveness of internal audit in Commercial banks of Ethiopia based on the case study of Wegagen Bank Share Company. The research was emphasized on factors such as Competency of internal auditors, independence of internal audit activity, Board and management support, Methodology/process of internal audit function and their impact on the effectiveness internal audit.

1.7.2. Limitation of the study:

The generalizability of the findings and conclusion drawn is limited that is the result from this research in sector other than commercial banks may give different outlook.
Chapter Two: Literature Review

2.1. Theoretical review

2.1.1. Definition and Scope of Internal audit:

**Internal auditing:** is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations (The IIA, 1999). It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes (IPPF, 2015).

**Assurance services:** involve the internal auditor’s objective assessment of evidence to provide an independent opinion or conclusions regarding an entity, operation, function, process, system or other subject matter. The nature and scope of the assurance engagement are determined by the internal auditor. Examples may include financial, performance, compliance, system security, and due diligence engagements.

**Consulting services:** are advisory in nature, and are generally performed at the specific request of an engagement client. The nature and scope of the consulting engagement are subject to agreement with the engagement client. When performing consulting services the internal auditor should maintain objectivity and independence. Examples include counsel, advice, facilitation, and training.

2.1.2. Types of internal audits:

Internal audit guideline of Wegagen bank Share Company, 2017, defines various types of audits as follows:

**Financial Audits:** These audits review accounting and financial transactions to determine if commitments, authorizations, and receipt and disbursement of funds are properly and accurately recorded and reported.

**Operations Audits:** These audits examine the use of resources to determine if resources are being used in the most effective and efficient manner to fulfill the organization’s mission and objectives.
**Compliance Audits:** These audits determine if entities are complying with applicable laws, regulations, policies and procedures the company and government.

**Information Systems (IS) Audits:** These audits review the internal control environment of automated information processing systems and how people use these systems. The audits usually evaluate system input, output; processing controls; backup and recovery plans; system security; and computer facilities.

### 2.1.3. International Internal Auditing Standards:

The Institute of Internal Auditors promulgates standards and guidelines for internal auditors in a publication titled the International Standards for the Professional Practice of Internal Auditing (ISPPIA), Code of Ethics, and The International Professional Practices Framework (IPPF). These standards are designed for all types of internal audits. These standards are principle-focused and provide a framework for performing and promoting internal auditing. The Standards are mandatory requirements consisting of statements of basic requirements for the professional practice of internal auditing and for evaluating the effectiveness of its performance. The standards apply to individual internal auditors and the internal audit activity. All internal auditors are accountable for conforming with the standards related to individual objectivity, proficiency, and due professional care and the standards relevant to the performance of their job responsibilities. These include:

1000- The purpose, authority, and responsibility of the audit activity must be formally defined in an internal audit charter, consistent with the mission of internal audit and the mandatory elements of the IPPF.

1100- The internal audit activity must be independent, and internal auditors must be objective in performing their work.

1200- Engagements must be performed with proficiency and due professional care.

1300- The Chief audit executive must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity.
2000- The chief audit executive must effectively manage the internal audit activity to ensure it adds value to the organization.

2100- The internal audit activity must evaluate and contribute to the improvement of the organization’s governance, risk management, and control processes using a systematic, disciplined, and risk-based approach.

2200- Internal auditors must develop and document a plan for each engagement, including the engagement’s objective, scope, timing, and resource allocations.

2300- Internal auditors must identify, analyze, evaluate, and document sufficient information to achieve the engagement’s objectives.

2400- Internal auditors must communicate the results of engagements.

2500- The Chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.

2600- When the Chief audit executives that managements has accepted a level of risk that may be unacceptable to the organization, the CAE must discuss the matter with senior management.

The purpose of the Standards is to:

- Delineate basic principles that represent the practice of internal auditing;
- Provide a framework for performing and promoting a broad range of value-added internal auditing;
- Establish the basis for the evaluation of internal audit practices;
- Enhance improved organizational processes and operations.

2.1.4. NBE Risk management guideline:

The National Bank of Ethiopia has issued guideline on May, 2010, which is called Risk management guideline of banking business. This document, consistent with international
standard and best practices, is expected to provide minimum risk management (risk identification, measurement, monitoring and control) standards for all banks in the country, namely, credit, liquidity, market and operational risks. The guidelines are thus expected to assist risk based supervision and contribute towards safety and soundness of the banking system. The bank also order all banks to have risk management structure which is concentrate fully on the risk management functions, preferably reporting directly to the board/its risk management committee. This comprehensive risk management program should at least contain:

- Active board and senior management oversight;
- adequate policies, procedures and limits;
- adequate risk monitoring & management information system; and
- Adequate internal control.

Risk management responsibilities:

**Board oversight:** Boards of directors have ultimate responsibility for the level of risk taken by their banks. Accordingly, they should:

- Approve the overall business strategies and significant policies of their organizations, including those related to managing and taking risks and should ensure that senior management is fully capable of managing the activities that their banks conduct.

- All members of board of directors are responsible for understanding the nature of the risks significant to their organizations and for ensuring that the management is taking the steps necessary to identify, measure, monitor and control these risks. The level of technical knowledge required of directors may vary depending on the particular circumstances at the bank. Consequently, what is most important is for directors to have a clear understanding of the types of risks to which their banks are exposed and to receive regular reports that identify the size and significance of the risks in terms that are meaningful to them. Directors should take steps to develop an appropriate understanding of the risks their banks face, possibly through briefings from auditors and experts. Using
this knowledge and information, directors should provide clear guidance regarding the level of exposures acceptable to their banks and have the responsibility to ensure that senior management implements the procedures and controls necessary to comply with adopted policies.

**Senior management oversight:** Senior management is responsible for implementing strategies in a manner that limits risks associated the bank’s activities. Management should therefore:

- Be fully involved in the activities of their banks and possess sufficient knowledge of all major business lines to ensure that appropriate policies, controls and risk monitoring systems are in place and that accountability and lines of authority are clearly delineated.

- Senior management is also responsible for establishing and communicating a strong awareness of and need for effective internal controls and high ethical standards. Meeting these responsibilities requires senior managers of a bank to demonstrate a thorough understanding of developments in the financial sector and a detailed knowledge of the activities their bank conducts, including the nature of the internal controls necessary to limit the related risks.

**Risk manager oversight:** At the organizational level, overall risk management should be assigned to an independent Risk Manager that preferably reports directly to the board risk management committee. The Risk Manager must be sufficiently independent of the business lines in order to ensure an adequate separation of duties and the avoidance of conflicts of interest. The Risk Manager takes full responsibility for evaluating the overall risks faced by the bank and determining the level of risks that shall be in the best interest of the bank. The functions of the Risk Manager should essentially to identify measure, monitor and control the risks undertaken by the bank. The risk management function provides independent oversight of the management of risks inherent in banks. The risk manager should be a member of the management team (but not part of internal audit). There must be no combination with internal audit, which has to remain separate with its own reporting line to the audit committee of the board.

The guideline defines bank risks as follows:
Credit risk: is the potential that a bank borrower or counterparty will fail to meet its obligations in accordance with agreed terms.

Liquidity risk: is the risk that a bank cannot meet payment obligations in a timely and cost effective manner.

Market risk: is the potential that changes in the market rates/process may have an adverse impact on the bank’s financial condition. In other words, it is the risk that the bank’s earnings or capital position will be affected by fluctuations in interest rate and foreign exchange rate.

Interest rate risk: refers to volatility in net interest income and the economic value of a bank’s assets, liabilities, and capital and off-balance sheet financial instruments.

Foreign exchange risk: results from changes in exchange rate between Birr (Ethiopia’s domestic currency) and currencies of the rest of the world.

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.

IT risk: arises from any potential adverse outcome, impairment, loss, violation, failure or disruption in the performance of business functions or processes due to the use of or reliance on technology. Exposure to this risk can result from among others, systems flaws, software defects and network vulnerabilities.

Legal risk: is the risk arising from the potential that unenforceable contracts, lawsuits, or adverse judgments can disrupt or otherwise negatively affect bank’s operations or conditions.

Regulatory risk: is the risk of being downgraded, fined, suspended, license revoked, etc arising from failure to comply with regulatory requirements or directives.

Strategic risk: refers to the potential negative impact on a bank’s earnings and capital that can arise in circumstances where decisions taken by the organization or the manner in which business strategies are executed result in losses or missed opportunities for the organization to remain relevant in the marketplace as a profitable and viable business entity.
**Reputational risk:** arises from negative publicity, be it true or not, regarding a bank’s business practices.

**Systemic risk:** refers to the danger that problems in a single financial institution might spread and, in extreme situations, such contagion could disrupt the normal functioning of the entire financial system.

### 2.1.5. Risk based internal auditing:

IIA (2014) defines risk based internal auditing (RBIA) as a methodology that links internal auditing to an organization’s overall risk management framework. RBIA allows internal audit to provide assurance to the board that risk management processes are managing risks effectively, in relation to the risk appetite. IIA (2014) defines RBIA internal audit should be able to conclude that:

1. Management has identified, assessed and responded to risks above and below the risk appetite.
2. The responses to risk are effective but not excessive in managing inherent risks within the risk appetite.
3. Where residual risks are not in line with the risk appetite, action is being taken to remedy that.
4. Risk management processes, including the effectiveness of responses and completion of actions, are being monitored by management to ensure they continue to operate effectively.
5. Risks, responses and actions are being properly classified and reported.

According IIA (2014), the implementation and ongoing operation of RBIA has three stages:

**Stage-1:** Assessing risk maturity: Obtaining on overview of the extent to which the board and management determine, assess, manage and monitor risks. There are three objectives to this stage:

1. assess the risk maturity of the organization;
2. report to management and to the audit committee on that assessment;
iii. Agree an audit strategy.

Stage-2: Periodic audit planning: Identifying the assurance and consulting assignments for specific period, usually annual, by identifying and prioritizing all those areas on which the board requires objective assurance, including the risk management processes, the management of key risks, and the recording and reporting of risks. Objectives of this stage are to:

i. Agree all the risk management responses and risk management processes on which objective assurance from internal audit is required;

ii. Produce an audit plan which lists all audits to be carried out over a specified period—usually a year.

Stage-3: Individual audit assignments: Carrying out individual risk based assignments to provide assurance on the part of the risk management framework, including on the mitigation of individual or groups of risks.

According IIA (2014), RBIA has the following benefits:

- An effective risk management framework will improve an organization’s governance and its chances of achieving its objectives over the long term.

- It makes a clear and valuable contribution to the risk management framework by providing objective assurance and by facilitating management’s efforts to improve the framework.

- It ensures that internal audit resources are directed towards assessing the management of the most significant risks.

- In order to discuss the responses deployed to manage risks and how management knows these are working properly the internal auditor may need to involve a greater number of more senior managers than might be involved in traditional audits.

- Reinforce management responsibility for risk management and contribute to a stronger risk management culture.
• RBIA is an effective way to achieve targets set for the internal audit activity.

• RBIA justifies the number of auditors required and staff expertise.

2.1.6. The role of internal audit to improve internal control system:

The ISPPPJA, 2017 stated that the internal audit activity must assist the organization in maintaining effective controls by The internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organization’s governance, operations, and information systems regarding the:

• Achievement of the organization’s strategic objectives.
• Reliability and integrity of financial and operational information.
• Effectiveness and efficiency of operations and programs.
• Safeguarding of assets.
• Compliance with laws, regulations, policies, procedures, and contracts. Evaluating their effectiveness and efficiency and by promoting continuous improvement.

Internal audit reviews the extent to which management has established sound systems of internal control so that objectives are set and resources applied to these objectives in an efficient manner. This includes being protected from loss and abuse. Adequate information systems should be established to enable management to assess the extent to which objectives are being achieved via a series of suitable reports. Controls are required to combat risks to the achievement of value for money and it is these areas that internal audit is concerned with. Compliance, information systems and safeguarding assets are all prerequisites to good value for money (K.H. Spancer Pickett, 2005).

2.1.7. The role of Internal Auditing in Enterprise risk management (ERM):

The main objective of internal auditing in risk management is providing assurance and information which includes assessing the effectiveness of risk management activity at the top management level to help them accomplish the organization’s objectives (The IIA, 2011).
Internal audit’s core role with regard to ERM is to provide objective assurance to the board on the effectiveness of risk management. The IIA, 2009 defines Core internal audit role in regard to ERM are:

- Giving assurance on the risk management processes.
- Giving assurance that risks are correctly evaluated.
- Evaluating risk management processes.
- Evaluating the reporting of key risks.
- Reviewing the management of key risks.

Determining whether risk management processes are effective is a judgment resulting from the internal auditors’ assessment that:

- Organizational objectives support and align with the organization’s mission;
- Significant risks are identified and assessed;
- Appropriate risk responses are selected that align risks with organization’s risk appetite;
- Relevant risk information is captured and communicated in a timely manner across the organization, enabling staff, management, and the board to carry out their responsibilities.

The IIARP, 2011, research paper: internal auditing role in risk management, internal auditors are finding they can play important roles in risk management, but there are many roles that internal audit activities are either not ready to pursue or are not proactive in pursuing. The IIARP, 2011 should serve as a call for action to internal audit activities in general and chief audit executives (CAEs) in particular. Specifically, CAEs have opportunities to:

- Educate and train audit committees and management on risk and risk management concepts.
- Provide assurance on the core internal audit roles described in an IIA Position Paper titled: the Role of Internal Auditing in Enterprise-wide Risk Management.
- Seek opportunities to perform more risk management consulting services in support of whoever is managing the risk management program, and formally communicate the results of those consulting services to the audit committee and management.
• Evaluate strategic risks; i.e., whether management has (1) comprehensively identified key strategic risks, (2) developed prudent risk management techniques to those risks, and (3) established sufficient monitoring of strategic risk “signposts” to identify risk occurrences in time to take the appropriate actions.

• Devote the time, resources, and leadership to developing internal audit teams so that they have the right level of skills and experience related to risk management.

• Use third-party and other internal resources to supplement the risk management skills of the internal audit activity.

2.1.8. Internal auditors’ role in corporate governance:

A basic definition of corporate governance is: “The system by which organizations are directed and controlled.” In effect, it is concerned with systems, processes, controls, accountabilities and decision-making at the heart of and at the highest level of an organization. The Organization for Economic Co-operation and Development (OECD) published its vision about Corporate Governance in 1999. One key element in improving economic efficiency is corporate governance, which involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently (OECD, 1999).

Internal auditing is one of the cornerstones of corporate governance, along with the board of directors, senior management, and external auditing. In other words, internal audit has played an active role in implementing effective governance and controls while being asked to assess the effectiveness of management’s control practices.

IIA (2014) defines the role of internal audit in corporate governance; it must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:
- Promoting appropriate ethics and values within the organization;
- Ensuring effective organizational performance management and accountability;
- Communicating risk and control information to appropriate areas of the organization;
- Coordinating the activities of and communicating information among the board, external and internal auditors, and management.

According to practice advisory 2110-3, internal auditors can act in a number of different capacities in assessing and contributing to the improvement of governance practices. Typically, internal auditors provide independent, objective assessments of the design and operating effectiveness of the organization’s governance processes. They also may provide consulting services and advice on ways to improve those processes.

The internal audit activity therefore plays an important strategic role in the governance function of an organization. That role includes providing leadership, assessing the adequacy of performance measurement systems, making appropriate recommendations, and assessing the achievement of corporate objectives (The ISPPIA, 2017).

2.1.9. Standards on the professional practice of internal audit:

i. Independence of internal audit activity:

The internal audit activity must be independent, and internal auditors must be objective in performing their work. Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the chief audit executive has direct and unrestricted access to senior management and the board. The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity. The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results. Internal auditors
must have an impartial, unbiased attitude and avoid any conflict of interest. Conflict of interest is a situation in which an internal auditor, who is in a position of trust, has a competing professional or personal interest. Such competing interests can make it difficult to fulfill his or her duties impartially (ISPPIA, 2017).

**ii. Competence of Internal auditors:**

Internal audit key competencies are a necessary skill to conduct effective internal audits. Internal audit key competencies includes: Interview skills, Testing and analysis skill, Documentation skills, Recommending results and corrective actions, Communication skills, Negotiating skills, and Commitments to learning (Moeller, 2009).

Engagements must be performed with proficiency and due professional care. Internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively must possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities. Internal auditors must apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility. Internal auditors must exercise due professional care during a consulting engagement by considering the: Needs and expectations of clients, including the nature, timing, and communication of engagement results, relative complexity and extent of work needed to achieve the engagement’s objectives and Cost of the consulting engagement in relation to potential benefits. Internal auditors must enhance their knowledge, skills, and other competencies through continuing professional development (ISPPIA, 2017).

**iii. Board and Management support:**

Board and management support refer to audit committee, senior management and audit customer (auditee) management support.

It is the interest of management to maintain a strong internal audit department (Adams, 1994). The Sarbanes-Oxley Act (SOX 2002, section 2) defines an audit committee as "a committee (or equivalent body) established by and amongst the board of directors of an issuer for the purpose of overseeing the accounting and financial reporting processes of the issuer and audits of the financial statements of the issuer". The audit committee has the obligation and
responsibility to: evaluate the organizational independence of the internal audit function and the individual objectivity of internal auditors, to discuss with the chief audit executive reports and the most significant findings of the internal audit activity, especially on the operative efficiency of internal controls, and to examine and approve the annual internal audit plan, to examine and approve the budget for the internal audit, to consider the relation between the internal and external audit and to coordinate its work, and participate in activities of appointing and dismissing the chief audit executive although an audit committee typically has regular contacts primarily with the CAE, all internal auditors should have an understanding of this very important relationship (Moeller, 2009).

iv. Methodology/process of internal audit activity:

The chief audit executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization’s goals. The internal audit activity’s plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board must be considered in this process. The chief audit executive must identify and consider the expectations of senior management, the board, and other stakeholders for internal audit opinions and other conclusions. The chief audit executive should consider accepting proposed consulting engagements based on the engagement’s potential to improve management of risks, add value, and improve the organization’s operations. Accepted engagements must be included in the plan. Internal auditors must develop and document a plan for each engagement, including the engagement’s objectives, scope, timing, and resource allocations. The plan must consider the organization’s strategies, objectives, and risks relevant to the engagement (ISPPIA, 2017).

2.2. Empirical review

2.2.1. Competency of Internal auditors

The competence of IA team plays a critical role next to independence of IA on the effectiveness of IA. It means proficiency of internal auditors, experience of internal auditors, effective communication with audittee, training and development, and access to information technology were a significant effect on the effectiveness of IA in ECBs. The problems observed in ECBs in
related with competence of IA teams were lack of sufficient certified person, limited on “Accounting and Finance” field of study, dishearten communication with head office level audittes, required of internal source trainings for newcomers, and shortage of IA software for processing audit activity (Tadiwos M, 2016). In House Trainings & developments by company themselves can enhance the auditors’ performance (Wubishet & Dereje, 2014). Similarly, the existence of adequate and competent IA staff in the Construction and Business Bank results with positive relationship with IAE and with high contribution for the IAE by performing their activities on time, cover the planned scope of auditing activities (Abreham Y, 2015).

The competence of internal auditors can be measured in terms of academic level, experience and the efforts of staff for continuous professional development and compliance with audit standards. Both the quantity of audit effort and the quality of professional care exercised will determine the overall quality of the internal audit work (Cohen and Sayag, 2010; Belay, 2007).

2.2.2. Independency of Internal auditors:

The independence of IA plays the highest critical role on the effectiveness of IA in ECBs. It means the existence of effective audit committee, individual IA independence, and organizational independence of IA was a significant effect on the effectiveness of IA in ECBs. The problems observed in ECBs in related with independence were IA report content variation based on addressee, lack of full access on BOD and senior management level to audit; and top management crucial role on the approval and dismissal of IA head. Further, IA of ECBs were grown in regard of to be responsible for BOD functionally and every quarter meeting with such a body (Tadiwos M, 2016). Similarly, Organizational independence refers to free access to necessary documents, information and data about the auditee under investigation, decision based on the scope, time and extent of auditing procedures, task accomplishments work without interference, and etc have positive relationships with IAE (Abreham Y, 2016).

The independence of internal audit department and the level of authority to which the internal audit staff report are the important criteria influencing the objectivity of its work, and added that organizational independence is more crucial to the effectiveness of the internal auditors, as it protects the auditor from pressure or intimidation, and increases the objectivity of the auditing work (Cohen and Sayag, 2010).
2.2.3. Management support for internal audit:

The management supports play a critical role next to independence of IA and competence of IA teams on the effectiveness of IA. It means the senior management (top management) awareness on IA needs and supports through financial and non-financial items were a significant effect on the effectiveness of IA in ECBs. In this regard, problems and strengths of ECBs IAD are identified. The problem observed in ECBs in related with management support was lower amount fund provided to IA team as bonuses and recompense. But they had a great strength of high financial support in terms of allocating high fund to this department (Tadiwos M, 2016). Similarly, Management support in terms of providing resources, giving trainings, introducing with new technologies, providing enough facilities and encouraging the internal audit process with commitments to promote and communicate their added value for the effectiveness of internal audit work in their office contributes for the IAE (Abreham Y, 2015).

The audit committee can strengthen the internal audit function and turn the internal audit into an important resource for implementation of its obligations (Turley & Zaman 2004).

Mihret and Yismaw (2007) in their case study of IA effectiveness on public sector shows that the component of management support consists of the response to audit finding and the commitment to strength internal audit which has significance influence on IA effectiveness. This means it is the interest of management to maintain a strong internal audit department and implementation of audit recommendations is highly relevant to IA effectiveness which is the component of management support.

The top management assigns importance to the function of IA, they will cooperate and support these processes by hiring proficient IA staff, developing career channels for IA staff, and providing organizational independence for IA work are the results of decisions made by top management (Cohen and Sayag, 2010).

2.3. Conceptual framework:

The direct relationship between competence of internal auditors, independency of internal auditors, management support and internal audit effectiveness was studies by previous research such as Tadiwos M, 2016; Abreham Y, 2015; Abu-azza, 2012; Mihret & Yismaw; Wubishet &
Dereje, 2014. This relationship is also adopted in ISPPIA as performance standards. The relationship between internal audit and risk management departments has also significant impact on effectiveness of internal audit activities. This research paper argues that agency, institutional and communication theories could be helped in building a conceptual framework of IA. Hence,

Based on the internal audit theories and empirical studies made by some scholar the researcher tries to attempt its own conceptual framework on determinants for effectiveness of IA in Commercial banks of Ethiopia:

**Figure 2.1: Conceptual framework of determinants for effectiveness of internal audit in Commercial banks of Ethiopia.**

1. **Internal auditors competence:**
   - a. Proficiency of Internal auditors
   - b. Due professional care
   - c. Continuing professional Development

2. **Internal audit independence:**
   - A. Organizational independence of internal audit function
   - B. Individual internal auditors’ independence

3. **Board and Management support:**
   - A. audit committee support
   - B. senior management support
   - C. auditee management support

4. **Internal audit Methodology/process:**
   - A. Risk based internal audit methodology

**Effective of internal audit:**
- A. Improve organization’s internal control system
- B. Improve risk management process
- C. Enhance good corporate governance.

**Source:** Own developed based on the Literature review.
2.4. Research Gap in effectiveness of IA

According to empirical literature review, limited studies have been conducted on factors that determine effectiveness of IA function. Mihret and Yismaw (2007) found significant relationship between Board and management support and effectiveness of internal audit. Mihret et. Al. (2010) and Wubishet & Dereje indicate that both the technical competence and continuous training are essentials requirements for effectiveness of internal audit functions. Moreover, these studies are more focused on factors such as Competence of internal auditors, independency of internal audit function, and management support to determine effectiveness internal audit function. However, the researcher has also identified the methodology or process used in internal audit function may enhance effectiveness of the internal audit activity of Commercial Banks of Ethiopia.
Chapter Three: Research Methodology:

3.1. Research Design:

A research design is simply the framework or plan for a study used as a guide in collecting and analyzing data. It is the blueprint that is followed in completing the study (Churchill & Brown 2007). According to (Adam and Kamuzora, 2008), research design can be understood as a detailed work plan which is used to guide a research study to achieve specified objectives of the research.

The researcher concentrated at Wegagen bank Share Company due to time and financial constraints. It should be noted that Commercial banks working in Ethiopia have also similarity in internal audit practices and their internal audit manual are similar. Moreover, NBE directive requires all banks to have risk based internal audit approach.

In this study, the researcher used explanatory research to discuss the outcome of study. Explanatory studies are showing the causal relationship between variables (Saunders, et al., 2009). Explanatory studies are necessary in such a study a situation or problem leads to the explanation of the relationship between variables. Therefore, studying the data in quantitative method through statistical tests such as correlation and regression in order to get the clearer view of the relationship has been explained in detail with reasons through qualitative data.

In this study the researcher applied a self-administered questionnaire as of its advantages. Some advantages can be like lowest cost option; allow participants to think more about the questions, perceived as more anonymous, and a rapid data collection technique (Cooper & Schindler, 2006). Therefore, the survey is conducted to know the factors determining effectiveness of IA with regard to competence of IA team, independence of IA, quality of IA work, and management support.

3.2.1. Sample size determination

Target Population: The target population for this research is all internal auditors of Wegagen bank share Company. The total population size is 310 internal auditors working in Head office and branches. Detail of the target population is:
• Director and Division-Managers: 4 in number.
• Internal Auditors working at head office & Branches: 229 in number.

Sample Size: Since to make census study is difficult and expensive, the researcher was used stratified random sampling technique. Hence, the simple size will be determined using statistics formula with, 95% confidence interval and 5% sampling error; i.e., 190.

\[
n = \frac{N}{1 + N(E)^2}
\]

where: n=sample size; N=population size; E=sampling error.

Therefore, 190 questionnaires were distributed to head office internal auditors and mail to branches to be filled by their resident auditors.

3.2. Data Collection:

Both primary and secondary data will be used to perform the study. The primary data was collected by using questionnaire from the targeted population all internal auditors of Wegagen bank Share Company and interview with the director of internal audit department of the bank. The secondary data was gathered from various materials written by scholars in the topic area, Wegagen bank’s internal audit charter and guideline, IIA and National bank of Ethiopia websites, which are relevant to this study.

The content of questionnaires was customized for both the independent and dependent variables. The questionnaires was prepared in the form of Likert-Scale type (showing respondents agreement or disagreement) by constructing into five point scale where the lowest scale represent strongly disagree and the highest scale represent strongly agree (Likert, 1932). The questionnaires distributed to the respondents were organized in to two parts; the first part comprised the demographic questions regarding the respondents, and the second part contained items relating to the effectiveness of IA and its determinants.

3.3. Method of Data Analysis:

After all the relevant data collected, the responses were sorted and coded using excel sheet, analysis is made using the statistical software known as Stata 12. A descriptive statistics, mainly,
frequency count, percentage, measure of central tendency (mean), measure of dispersions (Standard deviations) has been used to summarize and describe the results of observation. In addition, inferential statistics like ANOVA, t-test, and regression were used to identify the factors determining IA effectiveness and to determine the relationship among the variables and to test the research hypothesis. The dependent variable in this research was the internal audit effectiveness. The independent variables selected for this research were: Internal auditors’ competency, independency of internal audit, Management support, and internal audit methodology. The researcher used the summative score technique for the questions in each factor for each participant. This is because Likert scale is the common summative scores (Balnaves and Caputi, 2001).

Accordingly, the following model was formulated for this research study to test the research hypothesis developed:

\[ \text{IAE} = \mu + \beta_1 \times \text{IAC} + \beta_2 \times \text{IIA} + \beta_3 \times \text{BMS} + \beta_4 \times \text{IAM} + \varepsilon_i \]

Where:

IAE=internal audit effectiveness

IAC=internal auditors competency

IIA=independency of internal audit

BMS= Board and Management support

IAM= Internal audit Methodology/process

\( \mu \) = is a constant, which represent the effectiveness of IA when every independent variables are zero.

\( \beta_1 \) to \( \beta_4 \) =are the coefficients, in which every marginal change in the independent variables that affect IAE, and

\( \varepsilon_i \)=the error term
**Dependent variable:** The dependent variable used by the study is the effectiveness of internal audit function and it has been measured based on the previous study (Wubshet & Dereje, 2014). Independent variables: The independent variables used by the study are competence of internal auditors, independence of internal audit activity, Board & Management support, and Methodology/process internal audit; each one of independent variable has been measured based on the previous study (Wubshet & Dereje, 2014; Abreham Y, 2016; and Tadiwos M, 2016). Methodology/process used by internal audit has also been measured based on the Theory of internal audit.
Chapter Four: Data Analysis and Presentation

4.1. Introduction:

The chapter consists of two sections. The first section deals about descriptive statistics respondent information which collected through questionnaire. The second section deals about inferential statistics that is interpretation of quantitative data collected through questionnaire and document review. Therefore, this chapter presents the analysis and discussion of the research findings from primary and secondary data.

4.2. Descriptive Statistics

4.2.1. Response Rate:

The study targeted a sample of 190 respondents of internal auditors working at head office and branches from which 140 were filled in and returned the questionnaires making a response rate of 75%.

4.2.2. Respondents Profile:

The study sought to establish the Sex/Gender, Education background, Field of study, year of experience in banking industry and year of experience in internal auditing. The studies found that gender of the respondents were 58.6% Males and 41.4% Females. Thus both genders were involved in the study and the study did not suffered from gender bias. In terms educational background, 77.1% of the respondent are holders of Bachelor Degree, and the remaining 22.9% of the respondents indicated their highest level of education is Master’s Degree. Field of study of the respondents comprises: Accounting and finance 67.9%, Management 20%, Economics 6.4% and Information Technology 5.7%. Accordingly, majority of respondents studied accounting and finance which shows their educational background highly related with the internal auditing. The respondents also requested to indicate work of experience in banking industry. Hence, 17.9% of the respondents have a work experience of one to five years, 52.1% of the respondent indicated they have six to ten years work experience, and 30% of the respondents have above ten years work experience in banking industry. Finally, the respondent requested to indicate their years of experience in internal auditing. Accordingly, 35.7% have worked in internal audit for one to five
years, 47.2% have worked in internal audit for six to ten years and 17.1% of the respondents have been worked in internal audit above ten years. (Refer Table 4.2.2.). This implies that majority of the respondents have ample work experience in internal auditing and they are suitable for this study.

**Table 4.2.2.: Respondents profile:**

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Frequency(n)</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gender</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Male</td>
<td>82</td>
<td>58.6</td>
</tr>
<tr>
<td>Female</td>
<td>51</td>
<td>41.4</td>
</tr>
<tr>
<td>Total</td>
<td>140</td>
<td>100.00</td>
</tr>
<tr>
<td>Educational background</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bachelor’s degree</td>
<td>108</td>
<td>77.1</td>
</tr>
<tr>
<td>Master’s degree</td>
<td>25</td>
<td>22.9</td>
</tr>
<tr>
<td>Total</td>
<td>140</td>
<td>100.00</td>
</tr>
<tr>
<td>Field of study</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounting and Finance</td>
<td>95</td>
<td>67.9</td>
</tr>
<tr>
<td>Management</td>
<td>28</td>
<td>20</td>
</tr>
<tr>
<td>Economics</td>
<td>9</td>
<td>6.4</td>
</tr>
<tr>
<td>Information technology</td>
<td>8</td>
<td>5.7</td>
</tr>
<tr>
<td>Total</td>
<td>140</td>
<td>100.00</td>
</tr>
<tr>
<td>Work experience in banking</td>
<td></td>
<td></td>
</tr>
<tr>
<td>One to five years</td>
<td>25</td>
<td>17.9</td>
</tr>
<tr>
<td>Six to ten years</td>
<td>73</td>
<td>52.1</td>
</tr>
<tr>
<td>Above ten years</td>
<td>42</td>
<td>30</td>
</tr>
<tr>
<td>Total</td>
<td>140</td>
<td>100.00</td>
</tr>
<tr>
<td>Work experience in internal auditing</td>
<td></td>
<td></td>
</tr>
<tr>
<td>One to five years</td>
<td>50</td>
<td>35.7</td>
</tr>
<tr>
<td>Six to ten years</td>
<td>66</td>
<td>47.2</td>
</tr>
<tr>
<td>Above ten years</td>
<td>24</td>
<td>17.1</td>
</tr>
<tr>
<td>Total</td>
<td>140</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: Questionnaires and Stata output (2019)

4.2.3. Internal auditors’ competence:

The first section of the questionnaire (Q1-Q6) examines the competence of internal auditors. The questions are designed for the competence of the Internal Auditors’ in terms of individual and collective knowledge and skill to perform their assignments, exercise due professional care in performing their activities, efforts to enhance their knowledge through continuous professional development training, applying audit standards, procedures and techniques in performing audit engagements and the knowledge they have to identify fraud indicators and key information
technology risks. The research outcome revealed that cumulative mean value for the category was 3.80 which falls on an agree degree of agreement. This implied that the overall average response for the competence of Internal Auditors’ was agreed by the respondents. The questions under this category have got high rate except question no. 6 internal auditors of the bank posses’ knowledge to identify fraud indicators and key information technology risks as explained by mean scores of each 4.09, 4.00, 4.24, 3.55, 3.94, and 2.96, respectively. Moreover, the standard deviation of (Q1-Q6) were less than 1.00 and it indicates that the respondents perception were close to one another. (Refer Table 4.2.3.)

The results of this finding is similar with Tadiwos, M (2016) that concluded in his study that competence of internal auditors play a vital role for the effectiveness of internal audit. Moreover, the results of this finding is similar with Cohen and Sayag (2016) conclude in their study that quality of professional care will determine the overall quality of the internal audit work.

Moreover, The ISPPIA, 2017 states that internal auditors must possess the knowledge, skill, and other competencies needed to perform their individual responsibilities.

<table>
<thead>
<tr>
<th>Table 4.2.3. Internal auditors’ competence:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Internal auditors’ competence</strong></td>
</tr>
<tr>
<td>1. Internal auditors of your bank have possessed knowledge and skill to perform their individual responsibilities.</td>
</tr>
<tr>
<td>2. Internal audit staffs of your bank collectively have possessed knowledge and skill to perform internal audit responsibilities.</td>
</tr>
<tr>
<td>3. Internal auditors of your bank exercise due professional care in performing their activities.</td>
</tr>
<tr>
<td>4. Internal auditors of your bank enhancing their knowledge through continuous professional development trainings.</td>
</tr>
<tr>
<td>5. Internal auditors of the bank were applying internal audit standards, procedures and techniques in performing engagements.</td>
</tr>
<tr>
<td>6. Internal auditors of the bank have knowledge to identify fraud indicators and key information technology risks.</td>
</tr>
</tbody>
</table>

**Cumulative mean 3.80**

Source: Questionnaires and Stata output (2019)

4.2.4. Independence of internal audit activity:

The second section of the questionnaire (Q7-Q12) examines the independence of internal audit activity of the bank. The questions are designed for examination of functional Independence of
internal audit activity of the bank in terms of task accomplishments without management interference, independence internal auditors in determining the scope of their assignments, to report to the chief audit executive any situation in which an actual or potential to impairment of independence during engagement and access to necessary documents uncovered very important for the internal audit team to become effective in their task accomplishments. The outcome revealed that cumulative mean score value for the questions under (Q7-Q12) category in average was 3.97 which falls on an agree degree of agreement. This implied that the overall average response for the independence of internal audit activity was agreed by the respondents. All the questions under (Q7-Q12) category have got high rate as explained by mean scores of each of 3.99, 4.09, 4.14, 3.76, 3.92 and 3.93, respectively. Besides, the standard deviation of (Q7-Q12) were less than 1.00 and It indicates that the respondents perception on independence of internal audit activity of the bank were close to one another. (Refer Table 4.2.4.)

Therefore, the finding shows that most of the respondents agreed organizational and individual independence of internal audit/auditors is maintained at Wegagen bank Share Company.

The result of the finding is consistent with the previous studies conducted by (Tadiwos, M, 2016; Abreham, Y 2016; Cohen and Sayag, 2010) that, organizational and individual independence of internal audit/auditors is crucial to the effectiveness of the internal audit activity.

Moreover, ISPPIA, 2017 states that the internal audit activity must be independent, and internal auditors must be objective in performing their work.

**Table 4.2.4. Independence of internal audit activity:**

<table>
<thead>
<tr>
<th>Independence of internal audit activity</th>
<th>N</th>
<th>Mean</th>
<th>S.D</th>
</tr>
</thead>
<tbody>
<tr>
<td>7. In your bank Chief audit executive (Controller) functionally reports to the board of directors (or audit committee).</td>
<td>140</td>
<td>3.99</td>
<td>0.82</td>
</tr>
<tr>
<td>8. In your bank the chief audit executive (Controller) has direct and unrestricted access to senior management and the board.</td>
<td>140</td>
<td>4.09</td>
<td>0.72</td>
</tr>
<tr>
<td>9. In your bank Internal auditors functionally reports to Chief audit executive (Controller).</td>
<td>140</td>
<td>4.12</td>
<td>0.69</td>
</tr>
<tr>
<td>10. In your bank Internal auditors are free from interference of management in determining the scope of their assignments.</td>
<td>140</td>
<td>3.76</td>
<td>0.74</td>
</tr>
<tr>
<td>11. In your bank Internal auditors have unbiased attitude and conflict of interest that impair ability to perform his/her duties</td>
<td>140</td>
<td>3.92</td>
<td>0.69</td>
</tr>
</tbody>
</table>
and responsibilities.

| 12. In your bank Internal auditors feel free to report to the Chief audit executive (Controller) any situation in which an actual or potential to impairment of independence during engagement. | 140 | 3.93 | 0.80 |

Cumulative mean 3.97

Source: Questionnaires and Stata output (2019)

4.2.5. Board and Management support:

The third section of the questionnaire (Q13-Q16) examines board and management of the bank support to internal audit activity. The questions designed in terms of the audit committee promotes the independence of internal audit by protecting from management’s influence, management’s collaboration with internal audit in the whole internal audit process and support the internal audit department to have sufficient human resource and budget to successfully carry out its activities. All the questions under (Q13-Q16) category have got relatively high rate as explained by mean scores of each of 3.96, 3.09, 2.79, and 3.66, respectively. The respondents agreed on board and management support that cumulative mean score value was 3.53 which falls on an agree degree of agreement. This implied that the overall average response for board and management support was agreed by the respondents. Moreover, the standard deviation of (Q13-Q16) were less than 1.00 and It indicates that the respondents perception on independence of internal audit activity of the bank were close to one another. (Refer Table 4.2.5.)

The result of the finding is consistent with the previous studies conducted by Mihret & Yismaw (2007); Turkley & Zeman (2004; Cohen and Sayag (2010) that, management support plays a vital role to the effectiveness of the internal audit activity.

However, question no. 14 that respondents were asked does the audit customers (auditee) Collaborate with internal audit during the whole internal audit process. Majority of the respondents are disagree level agreement that had a mean response of 3.00. This implies that the audit customer may not cooperative to provide the necessary information and take timely remedial actions to audit findings.
Table 4.2.5. Board and management support

<table>
<thead>
<tr>
<th>Board and management support</th>
<th>N</th>
<th>Mean</th>
<th>S.D</th>
</tr>
</thead>
<tbody>
<tr>
<td>13. Audit committee of your bank promotes the independence of internal audit by protecting them from management’s influence.</td>
<td>140</td>
<td>3.96</td>
<td>0.74</td>
</tr>
<tr>
<td>14. In your bank audit customers (auditee) collaborate with internal audit during the whole internal audit process.</td>
<td>140</td>
<td>3.08</td>
<td>0.77</td>
</tr>
<tr>
<td>15. Senior management of your bank ensures the internal audit has sufficient human resource to successfully carry out its responsibilities.</td>
<td>140</td>
<td>3.75</td>
<td>0.79</td>
</tr>
<tr>
<td>16. In your bank internal audit department obtain a sufficient budget to successfully carry out its responsibilities.</td>
<td>140</td>
<td>3.66</td>
<td>0.81</td>
</tr>
</tbody>
</table>

Cumulative mean 3.53

Source: Questionnaires and Stata output (2019)

4.2.6. Internal audit methodology/process

The Fourth section of the questionnaire (Q17-Q20) examines the methodology/process of internal audit of the bank. The questions are designed for the internal audit methodology/process in terms of the internal audit department performs its activity based on risk-based audit methodology, internal audit plan is prepared on priorities of internal audit activity consistent with the organization’s goals, internal auditors performs individual audit assignments based on the risk-based audit methodology, and roles of risk management department and internal audit department are clearly separated. Most of the questions under this category have got relatively high rate as explained by mean scores of each of 3.60, 3.52, 3.29, and 3.57, respectively. The cumulative outcome of study on the internal audit methodology/process revealed that the mean score value was an average of 3.50 which falls on an agree degree of agreement. This implied that the overall average response for the internal audit methodology was agreed by the respondents. Besides, the standard deviation of (Q17-Q20) were less than 1.00 and It indicates that the respondents perception on the methodology/process of internal audit function of the bank were close. All the questions include in this section results have a mean response above 3.5, but question no. 19 that is Internal auditors perform individual audit assignments based on the risk-based audit methodology had assessed 3.29. (Refer Table 4.2.6.)
The result of the finding is consistent with the ISPPIA, 2017 that the CAE must establish a risk-based plan to determine the priorities of the internal audit activity consistent with the organization’s goals.

Table 4.2.6. Methodology of internal audit activity:

<table>
<thead>
<tr>
<th>Methodology of internal audit activity</th>
<th>N</th>
<th>Mean</th>
<th>S.D</th>
</tr>
</thead>
<tbody>
<tr>
<td>17. The bank implements risk-based internal audit methodology.</td>
<td>140</td>
<td>3.60</td>
<td>0.56</td>
</tr>
<tr>
<td>18. In your bank the Chief audit executive has prepared risk based annual audit plan to determine priorities internal audit activity, consistent with the organization’s goals.</td>
<td>140</td>
<td>3.52</td>
<td>0.53</td>
</tr>
<tr>
<td>19. In your bank internal audit teams perform individual audit assignment based the risk-based audit methodology.</td>
<td>140</td>
<td>3.29</td>
<td>0.46</td>
</tr>
<tr>
<td>20. In your bank internal auditors conduct a preliminary assessment of the risks relevant to each engagement.</td>
<td>140</td>
<td>3.57</td>
<td>0.58</td>
</tr>
<tr>
<td>Cumulative mean 3.50</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Questionnaires and Stata output (2019)

4.2.7. Internal audit Effectiveness:

Questions no 21-25 examine effectiveness of the internal audit activity of the bank. The questions are designed to examine if Competence of internal auditors, Independence of the internal audit activity, Board and management support, and the internal audit activity methodology/process have role for the effectiveness of the internal audit activity. Accordingly, all the questions under (Q21-Q25) category have got mean scores of 3.75, 3.79, 3.89 and 3.44, respectively. The cumulative outcome of study on the effectiveness of internal audit revealed that the overall average response for the internal audit effectiveness was 3.63 which shows on an agree degree of agreement. Moreover, the standard deviation of (Q17-Q20) were less than 1.00 and it indicates that the respondents perception on independence of internal audit activity of the bank were close to one another. (Refer Table 4.2.7.)

Table 4.2.7. Effectiveness of internal audit activity:

<table>
<thead>
<tr>
<th>Effectiveness of internal audit activity</th>
<th>N</th>
<th>Mean</th>
<th>S.D</th>
</tr>
</thead>
<tbody>
<tr>
<td>21. Competence of internal auditors is a determinant factor for the effectiveness of internal audit activity of your bank.</td>
<td>140</td>
<td>3.75</td>
<td>0.81</td>
</tr>
<tr>
<td>22. Organizational and individual independence of internal audit is a determinant factor for the effectiveness of internal audit activity of your bank.</td>
<td>140</td>
<td>3.79</td>
<td>0.78</td>
</tr>
</tbody>
</table>
23. Board and management support to internal audit is a determinant factor for the effectiveness of internal audit activity of your bank.

24. The methodology/process used by internal audit departments is a determinant factor for the effectiveness of internal audit activity of your bank.

<table>
<thead>
<tr>
<th></th>
<th>Number of items</th>
<th>Cronbach's Alpha</th>
<th>Cronbach’s Alpha Standardized Items</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source: Questionnaires and Stata output (2019)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4.3. Inferential statistics

4.3.1 Reliability Analysis

To measure the reliability of the questionnaires, Cronbach’s Alpha (α) was used and its value is 0.78, as indicated in the table cited below. Cronbach’s Alpha (α) that exceeds 0.70 is an acceptable value (Field, 2009). Therefore, the reliability of the questionnaires used in this study is acceptable and reliable enough for data analysis.

Table 4.3.1. Reliability Statistics

<table>
<thead>
<tr>
<th>Number of items</th>
<th>Cronbach's Alpha</th>
<th>Cronbach’s Alpha Standardized Items</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>0.78</td>
<td>1.00</td>
</tr>
</tbody>
</table>

Source: Questionnaires and Stata output (2019)

4.3.2. Correlation Analysis

The correlation analysis was utilized to reject or accept research hypothesis in previous audit research in addition to the regression analysis (Cohen and Sayag, 2010).

To measure inter-variables correlation, Pearson Correlation matrix was used and thus as depicted in Table 4.3.2 below the correlation between the variables is high. The study result indicates, there is a strong correlation between the dependent variable (effectiveness of internal audit) and all the independent variables (Competence of internal auditors, independence of internal audit activity, board and management support, and the methodology/process of internal audit).
Table 4.3.2. Pearson Correlations Matrix

<table>
<thead>
<tr>
<th>Variables</th>
<th>IAE</th>
<th>IAC</th>
<th>IIA</th>
<th>BMS</th>
<th>IAM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effectiveness of internal audit</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Competence of internal auditors</td>
<td>0.435</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Independence of internal audit activity</td>
<td>0.456</td>
<td>0.515</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board and management support</td>
<td>0.543</td>
<td>0.345</td>
<td>0.476</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Internal audit methodology/process</td>
<td>0.565</td>
<td>0.162</td>
<td>0.190</td>
<td>0.468</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Questionnaires and Stata output (2019)

4.3.3. Assessment of Normality:

In order to test the normality of data, Skewness and Kurtosis test of normality distribution were used. The Skewness and Kurtosis tests are showing normality when the result is within the range of +1 and -1 (Hair, et al., 1998). According to the graph cited below, the data has normality distribution.
4.3.4. Assessment of Multicollinearity:

Multicollinearity is a statistical problem which occurs when the explanatory variables (independent variables) are much correlated with each other (Hair, et al., 1998). It means when the strong correlation among predictors and the existence of r value greater than 0.80, tolerance value below 0.10, and Variance Inflation Factor (VIF) greater than 10 in the correlation matrix (Field, 2009). Tolerance in this case defined as a statistical tool which used to indicate the variability of the specified independent variables from other independent variables in the model (Pallant, 2007). Based on Table 4.3.2, the tolerance levels for all variables were greater than 0.10 and the Variance Inflation Factor (VIF) value for all variables were less than 10. Table 4.3.2. Pearson Correlations Matrix also shows the correlation between dependent and independent variables, the correlation matrix of all variables among the predictor was also less than 0.80. Therefore, correlation value, tolerance level, and VIF value indicates that there were no multicollinearity problem in this study.

### Table: 4.3.2. Collinearity statistics

<table>
<thead>
<tr>
<th>Model</th>
<th>VIF</th>
<th>Tolerance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competence of internal audit</td>
<td>1.62</td>
<td>0.618</td>
</tr>
<tr>
<td>Independence of Internal audit</td>
<td>1.58</td>
<td>0.632</td>
</tr>
<tr>
<td>Board and management support</td>
<td>1.39</td>
<td>0.722</td>
</tr>
<tr>
<td>Methodology internal audit</td>
<td>1.28</td>
<td>0.779</td>
</tr>
</tbody>
</table>

Source: Questionnaires and Stata output (2019)

4.3.5. Multiple Regression Analysis

To test the independent variables (competence of internal auditors, independence of internal audit activity, board and management support and internal audit methodology/process) will significantly explain the dependent variable (effectiveness of internal audit) multiple regression analysis was done. The results of the regression analysis are presented in Table 4.3.3 below. As indicated in the model summery (Table 4.3.3.) the appropriate indicators of the variable used to identify the IAE were explored. The most important benefit of R square is that it serves as a fast and easily interpretable measure for the goodness of fit of the estimated model (Reisinger, 1997). However, R Square is not an absolute indicator of goodness of fit. It is just a relative measure of explained variance relative to total variance in the dependent variable (Reisinger, 1997). This
study depends on participant’s perception which collected through questionnaire. Therefore, R square value more than 25% can be acceptable and good to fit (Reisinger, 1997; Thompson, 2002). Therefore, the value of R (0.51) is the correlation of the four independent variables with the dependent variable. The value of R square (0.51) is that 51% of the variance of effectiveness of internal audit significantly explained by the four independent variables. Therefore, 49% for the effectiveness of internal audit in Wegagen bank Share Company is contributed by other independent variables not included in this study.

Table 4.3.3. Model summary

<table>
<thead>
<tr>
<th>Model</th>
<th>R Square</th>
<th>Adjusted R Square</th>
<th>Std. Error of the Estimate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>.51</td>
<td>.49</td>
<td>.48</td>
</tr>
</tbody>
</table>

a. Dependent Variable: Effectiveness of internal audit  
b. Predictors: (Constant), competency, independency, Management support, Methodology

Source: Questionnaires and Stata output (2019)

4.3.6. ANOVA Statistics

The ANOVA statistics in Table 4.3.4 below reveals that the significance of the model by the value of F=34.82 at a level .000, which implies that there were strong relationship between the independent variables and the outcomes of the regression variables and are the best fit for the model to predict the effectiveness of internal audit activity in Wegagen bank share company.

Table 4.3.4. ANOVA statistics

<table>
<thead>
<tr>
<th>Source</th>
<th>Sum of Squares</th>
<th>df</th>
<th>Mean Square</th>
<th>F</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>19.52</td>
<td>4</td>
<td>4.879</td>
<td>34.82</td>
<td>.000</td>
</tr>
<tr>
<td>Residual</td>
<td>18.92</td>
<td>135</td>
<td>0.140</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>38.44</td>
<td>139</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a. Dependent Variable: Effectiveness of internal audit  
b. Predictors: (Constant), competency, independency, Management support, Methodology

Source: Questionnaires and Stata output (2019)
4.3.7. Coefficients of variables

The results of the Table 4.3.5 cited below shows coefficients of all the independent variables positive effect of the predicting independent variables. That means any proportional increase in the independent variables lead to a proportional increase in the dependent variable. This finding is consistent with most of the previous studies that are identified in this paper (Tadiwos, 2016; Abreham, 2016). Therefore, based on the coefficients of the dependent variable all the hypotheses proposed by the researcher are acceptable. Because all the four hypotheses stated the positive relationship between the independent and the dependent variables are meet. The independent variables with the level of significance value less than 5% could make a significance unique contribution to the predicted value of the dependent variable, beyond this level of significance the variable are not making a significance contribution for the prediction of the dependent variable.

Table 4.3.5. Regression of coefficients

<table>
<thead>
<tr>
<th>Effectiveness of internal audit</th>
<th>Variables</th>
<th>Coefficients</th>
<th>Std Error</th>
<th>Beta</th>
<th>t</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>(Constant)</td>
<td>-1.382</td>
<td>.443</td>
<td></td>
<td>-3.12</td>
<td>0.002</td>
</tr>
<tr>
<td></td>
<td>IAC</td>
<td>.311</td>
<td>.105</td>
<td>.210</td>
<td>2.96</td>
<td>0.004</td>
</tr>
<tr>
<td></td>
<td>IIA</td>
<td>.181</td>
<td>.077</td>
<td>.178</td>
<td>2.34</td>
<td>0.021</td>
</tr>
<tr>
<td></td>
<td>BMS</td>
<td>.261</td>
<td>.102</td>
<td>.196</td>
<td>2.55</td>
<td>0.012</td>
</tr>
<tr>
<td></td>
<td>IAM</td>
<td>.626</td>
<td>.105</td>
<td>.405</td>
<td>5.92</td>
<td>0.000</td>
</tr>
</tbody>
</table>

*P< 0.05, 95% level of Confidence

Source: Questionnaires and Stata output (2019)

The coefficients of regression in table 4.3.5 above are presented in the model below:

IAE = -1.382 + 0.311IAC + 0.181IIA + 0.261BMS + 0.626IAM

Where; a unit increase in competence of internal auditors, independence of internal audit activity, board and Management support, and methodology/process of internal audit will lead to a 0.311, 0.181, 0.261, and 0.626 increases in internal audit effectiveness, respectively. When, competence of internal auditors, independence of internal audit activity, board and Management
support, and methodology/process of internal audit is zero, the internal audit effectiveness will be decreased by 1.382. The independent variable are having significant effect on the effectiveness of internal audit since the P- value of the independent variables are less than 5% and they are positively related with the dependent variable.

4.3.8. Hypothesis test

The regression results obtained from the model were utilized to test the hypotheses developed in chapter One. The hypotheses sought to test significant influences of Competence of internal auditors, independence of internal audit activity, board and Management Support, the Methodology/process of internal audit function of the bank on the internal audit effectiveness.

i. **H 1: Competence of Internal auditors is positively associated with the effectiveness of internal audit activity of Wegagen bank Share Company.**

The first hypothesis tested competence of internal auditors’ has positive association with the effectiveness of internal audit in Wegagen bank Share Company. The regression result highly supported this hypothesis at (P<0.05) level of significance and with the positive signs of beta and statistics (β = 0.311 and t= 2.96). Therefore, the result shows competence of internal auditors positively effect on the effectiveness of internal audit function of Wegagen bank share company at a statistical significance level of (P<0.05).

The result supported by the Professional Practice of Internal Auditing standard that defines internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively must possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities. Knowledge, skills, and other competencies is a collective term that refers to the professional proficiency required of internal auditors to effectively carry out their professional responsibilities. Internal auditors are encouraged to demonstrate their proficiency by obtaining appropriate professional certifications and qualifications, such as the Certified Internal Auditor designation and other designations offered by The Institute of Internal Auditors and other appropriate professional organizations. The chief audit executive must obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part
of the engagement. Internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud. Internal auditors must have sufficient knowledge of key information technology risks and controls and available technology-based audit techniques to perform their assigned work. However, not all internal auditors are expected to have the expertise of an internal auditor whose primary responsibility is information technology auditing. Internal auditors must apply the care and skill expected of a reasonably prudent and competent internal auditor. In exercising due professional care, internal auditors must consider the use of technology-based audit and other data analysis techniques. Internal auditors must enhance their knowledge, skills, and other competencies through continuing professional development.

ii.  **H 2: Independence of IA is positively associated with the effectiveness of internal audit activity of Wegagen bank Share Company.**

The second hypothesis tested independence of IA positive association with the effectiveness of IA in Wegagen bank Share Company. The result shows independence of IA positively associated with the effectiveness of IA in Wegagen bank Share company at a statistical significance level of (P<0.05). The magnitude (β) of the effect of this variable on the effectiveness of IA was 0.181 and the t-value of 2.34. The positive magnitude sign and t-value of more than 2 are indicating a strong relationship between the independent and dependent variable (Hair, et al., 1998). Therefore, Organizational independence of internal audit is positively related to the Effectiveness internal audit activity of Wegagen bank Share Company.

The result is support by IIA, 2009 Standard 1110 the chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity. Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board:

- Approving the internal audit charter;
• Approving the risk-based internal audit plan;
• Approving the internal audit budget and resource plan;
• Receiving communications from the chief audit executive on the internal audit activity’s performance relative to its plan and other matters;
• Approving decisions regarding the appointment and removal of the chief audit executive;
• Approving the remuneration of the chief audit executive; and
• Making appropriate inquiries of management and the chief audit executive to determine whether there is inappropriate scope or resource limitations.

The chief audit executive (CAE), reporting functionally to the board and administratively to the organization’s chief executive officer, facilitates organizational independence. At a minimum the CAE needs to report to an individual in the organization with sufficient authority to promote independence and to ensure broad audit coverage, adequate consideration of engagement communications, and appropriate action on engagement recommendations. Administrative reporting is the reporting relationship within the organization’s management structure that facilitates the day-to-day operations of the internal audit activity.

Direct communication occurs when the chief audit executive (CAE) regularly attends and participates in board meetings that relate to the board’s oversight responsibilities for auditing, financial reporting, organizational governance, and control. The CAE’s attendance and participation at these meetings provide an opportunity to be apprised of strategic business and operational developments, and to raise high-level risk, systems, procedures, or control issues at an early stage. Meeting attendance also provides an opportunity to exchange information concerning the internal audit activity’s plans and activities and to keep each other informed on any other matters of mutual interest.

Such communication and interaction also occurs when the CAE meets privately with the board, at least annually.

Internal auditors are to report to the chief audit executive (CAE) any situations in which an actual or potential impairment to independence or objectivity may reasonably be inferred, or if they have questions about whether a situation constitutes an impairment to objectivity or independence. If the CAE determines that impairment exists or may be inferred, he or she needs to reassign the auditor(s).
A scope limitation is a restriction placed on the internal audit activity that precludes the activity from accomplishing its objectives and plans. Among other things, a scope limitation may restrict the:

- Scope defined in the internal audit charter.
- Internal audit activity’s access to records, personnel, and physical properties relevant to the performance of engagements.
- Approved engagement work schedule.
- Performance of necessary engagement procedures.
- Approved staffing plan and financial budget.

A scope limitation, along with its potential effect, needs to be communicated, preferably in writing, to the board. The CAE needs to consider whether it is appropriate to inform the board regarding scope limitations that were previously communicated to and accepted by the board. This may be necessary particularly when there have been organization, board, senior management, or other changes.

iii. **H 3: Board and Management support is positively associated with the effectiveness of internal audit activity in Wegagen Bank Share Company.**

The third hypothesis tested the board and management supports positive association with the effectiveness of IA in Wegagen bank Share Company.

Board support is defined in terms of the audit committee promotes the independence of internal audit by protecting from management’s influence.

Management support is defined in terms of providing resources, giving trainings, introducing with new technologies, providing enough facilities and encouraging the internal audit process with commitments to promote and communicate their added value.

The result shows Board and management supports positively associated with the effectiveness of IA in Wegagan bank Share Company at a statistical significance level of (P<0.05). The magnitude (β) of the effect of this variable on the effectiveness of IA is 0.261 and the t-value of 2.55. The positive magnitude sign and t-value of more than 2 are indicating a strong relationship between the independent and dependent variable (Hair, et al., 1998).
Therefore, the researcher accepts the hypothesis of the study that board and management supports is positively associated with the effectiveness of IA in ECBs.

iv. **H 4: The methodology/process of internal audit activity is positively associated with the effectiveness of IA of Wegagen bank Share Company.**

The last hypothesis tested is methodology/process of internal audit function positive association with the effectiveness of IA in Wegagen bank Share Company.

IIA standard 2010, the chief audit executive must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization’s goals. This means the chief audit executive is responsible for developing a risk-based plan. The chief audit executive takes into account the organization’s risk management framework, including using risk appetite levels set by management for the different activities or parts of the organization. If a framework does not exist, the chief audit executive uses his/her own judgment of risks after consideration of input from senior management and the board. The chief audit executive must review and adjust the plan, as necessary, in response to changes in the organization’s business, risks, operations, programs, systems, and controls.

IIA Standard 2200 also specifies internal auditors must develop and document a plan for each engagement, including the engagement’s objectives, scope, timing, and resource allocations. Internal auditors must conduct a preliminary assessment of the risks relevant to the activity under review. Engagement objectives must reflect the results of this assessment.

The result shows that there is strong relationship between methodology/process of internal audit and the effectiveness of IA in Wegagen bank Share Company at a statistical significance level of (P<0.05). The magnitude (β) of the effect of this variable on the effectiveness of IA was 0.626 and the t-value of 5.92.

Therefore, the researcher accepts the hypothesis of the study that board and management supports is positively associated with the effectiveness of IA in ECBs.

In short, the study reveals that the presence of positive relationships between all the four independent variables (competence of internal auditors, independence of internal audit activity, board and management support, and methodology/process of internal audit) used in this study and the dependent variable (internal Audit effectiveness). It means the overall contribution of
competence of internal auditors, independence of internal audit activity, Board and management support, the methodology used by internal audit department to effectiveness of internal audit accounted for 51% and a unit increase in competence of internal auditors, independence of internal audit activity, board and Management support, and methodology/process of internal audit will lead to a 0.311, 0.181, 0.261, and 0.626 increases in internal audit effectiveness, respectively.
CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1. Introduction

This chapter provides a summary of the major findings, conclusion and recommendations in relation to the stated purpose. It also gives suggestions on areas for further studies. The purpose of this study was to assess determinant factors of effectiveness of the internal audit in Wegagen bank Share Company. Specifically; it was attempting to validate the research hypothesis, competence of internal auditors, independence of internal audit activity, board and management support, and methodology/process of internal audit have positive impact on the effectiveness of internal audit.

5.2. Summary of Major Findings:

In recent years there is growing recognition of the important role of internal auditing in risk management process of organizations. This research paper contains the results of a study conducted at Wegagen bank Share Company in 2019. This study therefore aimed to assess factors that determine the effectiveness of internal audit in Wegagen bank Share Company. The study used both primary and secondary sources of data gathered through questionnaires and various materials written by scholars in the topic area, respectively. The study found out that all the independent variables were positively related with the internal audit effectiveness in Wegagen bank Share Company.

R square (0.51) is that 51% for the effectiveness of internal audit of Wegagen bank Share Company is contributed by the competence of internal auditors, independence of internal audit activity, board and management support and Methodology/process of and 49% is contributed by other independent variables not included in this study.

The regression coefficients remarked that, a unit increase in competence of internal auditors, independence of internal audit activity, board and Management support, and methodology/process of internal audit will lead to a 0.311, 0.181, 0.261, and 0.626 increases in internal audit effectiveness, respectively. When, competence of internal auditors, independence of internal audit activity, board and Management support, and methodology/process of internal audit is zero, the internal audit effectiveness will be decreased by 1.382. This implies that independence of internal audit activity, competence of internal auditors, board and management.
support, and methodology/process of internal audit activity, respectively were the major
determinant factors for the effectiveness of the internal audit in Wegagen bank Share Company.
However, participants responded internal auditors of the bank have no adequate knowledge to
identify fraud indicators and key information technology risks, they are also indicate the bank
senior management does not provide sufficient support to the internal audit department equipped
with sufficient human resource to perform its activities. Moreover, they responded resident
internal auditors working at branches do not perform individual audit assignments based on the
risk-based audit methodology.

5.3. Conclusion of the study:

Internal auditing is an independent, objective assurance and consulting activity designed to add
value and improve an organization’s operations. It helps an organization accomplish its
objectives by bringing a systematic, disciplined approach to evaluate and improve the
effectiveness of risk management, internal control and governance process. The study, therefore,
provides insights to improve the role of internal audit function in risk management, internal
control, and corporate governance of the banking industry in Ethiopia which takes the interests
of all stakeholders such as customers, suppliers, employees, creditors and government agencies.
The major contribution of this study was to investigate determinant factors for effectiveness
internal audit of Commercial banks in Ethiopia as banks play an essential role in the economy of
the country and mobilize the public money. Therefore, banks should be evaluated by
independent organ such as internal and external auditors and strictly regulated by government
body so as to protect the public interest.
The result of the study reveals that the presence of positive relationships between all the four
independent variables competence of internal auditors, independence of internal audit activity,
board and management support, and methodology/process of internal audit and the dependent
variable effectiveness of internal audit. Competence of internal auditors’ is one major
determinant factor that affects internal audit effectiveness in Wegagen bank Share Company.
The study also concludes that independence of internal audit activity is another determinant
factor that influences the internal audit effectiveness in Wegagen bank Share Company. Board
and management support is also a factor that determines the internal audit effectiveness in
Wegagen bank Share Company. Moreover, the study also concludes that the
methodology/process of internal audit function is another determinant factor that influences the internal audit effectiveness in Wegagen bank Share Company. The survey study carried out in this study was concentrated on few variables, thus, future studies could incorporate including other important variables in the study.

As a conclusion, even though the study result indicated that the internal audit function of the bank is effective and playing a value add role, there are weaknesses such as audit staffs of the bank do not have sufficient knowledge and skill on fraud detection and key information technology risks. Moreover, the bank senior management does not provide sufficient support to internal audit department to have sufficient human resource to perform its activities. Besides resident Internal auditors working at branches do not perform individual audit assignments based on the risk-based audit methodology.

5.4. Recommendations:

Considering the given concluding observations obtained through this research, the researcher forwarded the under listed recommendation/suggestions for improvement of the internal audit function of Wegagen bank Share Company:

- This research is a great importance to the audit committee, internal auditors and external auditors to use the findings in to account in their interactions to better equip internal audit function for their role in risk management, corporate governance and internal control system.
- The study result shows that internal auditors of the bank have knowledge gap on technology-based audit and identification of indicators of fraud techniques. Therefore, the researcher recommends that the bank should provide sufficient training on technology-based and fraud investigation audit techniques.
- The study result shows that the support providing by senior management to internal audit of the bank is not sufficient enough and the researcher advised senior management of the bank to provide the required assistance and support to the internal audit department by recruitment of sufficient and quality internal auditors and providing attractive salary and benefit packages.
✓ The NBE directive requires that commercial bank working in Ethiopia should use risk-based audit methodology/process. Even though the bank is implementing risk-based internal audit methodology at head office level, the study result shows that resident internal auditors working at the branches of the bank are not performing their duties using risk-based audit methodology. Therefore, the researcher recommend that concerned organ of the bank should design audit procedure which guides the resident auditors to implement risk-based audit methodology.

✓ The study result shows that competence of internal auditors, independence of internal audit activity, board and management support, and methodology/process of internal audit plays a vital role for the effectiveness internal audit functions. Moreover, international standard for the professional practice of internal auditing requires that the internal audit activity must be independent, and internal auditors must possess the knowledge, skills and other competencies needed to perform their work effectively, management should provide the necessary support to internal audit and risk-based audit methodology is a best approach of internal audit. Therefore, the research recommended that Commercial banks in Ethiopia should give more attention to the factors mentioned above to have effective and efficient internal audit department effectiveness and support their managements in risk management, strengthening internal control and corporate governance.

✓ The researcher also recommend further research to be carried out on other factors that contribute value for effectiveness of internal audit function of banking industry in Ethiopia.
References:

- IIARF (2011): Internal auditing role in risk management.
- IIA position paper: The role of internal auditing in Enterprise-wide risk management.
• Spencer, P. (2005): The essential handbook of internal auditing.

http://www.wegagenbanksc.com
http://www.theiia.org
Appendix I: Questionnaire for Internal Auditors:

ADDIS ABABA UNIVERSITY
COLLEGE OF BUSINESS AND ECONOMICS
DEPARTMENT OF ACCOUNTING AND FINANCE

Dear Respondents,

This is a questionnaire prepared for research paper on the topic area of “Factors that determine effectiveness internal audit in commercial banks” in partial fulfillment of the requirement of MSC in accounting and finance. Accordingly, this questionnaire is prepared to collect data that aim to identify factors determine effectiveness of internal audit in bank risk management. Moreover, I want to assure you that all the data and information collected through this questionnaire will be used for the sole purpose of the research and remains confidential. Therefore, you are kindly requested to respond to the questions with utmost good faith, freely and to the best of your knowledge. You don’t also require mention your name on the questionnaire.

With Best regards,

Address:

Negasi G/Aregawi

E-mail: negegebre68@gmail.com

Addis Ababa, Ethiopia.
Part I: - General Information

1. Sex/Gender: Male [ ] Female [ ]

2. Qualification (Educational background):
   - Diploma [ ]
   - Degree (BA, BSC) [ ]
   - Masters (MA, MSC, MBA) [ ]

3. Field of study on your highest educational level:
   - Accounting and Finance [ ]
   - Information Technology [ ]
   - Management [ ]
   - Economics [ ]

4. Year of experience in banking sector in any position:
   - One to five years [ ]
   - Six to ten years [ ]
   - Above ten years [ ]

5. Year of experience in internal auditing:
   - One to five years [ ]
   - Six to ten years [ ]
   - Above ten years [ ]

Part II: - Internal Audit Questionnaire:

Please mark “√” for each line in the labeled columns: if you Strongly agree=5, agree=4, Neutral=3, disagree=2, and strongly disagree=1.

<table>
<thead>
<tr>
<th>Factors</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. Competency of Internal Auditors:</strong></td>
<td></td>
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<tr>
<td>1. Internal auditors of your bank have possessed knowledge and skill to perform their individual responsibilities.</td>
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<tr>
<td>2. Internal audit staffs of your bank collectively have possessed Knowledge and skill to perform internal audit responsibilities.</td>
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<td>3. Internal auditors of your bank exercise due professional care in performing their activities.</td>
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<td>4. Internal auditors of your bank enhancing their knowledge through continuous professional development trainings.</td>
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<td>5. Internal auditors of the bank were applying internal audit standards, procedures and techniques in performing engagements.</td>
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<td>6. Internal auditors of the bank have knowledge to identify fraud indicators and key information technology risks.</td>
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<td><strong>B. Organizational and individual Independence of Internal Audit:</strong></td>
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<td>7. In your bank Chief audit executive (Controller) functionally reports to the board of directors (or audit committee).</td>
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<td>8. In your bank the chief audit executive (Controller) has direct and unrestricted access to senior management and the board.</td>
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<td>9. In your bank Internal auditors functionally reports to Chief audit</td>
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</tbody>
</table>
10. In your bank internal auditors are free from interference of management in determining the scope of their assignments.

11. In your bank internal auditors have unbiased attitude and conflict of interest that impair ability to perform his/her duties and responsibilities.

12. In your bank Internal auditors feel free to report to the Chief audit executive (Controller) any situation in which an actual or potential to impairment of independence during engagement.

C. **Board and Management Support:**

13. Audit committee of your bank promotes the independence internal audit by protecting them from management’s influence.

14. In your bank audit customers (auditee) Collaborate with internal audit during the whole internal audit process.

15. Senior management of your bank ensures the internal audit has sufficient human resource to successfully carry out its responsibilities.

16. In your bank internal audit department obtain a sufficient budget to successfully carry out its responsibilities.

D. **Methodology of Internal audit Activity:**

17. The bank implements risk-based internal audit methodology.

18. In your bank the Chief audit executive has prepared risk based annual audit plan to determine priorities internal audit activity, consistent with the organization’s goals.

19. In your bank internal audit teams perform individual audit assignment based the risk-based audit methodology.

20. In your bank internal auditors conduct a preliminary assessment of the risks relevant to each engagement.

E. **Effectiveness of Internal Audit:**

21. Competence of internal auditors is a determinant factor for the effectiveness of internal audit activity of your bank.

22. Organizational and individual independence of internal audit is a determinant factor for the effectiveness of internal audit activity of your bank.

23. Board and management support to internal audit is a determinant factor for the effectiveness of internal audit activity of your bank.

24. The methodology/process used by internal audit departments is a determinant factor for the effectiveness of internal audit activity of your bank.

Please comment if you have additional idea about the determinant factors of effectiveness of internal audit in your organization that is not addressed in this questionnaire.
Thank you for your cooperation!!

Appendix II: Documents review:

<table>
<thead>
<tr>
<th>Activity</th>
<th>Objective</th>
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<tbody>
<tr>
<td>1</td>
<td>Review the bank’s internal audit guideline/manual, internal audit charter, and NBE directives. To collect information if the bank’s manuals and charters are prepared in accordance with IPPSIA and IIA standards.</td>
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<tr>
<td>2</td>
<td>Review internal audit annual plans, internal audit reports, reports and internal audit programs and other working papers. To collect information if the department is working according its internal audit guidelines and NBE directives.</td>
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</tbody>
</table>