

THE EFFECT OF INTERNAL AUDIT IN THE MINIMIZATION OF AGENCY COST: THE CASE OF SELECTED COMMERCIAL BANKS IN ETHIOPIA

PREPARED BY: MERON HAGOS

ID NO: GSE/8186/15

ADVISOR: DR. DEGEFE DURESSA (PhD)

A Thesis Submitted to Addis Ababa University College of Business and Economics Department of Accounting and Finance in Partial Fulfillment of The Requirements for The degree of Master of Science (MSc) in Accounting and Finance

June 2025

Addis Ababa, Ethiopia

THE EFFECT OF INTERNAL AUDIT IN THE MINIMIZATION OF AGENCY COST: THE CASE OF SELECTED COMMERCIAL BANKS IN ETHIOPIA

ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND FINANCE

A Thesis Submitted to Addis Ababa University College of Business and Economics Department of Accounting and Finance in Partial Fulfillment of The Requirements for The degree of Master of Science (MSc) in Accounting and Finance

BY: MERON HAGOS

ADVISOR: DR. DEGEFE DURESSA (PhD)

JUNE 2025

ADDIS, ABABA, ETHIOPIA

DECLARATION

I declare that the work reported on the thesis "The Effect of Internal Audit in the Minimization of Agency Cost: the Case of Selected Commercial Banks in Ethiopia." has been presented for degree of Master of Science (MSc) in Accounting and Finance and is prepared wholly by myself under the supervision of Dr. Degefe Duressa. This work has not been submitted for any other degree, professional qualification, or similar work.

Declared By:

Name of the student's	Signature	Date
Meron Hagos	.....	18/06/2025

Verified By:

Name of the Advisor	Signature	Date
DR. DEGEFE DURESSA (PhD)	.....	18 June 2025

CERTIFICATION

This is to certify that the thesis prepared by Meron Hagos entitled: The Effect of Internal Audit in the Minimization of Agency Cost: the Case of Selected Commercial Banks in Ethiopia and submitted in partial fulfillment of the requirements for the Degree of Masters of Science in Accounting and Finance complies with the regulations of the University and meets the accepted standards with respect to originality and quality.

Signed by Examining Committee:

Advisor Degefe Duressa Signature _____ Date 18 June 2025

External Examiner Mekonnen M. (PhD) Signature _____ Date 18/06/2025

Internal Examiner Tadele Dy Signature _____ Date 18/06/2025

ACKNOWLEDGMENTS

I would like to start by expressing my utmost gratitude to the Almighty God and His Holy Mother, St. Mary, for giving me the strength to begin my journey and finish in a way that exceeded my expectations. The achievement of this research paper would not have been feasible without the help and guidance of my advisor, Dr. Degefe Duressa. The motivation and valuable feedback were crucial in fulfilling' this endeavor.

I want to take this opportunity to convey my appreciation to the respondents for their time and consideration, and for offering the essential facilities and resources for my research in a limited time frame. I owe a special debt of gratitude to all of them. Finally, I want to thank my family, friends, mentors, and colleagues whose support kept me motivated and aided me in overcoming many obstacles throughout my research journey. I appreciate it.

ABSTRACT

This research was conducted to evaluate the impact of internal audit on reducing agency costs. To reach this objective, the researcher employed an explanatory research design. A quantitative research method was utilized, and primary data was gathered via structured surveys to achieve the results. The overall population for the study comprised 100 internal auditors, thus the research used simple random sampling, allowing all participants an equal chance to be included in the study. Of the 100 individuals, 63 auditors filled out and submitted the questionnaires. Taking the banks into an account, the researcher chose 6 through purposive sampling methods, and the data were examined using descriptive and inferential statistics. The result of the study shows that Risk Management and Assessment, Evaluation of Internal Control, Monitoring and Oversight, Reporting of Audit Findings, Effectiveness of Internal Audit, and Role of Audit Committee minimize agency costs. Finally, the researcher recommended organizations to enhance, improve the internal audits, and train the staff department as a whole. It also suggested a coordination among the audit committee, management, and internal auditors regarding the issue matter. Further research is needed to gain a better understanding on the subject matter and any factors associated with it.

Keywords: Agency Relationship. Agency Cost. Conflict of Interest. Internal Audit. Commercial Banks.

Table of Contents

ACKNOWLEDGMENTS I
ABSTRACT II
LIST OF TABLES VI
LIST OF FIGURES VII
CHAPTER 1 1
INTRODUCTION 1
1.1. Background of the Study 1
1.2. Statement of the Problem 3
1.3. Objective of the Study 5
1.3.1. General Objective of the Study 5
1.3.2. Specific Objective of the Study 5
1.4. Significance of the Study 5
1.5. Scope of the Study 6
1.6. Limitations of the Study 6
1.7. Organization of the Study 7
1.8. Definition of Key Terms 7
CHAPTER 2 9
LITERATURE REVIEW 9
2.1. Theoretical Review 9
2.1.1. Corporate Governance 9
2.1.2. Agency Theory 10
2.1.3. Causes of Agency Cost 12
2.1.4. Ways of Mitigating Agency Cost 13
2.1.5. Types of Audit 15
2.1.6. Key Functions of an Internal Audit 16
2.1.6.1. Risk Assessment and Management 17
2.1.6.2. Evaluation of Internal Control 18
2.1.6.3. Monitoring and Oversight 19
2.1.6.4. Reporting of Audit Findings 20
2.1.7. Internal Audit Effectiveness and Agency Costs 21
2.1.7.1. Independence of an Internal Audit 22

2.1.7.2. The Assurance of Transparency in Internal Auditing 23
2.1.8. Role of the Audit Committee of the Board in Minimizing Agency Cost 25
2.2. Empirical Literature Review 26
2.3. Conclusion and Research Gap 28
2.4. Conceptual Framework 29
CHAPTER 3 30
RESEARCH DESIGN AND METHODOLOGY 30
3.1. Research Design 30
3.2. Research Approach 31
3.3. Target Population 31
3.4. Sampling Design 32
3.4.1. Sampling Frame 32
3.4.2. Sampling Technique 32
3.5. Data Source and Method of Data Collection 33
3.5.1. Data Collection Instrument 33
 Questionnaires 33
3.6. Data Analysis Technique 34
3.7. Validity and Reliability 35
3.8. Ethical Consideration 36
CHAPTER FOUR 36
DATE PRESENTATION, AND ANALYSIS OF FINDINGS 36
4.1. Introduction 36
4.1. Evaluation of Missing Values 36
4.2. Respondents' Profile 37
4.3. Descriptive Statistics for Study Variables 39
4.3.1. Risk Management and Assessment 42
4.3.2. Evaluation of Internal Control 44
4.3.3. Monitoring and Oversight 46
4.3.4. Reporting of Audit Findings 48
4.3.5. Effectiveness of Internal Audit 49
4.3.6. Role of Audit Committee 50
4.4. Classical Assumption Test 51

4.4.1. Linearity Test 51
4.4.2. Normality Test 52
4.4.3. Test of Homoscedasticity 53
4.4.4. Multicollinearity Test 54
4.4.5. Correlation Analysis 54
4.5. Regression Analysis and Hypothesis Testing Results 56
CHAPTER FIVE 61
SUMMARY, CONCLUSION AND RECOMMENDATION 61
5.1. Summary 61
5.2. Conclusion 62
5.3. Recommendation 62
5.3.1. Future Research Indication 63
REFERENCES 64
APPENDIX 69

LIST OF TABLES

TABLE 1. LIST OF BANKS 31
TABLE 2. TOTAL NUMBER OF POPULATION AND SAMPLE SIZE 33
TABLE 3. RELIABILITY OF THE STUDY 35
TABLE 4. PROFILE OF THE RESPONDENTS 37
TABLE 5. INTERNAL GOVERNANCE MECHANISM 40
TABLE 6. COST REDUCTION MECHANISM 40
TABLE 7. OBJECTIVE OF INTERNAL AUDIT 41
TABLE 8. RISK ASSESSMENT AND MANAGEMENT 42
TABLE 9. IDENTIFICATION OF RISK 43
TABLE 10. TYPE OF RISK HAVING GREATEST IMPACT ON AGENCY COST 44
TABLE 11. EVALUATION OF INTERNAL CONTROL 44
TABLE 12. EVALUATION OF INTERNAL CONTROL IN ALIGNING AGENCY RELATIONSHIPS 45
TABLE 13. EFFECTIVE INTERNAL CONTROL EVALUATION 45
TABLE 14. MONITORING AND OVERSIGHT IN MINIMIZING AGENCY COST 46
TABLE 15. TYPES OF MONITORING ACTIVITIES 46
TABLE 16. FOLLOW-UP MECHANISM FOR AGENCY COST 47
TABLE 17. TIMELY FOLLOW-UP 47
TABLE 18. AUDIT REPORTING IN MINIMIZING AGENCY COST 48
TABLE 19. TIMELY REPORTING OF AUDIT FINDINGS 48
TABLE 20. BENEFIT OF AUDIT FINDINGS 49
TABLE 21. EFFECTIVENESS OF INTERNAL AUDIT IN MINIMIZING AGENCY COST 50
TABLE 22. ROLE OF AUDIT COMMITTEE IN MINIMIZING AGENCY COST 51
TABLE 23. MULTICOLLINEARITY TEST 54
TABLE 24. CORRELATION ANALYSIS 54
TABLE 25. COEFFICIENTS 56
TABLE 26. MODEL SUMMARY 59

LIST OF FIGURES

FIGURE 1. CONCEPTUAL FRAMEWORK 29
FIGURE 2. LINEARITY TEST 52
FIGURE 3. NORMALITY TEST 52
FIGURE 4. TEST OF HOMOSCEDASTICITY 53

CHAPTER 1

INTRODUCTION

This section provides a comprehensive outline of the study's problem statement, objectives, and a fundamental summary of the gap in knowledge examined within the context of the broader literature. Furthermore, the implications, limitations, and scope of the research are explored, as well as the overall organizational structure of the dissertation.

1.1. Background of the Study

An agency relationship is a legal contract in which one or more persons, called the principals, act with the other, called the agent, to do an act for them, vesting the agent with some degree of discretion (Albert, 2016). Under such a scenario, the management acts as agents while the shareholders are principals. The principal is the one who relies on the agent to execute financial decisions and transactions to come to the desired outcomes. Hence managers must halt any conflicting interests and try to balance short-term financial goals, sustained feasibility, and ethical factors to meet the interests of these shareholders.

According to Carlo (2021), a conflict of interest has been proved to have a negative outcome for the organizations concerned, mostly placing them in situations where their survival and growth are jeopardized, and likewise causing damage to the stakeholders and the general public. Conflicts of interest become challenging for corporate governance when officers entrusted with organizational positions hold personal interests that may contrast with their responsibilities to the organization and its stakeholders. These conflicts can affect the governance models and hence contribute to poor decision-making, a lack of trust, and poor legal outcomes. What is needed to overcome these conflicts is a strong framework of disclosure, independent supervision, ethical standards, and effective auditing practices. According to Zoltán & Hoang Bui (2023), such procedures, when put in place and enforced, enable organizations to practice good corporate governance and reduce any adverse implications by aligning the interests of their management closer to those of their shareholders. Meckling & William (1976) introduced the concept of agency costs in their seminal 1976 business theory article. They showed how different conflicts between managers and owners could cause residual losses, operational inefficiencies, biased decision-making, higher capital costs, loss of prestige, and increased regulatory costs.

They also stated that when managers act in the interest of the shareholders, they bear all the costs from failing to pursue their goals, and yet gain only a few of the benefits. The agency costs reflect conflicts between the shareholders' and management's goals. Good monitoring and control discourage the managers from thinking about themselves first, before the interests of the shareholders, and thus engaging in self-beneficial transactions that harm the company. With the lessening of these costs, a company can make the goals of management compatible with those of the shareholders to a greater extent; thus reducing potential conflicts and making the decision-making process easier. A company has to make sure that resources are being put to good use and that the goals of shareholders and management are aligned.

Through agency theory, corporate governance becomes a necessity to ensure supervision, accountability for all parties, and alignment of interests between shareholders and management. It aims to decrease agency costs while giving management effective incentives to act in the best interest of shareholders through clear definitions of responsibility, enhanced transparency, and the establishment of strong oversight and control mechanisms. Such governance measures ensure that corporate performance is enhanced through improving management decisions taken on behalf of shareholders by reducing potential conflicts of interest (Brian, 2024).

Internal Auditing is a vital mechanism of corporate governance (IIA, 2018). Therefore, it plays an essential role in the overall efficiency of the company in internal controls, risk management practices, and governance structures. The internal auditing function is characterized by independence and impartiality that furnish assurance and consulting services to add value and improve organization operations. It gives assurance to an organization that there is a systematic and disciplined way of reviewing and enhancing the effectiveness of risk management, control, and governance processes to ensure that the objectives set by the organization are accomplished. Thereupon, at times, it is also called independent or objective assurance; thus, an internal audit can provide an edge in raising the value additions of an organization's operations. It gives organizations a systematic way to review and improve the effectiveness of their governance, control, risk management practices, thereby realizing their objectives. Although scientific studies have been on for centuries, agency costs have proven to be one of the most challenging issues in the corporate world. The agency problem arises from the inherent conflict between benefits and decision.

While agency problems are a persistent issue, understanding the causal relationships coupled with targeted policies and strategies can somewhat alleviate these problems (Poppy Sofia, Haryanto, & Sofik, 2024). It can be summarized that some basic steps toward reducing agency costs and improving the effectiveness of the company would include strength in governance practices, improved internal control, alignment of incentives, and establishment of strong ethical conduct.

Questions were recently raised about the continuing significance of audits for agency problems. It is a demand by the shareholders and debt holders to prove to them that a firm is operated in a manner that is in their best interest. This research was based on certain banks found in the Ethiopian banking sector, and particularly at the banks' headquarters based in Addis Ababa. It showed how an internal audit engaged in controlling the agency problem creates an optic into an effective internal audit process, which may turn out to be useful in alleviating the conflicts and inefficiencies between shareholders and management.

1.2. Statement of the Problem

Under modern corporate governance practices, agency costs remain one of the major challenges in the contemporary corporate setting. Agency costs are connected to the principal-agent problem or, in other words, the conflicts of interest between shareholders and management that cause higher costs related to monitoring and performance. Such conflicts may lead to a probable decrease in organizational efficiencies, lower value for shareholders, and misaligned decision-making (Nguyen, Doan, & Ha , 2020). Thus, internal auditing forms an important component of corporate governance, since it provides valuable assurance with regard to the existence and functioning of internal controls, risk management, and compliance procedures. The internal audit is, therefore, one of the most essential mechanisms of control in private and public organizations.

Whereas internal audits try to foster transparency and accountability, whether they, in fact, bring about a reduction in the costs of the agencies remains far from being clear. As Adams (1994) describes, the role of an internal auditor falls under two critical functions. They have to ensure that the management's reports on financial and operational performance are reliable and accurate. And secondly, they ensure that the management is acting in tandem with the organizational objectives and the regulatory requirements. Accordingly, internal auditors report their findings to the audit committee and senior management.

This helps bring to light discrepancies, inefficiencies, and non-compliance areas. Operations transparency reduces information asymmetry between the management and the shareholders. However Adams' work offers only a general overview and lacks detailed examination of particular internal audit practices that are most effective at bringing down agency costs. Strong internal audit functions play a very critical role in the reduction of agency costs, improved transparency, accountability, and governance. Nevertheless, there is limited focus on the practical aspects of internal auditing. Indeed, studies showing the functions of internal audits minimizing agency costs remains underexploited.

Cohen & Sayag (2010), adopted an exploratory method of analysis for the study that aims at building a conceptual understanding of effectiveness of internal audits in Israeli organizations. According to them, effective internal audit enhances stronger governance structures leading to improved alignment between management decisions and shareholder priorities. This study provides empirical evidence on how the effectiveness of internal auditing has a role in the reduction of agency expenses. It also helps align management's actions with the interest of shareholders by an objective evaluation and recommendation that would reduce conflict of interest and costs associated without using any direct quantitative measure for estimating agency costs.

Additionally, the study by Jachi & Yona (2019), indicates that increased transparency within the local authorities is associated with increased independence of the internal audit function. This would further put internal and independent auditors in an enhanced position to give unbiased judgment and analyses that stipulate to more transparency in the financial and operational processes. The paper assessed the influence of the independence of the internal audit function on transparency and accountability within local authorities in Zimbabwe. The study further highlighted that enhanced internal audit independence gives way to improved governance practices in local government entities.

Strong internal audit functions are associated with effective oversight and governance structures. This raises, however, some questions in certain quarters that need exploration, such as the lack of in-depth examination of certain procedures or specific tools within an internal audit department that maintain independence and their direct influence on these practices with regards to transparency and accountability.

In fact most studies reviewed, regarding issues such as the effectiveness of internal, which is associated with transparency and independency, are assumed rather than directly measured. Therefore, this needs to be quantified so that to measure and ensure that effectives of internal audit without a doubt minimizes agency cost.

In relation, understanding the importance of an internal audit in reducing agency costs of a corporation helps improve the corporation and ensures that managers align themselves with the investors' interests (Audrey, M.J., & Arnold, 2004). However, given the limited number of studies that have been carried out in Ethiopia and the existing gaps above, this study brought to light important lessons to show how internal auditing usage can be used to control and reduce agency costs which is helpful to practitioners while contributing to the wider corporate governance research. Additionally, through the solution of this problem, firms can decrease the costs of monitoring, enhance the process of decision making and strengthen the effectiveness and shareholders' value.

1.3. Objective of the Study

1.3.1. General Objective of the Study

The study's general objective is to assess the effect of the internal audit in minimizing agency costs in the case of selected commercial banks in Ethiopia.

1.3.2. Specific Objective of the Study

By the overall objective, the following are the specific objectives:

1. Assess key internal audit practices and functions that influence agency problem reduction.
2. Assess the effectiveness of an internal audit helps reduce agency cost.
3. Assess how the audit committee of the board minimize agency cost.

1.4. Significance of the Study

The significance of a study outlines why the research is important and how it contributes to the existing body of knowledge, practice, or policy. The study is significant because it brings various contributions to different aspects of organizational matters. By exploring how internal audits minimize agency costs, the study tries to provide new insights into how internal audit functions

impact agency costs. The study will help address gaps in the existing literature and offer more understanding of these dynamics.

These findings of the research put best practices into perspective, inform internal audit functions, and hence help in developing more adequate organizational strategies with reduced agency costs for better general efficiency. This also aids management recognize the worth of internal auditing activities, so the management would therefore make uninformed decisions to an extent; hence, finally, the study would be very instrumental as a ground or basis by which academicians, students, and professionals could embark on its implementation.

1.5. Scope of the Study

A study's scope entails defining its parameters and field of inquiry, as well as what is and isn't included in the analysis. Geographically, the study is carried out in Addis Ababa, Ethiopia. As the sector focus, the study concentrated on banking industries. The banking industry in Ethiopia consists of government-owned banks and private banks. The government bank includes the National Bank of Ethiopia (NBE), which is the issuing bank, the central bank, and the Development Bank of Ethiopia. Meanwhile, privately owned banks total 31 commercial banks. Nevertheless, this research is carried out on certain commercial banks, particularly at their main offices. This study analyzed internal audit practices and their role in minimizing agency costs in the year 2024/2025.

1.6. Limitations of the Study

This section of the study tried to show limitations in a research design that can affect interpretation of findings as well as generalizability or applicability of the larger populations. The researcher focused to one industry, and that is a banking industry, thereby apparently restricting broader applicability of findings. Specifically, the outcome did not carry over to other industries and didn't include wider trends or results that would have been produced from any additional work for other industries. This research encounters an additional limitation because of its smaller number of participants, which restricts the generalization of results to wider populations. Out of the 31 private banks available, the researcher selected 6 using purposive sampling techniques. The study involved survey and interview, which might introduces potential bias and subjectivity from respondents, threatening its reliability. Further, due to time

constraints, it was not possible to explore all potential variables that might have influenced the observed relationships.

1.7. Organization of the Study

The study is organized as follows: Chapter one introduces the study, problem statement, research questions, objectives, significance, scope, and limitations of the study. The literature review is discussed in chapter two, giving an in-depth examination of the theoretical review, empirical bases, and conceptual framework. Chapter three includes the research design, sampling and data gathering techniques, analysis methods, and ethical considerations. Chapter four contained the presentation and results of the research in detail while presenting the analysis of the findings of the study. Lastly, Chapter five contains the summary, conclusions, and recommendations of the study. The conclusion comes from the statement of data mentioned in chapter four. Likewise, the recommendation is at the end based on conclusions from the findings.

1.8. Definition of Key Terms

In a research study, it is essential to clearly outline key terms to facilitate comprehension of the concepts and terminology utilized in the paper. Below are words and meanings that will be used throughout the study.

Agent: a person who acts on behalf of, or represents someone. In this case, they are the managers who act on behalf of the agents.

Agency Cost: These costs arise when executives put personal goals ahead of shareholders' interests and, therefore, bring about inefficiencies, decreased shareholder value, or simply poor decision-making.

Agency Theory: It addresses the connection between the owner of a firm and the person appointed by him to run the business.

Conflict of Interest: Arises when different responsibilities or interests may impair objectivity in decision-making. A conflict of interest in corporate governance and internal auditing arises whenever personal or financial interests may influence the performance of a person to discharge his or her duties in an unbiased or effective manner.

Corporate Governance: The framework governing the relations among management, board, shareholders, and other stakeholders of a company. The purpose is to ensure accountability, transparency, and an appropriate decision-making process within an organization accordingly.

Internal Auditing: An independent function that provides assurance and consulting services in order to improve an organization's operations and add value to the organization. Among the areas of internal auditing is the systematic assessment and improvement of the effectiveness of risk management, control, and governance processes that help an organization achieve its objectives.

Principal: A principal would be a party that confers legal authority upon another to represent them in the conduct of some business.

Transparency: refers to the openness with which internal audit functions conduct their operations and report their findings and processes. It means that internal audits should be constructive in contributing to good governance and accountability and to the minimization of costs within agencies.

CHAPTER 2

LITERATURE REVIEW

A literature review offers a thorough synopsis and assessment of the body of knowledge regarding a certain subject. Within the framework of internal auditing and its function to reduce agency expenses, this part examines the study's theoretical analysis, empirical data, gaps, and conceptual framework.

2.1. Theoretical Review

The theoretical review generally involves a systematic scrutiny of and synthesis of the existing theories and conceptual frameworks related to a particular topic or research question. In this way, it will clarify the theoretical concepts and views that constitute a research field. The main part of this review is dedicated to the major theories on internal audit, agency costs, relationships among them, and the connected subjects.

2.1.1. Corporate Governance

According to Giang Nguyen Thuc Huong (2023), the foundation of corporate governance theories lies in agency theory, which addresses moral hazard risks. These theories have expanded to include stewardship theory and stakeholders theory, and have been influenced by resource dependency theory, transaction cost theory, and political theory. Furthermore, ethics theory, information asymmetry theory, and the theory of efficient markets have also been integrated into this framework. Out of these, agency theory, stewardship theory, and stakeholder theory are all crucial ethnocentric theories, with agency theory being the most influential perspective in corporate governance research, policy-making, and practice (Ali, 2019). Corporate governance represents the collection of rules, practices, and processes through which an organization is directed and controlled. It deals with how management, the Board of Directors, the Shareholders, and other Stakeholders of an organization interact with one another. Strong and proper governance of an organization tries to ensure that it remains accountable, equitable and transparent to all stakeholders such as investors, employees, consumers, and the community at large. Other examples of good corporate governance include compensation contracts that aligns the interests of managers with shareholders, such as through incentives tied to performance or stock options.

Regardless of whether the directors or the majority of shareholders control the company, there is always a conflict of interest between the organization and stakeholders who do not participate directly in corporate governance. The mere essence of corporate governance even a company law in general, is to set provisions for struggling against the conflict of interest between different interest groups who participate in corporate governance (Ljiljana & Tea, 2013). It guarantees that contracts are designed to reduce agency expenses and synchronize managerial behaviors with shareholder concerns.

The frameworks frequently have ways for shareholders to impact governance practices and make management responsible, like voting rights and shareholder proposals. Therefore, it guarantees the protection of shareholders' rights and the representation of their interests. Organizations can reduce agency costs and improve accountability, fairness, and transparency by putting in place strong governance mechanisms like well-structured board, robust internal controls, transparent reporting, and strong regulatory compliance.

2.1.2. Agency Theory

Agency Theory is a fundamental idea in economics and organizational management that focuses on the dynamics and tensions between principals and agents (G. Tyge & Oleg V., 2019). It offers a structure for comprehending how to synchronize the interests of individuals hired to carry out tasks for others with the interests of those individuals. This will help understand the conflicts and costs associated with the principal-agent relationship in organizations. It considers the problems and costs of this power shift, especially concerning conflicting interests and information asymmetry.

Conflicts of interest are important because they assure integrity and good decisions within organizations. Therefore, a conflict of interest could bring distrust, undermine performance, and promote some legal or ethical violations. The basic elements necessary in managing conflict of interest will revolve around transparency, disclosure, policies, independent oversight, and accountability. Agency theory, also called the principal-agent relationship theory, impacts the creation of governance mechanisms, in forming boards of directors, to guarantee their efficient supervision of management and decrease agency expenses.

It emphasizes the essence of shareholder rights protection and imply the means such as voting and audits of shareholders to strengthen supervision. The theory stands as support for establishing executive compensation programs that connect managers' motivations with the success of the company, thereby improving productivity and profitability at large (Thomas, 2024). In addition, companies can foster their internal controls and monitoring mechanisms to align managerial decisions with the objectives of the organization.

In this attempt, the theory acknowledges that whatever information is conveyed regarding the relationship of the agent, interests, or job performance could be harmful or considered as moral hazard. A moral hazard takes place when one party places a risk on another party without being accountable for all the consequences. This usually occurs after any transaction or agreement and is normally associated with a lack of accountability. The other case is adverse selection, which occurs when there is asymmetric information between contracting parties before the transaction: one party has more knowledge than the other. It generally happens in a market situation wherein, before the transaction, one party has more or better information than the other.

Moral hazard and adverse selection influence the agent's performance in two ways: lacking the necessary knowledge of what needs to be done and not fulfilling their designated responsibilities (Daniel & Humberto, 2013). The agency theory operates under the belief that both principals and agents act rationally and utilize contracts to optimize their financial gain.

Both moral hazard and adverse selection result in principals facing more costs to guarantee their agents act in their own best interests, leading to higher agency costs in an organization. Agency cost is a key principle in agency theory and corporate governance, which is the expenses linked to the disputes of interest between principals (like shareholders) and agents (like managers). These disputes occur when the goals of agents do not align with those of the principals.

In corporate governance, business corporations pursue practices and procedures that ensure they are well managed and realize their goals effectively. Within an emphasis on agency costs, alignment of incentives, implementing governance mechanisms, and valuable lessons are provided on creating successful contracts and management systems to reduce conflicts and improve organizational performance. Discussion and understanding agency costs are vital for enhancing organizational efficiency, enhancing corporate governance, optimization executive

compensation, reducing financial risks, and ensuring compliance with regulations as stated by (Chris, 2008).

Numerous studies on agency cost have developed from basic theories to more detailed examinations of incentive systems, governance methods, and behavioral influences. Key scholars, such as (Collier & Gregory, 1999) have influenced the comprehension of the origins of agency costs, their effect on company performance, and methods for reducing these costs. This research still impacts the evolution of corporate governance policies, compensation structures, and regulatory frameworks to decrease agency expenses and enhance organizational efficiency.

2.1.3. Causes of Agency Cost

Negotiations and ineffectiveness arise from the principal-agent dynamic, which causes agency costs. The modern enterprise system has brought forth a variety of agency conflicts attributable to this separation of powers within the enterprise: conflicts between managers and shareholders in terms of the decentralized equity and conflicts between the controlling shareholders and minority shareholders of equity concentration (Shan, 2020). Agency costs arise when two forms of agency conflicts do result in the manager, acting as an agent of the company, perhaps not act in a manner that would lead to maximizing company value and engaging in inefficient investment practices.

Significant progress has been achieved in empirically showcasing the factors contributing to agency costs within a company. One reason stated by (Eugene & Michael, 1983), was the difference in divergence between the two groups. Agency costs consist of expenses for organizing, monitoring, and bonding a group of agreements between parties with differing interests, in addition to the remaining loss generated due to the expense of completely enforcing contracts surpassing their advantages.

Shareholders seek to maximize their profit from investment and thereby ensure the company's growth and stabilization for the future. Their main concerns would be the possible profitability and consequent value of their investments. That being stated, managers who run the company may also have some objectives which might not be of shareholders' interest. They may turn into job security or personal credit in deriving short-term benefits for bonuses and promotions. This divergence gives rise to agency conflicts. Another reason is the asymmetry of information between managers and shareholders; elaborating on this, in George (1970), he stated that agents

have the upper hand over the principals in knowledge; this would then, in effect, facilitate incorrect yet efficient decision-making on the part of the principals.

George studied and showed how information asymmetry, especially in the context of second-hand car markets, creates imbalance and leads to better-informed sellers passing on to less well-informed buyers. Akerlof's identification of market inefficiencies finds a parallel in agency theory due to the prevalence of information asymmetry between the principals and the agents. Usually, the principals know less about their actions and the state of the company than the agents do. Lack of information may lead to poor decision-making and conflict of interest.

Another possible reason could be the ineffective governance structure of the organization. The study of Andrei & Robert (1977) attempts to show how mechanisms of governance affect agency costs arising from the separation of ownership and control and how these mechanisms work out in addressing the principal-agent problem; therefore any instances of ineffective governance modes may cause and aggravate the incurrence of agency costs. They pointed out concerns like supervision by ineffective boards and a lack of autonomy that could theoretically lead to the imposition of greater costs from erroneous management actions and bad decision-making.

2.1.4. Ways of Mitigating Agency Cost

The importance of minimizing agency costs is primarily linked to the enhancement of organizational efficiency, which improves firm value, refines elements of corporate governance, assists in risk management, and opens opportunities for proper establishment of an organization culture. This consists of different mechanisms and strategies that aim to minimize certain conflicts of interest between the principals (the shareholders) and the agents (the managers). All these can tie together managerial interests with those of shareholders for better corporate performance and for the reduction of waste and inefficiencies in the working of a sustainable business environment.

Reward and Recognition Programs

Incentive policies become significant strategies in agency cost reduction due to the closeness of alignment between the managers' interests and shareholders through creating compensation systems that align their interests (Matthew, Ann K., & Jill A, 2007). These include such performance-based pay practices as granting managers the option to purchase company stocks at

a set price in the future and tying bonuses to annual performance measures such as earnings per share (EPS), revenue growth, or cost control. A second category is that of long-term incentives and thoughtful compensation schemes, where rewards are given based on multiyear performance objectives.

This ensures that the managers will look for ways that are good for the firm in the long term. By aligning the incentives of managers with the objectives of shareholders, companies can lower agency expenses, improve performance, and establish stronger congruence between managerial behaviors and organizational goals (Edward J. & James D, 1994).

Frequent assessments and modifications help maintain the effectiveness and adaptability of incentive systems. That is regular performance evaluations must also be conducted to determine if the incentive systems are successfully aligning managerial actions with shareholder interests. A company should also establish reward systems that recognize employees and managers for their accomplishments that support company objectives and boost shareholder value. This strengthens wanted behaviors and ensures individual actions align with organizational goals. Incentives should be focused on producing better long-term performance and results rather than on short-term performance and results, even though the level of compensation is equally important for inspiring agents or executives (Ojo, 2009). Thus, incentives ought to be tied to programs that promote a stronger emphasis on long-term outcomes.

Fostering Organizational Culture

An adequate organizational culture is a prerequisite for forming a convergence of goals between principals and agents and minimizes agency costs. A sound culture guarantees managerial decisions to be in line with company objectives and the interest of its shareholders (Waewkanee & Sooksan, 2023). These would include a detailed code of conduct, which stipulates the expected ethical behavior in compliance with the rules and what the organization stands for. A variety of managerial behaviors should be covered, such as conflict of interest, transparency, and integrity. Training of the organization's employees and managers should be done regularly by the organization with respect to ethical behavior, compliance with the law, and principles set by the organization. This helps plant ethical standards in the organization culture and ensures that every person understands his or her responsibilities.

Monitoring and Control System

A broad approach would include the creation of performance measurement systems, improvement of internal controls, updating of reporting and feedback mechanisms, risk management, and strong governance and oversight in monitoring and control systems.

Such an approach can be implanted by firms in order to align managerial behaviors with shareholders' objectives, reduce agency costs, and improve organizational outcomes in general. Effective monitoring and management systems provide a framework for control, accountability, and continuous improvement in achieving the set or intended strategic objectives while nurturing a culture of transparency and integrity (Thu Doan & Loi Tan, 2022).

2.1.5. Types of Audit

Audits are conducted internally and externally for monitoring, controlling, and ensuring that systems, financial actions, and managerial conduct comply and to locate potential areas of difficulty. Both external and internal audits help to improve the financial integrity, operational efficiency, and regulation refrains of an organization. Despite having a common goal of enhancing organizational performance and accountability, audits differ in terms of their scope, objectives, and methodologies. The governance body obtains distinct sets of information and perspectives from these two kinds of audits (Janet L & Colbert, 2002). Both sets of auditors support the governance board in its responsibility to direct the organization in carrying out its mission effectively and efficiently.

External Audit

External auditors conduct an independent examination of an organization's financial statements to ensure they are accurate and not affiliated with the organization. OECD (2007) describes external auditors as "auditors of an organization which is not under the control of the organization and may not report to objectives set by the organization objective is to offer an impartial assessment of financial documents that are accurately represented and show a genuine reflection of the company's economic status. Their role lies in upholding the honesty and reliability of financial reports and building confidence in the company's financial operations. External audits are essential in promoting the overall health and integrity of an organization by enabling access to capital, pinpointing areas for enhancement, and ensuring accountability.

It is now an accepted fact that external auditor has an important role in corporate governance. The role of the external auditor has improved the mechanisms of monitoring and accountability for internal control in corporate governance and, thereby, reduced agency problems. Ojo (2009) states that external auditors would assist in creating an environment whereby management would find themselves being more accountable in the cost of agency.

Adverse actions of the independent auditor against managers and directors who recklessly or willingly manipulate accounting numbers and financial reports, perhaps by choices of appropriate accounting policies, may include punishments like reductions of annual bonuses and compensation of managers. Therefore, if this act is overlooked by the external auditor in a qualified opinion and if negligence exists, chances of proving such acts on the part of managers and directors may be very low.

Internal Audit

Internal auditing is seen as a function that adds value by enhancing an organization's operations, vital for enhancing the efficiency of risk management, control, and governance processes. The standards and principles set forth the occupation of the internal audit profession. This type of audit is performed in-house by the internal audit department of the company and is therefore an independent appraisal. Thus, the internal audit's primary focus is to assess and improve the whole internal control, governance, and risk management process (Abu Kai, 2023). It provides for the identification and prevention of errors, fraud, and inefficiencies. Internal auditors assist in ensuring that the health and wealth of an organizational entity are preserved through risk management and continuous improvement.

They enhance the success of an organizational entity by analyzing its processes, operations, and objectives while providing an independent advisory role to top and middle management to further foster a culture of continuous improvement in risk management, corporate governance, and internal controls.

2.1.6. Key Functions of an Internal Audit

Internal auditors have been recognized to assess and enhance an organization's internal controls, risk management, and governance. They perform audits in order to assess those control processes that are associated with governance and risk management for making them more efficient. They

deliver objective and unbiased evaluations for various activities performed within an organization based on certain standards and guidelines. They offer reassurance and advice to top management and the Board of Directors on the organizational governance structure so that the organization is properly governed through strategies designed by the board and assist management in carrying out its responsibilities.

This function basically gives the management a means for exercising control through highlighting the deficiencies in practices of management as identified by (Frezer, 2020). The study was one of the first to depict how imperative the control environment is to understand why there is a need for internal auditing to exist (Wanda A & Richard W, 1990).

The internal control set by the management is material in achieving the objectives, goals, and missions of an entity. One of the constants of this system is an internal audit. An internal audit has been described as a review mechanism that an organization can use to evaluate and identify the effectiveness, consistency, and achievement of its internal control. Also, the internal auditor will enhance an organizations effectiveness and efficiency by reporting weaknesses in its framework to management through appropriate suggestions.

All the vital functions of the internal audit serve one purpose – ensuring that the smooth running and high efficiency in handling risks while being compliant with rules and regulations, the audit function is required to monitor the management's performances while attesting their performance. The audit is one of the tools that can be used to help reduce agency costs. However, this type of audit could also involve costs, such as salaries and benefits of auditors, other resources needed for conducting audits, etc. Hence, organizations have to carefully consider how much internal audit oversight is necessary in the light of the size and complexity of the business, the level of agency problems, and the cost of the audit function. Internal auditors assist organizations to attain objectives, protect assets as well as maintain governance and performance standards through risk assessments, evaluations of controls, monitoring of compliance as well as consulting. (Dominic S.B & Nonna, 2011). Here are the basic internal audit activities that assist in minimizing agency costs or problems in any organization.

2.1.6.1. Risk Assessment and Management

It is an integral part of the internal audit process in which the risks that may impede the organizational objectives are identified, assessed, and mitigated. This would ensure forward-

looking risk management and proper resource utilization within an organization. It involves understanding potential threats and opportunities that may affect the organization, allowing the setting of appropriate management or mitigation measures well in time. The internal auditing functions will involve planning a work program combining coverage of the work to be done, what is to be achieved, and how these results be obtained in carrying out a risk assessment assignment. A good plan shall followed by its execution and reporting of results including identified risks and their impact and likelihood of occurrence with suggested remedial measures. Regular review and appraisal of the risk management initiatives along with controls and mitigation strategies will be done (Dominic S.B & Nonna, 2011).

The risk assessment reveals that there are areas where the management objectives may not coincide with shareholder interests (Mark R, Muhan, & Wei, 2022). Conflicts may arise on the account of the risks associated with executive compensation or the investment option. A well-designed risk assessment and management system would, therefore, allow organizations to better navigate uncertainty, protect resources, achieve compliance, and pursue strategic goals.

Early identification and mitigation of such risks actually raise business operational efficiency, resilience, and overall organizational stability, all of which are stepping stones toward long-term success and sustainability. It thus becomes the responsibility of the internal auditors to approach the risk assessment of strategic decisions in such a way that it guarantees the surrounding of risk management policies with corporate objectives and shareholders' interest.

Hence, the hypotheses are:

H_1: Risk assessment and management function of internal audit help minimize agency cost

2.1.6.2. Evaluation of Internal Control

Internal controls are rules and methods created to guarantee the precision and dependability of financial reports, adherence to regulations, and efficiency in business operations. They are also described as a procedure influenced by an organization's framework, tasks and power dynamics, employees, and management information systems, created to assist the organization in achieving particular goals or objectives. Internal controls are essential for encouraging optimal business operations, guaranteeing that management policies are followed, protecting assets, identifying

and stopping fraudulent activity, and making it easier to prepare trustworthy financial statements on time and accurately. (San Thida, 2023)

Internal controls must be assessed to ensure they are well-structured in a way to reduce risks and achieve organizational objectives. The internal control systems are designed to help organizations achieve their objectives, ensure the reliability of financial reporting, and ensure that the organization are in constant with laws and regulations (Kelvin Mutua, 2023).

These internal controls ensure that the interest of managers is aligned with that of shareholders; this reduces the agency problems and, consequently minimizing the agency costs. These include regular monitoring and auditing of managerial activities and financial reports. This ensures that managers put shareholders' interests ahead of personal gains, besides safeguarding the best interests of the organization. They also help ensure that activities are carried out by established policies and procedures. This reduces the likelihood of deviance that may lead to ineffective use of resources or costly litigation. The internal control is a business approach which saves the agency costs as well as the agency problem thus improving the general performance of relation as well the principal. The legal mandate requires the board of directors to be responsible for devising and adopting these measures (James P & James K, 1990).

It strengthens internal control through the issuance of more information to the principal (shareholder) on the activities of the agent (management), consequently reducing information asymmetry and thus investor risk and reduced returns. The Hypothesis for this case would be:

H_2: Effective evaluation of Internal Control would lead to the minimization of agency cost

2.1.6.3. Monitoring and Oversight

The oversight role of internal audit in reducing agency costs includes supervising and assessing different areas of the company's activities to guarantee efficient resource utilization and safeguarding principals' interests from possible conflicts with agents. Reviewing audit plans regularly to ensure they cover important areas concerning agency costs is part of this audit function. Audit reports are reviewed for discoveries concerning cost control and the execution of suggested actions. Secondly, the internal auditors evaluate the efficiency of the internal audit function in recognizing and dealing with areas of high agency costs. They also oversee post-

action efforts to ensure that necessary measures have been implemented resulting in decreased agency expenses. Research has demonstrated that adequate supervision decreases agency expenses by enhancing clarity and minimizing conflicts of interest among principals and agents. According to the study of Gerrit & Mohammad J (2010), the requirement for monitoring increases with the degree of information asymmetry between shareholders (represented by the board as principals) and management (agents). Effective monitoring procedures are correlated with enhanced risk management and reduced agency expenses.

Therefore the hypothesis for this argument would be:

H_3: The monitoring and oversight of an internal audit function minimizes agency cost

2.1.6.4. Reporting of Audit Findings

One of the internal audit's main responsibilities is to report audit findings (Dominic S.B & Nonna, 2011). For problems to be understood and resolved quickly, audit findings must be effectively reported. The primary objective of disclosing audit results to stakeholders is to provide an unbiased assessment of the company's risk management, compliance, and internal control systems.

Auditors must offer assurance regarding the preparation of the financial statements by the relevant financial reporting framework and the absence of material misstatements. Audit reporting is a function offering an assessment of the accuracy and fairness of the financial statements of audited entities, mitigating errors, and increasing the level of trust that intended users have in the financial reports created by management (Reiner, Daniel, & Joaquín, 2024).

The steps involved in the reporting process include gathering information, assessing findings, and drafting the audit report. Following that would be verification that the audit report is accurate and complete. Then, the results would be informed to the shareholders in the company.

The effective reporting platform allows transparency, accountability, and continuous improvement of the organization. By the best practices and by practically finding solution to challenges faced, internal auditors can have more value added from their findings and add value to the whole governance and risk management of the organization. Therefore, the hypothesis would be:

H_4: Reporting of Auditing Findings reduces agency costs.

2.1.7. Internal Audit Effectiveness and Agency Costs

In addition, internal audits are a key to the strong corporate governance of an organization. They would assure the shareholders that the decisions of the managers are framed around their interests and hence protect against agency costs while promoting better organizational performance. A good internal auditing department may even be able to reduce agency costs significantly from the reduction of monitoring costs, residual losses, and enhanced accountability and transparency of the organization. The internal audit function requires independence, adequate resources, and alignment of organizational objectives with best practice.

The audit team needs to be completely separate from management for them to make fair judgments on company processes and actions. This rule is paramount and is usually enforced with reporting directly to either the Board of Directors or to the Audit Committee. Being kept separate ensures that other department decisions don't sway people and that they see things objectively for the company and its stakeholders. Now, audit team members need to have some really good knowledge and skills, and they need practical experience, too. A dedication to ongoing professional growth is essential to staying abreast of emerging risks and regulatory demands. Audit reports must be straightforward, brief, and useful. They must convey recommendations, findings, and consequences. A proficient internal audit function guarantees that the required tasks have been completed and monitors the responses to audit recommendations.

Deng Akway & M. Ramadan (2019) explains that the role of audits in agency problems minimization is twofold: firstly, to increase the precision of financial reporting, and secondly, to provide investors with credible information to monitor agent's investment decisions and day-to-day activities. Also, an effective audit, therefore, gives better quality disclosures to investors that provide more avenues to evaluate the company's performance and ensure their resources are used effectively by its managers. An internal audit can be effective if two main the audit is independent and there is an assurance of transparency in the audit.

2.1.7.1. Independence of an Internal Audit

The independence of the internal audit function help lower the agency costs effectively. The internal and independent auditors are not under influence from management decisions and biases that may affect their evaluations. This reduces the potential of overlooking or covering up issues that may arise in agency cost. This independence allows internal auditors to render more candid and accurate reports on the financial health of the organization, operational effectiveness, and compliance with laws and regulations (Don A, Philip E, Lloyd, & Max H, 2006). This cuts down the chances of misrepresentation and is supposed to align the actions of management with the interest of shareholders. All the same, independent internal auditors can monitor management activity and enforce compliance with related policies and procedures. There will be creation of accountability and, what is more, help bring to light and correct possible gross mismanagement or fraudulent practices.

Independent audits help by giving impartial assessments, thus stopping managers from prioritizing their interests over shareholders, thus diminishing agency costs caused by conflicting incentives. The credibility of audit findings and recommendations is bolstered by autonomy in the internal audit function. Investors and regulators are more inclined to have confidence in the company's financial statements and governance procedures, which decreases the perceived risk and related agency expenses. In the study of (Elicana Mwiti, Walubuka, & Gichana, 2019), the researchers revealed how the independence of internal auditors impacts the financial performance of banks listed on the Nairobi Securities Exchange. They discovered that there is a positive correlation. If internal auditors lack independence, they could give biased or incorrect reports because of pressure from management or other stakeholders.

This could result in unnoticed misallocation or ineffectiveness, escalating the expenses for the organization since shareholders might not be informed or capable of dealing with problems promptly. A lack of independence may lead to internal audits not being able to detect important flaws in internal controls (Reiner, Daniel, & Joaquín, 2024). This lack of supervision can result in higher chances of fraudulent activities, mistakes, and operational inefficiencies, thereby increasing agency expenses linked to ineffective control settings. The lack of independence in internal auditing can greatly raise agency costs by causing ineffective management supervision,

weak internal controls, higher fraud risks, decreased accountability, and reduced stakeholder trust.

2.1.7.2. The Assurance of Transparency in Internal Auditing

If an organization sustains its integrity, accountability, and quality, it will consequently develop transparency in its internal auditing. This can be achieved by way of clear reporting structures, provision of detailed and concise reports, easy accessibility of audit information, impartiality and fairness in the outcome, adherence to ethical principles, and lastly, openness in culture. Transparency in internal auditing generally means that the activities, findings, and outcome of the audit function should be easily understandable and accessible to appropriate stakeholders. According to Klein (2002), increased transparency in internal auditing reduces the information asymmetry between management and shareholders. Various studies have shown that through transparent audit practices, shareholders receive accurate and timely information concerning the organization's financial position and its internal controls. Therefore, it lowers the possibilities of managers advancing their interests at the expense of shareholders, hence a reduction in the cost. Companies could more effectively align managers' interests with shareholders by ensuring that audit committees are independent. This conformity decreases agency expenses by improving the precision of financial statements and minimizing chances for management to prioritize their benefit over shareholders'. The auditors need to keep a repository that is accessible and secure for all audit documentation, which includes working papers, findings, and reports. These documents should be accessible to the appropriate stakeholders when necessary.

Transparency of the audit process would mean that stakeholders are able to understand the methodologies and procedures used in auditing for reasons supporting the findings. It involves risk assessment, selection, and actual testing (Abu Kai, 2023). If internal auditing is not transparent, it may lead to an increase in agency costs due to the adverse effects on governance, financial management, and stakeholder trust. The lack of visibility may cause mishandling or inefficiencies in operations to go unnoticed. Poor reporting of the findings from internal audits might leave the issues as they are, hence increasing operational and financial risks. Moreover, lack of transparency may cause the auditors to get biased or influenced by the management which in turn may cause certain unaddressed issues not to be reported or properly dealt with. The

difference between the interests of managers and shareholders can lead to increased agency costs" ((Yacine & Ephraim, 2015).

Without transparency, required control improvement cannot be found out or implemented. Weakness in controls will likely result in additional costs attributed to fraud, non-compliance, and inefficient operations. When the internal audits are not transparent, the investors and other stakeholders will lose trust and confidence in the organization's system of governance and financial reporting. That will automatically create a decline in the price of stock, increased costs in terms of investor communication, and the market image as well.

Properly established and fully functioning internal auditing departments lend support to organizations in risk management, internal controls, efficiency of operations, maintenance of governance and accountability, detection and deterrence of fraud, and assurance that the entity remains compliant with laws and regulations while enhances the financial reporting, giving strategic input, and promoting an ethical culture (Fadhilah, 2022). With such firm bases established, the organization can realize its objectives and goals and amass stakeholder trust in its successes and attain long-term sustainability.

If the internal audit function is not effective, serious negative consequences to the organization can arise. This means that an internal audit may be unable to see newer and older risks, allowing the institution to face losses with respect to financial areas, suffer interruptions in its operations, or be found wanting in respect to compliance. The risk management processes might not be dealt with adequately, which may have an impact on strategic objectives and operational stability.

In addition, the board of directors and audit committee could not have access to accurate and timely information on organizational controls and risk management, hence their ability to provide effective supervision may be constrained. This would cause an increase in the agency cost. Therefore, it is of great importance to ensure internal audits are made effective. The hypothesis for this contention thus would be:

H_5: The effectiveness of internal audit minimizes agency costs in an organization

2.1.8. Role of the Audit Committee of the Board in Minimizing Agency Cost

An audit committee of a board is exactly a sub-committee of the company's board of directors, made up by non-executive directors that are independent from the management of the concerned company.

The board of directors normally constitutes members to an audit committee that is supposed to monitor the financial reporting and auditing in order to determine the authenticity of the financial statements with respect to the relevant laws and regulations.

Being part of the vital corporate governance mechanism and as an integral member of the board of directors, an audit committee is playing a material role in the corporate governance over the management and control and accountable holding of the organizational entity in question. The board of directors normally designates members to an audit committee in order to oversee the process of financial reporting and auditing with regard to the validity of the financial statements and adherence to the relevant laws and regulations. An audit committee is a part of the board of directors and a major component in the structure of corporate governance, thus holding an important place in corporate governance concerning management, control, and accountability within an organization. Audit committees came into existence because of inappropriate auditing and poor management in the organizations, which meant a lack of trust in financial statements and frauds in the organization.

The audit committee also has responsibilities such as the maintenance of the relation between the internal auditor and the independent auditor, examination of work of independent auditors and supervision of the reporting stages in order to improve the effectiveness of the audit (Lawrence J & S Parker, 55-68). The audit committees formed in the corporate governance context serve effectively for the performance of internal audits and independent audits in a lucid and comprehensive manner by satisfying the demands of the entity.

The reports of the internal auditors are mandatorily forwarded to the audit committees. The business should fully support audit committees, backed by the management, and provide them with all the data that the audit committees need in order to be able to execute their duties and responsibilities. One of the crucial roles that audit committees play is as a medium in the effective management of the interactions between the internal audit system and the board of directors (Elif, 2022). This committee acts on behalf of the board of directors from whom it is

granted its authority to execute its corporate governance responsibilities that comprise supervising and tracking the organization's financial reporting, disclosure, internal and external examination, internal oversight, regulatory adherence, and risk handling processes; this is applicable to public, private, and mixed sectors, in addition to some non-governmental and nonprofit organizations (Ahmed Mohsen, 2014).

The Audit Committee saves the agencies money because it ensures that there will be accurate financial reporting, effective internal controls, proper risk management, and resolution of conflicts of interest. An audit committee assures transparency, accountability, and good ethical behavior of a company through independent supervision.

This saves the shareholders from using resources to monitor management and hence reduces the overall agency costs associated with the management-shareholder relationship. In the final analysis, the audit committee improves corporate governance, aligns interests between management and shareholders, and supports the long-term sustainability and profitability of the company. Hence the hypothesis for this assumption would be:

H_6: The audit committee of the board helps minimize agency costs in the company.

2.2. Empirical Literature Review

This study section presents systematic reviews or meta-analyses to provide a comprehensive and unbiased assessment of the empirical evidence on a specific topic. Researchers present multiple pieces of evidence in a thorough analysis that demonstrates their endorsement of the significance of internal audits in reducing agency costs. The research studies related to the issue being discussed are listed below.

The purpose of the article, Meckling & William (1976), is to develop a theoretical framework of understanding the nature of costs involved in the relation between owners and managers within an organization. The main issue here is how ownership structure influences the agency cost as well as the managerial behavior of the agent. The researchers introduced the concept of agency costs as costs arising from conflicts of interest between shareholders, on the one hand, and managers, on the other. These arise because shareholders seek to maximize their wealth, whereas managers may either have different personal goals or even act in a self-serving way. A detailed contract is then drawn up from the research with the terms to make the interest of the agent and

the principal align for harmony. The principal can improve the relationship of the agent and principal by having an expert and systems auditor and control system to monitor the agent. It was asserted that internal audit plays a considerable role in the minimization of agency costs. They reduce the chances of unethical practices by the managers and assure that the financial statements are accurate and reliable.

Effective internal audits can detect or stop managerial decisions that may not be congruent with the objectives of shareholders, hence making the interest of the managers' congruent with those of the shareholders. The paper of Deborah S., Hermanson, F. Todd, & Scott A. (2002), offers a comprehensive analysis and synthesis of empirical research on the efficacy of audit committees. The study examines empirical evidence regarding the effectiveness of audit committees in monitoring financial reporting and internal control systems.

The authors discuss the role that can be played by audit committees in effective governance and financial reporting requirements. The study indirectly examines how internal audit operations, under the supervision of audit committees, may contribute to lower agency costs. It is important to have audit committees that ensure internal auditors are performing their tasks properly and managerial decisions are being made in line with shareholder interests.

Moreover, the study showed that independent audit committees are more effective in controlling the internal audit function and ensuring its independence from management. This independence also lowers agency costs by stopping managerial self-interest and ensuring objective oversight. The Wright, Jeffrey, & Krishnamurthy (2004), examined the association of mechanisms of corporate governance that included internal auditing and quality of reporting. This study, therefore, use empirical review of the effect of internal auditing on reporting quality that indirectly inflicts an impact on the reduction of agency costs. Agency costs are reduced by improved monitoring of managerial activities through efficient internal audit functions and closer alignment with shareholder interests. Observation-based studies have often reported that firms with strong internal audit functions experience a lower level of financial misfeasance and are more effective in their management of operational risks. The study of DeFond & Jere (2005)**,** sought to assess the influence of the Sarbanes-Oxley Act on auditing procedures and corporate governance. It investigates the impact of regulatory changes on the efficiency of internal audits and corporate governance. The research used existing literature and empirical studies to evaluate

the influence of Sarbanes-Oxley on auditing and corporate governance procedures. It examined alterations in regulatory mandates, audit criteria, and corporate governance frameworks, and assessed how they impacted financial reporting and internal audit efficiency. The study of the Sarbanes-Oxley Act in 2002, enforced stricter regulations on financial reporting and auditing.

It was discovered that the act resulted in notable enhancements in financial reporting quality and the empowerment of internal auditors was increased. By implementing more stringent internal controls and mandating more thorough auditing practices. Sarbanes-Oxley ensured that managerial behaviors were in line with the interests of shareholders. This arrangement decreases agency expenses by guaranteeing that financial statements are more trustworthy and that management is responsible for financial disclosures. Enhanced internal controls decrease the likelihood of financial errors and fraudulent behavior. Internal audits help to cut down the costs of the agencies regarding managerial misfeasance and increase the reliability of financial information by improving the effectiveness of the internal controls. In a nutshell, there is an empirical evidence constantly showing the significance of internal auditing in agency cost reduction. Accordingly, internal auditors help managers to converge with shareholders and diminish agency costs by way of monitoring, fraud and other detection, compliance, improvement of operational efficiency, strengthening corporate governance and improving financial reporting.

2.3. Conclusion and Research Gap

The research sought to identify the discovered findings through examining and investigating the above different empirical reviews as well as theoretical facts. It does not mean that findings related to one country directly applies with that of another country and from a sector to another. Each nation and kind of organization has its own different culture, economic background, political environment, compliance rule and regulation in public sector and more of these reflections that needs to take into account. An agent's costs are incurred by the firm when they don't have decision-making authority as directed by their principal. Therefore, the issue lies in the division of property and authority. This conflict of interest can be lessened through internal audits. Within the business context, internal audit's primary function is to investigate and validate the effectiveness of an organization's governance practices (including risk management and internal control procedures) in addition to checking compliance with relevant laws and

regulations. Even though the concept has been refined through various stages, the conflicting interests of principals and agents remain a significant concern. Researchers are still exploring ways to decrease agency costs through corporate governance, monitoring, and incentives.

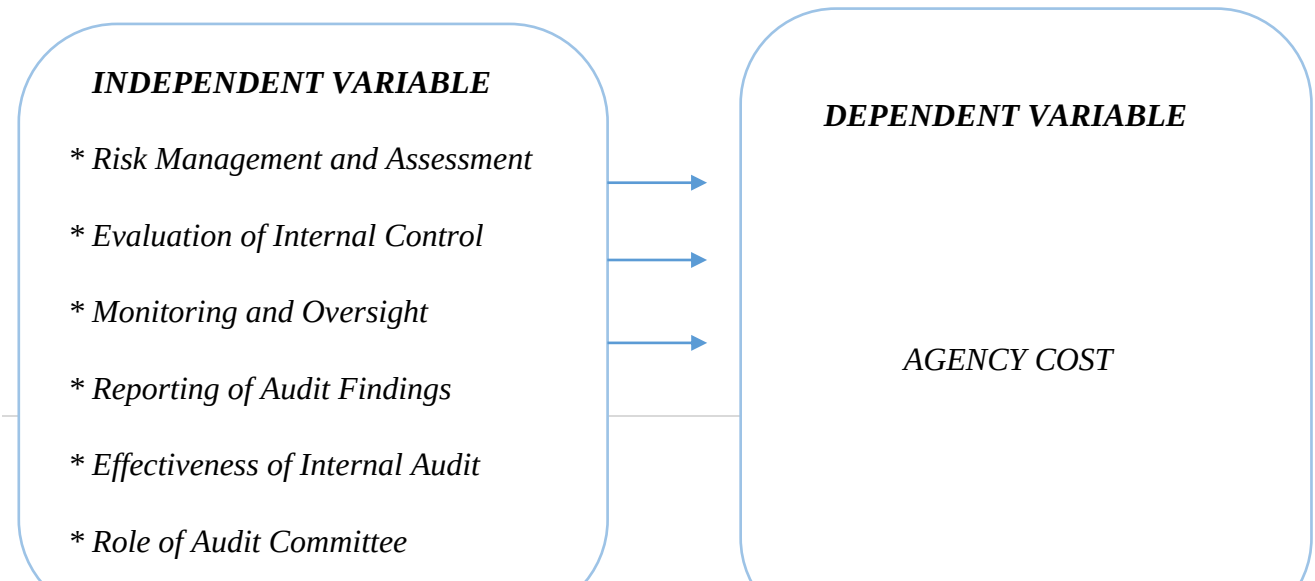
Additionally, in the reviewed studies, scholars obviously found out that an effective internal audit function serves as a key mechanism for reducing agency costs by increasing transparency, strengthening governance, and improving risk management. However it is less likely these are focused. But the list of suggestion for minimizing agency cost in light of internal auditing is very rare. Thus, this research focused in to investigate the phenomena of the Ethiopian private banks internal audit and their role in minimizing agency costs.

2.4. Conceptual Framework

A conceptual framework offers a coherent perspective from which to understand a research problem and to investigate it. It consists of defining key terms and variables, their interrelationships, the theories undergirding the research, and the articulation of the assumptions and limitations of the main topic. A conceptual framework for the present study is developed that could portray a relationship between the internal audit function and agency cost in selected commercial banks in Ethiopia, as shown in the following model.

The model characterizes independent variables such as the functions of internal audit, independence of internal audit, effectiveness of internal audit, and transparency of internal audit with the potential to reduce agency cost—depicted here as a dependent variable in the study.

Figure 1. Conceptual Framework





Source: Own survey, 2025

CHAPTER 3

RESEARCH DESIGN AND METHODOLOGY

This chapter offers a detailed explanation of the process of conducting research. It describes the framework utilized, the process of collecting and analyzing data, and the reasoning behind the decisions. The section consists of the research design, research approach, target population, sample and sampling technique, data source and data collection method, data analysis, and ethical considerations.

3.1. Research Design

The Research Design section outlines a thorough strategy for the implementation of a study. It describes the general layout of the study, detailing the techniques and steps taken for data collection and analysis. The study of internal audits on agency costs adopted an explanatory research design. An explanatory research design aims to understand and clarify the connections between variables, often emphasizing causation. This method is commonly employed to offer an understanding of why specific events happen and the way various variables influence each other.

This type of research design helps to thoroughly investigate and explain the role of audit on agency cost and provide insightful findings.

3.2. Research Approach

A research approach shows how research is carried out including philosophical beliefs, research techniques, and data analysis methods. A quantitative research approach is used for designing and implementing so that the study will effectively address the research questions and objectives. This type of research approach uses statistical analysis to examine hypotheses and discover any relationship among variables.

3.3. Target Population

The target population in research is the complete set of individuals or entities that a study seeks to conclude about. It is the larger population from which a sample is selected and to which the research results are meant to be applied. According to the National Bank of Ethiopia (2024) report the banking industry consists of government-owned banks and private banks. The government bank includes the National Bank of Ethiopia (NBE), which is the issuing bank, the central bank, and the Development Bank of Ethiopia.

Meanwhile, privately owned banks total 31 commercial banks. Those who were established before the year 2005 are chosen based on the year of establishment. The selection was made based on the fact that older establishments have more data accessible. As a result, the research was conducted on six different banks. The emphasis was made to be on their headquarters within the internal audit department. The banks chosen for the study are listed below.

Table 1. List of Banks

Commercial Banks	Year of Establishment
1. Bank of Abyssinia	1996
2. Cooperative Bank of Oromia	2005
3. Dashen Bank	1995
4. Lion International Bank	2006
5. United Bank	1998
6. Wegagen Bank	1997

3.4. Sampling Design

3.4.1. Sampling Frame

A sampling frame provides a comprehensive account of all the cases in the census sampling from which the sample is selected. The sample frame for this research consisted of 100 employees in the internal audit department at the headquarters of the six selected banks. The hundred auditors don't include those investigating transactions within branches in the city and beyond. This is due to branch auditors not involving directly with the issue between managers and shareholders. Among the participants, senior auditors and team leaders for each bank have been selected for the requested interview.

3.4.2. Sampling Technique

Sampling involves choosing a smaller group of people or things from a bigger population to gauge the characteristics of the entire population. The method of sampling or sampling technique involves examining a population by collecting information and evaluating that data. It serves as the foundation for the data, where the sample space is vast.

This study employed a non-probability sampling method, specifically, judgmental sampling (purposive sampling). This type of sampling selects individuals based on the judgment of the researcher. In this method, units are chosen due to possessing the identical traits required for a sample. To put it differently, in purposive sampling, units are chosen "intentionally." As discussed above, the six banks were selected by the year of their establishment.

The total number of internal auditors at the headquarters, excluding those who audit branch transactions, is 100. Therefore, taking into account the entire population, the researcher utilized a simple random sampling technique, ensuring that each participant had an equal opportunity to be chosen. From the total of one hundred, 63 participants (63%) provided their responses, while the other 37 respondents (37%) did not respond.

Number	Name of the Banks Selected for the Study	Total Population in Each Bank's Internal Audit Department (Excluding auditors	Total Number of Questionnaires Returned	Total Number of Questionnaires Not Returned

		who audit branch transactions)		
1.	Bank of Abyssinia	20	13	7
2.	Cooperative Bank of Oromia	15	10	5
3.	Dashen Bank	15	11	4
4.	Lion International Bank	10	4	6
5.	United Bank	15	7	8
6.	Wegagen Bank	25	18	7
	TOTAL	100	63	37

Table 2. Total Number of Population and Sample Size

Source: survey data, 2025

3.5. Data Source and Method of Data Collection

The process of data collection involves gathering and measuring information regarding variables of interest. It allows individuals to address defined research inquiries, examine, formulate theories, test them, and assess results. This study utilized primary data sources, allowing a gain to a more comprehensive understanding of the dynamics.

A primary source of data collection enables a thorough examination of both the benefits and unintended consequences. Directly obtaining information from the source through primary data collection is critical to producing precise and dependable research findings. The study employed surveys and questionnaires to be collected directly by the respondents and interviews to gather detailed insights.

3.5.1. Data Collection Instrument

Data-collection tools comprise tests, surveys, inventories, interview guides, rating scales, research plans, or other methods employed to gather information on largely similar items from various respondents. This study utilized two instruments to analyze and summarize the data that is gathered. These are questionnaires and interviews.

- **Questionnaires**

A questionnaire consists of questions or items to collect information from respondents regarding their views, experiences, or attitudes. The research inquiries utilized a mix of open and closed-

ended questions in the quantitative data collection tool. The study employed a self-administered questionnaire to gather quantitative cross-sectional data, which was then analyzed using SPSS (Statistical Package for Social Science) version 30. Likert scale awarding values to their reasons as **1= strongly disagree; 2= disagree; 3= neutral; 4= agree; 5= strongly agree**, multiple-choice questions and open-ended queries were provided on the questions.

3.6. Data Analysis Technique

The research aims to explore the independent variables which are the functions, independence, effectiveness, and transparency within the selected Ethiopian commercial banks that can affect and minimize the dependent variable which is agency cost. The study utilized quantitative data analysis and employed statistical techniques such as multiple regression analysis and correlational analysis. Below is the linear relationship between the independent and dependent variables in multiple regression analysis.

$$Y = Mean\ (Bo, \beta_1 RMA, \beta_2 EIC, \beta_3 MO, \beta_4 RAF, \beta_5 EIA, \beta_6 RAC) + \epsilon$$

Where:

Y = Agency Cost

RMA = Risk Management and Assessment

EIC = Evaluation of Internal Control

MO = Monitoring and Oversight

RAF = Reporting of Audit Findings

EIA = Effectiveness of Internal Audit

RAC = Role of Audit Committee

β1, β2…, β7 are the coefficients associated with each independent variable.

ϵ is the error term

3.7. Validity and Reliability

Validity in research indicates how well a study measures what it aims to measure, confirming that the findings genuinely represent the phenomenon under investigation and are not affected by outside factors; it fundamentally represents the "accuracy" of the research results, showing whether the research tools and methods effectively capture the target concept or variable. To conduct this research, questionnaires and interviews were created to assess if internal audit is viewed as an effective indicator of agency costs. It is also ensured that the questions effectively reflect the various elements of agency costs.

Furthermore, Reliability denotes the dependability of a measurement instrument, indicating how consistently it yields the same outcomes when utilized multiple times under identical circumstances, thereby reflecting the steadiness and credibility of the gathered data; a dependable study is one where the results can be reproduced if the research is repeated using the same methodologies on a comparable sample, indicating that the outcomes are not the result of random error or chance fluctuations. The reliability of the study was evaluated using Cronbach's statistics. According to the researcher, Cronbach's, the overall consistency of the study is “Acceptable”.

Table 3. Reliability of the Study

Item-Total Statistics	
	Cronbach's Alpha Statistics
Audit Effectiveness	0.6
Risk Assessment and Management	0.7
Evaluation of Internal Control	0.7
Monitoring and Oversight	0.6
Reporting of Audit Finding	0.6
Role of Audit Committee	0.6

Source: SPSS data, 2025

3.8. Ethical Consideration

The study on how internal audit reduces agency costs will uphold the rights and dignity of individuals and the community. They would be informed of the research's purpose, procedures, and potential impacts. The researcher made sure their involvement was willingly given and free from force or excessive influence. During the data collection phase, the researcher adhered to a strict ethical principles to protect the rights and confidentiality of the participants. All in all the researcher was committed to following the appropriate laws and regulations on data protection and research ethics.

CHAPTER FOUR

DATE PRESENTATION, AND ANALYSIS OF FINDINGS

4.1. Introduction

This study examined the role of internal audit in minimizing agency costs in selected commercial banks in Ethiopia. This chapter focused on presenting, analyzing, and interpreting the study's findings to fulfill the objective. This section on data analysis and interpretation consists of various facts and information obtained from primary data, which includes employee perspectives collected through questionnaires and in-person interviews.

4.1. Evaluation of Missing Values

In statistics, missing data refers to instances where a value for a variable is not available for an observation. The presence of missing values is a frequent issue and can greatly impact the inferences that can be made from the data. In this research, some respondents did not answer certain questions. The number of missing values from each variable is 154. This smaller data set

was utilized for all subsequent analyses conducted in this study and reduced the chance of being analyzed to get the needed information.

4.2. Respondents' Profile

According to research, a "respondent profile" displays the demographic details of study participants. As presented in Table 4.1, the profile of the participants, including the gender of respondents, their educational qualifications, current positions, years of service in the bank, and years in their current roles, is detailed below.

Table 4. Profile of the Respondents

		Total Number	Total Percentage %
Gender of the respondents	Male	47	74.6%
	Female	16	25.4%
Educational level	Diploma	0	0.0%
	BSC/BA	22	34.9%
	MSc/MA	39	61.9%
	PHD	2	3.2%
	Other	0	0.0%
Year of service in the correspondent bank	Below 5 years	7	11.7%
	5-10 years	23	38.3%
	10-15 years	21	35.0%
	Above 15 years	9	15.0%
Bank of the respondents	Bank of Abyssinia	13	20.6%
	Cooperative Bank of Oromia	10	15.9%
	Dashen Bank	11	17.5%
	Lion International Bank	4	6.3%
	United Bank	7	11.1%
	Wegagen Bank	18	28.6%
Current position in the bank	missing	1	1.5%
	Senior Manager	2	3.2%
	Audit Specialist	5	7.9%
	Auditor(Officer)	34	54.0%
	Team and Division Manager/Leader	10	15.9%
	Senior Auditor	11	17.5%
Year of service in current position	Below 5 years	41	65.1%
	5-10 years	14	22.2%
	10-15 years	7	11.1%
	Above 15 years	1	1.6%

Source: survey data, 2025

The whole study targeted 100 respondents from the head offices of six banks. According to Table 4, most of the respondents working in the banks (74.6%) are male, while the rest (25.4%) are female. This result shows that there are more of male auditors in the departments. It can ensured that both (male and female) participants were fairly involved in the study and the findings didn't suffer from any gender based biasedness.

Regarding the education level, 61.9% of the participants are MSc/MA holders. The second and third on the education level are BSC/BA (34.9%) and PhD holders (3.2%). It is a known truth that a person's educational background will likely influence how they respond. Nearly every respondent had the information, ability, abilities, and managerial experience necessary to answer the research on the subject at hand, according to the survey. The study's result shows that the majority of the respondents have been working in the correspondent bank for five to ten years. Specifically, 38.3% fall under this category. The rest who have been working for five years are 11.7%, and those above 15 years are 35%.

The participants as a whole totaled sixty-three in number. Of the respondents, the highest percentage (20.6%) belongs to the Wegagen Bank. Abyssinia, Dashen, Cooperative Bank of Oromia, United, and Lion come in places respectively. The majority of respondents are currently working as an Auditor or Officer. 17% of the participants are senior auditors and out of 63, 10 are working as team and division managers or leaders. The remaining are audit specialists and senior managers.

Among the respondents, over 65% of participants wrote that they have worked in their current position for less than five years. 22% worked between five and ten years. Only one person from the questionnaire filled that they have been working in the same position for over 15 years. The result shows that the participants have experience in audit matters and can provide the required information with ease.

4.3. Descriptive Statistics for Study Variables

The practice of examining statistics that describe or quantitatively characterize features from a set of data is known as descriptive statistics. It describes how variables in a sample or population relate to one another to summarize data in an ordered way. The purpose of this study was to find the internal audit's role in minimizing agency costs. According to the findings, the questionnaire asked for an internal governance mechanism that is effective in reducing agency costs.

More than half (68.3%) of the respondents replied that having regular assessments or internal audits is effective. From the below Table, one can see that internal audits are an effective way to reduce or minimize agency costs.

Table 5. Internal Governance Mechanism

	Frequency	Percent
Missing	2	3.1
Clear Delegation of Authority	11	17.5
Having Internal Audits	43	68.3
Employee Training on Ethics and Corporate Responsibility	6	9.5
Reward and Recognition Programs	1	1.6
Total	63	100.0

Source: survey data, 2025

17.5% of the answers belong to those who said that giving a clear delegation of authority to the respected parties is vital to the company's bottom line and lessens the effect of agency cost in the organization. The remaining percentages 9.5% and 1.6% are employee training and reward and recognition programs respectively. Utilizing internal audits to reduce agency costs comes with additional costs.

In the questionnaire and according to Table 6. respondents were asked how their banks deal with such expenses and the majority (54%) replied that for the costs of audits, having and implementing strong corporate governance practices like audit committees would lower them. Secondly, 41.3% of the respondents choose to adopt audit systems and data analytics tools. These auditing tools lower audit expenses by enhancing efficiency and minimizing human mistakes, resulting in more comprehensive and accurate audits.

Table 6. Cost Reduction Mechanism

		Total Number	Total Percentage %
Outsourcing internal audit functions to third-party firms	Missing	10	15.9%
	not selected	50	79.3%
	Selected	3	4.8%
Adopting audit systems and data analytics tools	Missing	10	15.9%
	not selected	27	42.8%
	Selected	26	41.3%
Implementing strong corporate governance practices, such as audit committees	Missing	10	15.9%
	not selected	19	30.1%
	Selected	34	54.0%
Decentralizing audit functions to branch-level staff	Missing	10	15.9%
	not selected	39	61.9%
	Selected	14	22.2%

Source: survey data, 2025

To know how an internal audit minimizes agency cost, the study sought to determine the primary objective of an internal audit and its major functions in the banks studied. Based on Table 7. the respondents mostly (74.6%) chose the evaluation of internal control to be the primary objective of internal audit. 58.7% and 50.8% of the responses are the assessment of risk management and reporting audit findings. Monitoring and oversight of a matter is also an important part of an internal audit's objectives, out of 100, 33% picked it.

Of sixty-three participants, nine chose the "Others" option. Based on their responses, an internal audit aims to provide reasonable assurance so that an organization's risk management, governance, and internal control systems are functioning effectively, enabling the company to reach its objectives by pinpointing possible issues and suggesting enhancements.

Table 7. Objective of Internal Audit

		Total Number	Total Percentage %
Assessing the Risk Management Process	not selected	26	41.3%
	Selected	37	58.7%
Monitoring and Oversight	not selected	42	66.7%
	Selected	21	33.3%
Evaluating Internal Control System	not selected	16	25.4%
	Selected	47	74.6%
Reporting of Audit Findings	not selected	31	49.2%
	Selected	32	50.8%
Others	not selected	54	85.7%
	Selected	9	14.3%

Source: survey data, 2025

In the following section, the researcher examined descriptive statistics for the following independent variables as stated in the first part of the study: Risk Management and Assessment, Evaluation of Internal Control, Monitoring and Oversight, Reporting of Audit Findings, Effectiveness of Internal Audit, and Role of Audit Committee.

4.3.1. Risk Management and Assessment

One of the functions of internal audit is assessing risk areas and managing them. This role requires a thorough assessment of possible risks and their management to prevent any harm to the organization as a whole. The study sought to determine the extent to which respondents agreed that the risk and management function of an internal audit minimizes agency costs. According to the table down below, 98.4% chose “yes” and 1.6% chose “no”. Hence the majority of respondents agreed that this part of the internal audit minimizes agency cost.

Table 8. Risk Assessment and Management

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	62	98.4	98.4	98.4
	No	1	1.6	1.6	100.0
	Total	63	100.0	100.0	

Source: survey data, 2025

Identifying risks related to agency cost is a first and vital step of risk assessment that helps any organization with its financial performance, strengthen its corporate governance and increase shareholders value. According to Table 9, the internal auditors mainly (50.8%) chose the option "Reviewing financial statement and performance metrics" they use to reveal the areas where the agents are acting in their own best interest at the expense of the principals.

Secondly, both evaluation of governance structure and risk assessment tool are utilized equally with the percentage of 46%. Twenty two people answered that evaluating if there is conflict of interest between the two parties is a way of identifying risk that is related to the rise of agency of cost. The rest 31.7% of respondents marked that analyzing the management's compensation structures is a way of identifying risk.

Table 9. Identification of Risk

		Total Number	Total Percentage %
Reviewing financial statements and performance metrics	Missing	3	4.8%
	not selected	28	44.4%
	Selected	32	50.8%
Evaluating the governance structure	Missing	3	4.8%
	not selected	31	49.2%
	Selected	29	46.0%
Analyzing compensation structures	Missing	3	4.8%
	not selected	40	63.5%
	selected	20	31.7%
Utilizing a risk assessment tool	Missing	3	4.8%
	not selected	31	49.2%
	selected	29	46.0%
Evaluating if there is any conflict of interest	Missing	3	4.8%
	not selected	38	60.3%
	selected	22	34.9%

Source: survey data, 2025

The researcher asked about the risk type to better understand which the greatest effect on agency has cost so that the banks would manage them. The auditors claim that the financial risk with a percentage of 47.6% has the greatest impact on the agency relationship, hence increasing agency costs.

According to Ghofar & M.N. (2015), the concept of corporate governance emphasizes risk management as a way of minimizing agency costs, especially considering that financial risk creates incompetency in organizations. Operation risk (27%) and reputational risk (17.5) come second and third respectively. At the last place, which is, legal and regulatory risks have the least impact on agency costs compared to the choices provided.

Table 10. Type of Risk Having Greatest Impact on Agency Cost

	Frequency	Percent	Valid Percent	Cumulative Percent
Missing	3	4.8	4.8	4.8
Financial Risks	30	47.6	47.6	52.4
Operational Risks	17	27.0	27.0	79.4
Reputational Risks	11	17.5	17.5	96.8
Legal and Regulatory Risks	2	3.2	3.2	100.0
Total	63	100.0	100.0	

Source: survey data, 2025

4.3.2. Evaluation of Internal Control

Evaluating internal controls, being a function of internal audit, plays a crucial role in reducing agency within an organization. Table 11. shows that 95.2% of the respondents agree with the statement that "evaluating internal control leads to a minimized agency cost." These in turn will contribute to the banks by improving their overall financial performance as well as increase the value of these firms.

Table 11. Evaluation of Internal control

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	60	95.2	98.4	98.4
	No	1	1.6	1.6	100.0
	Total	61	96.8	100.0	
Missing		2	3.2		
Total		63	100.0		

Source: survey data, 2025

Internal control activities consist of policies and procedures designed to guarantee that management directives are functioning effectively in alignment with shareholder interests and to confirm the efficacy of internal control. Concerning the table down below, 73% of the respondents claim that establishing clear accountability for financial reporting is the one way to align the agency relationship. Secondly, 68.3% of participants chose to align performance metrics, such as revenue growth and market share with long-term goals. From the choices, 26 people stated that minimizing opportunities for management to act in self-interest is a way of aligning agent behavior with the principal's concern.

Table 12. Evaluation of Internal Control in Aligning Agency Relationships

		Total Number	Total Percentage %
Establishing clear accountability for financial reporting	not selected	17	27.0%
	Selected	46	73.0%
Ensuring performance metrics align with long-term goals	not selected	20	31.7%
	Selected	43	68.3%
Minimizing opportunities for management to act in self-interest	not selected	37	58.7%
	Selected	26	41.3%

Source: survey data, 2025

An effective evaluation of internal controls demonstrates a dedication to transparency and accountability, which boosts shareholder confidence and lowers agency costs. Table 13. shows how the auditors ensure that there is effective internal control evaluation. 69.4% of responses are about ensuring that internal controls are functioning well and that is on a day-to-day basis. 42 and 39 participants respectively claim that making sure that designed controls are aligned with organizational objectives and ensuring the outcomes and process of these controls are well-documented are ways to ensure that internal evaluations are effective.

Table 13. Effective Internal Control Evaluation

	Total Number	Total Percentage

			%
Making sure that designed controls are aligned with organizational objectives	not selected	20	32.3%
	selected	42	67.7%
Ensuring internal controls are functioning as intended on a day-to-day basis	not selected	19	30.6%
	selected	43	69.4%
Ensuring the outcomes and process of these controls are well-documented	not selected	23	37.1%
	selected	39	62.9%
Ensuring that the internal control system is critically analyzed and not unbiased	not selected	30	48.4%
	selected	32	51.6%

Source: survey data, 2025

4.3.3. Monitoring and Oversight

Active monitoring and strong oversight are essential for lowering agency costs by addressing the possible conflicts of interest that exist between agents and principals and maximizing value creation. Table 14. shows us that 85.7% of respondents agree that the monitoring and oversight function of internal audit helps minimize agency costs. Out of 63, nine people chose the "no" option, disagreeing with the statement.

Table 14. Monitoring and Oversight in Minimizing Agency Cost

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	54	85.7	85.7	85.7
	No	9	14.3	14.3	100.0
	Total	63	100.0	100.0	

Source: survey data, 2025

An organization utilizes various monitoring activities that effectively identify agency problems. These monitoring efforts help companies gain a deeper understanding of potential issues and enable them to implement corrective measures. In Table 15. having automated and regular monitoring systems is by far the best way to distinguish these problems. Both third-party monitoring and self-reporting mechanisms get 25% of respondents. Peer reviews among auditors comes at last with a total percentage of 15%.

Table 15. Types of Monitoring Activities

	Total	Total Percentage %

		Number	
Third-party monitoring	not selected	45	75.0%
	Selected	15	25.0%
Automated monitoring systems	not selected	33	55.0%
	Selected	27	45.0%
Self-reporting mechanisms	not selected	45	75.0%
	Selected	15	25.0%
Peer reviews	not selected	51	85.0%
	Selected	9	15.0%
Regulatory monitoring	not selected	33	55.0%
	Selected	27	45.0%

Source: survey data, 2025

The agency problem poses a significant challenge that needs to be addressed because of its adverse effects on both organizations and shareholders. In light of this, it is essential for an organization to implement a follow-up system to manage it. Regarding the table below, 76.2% of participants indicated that a follow-up exists, while 22.2% reported that it does not.

Table 16. Follow-up Mechanism for Agency Cost

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	yes	48	76.2	77.4	77.4
	No	14	22.2	22.6	100.0
	Total	62	98.4	100.0	
Missing	8	1	1.6		
Total		63	100.0		

Source: survey data, 2025

To address agency problems, any follow-ups should be conducted promptly, allowing for early detection of the issue and the opportunity to implement necessary actions. The data down below shows that above 80% of values are missing or not responded to. Apart from that 12.7% of the replies are those who answered the follow-up is done quarterly every year. Both “yearly” and “monthly” get 3.2% of replies.

Table 17. Timely Follow-up

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	yearly	2	3.2	16.7	16.7
	quarterly	8	12.7	66.7	83.3
	monthly	2	3.2	16.7	100.0
	Total	12	19.0	100.0	
Missing	8	51	81.0		
Total		63	100.0		

Source: survey data, 2025

4.3.4. Reporting of Audit Findings

Reporting audit results is a key responsibility of an auditor. Internal auditors relay information to shareholders by presenting these audit results. These results contribute to establishing and strengthening trust between agents and principals. Table 18. shows that 92.1% of the respondents agree that conveying the findings helps identify and minimize agency costs. Out of sixty-three respondents, five of them chose the "no" option in the questionnaire.

Table 18. Audit Reporting in Minimizing Agency Cost

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	58	92.1	92.1	92.1
	No	5	7.9	7.9	100.0
	Total	63	100.0	100.0	

Source: survey data, 2025

The findings of audits should be reported to the relevant parties promptly and efficiently. Prompt reporting is crucial for making informed decisions, mitigating risks, and ensuring the overall success of the organization. Down below is a table showing that 82.5% of participants have answered that there is a timely reporting of audit findings, while 4.8% claimed otherwise.

Table 19. Timely Reporting of Audit Findings

	Frequency	Percent	Valid Percent	Cumulative

					Percent
Valid	yes	52	82.5	94.5	94.5
	No	3	4.8	5.5	100.0
	Total	55	87.3	100.0	
Missing	8	8	12.7		
Total		63	100.0		

Source: survey data, 2025

Regarding the benefit of audit findings, the majority of the respondents (83.9%) replied identifying risks that could lead to agency costs. Secondly, ensuring compliance with laws and regulations comes with a percentage of 59.7%. Besides the two options, improving and strengthening organizational culture (53.2%) and detection of inefficiencies (46.8%) follow respectively.

Table 20. Benefit of Audit Findings

		Total Number	Total Percentage %
Detection of inefficiencies	not selected	33	53.2%
	selected	29	46.8%
Identify potential risks that could lead to significant costs	not selected	10	16.1%
	selected	52	83.9%
Ensuring compliance with laws and regulations.	not selected	25	40.3%
	selected	37	59.7%
Improving and strengthening organizational culture	not selected	29	46.8%
	selected	33	53.2%

Source: survey data, 2025

4.3.5. Effectiveness of Internal Audit

An effective internal audit serves as an essential oversight mechanism for management, aids in the prevention and identification of agency issues, and fosters a culture of auditor independence, accountability, and transparency. The auditors would give independent, transparent, and objective assessments of the organization's governance, risk management, and internal control process. According to the mean, most respondents agreed that internal audit effectiveness minimizes agency cost (M = 4.44, SD = 0.562).

The table below represents a high consistency and reliability among statements in questioners. There is a positive perception in the case of independent internal audits tackling fraudulent actions (M = 4.10, SD = 0.995). However, the calculated SD for this variable is .995, which is larger than others. This shows a larger variation in the responses of respondents.

Table 21. Effectiveness of Internal Audit in Minimizing Agency Cost

Descriptive Statistics			
	N	Mean	Std. Deviation
Internal Audit Effectiveness Minimizes Agency Cost	63	4.44	.562
Independent Audit Guarantees Unbiased Assessment of Management Action	63	4.11	.882
An independent Internal Audit tackles fraudulent actions	63	4.10	.995
Transparent Audit reports Identify Inefficiencies in Decision-Making	63	4.29	.551
Transparency of Internal Audits Provide The Board With the Necessary Data To Supervise management	63	4.30	.663
Valid N (listwise)	63		

Source: survey data, 2025

4.3.6. Role of Audit Committee

Based on the information obtained by the researcher, the audit committee is a component of the Board of Directors, which is elected to represent the interests of the Board and is tasked with monitoring financial statements, internal controls, and fostering an ethical culture. By carrying out their duties, audit committees significantly help reduce agency costs. Table 22. shows that the majority responded to the audit committee's evaluation of reducing agency costs (M = 4.13, SD = 0.729). The findings show that there is a high consistency and reliability among statements in questioners. The highest SD is the audit committee supervision in reducing agency costs (M = 3.78, SD = 1.007). This shows a larger variation in the responses of respondents.

Table 22. Role of Audit Committee in Minimizing Agency Cost

Descriptive Statistics			
	N	Mean	Std. Deviation
The Audit Committee's Supervision Reduces Agency Cost	63	3.78	1.007
The Audit Committee's Evaluation Reduces Agency Cost	63	4.13	.729
The Audit Committee's Assessment of Agency Cost Reduces Agency Cost	63	4.03	.695
The Audit Committee's Identification of Conflict of Interest Reduces Agency Cost	63	3.92	.867
The Audit Committee Ensures The Follow-Up of Ethical Norms	63	3.87	.959
Valid N (listwise)	63		

Source: survey data, 2025

4.4. Classical Assumption Test

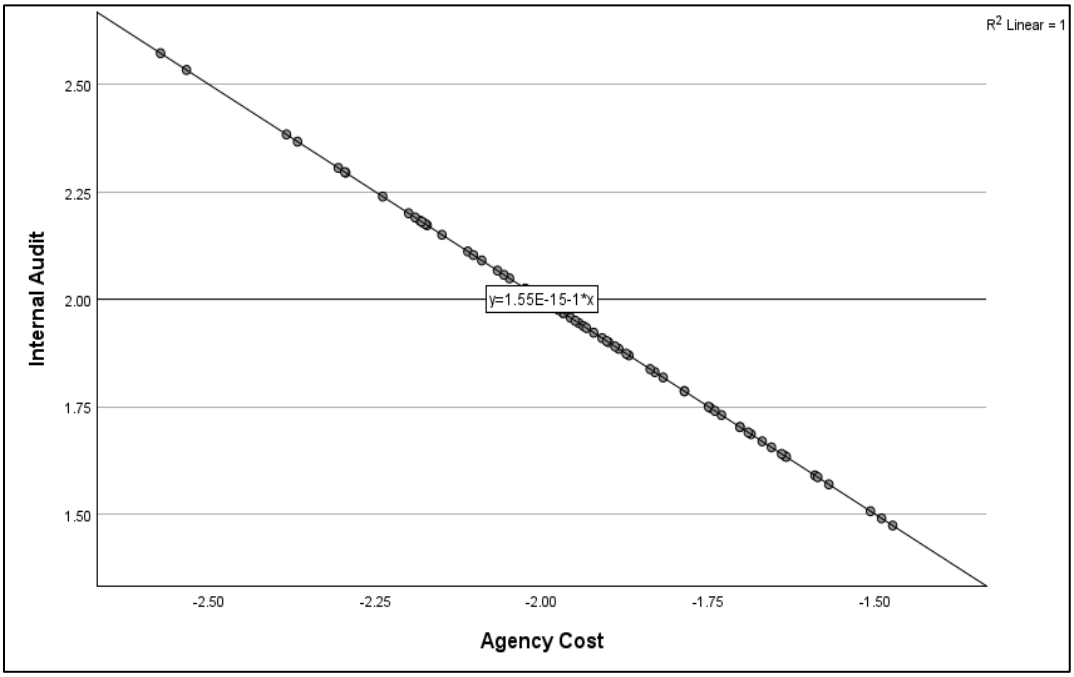
The goal of classical assumption testing is to ensure that the derived regression equation is precise in its estimations, free from bias, and consistent. Key assumptions that need to be satisfied in regression analysis encompass linearity, normality, multicollinearity, heteroscedasticity, and correlation tests. Hence in this section, these tests were performed to examine whether the hypothesis described was met and if the results were acceptable.

4.4.1. Linearity Test

A linearity test is conducted to assess whether there is a significant linear correlation between two or more variables. The findings from these tests can subsequently assist in selecting the most suitable regression model to be utilized. Observing the figure down below, there is a linear property between the two variables i.e. independent and dependent. This can be proven by the alignment of the dots against the reference line.

As shown in the figure, there is a negatively sloping curve. This is to show that there is a linear relationship between the independent and dependent variables. However when one increases, the other variable declines in value.

Figure 2. Linearity Test

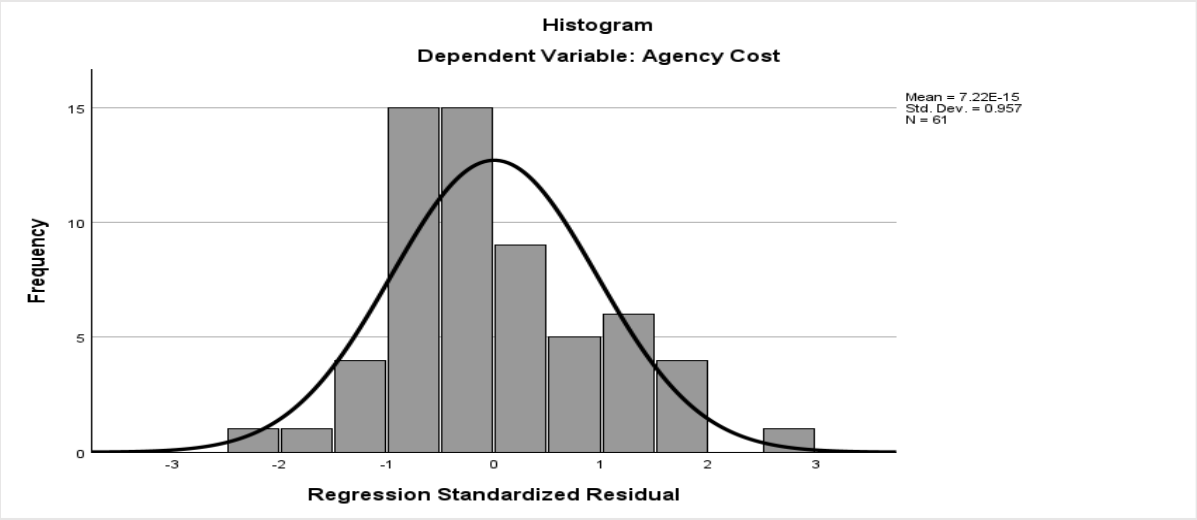


Source: SPSS data, 2025

4.4.2. Normality Test

A normality test is employed to assess if the data follows a normal distribution. Quality research data is characterized by a normal distribution. Figure 3. is a normal distribution, which is bell-shaped and indicates that the data is evenly distributed, thus making it representative of the population. Histograms are useful for examining the center, dispersion, and form of a data set. They can serve as a visual aid for assessing normality. This method offers an excellent means to analyze the distribution of data.

Figure 3. Normality Test

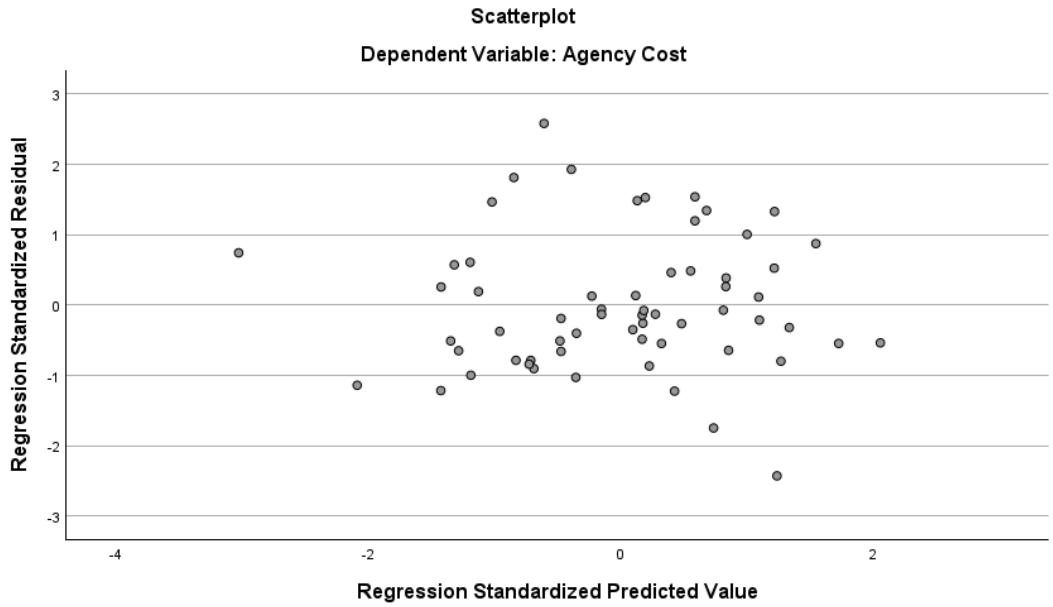


Source: SPSS data, 2025

4.4.3. Test of Homoscedasticity

Heteroscedasticity testing is conducted to determine whether the residual variance of a regression model varies across different observations. As the forecasted values rise, the dispersion of the errors should be approximately alike. The plot down below resembles a random scatter of points. Therefore, the model exhibits homoscedasticity.

Figure 4. Test of Homoscedasticity



Source: SPSS data, 2025

Table 24. Correlation Analysis

4.4.4. Multicollinearity Test

The Multicollinearity Test assesses whether there is a strong correlation among variables in a multiple regression model. The evaluation of multicollinearity can be determined through the tolerance value and the Variance Inflation Factor (VIF). When the tolerance value exceeds 0.10 and the VIF is below 10, it indicates the absence of multicollinearity. High levels of multicollinearity impede the ability to evaluate the individual importance of each independent variable. When multicollinearity is significant, there's an increased chance that a strong predictor of the outcome may be incorrectly identified as non-significant and excluded from the model. Hence, the study has tested multicollinearity based on the VIF value (<10), tolerance level (>0.10), and R-value. The findings suggest that there is no multicollinearity problem with the independent variable's dimensions, as shown by the fact that all tolerance values are larger than 0.10 and all VIF values are less than 10.

Table 23. Multicollinearity Test

Model		Collinearity Statistics	
		Tolerance	VIF
	(Constant)		
	Audit Effectiveness	.800	1.250
	Risk Assessment and Management	.923	1.083
	Evaluation of Internal Control	.488	2.051
	Monitoring and Oversight	.941	1.063
	Reporting of Audit Finding	.478	2.092

Source: SPSS data, 2025

4.4.5. Correlation Analysis

Correlation analysis is a statistical technique employed in research to evaluate the intensity of the linear relationship between two variables and assess their connection. It measures how the variation in one variable corresponds to the variation in the other. Analyzing correlations is crucial as it enables researchers and analysts to recognize and comprehend the relationships among various variables in a dataset, unveiling possible patterns, trends, and dependencies between them. The correlation matrix in Table 4.21 showed the result of the Pearson Correlation between variables. It produced statistical evidence where the dependent and independent have significant and negative linear relationships with performance at 0.05 significant levels.

		Audit Effectiveness	Risk Assessment and Management	Evaluation of Internal Control	Monitoring and Oversight	Reporting of Audit Finding	Role of Audit Committee	Agency Costs
Audit Effectiveness	Pearson Correlation	1						
	Sig. (2-tailed)							
	N	63						
Risk Assessment and Management	Pearson Correlation	.125	1					
	Sig. (2-tailed)	.336						
	N	61	61					
Evaluation of Internal Control	Pearson Correlation	.318*	.152	1				
	Sig. (2-tailed)	.011	.243					
	N	63	61	63				
Monitoring and Oversight	Pearson Correlation	.047	.002	.250*	1			
	Sig. (2-tailed)	.715	.990	.048				
	N	63	61	63	63			
Reporting of Audit Finding	Pearson Correlation	.386**	-.033	.683**	.147	1		
	Sig. (2-tailed)	.002	.801	<.001	.250			
	N	63	61	63	63	63		
Role of Audit Committee	Pearson Correlation	.539**	.066	.098	-.031	.145	1	
	Sig. (2-tailed)	<.001	.612	.447	.808	.258		
	N	63	61	63	63	63	63	
Agency Costs	Pearson Correlation	-.798**	-.465**	-.564**	-.244	-.521**	-.698**	1
	Sig. (2-tailed)	<.001	<.001	<.001	.059	<.001	<.001	
	N	61	61	61	61	61	61	61

Source: SPSS data, 2025

*. Correlation is significant at the 0.05 level (2-tailed)

4.5. Regression Analysis and Hypothesis Testing Results

This part of the research report showcases the statistical results derived from a regression analysis, detailing the coefficients for all independent variables, their significance levels (p-values), and the statistical significance of the overall model. This information enables researchers to evaluate hypotheses regarding the relationships among the variables in the dataset.

Regression analysis is a statistical approach that assesses the connection between different variables. It can be utilized to forecast or clarify one variable by using the values of other variables. To investigate the possible connections among the predictor variable and outcome variable, as well as to evaluate the research hypotheses, multiple regression analyses were performed. According to the table down below, "beta coefficients," indicate the magnitude and direction between variables in regression analysis, assuming that all variables are standardized to a mean of 0 and a standard deviation of 1. Each hypothesis is analyzed using the coefficients table.

Table 25. Coefficients

Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-1.182	.641		-1.843	.071
	Audit Effectiveness	-1.741	.156	-.618	-11.182	<.001
	Risk Assessment and Management	-.996	.139	-.368	-7.153	<.001
	Evaluation of Internal Control	-.888	.390	-.161	-2.275	.027
	Monitoring and Oversight	-.759	.314	-.123	-2.419	.019
	Reporting of Audit Finding	-.854	.395	-.154	-2.160	.035
	Role of Audit Committee	-.263	.036	-.680	-7.253	<.001

Source: SPSS data, 2025

- **H_1: There is a negative significant relationship between risk assessment & management and agency cost**

From the findings and looking at the above table, risk assessment and management had a standardized coefficient (Beta) of -0.368 ($t = -7.153$ $p < 0.05$), indicating a negative relationship. This means that when auditors exhibit effective risk assessment and management, eventually agency costs decrease. Hence H1 or the alternative hypothesis was accepted by the study since it states that there is a negative significant influence of risk assessment and management on agency cost.

This paragraph supports the study conducted by Abdulateif A., Abdullah A., & Abdelaziz S., (2024), titled "Effects of Risk Committee on Agency Costs and Financial Performance". The research focused on understanding the effects of the characteristics of risk committee on agency costs and financial performance. The results indicated that risk committee was negatively and significantly associated with agency costs while positively associated with financial performance.

Thus, the proposed hypothesis is accepted.

- **H_2: There is a negative significant relationship between effective evaluation of internal control and agency cost**

From the findings and looking at the above table, the evaluation of internal control had a standardized coefficient (Beta) of -0.161 ($t = -2.275$, $p < 0.05$), indicating a negative relationship. This means that when auditors exhibit effective evaluation of internal, eventually agency costs decrease. Hence H1 or the alternative hypothesis was accepted by the study since it states that there is a negative significant influence of the evaluation of internal control on agency cost.

Yang (2019) examined "Internal Control, Double Agency Costs, and Corporate Social Responsibility," and found that effective internal control can increase corporate social responsibility performance and reduce double agency costs which supports the second hypothesis.

As such, the researcher accepts the proposed hypothesis.

- **H_3: There is a negative significant relationship between monitoring & oversight and agency cost**

From the findings and looking at the above table, monitoring and oversight had a standardized coefficient (Beta) of -0.123 ($t = -2.419$, $p < 0.05$), indicating a negative relationship. This means that when auditors exhibit effective monitoring and oversight, eventually agency costs decrease. Hence H1 or the alternative hypothesis was accepted by the study since it states that there is a negative significant influence of the monitoring and oversight on agency cost.

In the research of Wright, Jeffrey, & Krishnamurthy (2004) entitled "Corporate Governance Mosaic and Financial Reporting Quality", as stated in the empirical evidence, the study proposes that agency costs can be reduced by enhancing the monitoring and oversight function of activities, and more closely aligning the interest of shareholders.

Therefore, the suggested hypothesis is accepted.

- **H_4: There is a negative significant relationship between reporting of audit findings and agency cost**

From the findings and looking at the above table, the reporting of audit findings had a standardized coefficient (Beta) of -0.154 ($t = -2.160$, $p < 0.05$), indicating a negative relationship. This means that when auditors exhibit effective reporting of audit findings, eventually agency costs decrease. Hence H1 or the alternative hypothesis was accepted by the study since it states that there is a negative significant influence of the reporting of audit findings on agency cost.

The research conducted by Wright, Jeffrey, and Krishnamurthy in 2004,"Corporate Governance Mosaic and Financial Reporting Quality", analyzed the relationship between internal auditing mechanisms of corporate governance and quality of reporting in terms of agency cost. It provided evidence for the effect of internal auditing on reporting quality and its impact on the reduction of agency costs, supporting the hypothesis.

Thus, the proposed hypothesis is accepted.

- **H_5: There is a negative significant relationship between the role of the audit committee and agency cost**

From the findings and looking at the above table, the role of the audit committee had a standardized coefficient (Beta) of -0.680 ($t = -7.253$, $p < 0.05$), indicating a negative relationship. This means that when auditors exhibit the role of the audit committee increases, eventually agency costs decrease. Hence H1 or the alternative hypothesis was accepted by the study since it states that there is a negative significant influence on r the role of the audit committee on agency cost.

In the research conducted by Charlie, David, Gao-Liang, & Qinghua (2011), titled "Do Audit Committees Reduce the Agency Costs of Ownership Structure?", it was discovered that audit committees serve as an addition to existing internal governance mechanisms by mitigating agency conflicts inherent in ownership structure.

Thus, the proposed hypothesis is accepted.

- **H_6: There is a negative significant relationship between internal audit effectiveness and agency cost**

From the findings and looking at the above table, internal audit effectiveness had a standardized coefficient (Beta) of -0.618 ($t = -11.182$, $p < 0.05$), indicating a negative relationship. This means that when auditors exhibit effective internal audits, eventually agency costs decrease. Hence H1 or the alternative hypothesis was accepted by the study since it states that there is a negative significant influence on the internal audit effectiveness on agency cost.

Cohen & Sayag (2010) examined the study designed to conceptualize the effectiveness of internal audits at Israeli organizations. As they suggested, an effective internal audit enhances stronger governance structures with the goal of better aligning management decisions with shareholder interests.

Thus, the proposed hypothesis is accepted.

Table 26. Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.930[a]	.866	.853	.09771

Source: SPSS data, 2025

The summary shows an overall statistical learning model including its key parameters, performance metrics, and structure. According to the model:

- $R^2 = 0.866$ or 86.6%

This metric shows that 86.6% of the total variation in the dependent variables agency cost is explained by the independent variables, which are risk management and assessment, evaluation of internal control, monitoring and oversight, reporting of audit findings, effectiveness of internal audit and role of audit committee in the model. This indicates a very strong fit and that the independent variables are highly effective in predicting the dependent variable.

- Adjusted $R^2 = 0.53$ or 85.3%

85.3% of adjusted R^2 shows that the independent variables which are risk management and assessment, evaluation of internal control, monitoring and oversight, reporting of audit findings, effectiveness of internal audit and role of audit committee contribute significantly in explaining agency cost and the model of $-Mean\ (Bo, \beta_1 RMA, \beta_2 EIC, \beta_3 MO, \beta_4 RAF, \beta_5 EIA, \beta_6 RAC) + \epsilon$. The remaining 14.7% is the ϵ or the control variables. The minor difference between R^2 and Adjusted R^2 (only 1.3%) indicates that the majority of independent variables are significantly contributing. As both the R^2 and Adjusted R^2 are high and similar to each other, the model is strong and well-fitted.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1. Summary

The research had attempted to examine the contribution of internal auditing in minimizing agency costs among selected commercial banks. In order to achieve the study objectives, primary data was gathered and assessed on descriptive statistical analysis. Significantly, the research had attempted to examine the role of internal audit, audit committee, and their efficacy in addressing agency problems. The following summary of the study is hence provided below, considering the objective and findings.

The research involved sixty-three internal auditors from a total of eighty auditors forming the sample size. To gather information, the researcher employed a structured questionnaire and conducted interviews that were administered in person to the participants. The questionnaire consisted of 27 items. A frequency table was utilized to present the descriptive analysis. These include gender, and male respondents are the majority of the respondents with a percentage of 74.6%. The education level, where the “BSC/BA” option holds 34.9% of responses. From the positions given on the choice, the title “Auditors (officers) were chosen the most. The auditors who worked below five years in their current position are forty-one or 65.1 expressed in percentage.

The researcher applied the Cronbach's alpha test, and for hypothesis testing, the researcher utilized tools such as frequencies, mean scores, standard deviations, percentages, T-test, and Pearson's correlation coefficient analysis. The outcomes of the factor analysis indicated that the six independent variables (risk assessment and management, evaluation of internal control, monitoring and oversight, reporting of audit findings, internal audit effectiveness, and the role of the audit committee) exhibited a significantly negative relationship with the dependent variable. The Cronbach's alpha test was used to evaluate the measures' validity and reliability in order to confirm their consistency and make sure they appropriately represented the dependent variable. The impact of internal audits on agency expenses in a subset of Ethiopian commercial banks was evaluated using the mean score and F test, which revealed a negative association.

5.2. Conclusion

The study analyzed the effect of internal audits in lowering agency costs in case of selected The researcher found that internal audits (which include risk assessment and management, evaluation of internal controls, monitoring and oversight, reporting of audit findings, the effectiveness of internal audits, and the functions of the audit committee) negatively impact agency costs within an organization.

When management and stockholders have competing interests, agency costs result. According to the study's findings, internal auditing is an essential part of corporate governance that strengthens these two parties' alignment toward a common objective that is advantageous to the company as a whole. According to the study's findings on the Pearson correlation, all of the explanatory variables and the banks' agency costs are significantly correlated. The study has also found that all of the explanatory variables significantly affect the agency cost at p-value <0.05. It revealed that there is a significant negative relationship between the two variables. Consequently, based on this study's findings, it can be concluded that internal audits assist organizations in reducing agency costs and contribute to a more efficient and effective operation, ultimately benefiting all stakeholders involved.

5.3. Recommendation

Based on the findings of the research, the researcher proposes the following recommendations:

- Given the findings, the study suggests that organizations to allocate resources toward developing and improving their internal audit teams to guarantee that risk assessments, internal control evaluations, monitoring, and audit reports are comprehensive, precise, and prompt. The internal audit function needs to be adequately resourced with skilled professionals and possess a budget that is enough to perform its duties efficiently.
- Secondly, the study suggests that internal auditors and management to have an ongoing prospects for training and development. Training segments include audit processes, risk management design and practices, and corporate governance matters to ensure they are up to date in identifying potential conflicts of interest and inefficiencies in the organization. These modules can also focus on the importance of ethical behaviors, integrity, and compliance to the banking industry.

- The study advises that internal auditors to be consistent and frequent in an audit committee reporting schedule. This will help in identifying problems quicker, make appropriate adjustments to strengthen controls, and to further nurture a culture of transparency and ethical behavior commission. Each of these will further assist banks in reducing the likelihood and implications of conflicts of interest and agency costs.
- Additionally, the study recommends that these banks to encourage coordination, such as having open line communication, among the audit committee, management, and internal auditors to take an early and proactive approach in identifying and minimizing the risk of agency cost. This will also enable the sharing of perspectives and knowledge among the three stakeholders and also contribute to reducing information asymmetry.

5.3.1. Future Research Indication

Based on the results of this study, various directions for future research can be investigated to enhance the comprehension of the impact of internal audits on agency costs, corporate governance, and organizational performance. Below are implications for further research on the subject matter.

Future research could explore how internal audits impact agency costs in different sectors, such as manufacturing and technology and others. This would provide opportunities for comparative analysis and assist in recognizing industry-specific elements that could affect the connection between internal audits and agency costs.

This research concentrated on internal audits, subsequent studies might investigate how external audits collaborate with internal audits to enhance the reduction of agency costs. Gaining insights into the connection between these two audit functions could offer a more thorough understanding of corporate governance mechanisms. Furthermore, one can explore how audit quality contributes to reducing agency costs. Examining these factors might offer a more precise insight into how the effectiveness of internal audits influences agency costs directly.

REFERENCES

Abdulateif A., A., Abdullah A., A., & Abdulaziz S., A. N. (2024). Effects of Risk Committee on Agency Costs and Financial Performance. *Featured Papers in Corporate Finance and Governance*.

Abu Kai, K. (2023). An Assessment of the Effectiveness of the Internal Audit on the Performance of the Public Sector: Case Study of the National Revenue Authority (NRA). *Scientific Research*.

Adams, M. (1994). Agency Theory and the Internal Audit. *Managerial Auditing Journal*.

Ahmed Mohsen, A.-B. (2014). The Role of Audit Committee in Corporate Governance: Descriptive Study. *SSRN Electronic Journal*, 25.

Albert, O. (2016). AGENCY: A review of the agency relationship concept cost problems and strategies for solving agency problems.

Ali, E. (2019). The Corporate Governance Theoretical Framework. In *Corporate Governance of Banks in Libya*. De Gruyter Oldenbourg.

Andrei, S., & Robert, W. V. (1977). A Survey of Corporate Governance. *The Journal of American Finance Association*, 35-55.

Audrey, G., M.J., M., & Arnold, S. (2004). The role of the internal audit function in corporate governance: A synthesis of the extant internal auditing literature and directions for future research. *Journal of Accounting Literature*.

Brian, D. (2024). Impact of Corporate Governance Structures on Strategic Decision-Making Processes in Organizations. *International Journal of Strategic Management*.

Carlo, E. (2021). Assessing conflict of Interest in an organization. *Corporate Ownership & Contro*, 102-116.

Charlie X. Cai, D. H. (2009). *Do Audit Committees Reduce the Agency Costs of Ownership Structure?*

Charlie, C., David, H., Gao-Liang, T., & Qinghua, W. (2011). Do Audit Committees Reduce the Agency Costs of Ownership Structure? *SSRN Electronic Journal* .

Chris, F. (2008). Agency costs and corporate governance mechanisms: Evidence for UK firms. *International Journal of Managerial Finance* .

Cohen, A., & Sayag, G. (2010). The Effectiveness of Internal Auditing: An Empirical Examination of Its Determinants in Israeli Organization. *Australian Accounting Review*, 296-307.

Collier, P., & Gregory, A. (1999, October). Monitoring and Agency Costs in Financial Institutions: Evidence from the Banking Sector. *Journal of Banking & Finance*.

Daniel, G., & Humberto, M. (2013). Simultaneous Adverse Selection and Moral Hazard. *Upenn Economics Department*, 65.

Deborah S., A., Hermanson, D. R., F. Todd, D., & Scott A., R. (2002). Audit Committee Effectiveness: A Review and Synthesis of the Empirical Evidence. *Journal of Accounting Literature*, 38-75.

DeFond, M., & Jere, R. (2005). Audit Research After Sarbanes-Oxley. *Auditing A Journal of Practice & Theory 24(Supplement)*.

Deng Akway, I., & M. Ramadan, D. (2019). *The Role of Audit Quality in Reducing Agency Costs and Cost of Equity Capital: An Empirical Study on Companies listed in the Egyptian Stock Exchange.* Alexandria Journal of Accounting Research.

Dominic S.B, S., & Nonna, M.-B. (2011). The internal audit function, Perceptions of internal audit roles, Effectiveness and Evaluation. *Emerland Insights* .

Don A, M., Philip E, T., Lloyd, T., & Max H, B. (2006). Conflicts Of Interest And The Case Of Auditor Independence: Moral Seduction And Strategic Issue Cycling. *Academy of Managment*.

Edward J., Z., & James D, W. (1994). The Costs and Benefits of Managerial Incentives and Monitoring in Large U.S. Corporations: When is More Not Better? *Strategic Management Journal*, 121-142.

Elicana Mwiti, M., Walubuka, D., & Gichana, M. (2019). Internal Auditors' Independence and Financial Performance of Listed Banks at the Nairobi Securities Exchange. *International Journal of Scientific Research and Management*, 10.

Elif, Ş. (2022). he Relationship between Audit Committee and Corporate Governance in Companies. *Journal of Industrial Policy and Technology Management*.

Eugene, F. F., & Michael, C. J. (1983). Agency Problems and Residual Claims. *Chicago Journals*, 327-349.

Fadhilah, R. (2022). Analysis of the Role of Internal Audit in Enhancing Company's Internal Control.

Frezer, G. (2020). Role of Internal Audit in Organizational Goal Government Revenue Authority. *Achievement: The case of Addis Ababa City*, 69.

G. Tyge, P., & Oleg V., P. (2019). Agency Theory in Business and Management Research.

Gathogo, F. N. (2018). *Effect of internal auditing on agency problem in Kenyan companies: A case of companies listed at the Niorbi security exchange.*

George, A. A. (1970). The Market for "Lemons": Quality Uncertainty and the Market Mechanism. *The Quarterly Journal of Economics*, 488-500.

Gerrit, S., & Mohammad J, A. (2010). Monitoring Effects of the Internal Audit Function: Agency Theory versus other Explanatory Variables. *International Journal of Auditing*, 1-108.

Ghofar, A., & M.N., S. (2015). Corporate Governance and Contigency Theory. *Contributions to Management Science* , 188.

Giang Nguyen Thuc Huong, H. M. (2023). Institutions, Agency Theory in University Governance and the Role of Internal Audit: From the Private Sector Perspectives to the Case of Vietnamese Public Higher Education. 594–607.

IIA. (2018). *Internal auditing's role in corporate governance.* USA: The Institute of Internal Auditors.

Jachi, M., & Yona, L. (2019). The Impact of Independence of Internal Audit Function on Transparency and Accountability Case of Zimbabwe Local Authorities. *Research Journal of Finance and Accounting*.

James P, W., & James K, S. (1990). The Efficiency of Internal and External Corporate Control Mechanisms. *Academy of Managment*, 421-458.

James S, A., & Rebel Allen, C. (1999). Agency Costs and Ownership Structure. *The Journal of Finance*.

Janet L, & Colbert. (2002). Corporate Governance: Communicatios from Internal and Exernal Auditors. *Managerial Auditing Journal*, 147-152.

Jerry, Z., Ross, W., & Jerold, Z. (1983). Agency Problems, Auditing, and the Theory of the Firm: Some Evidence. *The Journal of Law and Economics*, 613-633.

Kelvin Mutua, M. (2023). Internal Control Systems and their role in Financial Fraud Prevention in Kenya. *African Journal of Commercial Studies*.

Klein, A. (2002). Audit committee, board of director characteristics, and earnings management. *Journal of Accounting and Economics*, 375-400.

Lawrence J, A., & S Parker. (55-68). The effects of audit committee and independence on corporate fraud. *Managerial Finance*, 2000.

Ljiljana, M., & Tea, H. (2013). Reducing Agency Costs by Selecting an Appropriate System of Corporate Governance.

Mark R, D., Muhan, Z., & Wei, S. (2022). How Shareholders Impact Stakeholder Interests: A Review and Map for Future Research. *Journal of Management.*

Matthew, R., Ann K., B., & Jill A, B. (2007). Examining the Relationships Between Monitoring and Incentives in Corporate Governance. *Journal of Management Studies*.

Meckling, M. C., & William, H. (1976). Theory of the firm: Managerial behavior, agency costs, and ownership structure. *Journal of Financial Economics*, 305-360.

Muturi, W. (2016). Effect of Internal Control Systems on the Financial Performance of Higher Education Institutions in Puntland. *International Journal of Economics, Commerce and Management*, 762-780.

Nguyen, A., Doan, D., & Ha , L. (2020). Corporate Governance and Agency Cost: Empirical Evidence from Vietnam. *Economics and Finance*.

Nzau, N. (2019). Relationship Between Agency Costs and Financial Performance of Micro-Finance Institution in Machakos Country.

OECD Annual Report. (2007). 131.

Ojo, M. (2009). The Role of External Auditors in Corporate Governance: Agency Problems and the Management of Risk.

Poppy Sofia, K., Haryanto, H., & Sofik, H. (2024). The impact of corporate governance, internal control, and corporate reputation on employee engagement: a moderating role of leadership style. *Cogent Business & Management*.

Ranindya, H., & Ridoni Fardeni, H. (2023). Agency theory: Review of the theory and current research.

Reiner, Q., Daniel, S., & Joaquín, S. (2024). Measures for enhancing auditor independence: Perceptions of spanish non-professional investors and auditors. *European Research on Management and Business Economics*.

Richard, F. (2024). Regulatory Compliance and Monitoring Systems Regulatory Compliance and Program Monitoring.

S.jahera, & Janet, L. (1988). The role of the audit and agency theory. *Journal of applied business research*.

San Thida, A. (2023). *Internal Control Practices, Fraud Prevention And Financial Performace of "A" Bank.*

Shan, L. (2020). A Review of the Relationship between Agency Cost and Corporate Investment Efficiency. *American Journal of Industrial and Business Management*.

Thomas, B. (2024). Theoretical Foundations of Governance and Executive Compensation in Bay Area Benefit Corporations. 211.

Thu Doan, N., & Loi Tan, N. (2022). The Key Strategies for Measuring Employee Performance in Companies: A Systematic Review.

Waewkanee, A., & Sooksan, K. (2023). Toward a sustainability organizational culture model. *Journal of Cleaner Production*.

Wanda A, W., & Richard W, K. (1990). Distinctive Characteristics of Entities with an Internal Audit Department and the Association of the Quality of such Departments with Errors. 485 - 512.

Wanyonyi, L. N. (2018). *The Impact of Agency Costs in Financial Performace of Commercial Banks in Kenya.* Retrieved from UoN Digital repository.

William, M. (1976, October). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, 305-360.

Wright, A., Jeffrey, C., & Krishnamoorthy, G. (2004). Corporate Governance Mosaic and Financial Reporting Quality. *Journal of Accounting Literature*, 87-152.

Yacine, B., & Ephraim, C. (2015). Managerial risk incentives and investment related agency costs. In *International Review of Financial Analysis* (pp. 191-197).

Yang, J. (2019). Internal Control, Double Agency Costs and Corporate Social Responsibility. *Journal of Social Sciences* .

Zoltán, K., & Hoang Bui. (2023). The impacts of corporate governance on firms' performance: from theories and approaches to empirical findings. *Journal of Financial Regulation and Compliance*.

APPENDIX

ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

MASTER'S DEGREE IN ACCOUNTING AND FINANCE

Research Questionnaire

Dear Respondents,

I am Meron, a graduate student of Addis Ababa University College of Business and Economics graduate student. I am inviting you to participate in this research to complete the following survey. This study aims to find the role of Internal Audit in the Minimization of Agency Costs: in Selected Commercial Banks in Ethiopia. The questionnaire will require approximately 10-15 minutes to complete. It is not an obligation to respond to this question under any circumstances. Nonetheless, this will help me finish my research and improve my comprehension of the study's focus. The gathered data will be kept private and utilized exclusively for academic reasons.

Notes to be considered:

- Read each statement carefully.
- Kindly place a tick mark (✓) next to the questions with boxes and write your answer for questions in the space given.
- You are not required to write your name.

Thank you in advance

Section I. Biographical Information

1. Gender □ Male □ Female
2. Educational level: □ Diploma □ BSc/BA □ MSc/MA □ PhD □ Others
3. Which bank are you working at? _____
4. Year of service in the correspondent bank □ Below 5 years □ 5-10 years □ 10-15 years □ Above 15 years
5. What is your current position in the bank? _____

6. How long have you been in your current position? □ Below 5 years □ 5-10 years □ 10-15 years □ Above 15 years

Section II. Internal Audit Function

This section of the questionnaire will demonstrate an understanding of the issue regarding the functions of internal audit.

1. Does your bank have a dedicated internal audit department?

   □ Yes

   □ No

2. To whom does the internal audit department report? To the:

   □ Board □ Audit Committee □ Management

3. Which internal governance mechanism is the most effective at reducing agency costs based on the choices stated below?

   □ Clear delegation of authority

   □ Regular internal assessments (Having internal audits)

   □ Employee training on ethics and corporate responsibility

   □ Reward and Recognition Programs

4. Based on question 3, if you chose internal audits, which of the following mechanisms does your bank use to minimize the costs of internal audits while also lowering agency costs? (Please select all that apply)

   □ Outsourcing internal audit functions to third-party firms
   □ Adopting audit systems and data analytics tools
   □ Implementing strong corporate governance practices, such as audit committees
   □ Decentralizing audit functions to branch-level staff

5. What is the primary objective of an internal audit? (Please select all that apply)

□ Assessing the risk management process

□ Monitoring and Oversight

□ Evaluating internal control system

□ Reporting of Audit Findings

□ Others, (please specify), _____

6. Does the risk assessment and management function of an internal audit help minimize agency costs?

□ Yes □ No

7. How do the internal auditors identify any risk that is related to agency cost? Please choose any means that apply

□ By reviewing financial statements and performance metrics

□ By evaluating the governance structure

□ By analyzing compensation structures

□ By utilizing a risk assessment tool

□ By evaluating if there is any conflict of interest

8. Which type of risks identified by internal auditors have the greatest impact on agency costs?

□ Financial risks □ Operational risks □ Reputational risks

□ Legal and regulatory risks □ Others, (please specify), _____

9. Does the evaluation of internal control minimize agency costs?

□ Yes □ No

10. How can evaluating internal control systems help align management's behavior with shareholder interests, thereby reducing agency costs? (Please select all that apply)

□ Establishing clear accountability for financial reporting

□ Ensuring performance metrics align with long-term goals

□ Minimizing opportunities for management to act in self-interest

□ Others, (please specify), _____

11. How does the internal audit ensure an effective internal control evaluation? (Please select all that apply)

□ Making sure that designed controls are aligned with organizational objectives

□ Ensuring internal controls are functioning as intended on a day-to-day basis

□ Ensuring the outcomes and process of these controls are well-documented

□ Ensuring that the internal control system is critically analyzed and not unbiased

□ Others, (please specify), _____

12. Does the monitoring and oversight of an internal audit function minimize agency costs?

□ Yes □ No

13. What types of monitoring activities described below are the most utilized and effective in detecting agency in the department? (Please select all that apply)

□ Third-party monitoring □ Automated monitoring systems

□ Self-reporting mechanisms □ Regulatory monitoring

□ Peer reviews

14. Does the department have a monitoring or follow-up mechanism for cases like agency costs?

□ Yes □ No

15. Does reporting of audit findings minimize agency costs?

□ Yes □ No

16. If you say yes, is there a timely reporting of audit findings that helps reduce agency costs?

□ Yes □ No

17. What is one benefit of audit finding do you think is the best in minimizing agency cost? (Please select all that apply)

□ Detection of inefficiencies

□ Identify potential risks that could lead to significant costs

□ Ensuring compliance with laws and regulations.

□ Improving and strengthening organizational culture

□ Others, (please specify), _____

Section II. Internal Audit Effectiveness

The second part of the questionnaire will show how an internal audit's effectiveness and the audit committee's role reduce agency costs. For the following statements put (√) sign for your level of agreement based on the scales below.

Key for Scales: 1 = strongly disagree; 2 = disagree, 3 = neutral; 4 = agree and 5 = strongly agree

I. ***Internal Audit Effectiveness in Minimizing Agency Costs***

No	***Internal Audit Effectiveness***	**1**	**2**	**3**	**4**	**5**
1	Internal audit effectiveness minimizes agency cost					
2	The independence of internal audit guarantees unbiased assessment of the management actions.					
3	An independent internal audit department is more effective in identifying and tackling fraudulent actions that could increase agency costs.					
4	The transparency of internal audit reports helps identify possible inefficiencies in management's decision-making.					
5	The transparency of internal audits helps provide the board with the necessary data to efficiently supervise management and lower agency costs.					

II. ***Role of the Audit Committee of the Board in Minimizing Agency Costs***

No	***Role of the Audit Committee of the Board***	**1**	**2**	**3**	**4**	**5**
1	The audit committee supervises the financial reporting, hence lowering the chances of misstatements, thus lowering agency costs.					
2	The audit committee's evaluation of internal controls and risk management helps lower the likelihood of mismanagement and minimizes agency costs.					
3	The audit committee assesses the work of independent auditors and supervises the reporting phases to enhance the audit's effectiveness.					
4	The audit committee plays an active role in identifying and addressing conflicts of interest between management and shareholders.					
5	The audit committee guarantees that the company follows ethical norms, preventing the management from participating in unethical behaviors that might result in increased agency costs.					