



**FACTORS AFFECTING INTERNAL AUDIT EFFECTIVENESS:  
THE CASE OF ETHIOPIAN INSURANCE COMPANIES**

**BY: AREFAYNE WODAJO**

**A RESEARCH THESIS SUBMITTED TO THE DEPARTMENT  
OF ACCOUNTING AND FINANCE, COLLEGE OF BUSINESS  
AND ECONOMICS, IN PARTIAL FULFILLMENT OF THE  
REQUIREMENT OF MASTER OF SCIENCE (MSC) IN  
ACCOUNTING AND FINANCE**

**ADDIS ABABA, ETHIOPIA  
FEBRUARY 2019**

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**ADVISOR: HABTAMU BERHANU (PhD)**

**ADDIS ABABA, ETHIOPIA  
FEBRUARY 2019**

## **Statement of Declaration**

I certify that the ideas contained in this study are entirely my own, except where otherwise acknowledged. I also certify that the work is original and has not been submitted for any other award.

Student Name: - Arefayne Wodajo

Signature: - \_\_\_\_\_

Date: February 28, 2019

## **Statement of Certification**

This is to certify that Arefayne Wodajo has carried out this research thesis on the topic entitled “Factors Affecting Internal Audit Effectiveness: the case of Ethiopian Insurance Companies” in partial fulfillment for the award of Masters of Science (Msc) in Accounting and Finance under my guidance and supervision. I certify that this research work is original in nature and has not presented in any means and to any award.

Name of Advisor: - Habtamu Berhanu (PhD)

Signature: - \_\_\_\_\_

Date: - February 28, 2019



## ABSTRACT

*IA activity plays a crucial role within an organization. IA activity helped an organization by evaluating the risks whether they are under control or worth taking. The overall objective of the study is to examine the factors determining the effectiveness of internal audit in Ethiopian Insurance private companies. The study focused on all Ethiopian private 16 insurance companies head office internal auditor's staffs and Finance and accounts, insurance operation and HR department managers. Explanatory research design has been used with primary and secondary data by using mixed research method by employing quantitative and qualitative research methods. The quantitative research method used through 91 usable self-administered questionnaires. These questionnaires were constructed in 5-point likert scale, distributed to internal auditors and to triangulate the data additional questionnaires were distributed to department head of Ethiopian insurance companies and analyzed using STATA statistical software. The qualitative research method used through documents review and interview. The Ordinary Least Square (OLS) linear regression model was used to analysis the collected data and examines the association between IAE and four study's variables. According to the results of the study; competence of IA teams, quality of IA, and management support were strong but not significantly effect on the effectiveness of internal audit regarding on value adding role, enhance department performance, and enhance organizational performance. However, independence of IA is the sole factor determining effectiveness of internal audit in Ethiopian insurance companies. The researcher mainly recommended; the country's financial regulatory organ (i.e National bank of Ethiopia) should work more on the ways of ensuring the organizational independence of internal auditors and should have to develop transparent and well organized approaches. Additionally, private insurance companies need to ensuring the effective functioning and changing the audit approach of Audit committee in line with current global to gain the benefit on advancement internal audit standards, approving and implementing internal audit charter and audit manual in each insurance company, audit report should be standardized and approve audit strategy.*

**Key words:** *Internal Audit, Ethiopian insurance companies, and Effectiveness of Internal Audit.*

## **ACKNOWLEDGEMENTS**

The preparation of this study in such attractive format required me efforts and inputs of ten rock-hard months. The outcome is a combination and amalgamation of lots of thoroughness of more people than it is feasible to see. Therefore, I would like to express my gratitude to those individuals especially to Ato Alemzewed Ayle, W/ro Eden Frehiwot & her husband Dr. Eyob and organizations who contributed in different ways to the successful completion of this study. Above all, I praise my God for enabling me to complete this study.

I am unequivocally indebted to my advisor Dr. Habtamu Berhanu who supports me in providing of constructive critiques, comments, and suggestion which helped me in accomplishing of the objective of the study. He also continued to provide wisdom and insight, as well as encouragement and support throughout the study.

I would like to extend my honor and prize to the members of my family, my two son Naty & Amen and, most importantly, to my wife W/ro Hana Berhanu. She has raised me to this height and depth. All the tributes of my success should go to her. My wife support will be unforgettable throughout my life. I wish for her long life and satisfaction.

Most of all, my cordial appreciation goes to the internal audit department staff of Ethiopian private insurance companies. They have meticulously made their inputs and shared their perspectives and comments with me.

Last of all but not the least, I am truly grateful to all who have devoted their precious time and expertise, and lent me their hands at all steps of the preparation of this study. Their immeasurable inputs and support that they have made in the course of processing and preparing this study is in fact too august to put it in terms of words.

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## **LIST OF ACRONYMS**

AAA- Association of American Accountants

CBOK - Common Body of Knowledge

COSO - Committee of Sponsoring Organizations

CPA – Certified Public Accountant

EIS (C) - Ethiopian Insurance Sector (Companies)

ERM - Enterprises Risk Management

IA - Internal Audit

IAE -Internal Audit Effectiveness

IAF - Internal Audit Function

IIA - Institute of Internal Auditors

IPPF - International Professional Practices Framework

MoFEC - Ministry of Finance and Economic Cooperation

NBE - National Bank of Ethiopia

# CHAPTER ONE

## INTRODUCTION

### 1.1. Background of the study

The role of auditors in auditing has increased dramatically changed, primarily because of the increased size and complexity of many corporations. The subject of governance has become a pertinent issue for business, government, politics, and the general public. In both the private and the public sectors, there is an increasing demand for good governance in terms of accountability and transparency, and internal audit function within organizations has an important role to play in the achievement of these objectives. (Taiwo, Samuel & James, 2016)

Many organizations are showing concern to their internal auditors in order to give guidance and advice at different levels of management (Davies, 2001). This is because, the internal audit plays an important role in the organizational process, and therefore it is not only required to perform ordinary assurance activities, but also to serve as a strategic partner of the organization and add value to its activities towards improving organizational processes and ensuring their effectiveness and efficiency (Al-Twaijry, Brierley, & Gwilliam, 2003; Savouk, 2007; Mihret, James, & Joseph, 2010).

IIA (2001) explain that internal auditing is an independent, objective assurance and activity designed what value and improves and organizations operations. An internal audit function could be viewed as a “first line defense” against in adequate corporate governance and financial reporting. Corporate governance is an organizational approach which provides assurance to external stakeholders that an organization unfulfilling its responsibility to them.

These days, researchers and practitioners have given more emphasis on IA and internal auditor’s role to the company operations than earlier. (Baharud- din, et al., 2014; George, et al., 2015; Changwony & Rotich, 2015). For the time being, increasing attention has risen on issues such as performance evaluation and effectiveness of IA (Mihret & Yismaw, 2007; Belay, 2007; Mihret, et al., 2010; Abu Azza, 2012; Ramachandran, et al., 2012; Endaya & Hanefah, 2013; Wubishet & Dereje, 2014; George, et al., 2015).

Internal auditors which are the focus of this study and also the key employee of public offices, are expected to work independently and objectively to enhance high quality of public services, achieve good internal control system, avoid corruption, ensure good corporate governance system, promote accountability and greater transparency (Van Peurseem, 2005; Belay, 2007; Coram et al, 2008;).

Therefore, it is important to have effective internal audit function/unit as part of modern governance system in different sector. In corporate governance internal audit (IA) issue has received increasing attention in recent years, due to different reasons. To mention some of them, internal audit links to the internal control-risk management system; improve organizational efficiency and effectiveness through providing constructive criticism and recommendations about organizations status; reduce information asymmetry during decision making; serves as an important internal assurance in the business and financial reporting process of corporations (Mihret and Yismaw, 2007; Cohen and Sayag, 2010; Soh and Bennie, 2011).

According to Ethiopian Insurance Business Proclamation 746/2012 an insurance company provides services under main class of business such as long term insurance business or general insurance business which benefit all of the society and encourage equal opportunity to benefit from those services. This research focused and interprets the study results on factors of Internal Audit effectiveness in the selected insurance companies operating in Ethiopia.

## **1.2. Statement of the problems**

Insurance plays a crucial role in fostering commercial and infrastructural businesses. It promotes financial and social stability; mobilizes and channels savings; support trade, commerce and the overall wellbeing in a country (Malik 2011). This implies that insurance companies are helping the economy one way by transferring and sharing of risk which can create confidence over occurrences of uncertain event and in another way insurance companies like other financial institutions plays the role of financial intermediation so as to channel financial resources from one to the other. Therefore, we can divide insurance companies in to two broad categories bases on their role to the economy, the general insurance companies and life insurance companies.

The National Bank of Ethiopia also indicated that the Ethiopian economy which had showed 9.3 percent average annual growth during 2013/14 - 2017/18 fiscal years and the insurance market also registered average growth of 26% during 2017/18. Therefore, economic growth is one of the prerequisites for the development of insurance market.

Local studies were conducted regarding Challenges and Opportunities, internal audit practices, corporate governance on financial performance and the Role of Internal Auditors in insurance industry (Temesgen, 2015; Gardachew, 2015; Amina, 2016). There are also researches conducted on public sector of Ethiopia. (Mihret and Yismaw, 2007; Mihret, 2010; Guruswamy, 2012; Mebratu, 2015; Hailemariam, 2014). These studies gave great emphasis on the factors affecting the effectiveness of the internal auditors on public sector. Attempts were not made in the Insurance industries which plays an critical role that are introducing risk pooling and reducing the impact of large losses, the sector reduces the amount of capital that would be needed to cover these losses, encouraging additional investment, output, innovation, and competition. (Ethiopian insurance business proclamation no.746/2012)

Despite its importance, effectiveness of IA in Ethiopian insurance sector (EIS) has unexplored so far. As to the researcher knowledge, there is no empirical research on such area. Thus, examining IA effectiveness in Insurance sector which has not been extensively studied yet in developing countries especially in Ethiopia can contribute to address the gap in the literature (Wubishet & Dereje, 2014; Mihret & Yismaw, 2007; Abu-Azza, 2012; Mihret A.G., 2011).

This study examine the factors determining the effectiveness of IA in EIS according to the framework created by George, et al., (2015) quality of IA, competence of IA team, independence of IA, and management support. Therefore, the study aimed to examine the factors determining effectiveness of IA in Ethiopian insurance companies.

### **1.3. Objective of the Study**

#### **1.3.1. General Objective**

The general purpose of this study is to examine the factors affecting internal audit effectiveness in Ethiopian insurance companies.

### **1.3.2. Specific Objective**

Specifically, the researchers tried to achieve the following objectives;

- To examine the effect of Adequate and Competent IA staff placement in the internal audit effectiveness in Ethiopian insurance companies.
- To assess the contributions of organizational independence of internal auditors for IAE in Ethiopian insurance companies.
- To look over the contributions of management support for IAE in Ethiopian insurance companies.
- To evaluate the role of quality of Audit work for IAE in Ethiopian insurance companies.

### **1.4. Research questions**

This research intended to answer the following research questions:-

- ✎ What is the effect of the support given by the management to IA in enhancing the IAE?
- ✎ Does adequate and competent internal audit staff impacts on IAE?
- ✎ Does internal audit independence affect IAE?
- ✎ What is the effect of quality of audit work on IAE?

### **1.5. Research Hypotheses**

After related literatures were extensively reviewed on management support, organizational independence of internal auditors, adequate competent internal audit staff, and the quality of audit work IAE, the following directional research hypotheses were developed.

H1: Competence of IA teams has positive and significant effect on the EIA in Ethiopian insurance companies (EIC).

H2: Independence of IA has positive and significant effect on the effectiveness of IA in EICs.

H3: Quality of IA work has positive and significant effect on the effectiveness of IA in EICs.

H4: Management supports have positive and significant effect on the EIA in EICs.

### **1.6. Scope of The Study**

The relevant dimensions selected in particular for this study is limited to such factors; management support, adequate and competent internal audit staff, IA independence and quality of Internal audit work. The target groups of the population are the internal audit team/staff and some selected other department's staff.

The research restricted the study area on Ethiopian private insurance company with a focus on Internal Audit Department at head office staffs in related with effectiveness of Internal Audit.

### **1.7. Significance of the Study**

This study was conducted to examine the effect of management Support, existence of IA independence, adequate and competent internal audit staff and the quality of audit work on internal auditor's effectiveness in Ethiopian insurance companies. The study's outcomes have three important significances.

First, the study's conclusions would be used in internal auditors' effectiveness improvement strategy and policy by the Insurer Company & NBE. Second, they enable management to take corrective measures by specifically identifying significant factors of internal auditor's effectiveness.

Second, the study outcomes would contribute to the literature by developing base for a conceptual understanding of internal auditors' effectiveness in Ethiopia insurance companies. Finally, the study identifies future research areas that would have advantage for other researchers to conduct further study in the area. Therefore, the study can contribute to the country at large regarding the effectiveness of Internal Audits in related companies.

### **1.8. Limitation of the Study**

The limitation of this study is readily apparent. The generalizability of the findings and the conclusions drawn is limited. Because each country either developed or developing such as: Ethiopia and sectors other than insurance has their own nature and culture. The results from a survey in other setting (country or other sector) may give different outlook. Therefore, to generalize such a result in those different settings may worth the result. Inevitably, this study has methodological flaws and limitations that could have significant effect on the quality and reliability of findings. There is also the possibility that the internal auditors' responses may have incorporated biases or perhaps only indirectly reflected underlying beliefs and perceptions.

## **CHAPTER TWO**

### **REVIEW OF LITERATURE**

#### **2. Theoretical and Conceptual Literature**

##### **2.1. Auditing definition**

A comprehensive definition of auditing expressed on A Statement of Basic Auditing Concepts AAA, (1973) as follow:

Auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.

Several types of auditors are in practice today. According to (William, Et.al, 2014) Auditing can be classified into: External Audit and Internal Audit. The auditors who act in such type of audit are known as External Auditors and Internal Auditors respectively. An external auditor may practice as a sole proprietor or as a member of a CPA firm. Such auditors are called “external” or “independent” because they are not employees of the entity being audited. External auditors audit financial statements for publicly traded and private companies, partnerships, municipalities, individuals, and other types of entities. On the other auditors who are employees of individual companies, partnerships, government agencies, and other entities are called internal auditors. The Institute of Internal Auditors (IIA) is the primary organization supporting internal auditors. Its mission is to “provide dynamic leadership for the global profession of internal auditing.” The IIA has developed a set of professional standards to be followed by internal auditors. Internal auditors often conduct financial, internal control, compliance, operational, and forensic audits within their organizations. In some cases they may assist the external auditors with the annual financial statement audit. IAs also often is involved in assurance and consulting engagements for their entities.

##### **2.2. Definition and roles of Internal audit**

Different literatures defines internal audit in different ways but the standard definition is made up of important issues that form the basic framework of internal audit principles. A simple and more traditional meaning of internal auditing is defined as: an independent appraisal function established within an organization to examine and evaluate its activities as a service to the

organization. Later on, the new Institute of Internal Audit (IIA, 2001), defined internal audit as:

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

IA activity plays a crucial role within an organization. IA activity helped an organization by evaluating the risks whether they are under control or worth taking. Paper titled 'the Role of Internal Audit in Risk Management' (2009). The IIA emphasizes that the board and management are responsible for actual risk management, and that internal audit's role is to provide assurance on the process that management uses and to consult on ERM, provided the activity does not jeopardize internal audit's independence and objectivity. To further clarify, the IIA provided examples of various roles that IA may and may not undertake in ERM. There are considerable opportunities for internal audit to broaden its traditional scope and add value to their organization's ERM program. Today despite the modest level of top-down direction received from the audit committee and management, IA activities have made strides in playing a role in risk management and will continue to do so. The 2010 IIA Global Internal Audit Survey (a component of the Common Body of Knowledge [CBOK] studies) indicated that 57 percent of IA activities around the world perform audits of enterprise risk management processes. Furthermore, 20 percent of respondents indicated that they believed performing such audits would become more prominent over the next five years. (The IIARF White Paper) As a result, senior management and the board increased their reliance on the IA to improve the organization's operation and to systematically evaluate the management or organizational risks, controls and governance processes which are essential factors in the achievement of objectives (Gupta, 2001).

The need for improved internal control and auditing mechanisms is one of the most important issues in public debate regarding corporate governance. Compliance with corporate governance principles especially IAF leads to better organizational performance (Omolaye and Jacob, 2017). The literature also indicates that external auditors' reliance on internal audit work could produce a significant cost saving through reduction of external audit time. External auditors assess IA work to determine the extent of their reliance differences between his work

and the work of the internal auditor. Such reliance is also considered as an area where IA adds value through reduced audit fees (Krishnamoorthy, 2001, 2002; Morrill and Morrill, 2003; Mihret 2010; Mihret, James and Mula 2010).

Hence, It is mandatory to enhance the quality of IA activities and audit processes, the external auditor should verify the integrity, transparency and commitment of IA to the internal audit standards in preparing the report and that it is in favor of the external auditor and the external auditing process to activate the communication between him and the internal auditor in order to achieve a positive role in facilitating the external audit process. (Laith, 2016)

The global economic environment is continuously changing. The organizations are interested in increasing their performance, a desire that is not possible if their internal auditing department is not keeping up the pace to identify the potential risks, the evolution of the processes and the results of the changes from the external environment with the fast rhythm of development of the economic entities. There is a direct relation between the company's performance and the internal auditing function, the performance being the effect and the internal auditing function being one of the causes.

In the last decades, important changes took place in what concerns the attention given to the evaluation of the benefits, effectiveness and performance of internal auditing. Therefore, internal auditing registers a continuous evolution, determined by the dynamic environment in which it operates. (Audit financiar, 2017) Hence, Value adding role of IAF is helping to achieve the efficiency, effectiveness and economy of the company's performance and of resources utilization, helping management to achieve the company's goals. (Pinto, et, al., 2014) However, Value adding is also influenced by the effectiveness of the internal auditing (Mihret & Woldeyohannis, 2008; Mihret, et al., 2010; Mihret A.G., 2011). However, different researchers suggest that the IA function may not always be effective (Al-Twajjry, et al., 2003; Mihret & Yismaw, 2007; Mihret, et al., 2010; Ramachandran, et al., 2012; Wubishet & Dereje, 2014). Some scholars advocated to assess effectiveness of IA in varies scope (Al-Twajjry, et al., 2003; Mihret & Yismaw, 2007; Mihret, et al., 2010; Abu-Azza, 2012; Ramachandran, et al., 2012; Wubishet & Dereje, 2014).

### **2.3. Internal Audit in Insurance companies**

The demand for both external and internal auditing is sourced in the need to have some means of independent verification to reduce record-keeping errors, asset misappropriation, and fraud within business and non-business organizations (The IIA, 2003).

As the internal auditing profession became more firmly established, it responded quickly to new demands from significant regulatory and legislative mandates, as well as high-profile (inter)national reports: the passage of the Foreign Corrupt Practices Act (1977), particularly its emphasis on internal controls; the issuance of the Report of the National Commission on Fraudulent Financial Reporting (Treadway Commission Report, 1987); the Report of the Committee of Sponsoring Organizations (COSO) of the Treadway Commission (COSO, 1992); as well as the subsequent internal control frameworks presented by the Cadbury Committee Report (Cadbury Report, UK); the Criteria of Control Committee (CoCo Report, Canada); and the King Committee (King Report, South Africa); the amendments to the U.S. Federal Sentencing Guidelines (1995); recent changes in the New York Stock Exchange rules regarding the structure and composition of the Board of Directors of listed companies as well as the requirement for all publicly listed companies to have an internal audit function; the newly passed Sarbanes-Oxley Act of 2002; and ongoing calls for better organizational governance.

The market today, according to current economic conditions, requires corporate governance to perform effectively as much as possible. Besides, one of the major causes of the financial crisis is the failure in corporate governance. This corporate failure was also similar in insurance industry. In recent years, enterprise risk management has played an important role for companies and financial institutions. As the economic crisis is increasingly affecting the economic activities, the main focus of many internal audit directors is to find ways to add value to their businesses. (Michalis, et al., 2013)

SOX Section 404 reports illustrates that internal audit can be a powerful tool for improving operations, enhancing controls, managing risks, and promoting sound corporate governance. In the current environment of high accountability and continuing governance failures (e.g., stock option backdating), such elements are vital to organizational success. (SOX Reports, 2008) This becomes relevant; given the fact that effective IAD is critical for the survival of strong insurance sector.

Insurance is the pooling of fortuitous losses by transfer of such risks to insures, who agree to indemnify insured for such losses, to provide other pecuniary benefits on their occurrence, or to render services connected with the risk E. Rejda (2008). In line with financial stability forum (2000), it classifies insurance in to three major categories (i) life insurance (ii) non-life insurance and (iii) reinsurance.

Insurance is an important and growing part of financial sector in virtually all developed and developing countries. A resilient and well regulated insurance industry can significantly contribute to economic growth through transfer of risk and mobilization of savings. In addition, it enhances financial system efficiency by reducing transaction cost, creating liquidity, and facilitating economies of scales in investment. The insurance industry is different from other financial services in that its main role is to spread financial loss (Financial Stability Forum Report, 2011).

Carmichael and Pomerleano (2002) identified several main contribution of insurance that for instance, insurance promotes financial stability among households and firms by transferring risks to an entity better equipped to withstand them; it encourages individuals and firms to specialize, create wealth and undertake beneficial projects they would not be otherwise prepared to consider.

Hifza Malik (2011) insurance plays a crucial role in fostering commercial and infrastructural businesses. From the latter perspective, it promotes financial and social stability, mobilizes and channels savings, supports trade, commerce and entrepreneurial activity and improves the quality of the lives of individuals and the overall wellbeing in a country. Due to these facts the effectiveness of IA in insurance cannot be undermined. EIA would have positive association on the organizational performance in insurance company (Gamage, et al., 2014).

Internal auditors is been considered as an effective function in new developments in governance structure because it provide an important role in assessing internal control effectiveness (Dittenhofer, 2001; Al-Shetwi, Ramadili, Chowdury, & Sori, 2011) that is why an effective internal audit function will usually add value and improve an organization's operations effectively (New Delhi, 2006; Ahmad et al, 2009).

NBE issued Insurance corporate governance directive no. 42/2015 made a direct contribution to the establishment of effective internal audit system to perform internal audit functions to put in place. The National Bank's inspectors conduct assessments over control infrastructures of

insurance companies and forward recommendations for the improvement there on. NBE in the yearly supervision report highlighted irregularities related to risk management, good governance and control weakness. In order to rectify those findings NBE recommended strengthening internal audit function. (Mihret et al. 2010)

The value-adding role of IA presumes that IA is effective. Nevertheless, the literature implies that IA effectiveness tends to be influenced by the contextual dynamics within which internal audit is practiced. Through the extended role of IA, internal auditor has become an essential monitoring mechanism in corporate governance along with the external auditor, audit committee, and executive management (Gramling et al. 2004). The aim of IA is to assist an organization in achieving its objectives (Roth 2003; Hass et al. 2006).

For this purpose, IA can perform a wide variety of activities in the form of assurance or consulting services. First, it can provide assurance that the organization's systems of control are designed properly and operate effectively. Second, it can act as a management consultant to improve risk management (Spira & Page 2003). Third, it can assist the audit committee and external auditors in monitoring the internal control system (Goodwin 2003). Fourth, it can reduce fraud, misappropriation of assets and misreport financial information (Coram et al. 2008). Briefly, the internal audit function (IAF) is the cornerstone of the corporate governance, which contributes to improving the productivity, efficiency and performance of the company in both private and public sector (Mihret et al. 2010).

Therefore, internal auditors shall provide an effective examination or review of financial transactions in order to ensure that; all collection is acknowledged with receipt, expenditure of all funds and other resources of the organization are in conformity with the policies and procedures of the organization. In this context, the scope of the internal audits should be wider in such a way that would include; unlimited access to all records, personnel and asset of the organization (Jahnsen, 2001; Zahran, Chulkov & Inomata, 2010). Therefore, it's important to consider the functions of internal audit in any organizations in order add to such organization.

PKF Littlejohn's internal audit survey for 2015 reported that, where IA functions have engaged with the regulators over the last 12 months, this has usually been to discuss evaluation and testing of IAE. This shows it is vital to have a robust process in place for assessing internal audit effectiveness. The last few years have seen several changes in internal audit in the financial services sector. Here are three of the main reasons why:

**The financial crisis** - This has led to a greater focus on the importance of effective governance, risk management and internal control. Regulators have become more concerned with and more reliant on the effectiveness of internal audit functions.

**Solvency II** - The move towards implementing Solvency II has had wide ranging implications for the governance, risk management and internal control of insurers. These include specific requirements for an effective IA function. As implementation gets closer, now is the time for insurers to assess whether their internal audit function is fit for purpose for Solvency II.

**New CIIA and Global IIA guidance** - In 2013, the Chartered Institute of Internal Auditors issued new guidance for effective internal audit in the financial services sector. This raised the bar for internal audit functions and redefined what it means to be effective. More recently, the Global IIAs has introduced a new International Professional Practices Framework (IPPF) for IA. This recognizes the need for the profession to adapt to the speed of global change and risk. The new IPPF provides a strong, flexible framework for internal audit and helps ensure internal audit has what it takes to tackle new and emerging risks and challenges.

Other factors suggest that internal audit has much more change ahead. Firms' risk-governance models are undergoing significant change, with a strong and effective three-lines-of-defense model at the heart of regulators' intentions. Ongoing prudential and conduct regulatory reforms will continue to heavily impact internal audit, as will material changes to firms' strategies and business models. Taken together, the necessary transformation in internal audit requires the function to focus on the integrity of the risk-governance framework, use new methods and tools, develop a more dynamic people model, and contribute to sustainable firm economics and strengthened risk governance.

An effective internal audit is integral to sound risk governance and a key enabler for directors and executive management to fulfill their own governance responsibilities. Past failings in controls and risk management have cost firms and the industry dearly in fines, settlements and reputation. Strong board and senior management support for this transformation is important, as bold changes are required so internal audit can fulfill its elevated role.

Internal Audit plays a critical role in providing objective assurance that protects the business against risk, supports strategic decision making and improves business performance. Solvency II emphasizes the importance of an independent internal audit function as well as good governance practices within an insurance company (PWC, 2016).

In 2013, the Dutch central bank (DNB) conducted a study into the internal audit function (IAF) at Dutch banks. At a certain point in the study, the following challenging question presented itself: “When can an IAF be considered effective?” In the meetings between the IIA Netherlands Board and DNB, both parties struggled with this question. It was then already clear that many factors needed to be considered to be able to answer this question. Around eighteen months ago, a number of internal auditors from the financial sector launched a debate about this issue. In The Netherlands and internationally, an inventory was made of the available frameworks of standards, best practices and performance indicators. There were many discussions and debates to determine to what extent certain elements could help to answer the above challenging question (IIA Nederland).

The quality of an IAF is primarily related to its effectiveness. How effective is an IAF and how can you measure that? Measuring the effectiveness of an IAF is not easy to do. Besides quantitative aspects, many qualitative aspects play a role. In addition, the various stakeholders have different, and to some extent conflicting, expectations in terms of the role and duties of the IAF (IIA Nederland).

Looking at the existing literature, there are many possible answers to this question. The possible answers make a controversy or a little bit consensus in setting a common guideline that determine the effectiveness of IA (Mihret & Yismaw, 2007; Arena & Azzone, 2009; Mihret, et al., 2010; George, et al., 2015). Prior researchers related effectiveness of IA with:

- Thematic study into the effectiveness of the IAF in small and medium-sized insurers, the DNB applied six assessment criteria/categories such as Effectiveness, Performance requirements, Audit Charter, Scope, Outsourcing and Proportionality. The DNB stated that it expects insurers to expressly assess and evaluate their IAF on the basis of concrete and appropriate criteria.
- Co-operation between internal auditors and external auditors, management support, and organizational setting (Arena & Azzone, 2009);

#### **2.4. Theories of Internal Audit**

Theory is defined by Gill and Johnson (2002:229) as ‘a formulation regarding the cause and effect relationships between two or more variables, which may or may not have been tested’. In a similar contribution to that of Sutton and Staw (1995), Whetten (1989) contends that if the presence of theory is to be guaranteed, the researcher must ensure that what is passing as good

theory includes a plausible, coherent explanation for why certain relationships should be expected in our data.

Relevant literature and associated theories that have been formulated on internal audit concepts such as Agency, contingency, lending credibility, Institutional and Communication theories discussed as follows:

#### **A. Agency Theory**

Agency theory is all about the relationship among the organization owner(s) and its top management (Adams, 1994). It supports a positivist group of philosophy (Adams, 1994; Changwony & Rotich, 2015). In corporate form of organizations the top management manages the whole organization on behalf of the owners as an agent. Jensen and Meckling (1976) focuses on the relationship between the agents and the principals with the argument that managers (agents) engage in actions that promote their own interests at the expense of principals and proposes solutions to the unaligned goals and different risk profiles.

The agency theory acknowledges the separation of business ownership and management as business owners resort to hiring the services of professionals who run the entities on a day to day basis (Horn & Tyler, 2011). As a result of this, management can use its power for personal benefits. Therefore, it is unquestionable to employ an independent body (internal auditors) which are the agents of audit committee and the board of directors' to evaluate the top management performance and control whole activities of the organization to protect the owners from such theft and to reduce the problems for the sake of the organization stakeholders (Endaya & Hanefah, 2013; Peurseem & Pumphrey, 2005).

However, internal auditors may have different motives (financial rewards from managers, personal relationships with managers) to act against the board of directors interest and its audit committee. To perform internal audit activity professionally and perfectly, they must have the ability to make well-justified judgments, future positioning of internal auditors and their salaries, educational and professional certification, and experience in conducting an audit (Endaya & Hanefah, 2013; Greenawalt, 1997; Mihret & Yismaw, 2007). And the existence of an effective audit committee with absolute authority in the organization has resolved the above problems (Endaya & Hanefah, 2013).

Adams (1994) in his article stated that Agency theory can provide for richer and more meaningful research in the internal audit discipline. Agency theory contends that internal

auditing, in common with other intervention mechanisms like financial reporting and external audit, helps to maintain cost-efficient contracting between owners and managers. Agency theory may not only help to explain the existence of IA in organizations but can also help explain some of the characteristics of the IAD, for example, its size, and the scope of its activities, such as financial versus operational auditing.

In other way, this theory entails entrusting resources in the hands of the agents, and these agents in turn should produce reports on the day-to-day running of the business, this is usually in both quantitative and qualitative manner (Malmir, Shirvani, Rashidpour & Soltani, 2014). The agents entrusted with resources are assumed to have a sense of accountability in demonstrating how the resources have been used. The fundamental purpose of the auditor is therefore to promote confidence-reinforcing trust in financial information. Agency theory is therefore a theory that is useful in accountability and helps in the development of audit.

Therefore, IA has so many attributes for corporate firms like insurance companies by accomplishing its goals, brings a disciplined and systematic approach to well improve and evaluate risk management's effectiveness, control and governance processes. (Weil, 2002)

### **B. Institutional Theory**

Institutional theory explains how organizational structures and practices are shaped through changes induced by normative pressures, including both external and internal sources such as laws and regulations, or by the professions (Zucker, 1987; Mihret et al., 2010; Abu-Azza, 2012).

Institutional theorists consider organizations as members of an 'organizational field', which comprises several organizations or industries that are interrelated in some way. This interrelation is exhibited in the form of relationship of dependence of some form that leads some organizations to influence others. DiMaggio and Powell (1983) argue that institutions result from the processes of structuration that create structures. Structures are rules and resources that enable functioning of social systems (Giddens, 1984).

DiMaggio and Powell (1983) explain three institutional pressures coercive, mimetic and normative isomorphism that influence organizational structures and practices. Coercive isomorphism takes place as a consequence of organizational attempts to gain legitimacy; mimetic isomorphism occurs when organizations respond to uncertainty by emulating practices of other

organizations; and normative isomorphism arises when institutional changes happen due to organizations recognition of professions.

In the same way, Arena & Azzone, (2009) identified the institutional pressures that impact both individuals in part and organization as a whole as laws and regulations (coercive isomorphism); choices of other organizations (mimetic isomorphism); and consultation or professional bodies (normative isomorphism). Isomorphic processes can increase the efficiency of IA activities of an organization.

### **C. Communication theories**

Both IIA Standards and previous studies support the study of internal auditing according to effective communication theory. Earlier studies confirm the importance of effective communication skill in organizations specifically in IAD (Golen, 2008; Hahn, 2008). In ability to communicate effectively can be related to inappropriate information or communication complexity (Endaya & Hanefah, 2013). Both little and much information are not suitable to communicate effectively (Hahn, 2008). Internal auditors effective communication can be explained through the existence such effective communication between internal auditors and auditee, internal auditors and organization members, and internal auditors themselves (Endaya & Hanefah, 2013). Effective communication skill is a need for internal auditors and internal audit effectiveness since this study examined such a skill through communication theory.

### **2.5. Empirical Literatures**

As the main aim of this research is to assess the effectiveness of internal audit, different authors and researcher's idea and recommendations regarding the related topic of internal audit are analyzed and presented. Although the prologue of internal audit in Ethiopia are dated in the 1940s the time also the united states and most European countries are adapted; the effectiveness of internal audit in the insurance industry in particular are challenged because of the factors that hinder the development of internal audit in Ethiopia. For the ease of presenting the literature those studies regarding the main factors that influence the effectiveness of internal audit; such as management support, the perceptions of the management, organizational independence of internal auditors, adequate and competent of internal audit staff, and Quality of Internal Audit reviewed by different researchers are included in this literature as they are proofed the key determinant factors their respective case studies.

### **2.5.1. Management support**

Organization's management has a close relationship with internal auditors in their day to day activities. They need good support and perception from their management to be more effective and to achieve the audit objectives. Management support is expressed in terms of supporting the auditing process by fulfilling the necessary resources, finance, transport if required, providing training, introducing auditors with new technology and procedures, budgeting funds for certification another facilities that facilitate the internal auditing works. Management support has a far reaching consequence on IA effectiveness in organizations.

Management support is the determinant of IAE (Mihret & Yismaw, 2007; Mihret & Woldeyohannis, 2008). Given the fact that IA activities are performed in dynamic and supportive environment; internal auditor expects a support from top management. According to SPPIA of 1110-organizational independence to perform their work effectively internal auditors should get a support from top management, BOD, cooperation from auditees (IIA, 2011). So, top management support has also necessary for effective work performance and enhancing IA team competence and independence. Different researchers agree on the critical role of management support. Albercht, et al., (1988) identify four factors to enhance IA effectiveness. These four factors were top management support, an appropriate corporate environment, high quality internal audit staff, and an appropriate corporate environment. In the other side, Sarens & DeBeelde, (2006) find that the overall acceptance and appreciation of IA within the company is strongly depended upon the support it receives from senior management. Finally, Abu-Azza, (2012) explain management support as a motivation provided by top management to IAs. These motivations were explained by Abu-Azza, (2012) as providing education and training programs to IA teams; adequate budget to IAD; bonuses and recompense to IA teams; and acceptance and implementation of IA recommendations.

Financial support can be expressed interms of providing adequate budget to IAD and giving financial incentives (bonuses and recompense) to IA teams (Abu-Azza, 2012). According to Paape, (2007) adequate budget to IAD has a crucial role to have a competent IA team. In addition, such financial support has a positive influence on the independence of IA team (Mizrahi & Ness-Weisman, 2007). Gortiz, (2004) argued that financial incentives through bonuses and recompense enhance the effectiveness of IA team in working area. Therefore, management support has a significant relationship with effectiveness of IA.

### **2.5.2. Independence of Internal Audit**

Independence has no single meaning and interpretation across the people; hence the concept is subject to ambiguity and uncertainty (Wines, 2012). However, for the purpose of the case study independent refers to the concept of being free from any management influence while internal auditors perform audit activities and issue audit report (MoFED, 2004; Belay, 2007). Prior literatures deal more about independence in external auditor's aspect (Cohen & Sayag, 2010). But nowadays, emphases are given for internal auditor's independence (Stewart & Subramaniam, 2010).

Independence is the core stone of IA effectiveness. Because, IA effectiveness cannot be realize without the independence of IAD (Vanasco, et al., 1996; Cohen & Sayag, 2010). Therefore, the position of IA in an organization is bounded; it is a corporate unit that should have a large degree of autonomy and independence in order to perform its activities in a proper manner (Arena & Azzone, 2009). Independence to this aspect means that independence in mind and independence in appearance (Stewart & Subramaniam, 2010).

Independence is fundamental to the reliability of auditor's reports. Those reports would not be credible, and investors and creditors would have little confidence in them, if auditors were not independent both in fact and appearance. The assurance services provided by auditors derive their value and credibility from the fundamental assumptions of independence of mind and independence in appearance (Stewart and Subramanian, 2010; Wines, 2012). While the internal audit typically focuses on the whole management process, to maintain objectivity, to increase the reliability of information, to be free from unacceptable risk of material bias, and to issue reasonable and credible audit opinion, it is required to be independent (IIA,2001).

Independence can be explained as follows in respect of Abu-Azza, (2012):

“The concept of independence is generally used to mean the ability of the auditor to be fair and objective in his/her review and appraisal and not to be under undue pressure from any party to the extent that this could bias his/her opinion.”

Similarly, Institute of Internal Auditors (IIA) 1100 independence standard states about independence as ‘internal audit activity should be independent in performing their work’ (IIA, 2011). The standard state word by word about independence as follows:

“Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner”.

In essence, two factors might influence the independence of IA. Firstly, the organizational independence of IA functions and secondly, the individual independence of internal auditors (Goodwin-Stewart & Yeo, 2001). Organizational independence can be explained as the relationship between the internal audit activity and the audit committee. Whereas, individual independence of internal auditors is all about individual staffs in IAD independence and objectivity with look upon the use of IA activity as a ground for top management level (Goodwin-Stewart & Yeo, 2001). To this view, organizational independence can be fulfilled through reporting IA activities to higher bodies in the organization. While, individual independence can be fulfilled through staffs impartiality, biasedness', and avoiding of conflict of interests (IIA, 2001).

The IIA has issued a number of attribute standards (IIA, 2011) and associated practice advisories (IIA, 2009) relating to independence. To this stand, attribute standard 1130 states 'the need to adequately disclose to appropriate parties any impairment to independence'. Impairment in such a term deals about the assessing of organizational activities all over again until at least one year beyond; personal conflicts of interests; scope and resource limitations; and restrictions on access to information, personnel, and property. Attribute standard 1110 states that IAD director must communicate directly with the board of the corporate firm (KPMG, 2003; IIA, 2011). According to the standard, the IAD director confirms the organizational independence of IAD at least once in a year in corporate organizations. Therefore, to whom IAD report its activity has a significant effect on the independence of IA and consequently effectiveness of IA.

IAD must be able to exercise its assignments in its own initiative in all departments, establishments, and functions of the organization. IA must be free to report its findings and appraisals and to disclose them internally. The head of IAD should have clear authority to communicate directly and on his or her own initiative to the board, the chairman of the board, or the chairman and members of the audit committee (IIA, 2011). Benefits of being report to such bodies like the board audit committee (board of directors subcommittee) can have the following advantages. Firstly, it extends the scope of auditee without any fear. For example, executive management and president can be the part of audit. Secondly, the Audit Committee Board (ACB) can't watered-down any finding of IA. Third, it increases the BOD attitude

towards IAD which may have a positive effect on budget allocation. Fourth, the independence of IA is absolute. Finally but not the least, BOD can critically evaluate IAD (KPMG, 2003).

According to Goodwin & Yeo, (2001), if audit committee (AC) is comprised of independent directors, then strong level of relationship would exist between internal auditors and AC. Strong AC and IAD relationship can enhance independence of internal auditors and in effect a positive result on the effectiveness of IA (Stewart & Subramaniam, 2010). In addition, considering IAD as a ladder for managerial position in the organization is also appeared. When chief internal auditor are appointed or removed from their position; AC should play a pivotal role. Because it enhances the responsibility of chief internal auditor to the AC and as a result it increases the independence of internal auditors (KPMG, 2003; Pickett, 2005).

IA effectiveness can be improved through conducting regular meeting between internal auditors and audit committee (Verschoor, 1992; Scarbrough, et al., 1998). AC should meet internal auditors at least twice a year. The first stage at the beginning of the audit task to review the audit plan and the second stage at the ending of the audit task to review audit findings (Kolins, et al., 1991). In the aforementioned stage meetings, the AC and IA director must meet privately without the presence of management (KPMG, 2003; IIA, 2011). Because, it enhance the IA independence (Goodwin-Stewart & Yeo, 2001). The present study extends the finding of the commercial banking study which enables comparison of the results from the two regulatory environments.

The report addressee has also a significant impact on independence of IA (Chapman, 2001; Eisa, 2008). To whom the department makes the report functionally can an indicator of both its independence and its position in the organization (Abu-Azza, 2012). So as to that, the level to whom IAD reports has a significant impact on internal auditor's independence. Similarly, internal auditors can state their opinions without any bias or restrictions (Sawyer, et al., 1988). Since IA director and his/her colleagues fulfill their duty effectively without any fear about the dismissal as a result of a report; IA director must be approved or removed by top level management with higher participation of the board (Raghunandan & Mchugh, 1994; Sawyer, 1995; IIA, 2011).

### **2.5.3. Adequate and competent of internal audit staff**

Adequate staffing is essential for a system to its full capability. Weakness in staffing can lead to mismanagement, error and abuse, which can negate the effect of other controls (MoFED,

2004). The size of IA staff and the competency of internal audit are the critical characteristics of IA quality that can't be separated. This means at the absence of one dimension the other cannot contribute to the quality of internal auditors. Additionally, IA team requires a wide range of competencies to improve organizational and department performance with a value adding role (Burnaby, et al., 2009). Authors expressed such competency in different aspect. For instance, Baharud-din, et al., (2014) and Belay, (2007) relate competence to the ability of an individual to perform a job or task properly base on the educational level, professional experience, and the effort of the staffs for continuing professional development. To this regard, Baharud-din, et al., (2014) measure competency in terms of academic level, experience, skill, and training and development effort of IA team. According to Mihret, et al., (2010) competence requires knowledge and professionalism which acquire from education, job training, and experience. Similarly, internal auditors must be competent in their work and educational level to enhance effectiveness of IA (Burnaby, et al., 2009; Al-Twaijry, et al., 2003; Abu-Azza, 2012).

Auditors must comply with minimum continuing education requirements and professional standards published by their relevant professional organizations (IIA, 2001). The IIA's standard 1210, on proficiency of the auditor require that the internal auditors should possess the knowledge, skill and other competencies need to perform their responsibilities (IIA, 2001). As part of this, Competency Framework for Internal Auditing (CFIA) focuses on the skills needed by an individual person to be an efficient internal auditor. The literature review specifically conducted on the communication skills (Smith, 2005) stated that the development of effective communication skills (such as listening, interpersonal, written and oral communication skills) is an important part of internal auditor's advancement potential. Internal auditors must possess highly developed communication level skills to become a successful professional. The development of these skills is not only enhances the auditor's potential, but will also improve the quality of audits produced. In addition to the above dimension of IA quality, the competence of internal auditors can be measured in terms of academic level, experience and the efforts of staff for continuous professional development and compliance with audit standards. Both the quantity of audit effort and the quality of professional care exercised will determine the overall quality of the internal audit work (Cohen and Sayag, 2010; Belay 2007). Arena and Azzone, (2009) also stated that IA

effectiveness increase in particular when the ratio between the number of skilled internal auditors and employees grows. This shows that sufficiently large number of skilled professionals enables the IA to do its duties.

Prior studies shows that competency play a critical role in the effectiveness of IA (Abu-Azza, 2012; Albercht, et al., 1988; Arena & Azzone, 2009; Baharud-din, et al., 2014; Belay, 2007; George, et al., 2015; Mihret & Yismaw, 2007; Mihret, et al., 2010; Ramachandran, et al., 2012; Wubishet & Dereje, 2014). If an organization has competent internal audit staff, then the following benefit will realized in the firm. Firstly, they have the ability to conduct effective audit in the organization. Secondly, it reduces the cost of audit which scarified to external auditors as a result of external auditors make their investigation depends on internal audit reports (Goodwin-Stewart & Kent, 2006). Thirdly, internal auditors can provide information regarding on reports in an ideal position (Engle, 1999).

According to internal auditor's perception on IAD, internal auditors may either work in the department with recognizing it as a career or as a gateway to a managerial position (Albercht, et al., 1988; Goodwin-Stewart & Yeo, 2001). As noted, career auditors engaged are becoming less in number than who are interested in management career (Goodwin-Stewart, 2001). Hence, the effectiveness of IA has associated with degree to which a focus given to managerial career in the organization (Cohen & Sayag, 2010).

#### **2.5.4. Quality of Internal Audit**

This study evaluated audit quality in perspective of effective audit planning and supervision (Prawit, et al., 2010), IA field work (Ratliff, et al., 1996), finding and reporting, follow-up of IA recommendations, and effective communication with external auditors.

Adequate planning is essential to make IA (Arens, et al., 2012; Nagy & Cenker, 2002). IAD should adequately plan activities at organizational level and in each specific engagement (Prawit, et al., 2010). IA plan includes strategic and annual planning, audit objectives and audit programs for each audit engagements (Mihret & Yismaw, 2007). In this case, annual IA plan is the main mechanism to match the work of IA to the needs and expectations of the audit committee, external auditors, and senior management (IIA, 2001). According to ISPPIA, the IA director must establish risk-based plans consistent with the organization's goals to determine the priorities of the IA activity (IIA, 2011). The appropriate number of audit staff and the time required for each audit to be determined in advance of field work (Tandon, et al.,

2010). Thus, audit plan helps IAD to effectively discharge its objective (Mihret & Yismaw, 2007) and an indicator for effectiveness of IA (Al-Twajjry, et al., 2003; Albercht, et al., 1988; Mihret, et al., 2010; George, et al., 2015). In addition, IA programs used to monitor internal auditor activity (Al-Twajjry, et al., 2003; IIA, 2011; Mihret & Yismaw, 2007). According to SPPIA 2240, internal auditors must develop and document IA programs which used to achieve IA objectives (IIA, 2011). This IA programs must be approved before implementation.

IA fieldwork is all about the performance what the auditors planned in the initial stage (Mihret & Yismaw, 2007). At the time of IA field work, internal auditors are required to be careful while collection of evidence and evaluating the auditee status (Mihret A.G., 2011). Thus, IAs should give special attention to IA fieldwork. Because it is the vantage point of IA works. Working papers are used in the field work stage audit process (Arens, et al., 2012). Audit programs can be supported by audit working papers (Tandon, et al., 2010). Working papers can be used to document evidences so as to make a report, provide reference during the process of the audit which assists audit plan, and evaluate IA activity (Ratliff, et al., 1996).

The end product of any audit work culminates in writing of an audit report, but unlike the external auditor's report, the internal audit report is not standardized short-form in its content (Kinfu & Bayou, 2009). According to Sawyer & Vinten, (1996) one of the roles of IA is to identify the main weaknesses of the organization and provide recommendations to such problems. Further, SPPIA 2060 of IIA state that, the chief audit executive or audit director must prepare accurate audit reports which include significant risk exposures and control issues to senior management administratively and the board functionally (IIA, 2011). Consequently, the audit report of internal auditor requires a lot of imagination and creativity with communicative ability in its writing. Therefore, internal audit report should basically include: detail of purpose and scope of audit; description of tools and procedures of audit; findings, suggestions and opinions; and recommendations (Kinfu & Bayou, 2009).

The trust of external auditors on the work of internal auditors has grown quite fast (Ward & Robertson, 1980). The main reason for such trust on internal auditors is the quality of work performed by internal auditors (Schneider, 1984; Haron, et al., 2004; Mihret & Admassu, 2011). Existence of effective communication between internal and external auditors has mutual benefit. It increases the efficiency and credibility of financial statements on the external auditors' side and it used to obtain essential information in the assessment of risks in

internal auditors side (Abu-Azza, 2012). In addition, if effective communication exists between internal and external auditor, then it will increase the total coverage of auditee effectively and can add value to the organization through reduced external audit fees (Engle, 1999; Al-Twajry, et al., 2004; Goodwin & Kent, 2006; Haron, et al., 2004; Felix, et al., 2001). As a result, the interaction between internal and external auditors can contribute to the effectiveness of IA (Abu-Azza, 2012). According to IIA, (2011) the chief audit executive or audit director should effectively communicate with external auditors in regard of sharing of information and coordinating activities to ensure proper coverage and minimize duplication of efforts.

#### **2.5.5. Internal Audit Effectiveness**

Transparency, public accountability, responsiveness, and effectiveness are the four good governance characteristics (Belay, 2007).

Different authors defined the term “effectiveness” as follows; For instance, Arena and Azzone (2009) defined effectiveness as “the capacity to obtain results that are consistent with targets”, (Mihret and Yismaw, 2007) IAE is defined as “the extent to which an internal audit office meets its supposed objective or the extent to which it meets the intended outcome”, and Dittenhofer (2001) “Effectiveness is the achievement of internal auditing goals and objectives using the factor measures provided for determining such factors”. All the three authors defined effectiveness in terms of achieving the internal audit goals and objectives, though interpreted in different ways. Mihret and Yismaw (2007) described the characteristics of effective internal audit unit from the internal audit point of view. Effective Internal Audit undertakes an independent evaluation of financial and operating systems and procedures, contributes to the achievement of organizational goals, needs management’s commitment to implement recommendations, provides useful recommendations for improvements as necessary, affected negatively by lack of attention from management which in turn adversely affects the auditee attributes, and management support is a natural quid pro quo for effective internal audit.

Effectiveness is the ability of an organization to account successfully for its output and operations to its various internal and external constituencies (Gregory & Ramnaravan, 1983). Similar description can be used to define IA effectiveness (IIA, 2010). IA activity has its own objectives. Therefore, to achieve those objectives there are factors that influence the achievement of those objectives (Mihret A.G., 2011). Similar to this, IA effectiveness is also

explained by Mihret & Yismaw, (2007) as the extent to which IA office is able to meet its pre-set objectives. In addition of this, IA is effective when it provides the required service expected from the activity (Arena & Azzone, 2009; Mihret & Yismaw, 2007).

IA has an important role in helping a firm to achieve its objective when it is implemented, operated, and managed effectively (Changwony & Rotich, 2015; Mihret & Yismaw, 2007; Arena & Azzone, 2009). The backbone of organization's strength in general and each auditee in particular is contributed from the effectiveness of IA (Ditternhofer, 2001). Organizations which effectively implemented, operated and managed internal auditing were better able to identify their business risks and system inefficiencies for the sake of taking corrective actions and improvement in the process (Changwony & Rotich, 2015).

Internal audit (IA) effectiveness has not been studied yet extensively. There is a limitation on research conducted concerning IA effectiveness. According to Endaya & Hanefah, (2013) the reason for such a limitation on literatures is mainly lack of sufficient attention given to the theories which could use to design the conceptual framework of IA effectiveness. Some academic studies (Al-Twaijry, et al., 2004; Arena & Azzone, 2009; Mihret & Yismaw, 2007; Mihret, et al., 2010; Wubishet & Dereje, 2014; Abu-Azza, 2012; Ramachandran, et al., 2012) has advocated further research and the need for a more comprehensive study on the issue of IA effectiveness. But there is no any generally accepted guide for this purpose.

Earlier researchers have seen IA from different attributes that perceived to be relevant in identifying the factors determining effectiveness of IA ranging from publicly owned firms to privately owned firms. Researchers studied on the issue of IA effectiveness had used different approaches to investigate its effectiveness. But there is no any generally accepted guide for this purpose. For instance, Al-Twaijry, et al., (2004) and Yee, et al., (2008) used SPPIA (which is established by IIA) as a guideline; Arena & Azzone, (2009); George, et al., (2015); Endaya & Hanefah, (2013); Mihret & Yismaw, (2007); and Abu-Azza, (2012) developed their own models to investigate and determine IA effectiveness.

This sub part of the literature review help to see what exist in reality beside the theoretical aspects. Mihret & Yismaw, (2007) tried to make their own model by focusing on factors which has an impact on the effectiveness of IA such as IA quality, management support, organizational support, attributes of the clients, and the interplay among them. This model also used by Mihret A.G., (2011) for evaluating the contribution of IA reengineering to its

effectiveness in Ethiopian public enterprises. A further view relates internal auditing as a value adding function to an organization (Arena & Azzone, 2009). According to Arena & Azzone, (2009) IA effectiveness is an activity which can be measured through characteristics of IA team, the audit processes and activities, and the organizational links. This model also used by Ramachandran, et al., (2012) for measuring the effectiveness of IA in Tanzanian CBs.

Ramachandran, et al., (2012) study on the effectiveness of IA in Tanzanian CBs carried out through a structured questionnaire survey which is prepared in a five Likert scale model. In total 120 questionnaires were administered to employees using a convenience sampling technique and 67.5% response rate were maintained. The employees selected include internal auditors, line managers, and members of the management team, audit committee members and external auditors of the selected banks. The collected data analyzed quantitatively through regression. The result of the study showed positive relationship between IA resources and competencies and IA effectiveness, a significant relationship between level of interaction between the internal auditors with audit committee and IA effectiveness, and no significant relationship between IA activities and IA effectiveness. This means the level of involvement of internal auditors in risks management activities are not perceived to be very important. Internal auditors in Tanzanian CBs were undertaking IA just because it was a statutory requirement rather than providing quality service. In general out of the three hypotheses developed, two were supported and one was rejected.

Abu-Azza, (2012) also conducted a study on the perceived effectiveness of the IA in Libya. The study targeted Libyan public enterprises. It addressed the issue of IA effectiveness by identifying seven qualitative factors considered to be important for effective IA, namely, independence, competence, scope of internal auditing work, performance of internal auditing work, coordination and co-operation between the internal and external auditor, management support, and awareness of the benefits of effective internal auditing within organizations. Qualitative research design is adopted and data gathered through semi-structured interviews with chief executive officers, IA directors, managers of administrative affairs, managers of financial affairs and the general auditors. Finally, the study concluded that IA in Libyan public enterprises has not perceived as being effective.

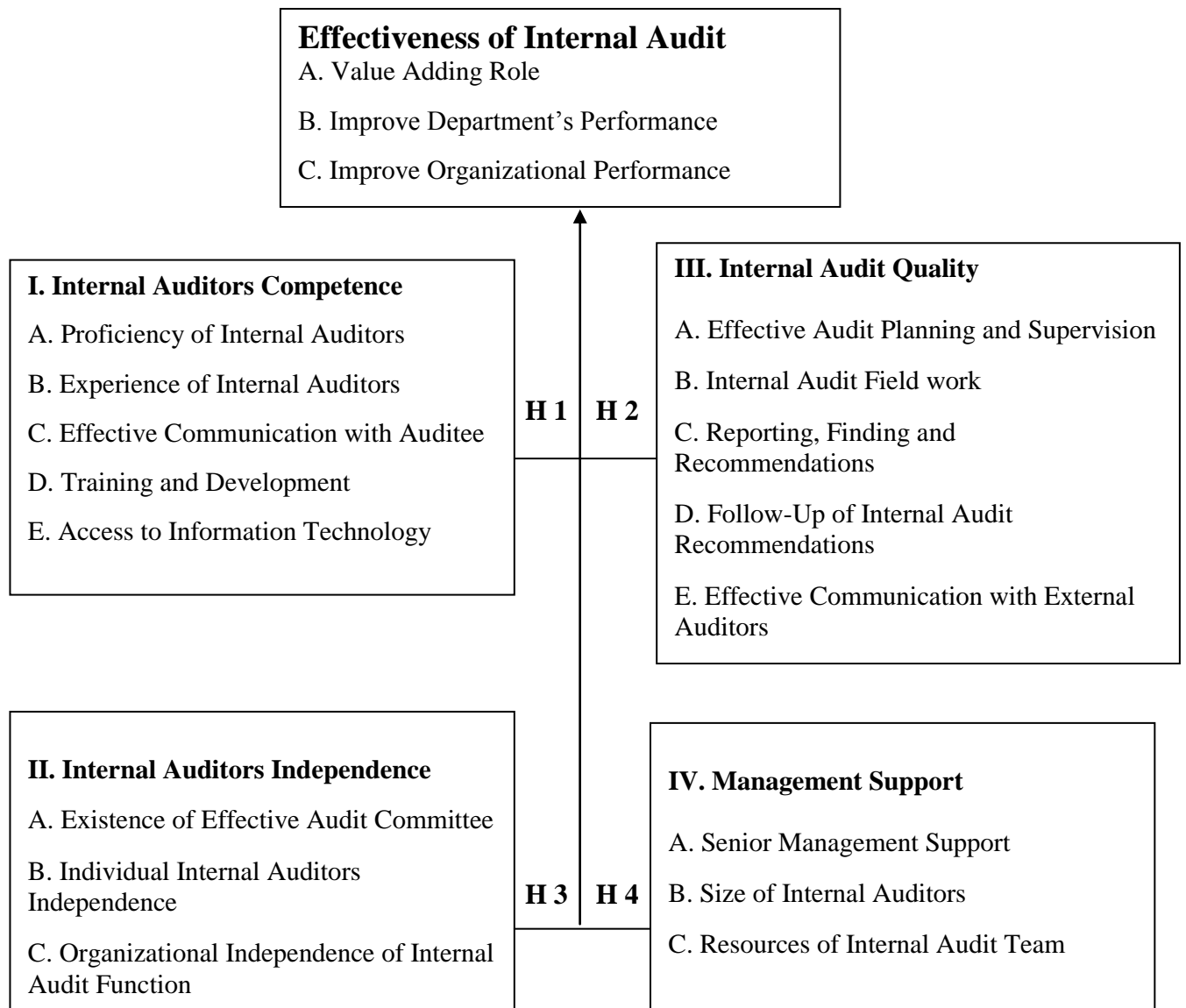
Finally but not the list, George, et al., (2015) conducted a study on factors determining IA effectiveness in Greece business environment. The researchers addressed the issue of IA

effectiveness by identifying four factors of IA, namely, competence of IA team; independence of IA; IA quality; and management support. The study made in 40 companies listed on the Athens stock exchange. Empirical evidences were collected through mailed survey. Finally, using factor and regression analysis the study concluded that IA has a major importance for Greek business environment by supporting all factors.

IA is expected to add value to organizations by effectively managing IA activity; reviewing operations and programs to ascertain the extent to which results are consistent with the organization's goals; establishing audit plans, reports and programs to achieve audit objectives; and determining appropriate and sufficient timeframes to achieve objectives (George, et al., 2015).

## **2.6. Conceptual Framework**

From the empirical literature studied it can be noted that effectiveness of internal audit function is determined by different variables. According to on George, et al., (2015), Endaya & Hanefah, (2013), and Abu-Azza (2012) study on IA; the researcher tries to attempt its own conceptual framework on the factors determining effectiveness of IA. The Conceptual framework showing the interdependence between the variables is depicted below as follows:



**Figure 2.1 : Conceptual Model for Effectiveness of Internal Audit in Ethiopian Insurance companies**

### 2.7. Conclusion and Knowledge Gap

This literature review chapter has argued that the dynamics in an internal audit setting influence internal audit effectiveness. It has also maintained that effective internal audit could contribute to accomplishment of organizational objectives. According to the literature review

is argued four potential factors related with the effectiveness of IA. These are competence of IA teams, independence of IA, quality of IA work, and management support. The researcher suggests the following gaps in the literature:

- A) Little prior research has extensively examined the influence of context factors on internal audit effectiveness and the possible interplay of these factors. Some researchers advocated further research and the need for a more comprehensive study on the issue of IA effectiveness.
- B) In past decades, limited studies have been conducted in effectiveness of IA in Ethiopia.
- C) Insurance plays a crucial role in fostering commercial and infrastructural businesses. It promotes financial and social stability; mobilizes and channels savings; support trade, commerce and the overall wellbeing in a country. This implies that insurance companies are helping the economy one way by transferring and sharing of risk which can create confidence over occurrences of uncertain event and in another way insurance companies like other financial institutions plays the role of financial intermediation so as to channel financial resources from one to the other. Unlike this reality as per the knowledge of the researcher the issue of IA in insurance sector could not get attention as expected. From those studies conducted on Ethiopian perspective focused on internal audit practices and profitability of insurance sector without considering the effectiveness of internal audit function in financial sector (especially private insurance sector).
- D) Research in auditing has traditionally been conducted and interpreted under the theoretical aspect of agency theory. Some researchers recommended institutional theory. But lack of literatures with a combination of agency, institutional, and communication IA theories.
- E) Measures and theoretical bases of the various concepts related to internal audit effectiveness, antecedents and IA contribution to organizational performance were neither sufficiently clear nor consistent especially in the study areas;

Therefore, this study identify the factors determining the effectiveness of IA in EICs according to the framework created by George, et al., (2015) quality of IA, competence of IA team, independence of IA, and management support using mixed research method and both data collection techniques. In addition, the result of the study interpreted based on Endaya & Hanefah, (2013) IA theory including agency, institutional and communication theories.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1. Introduction**

The previous chapter shows what both theoretical and empirical evidences say about the effectiveness of IA. The literature review part is helpful and contributes to the selection of the methodologies. An important part of the research activity is to develop an effective research design which shows the logical link between the data collected, the analysis and conclusions to be drawn. This design satisfies the most suitable methods of investigation, the nature of the research instruments, the sampling plan and the types of data (De Wet, 1997). So, this chapter outlines and explains the methodology which addresses the research objectives and test the research hypotheses formulated in Chapter one. In this section the research design, sampling type, research instrument, the dependent and independent variables applied throughout the research, and finally the model specifications used for data analysis which is applicable and use in the study are included.

#### **3.2. Research Design**

The study focused on examining the factors affecting internal audit effectiveness in the Ethiopian insurance companies and used explanatory research to discuss the outcome of study. Explanatory studies are showing the causal relationship between variables (Saunders, et al., 2009). Explanatory studies are necessary in such a study a situation or problem leads to the explanation of the relationship between variables. Therefore, studying the data in quantitative method through statistical tests such as correlation and regression in order to get the clearer view of the relationship has been explained in detail with reasons through qualitative data. The data used to conduct this study is the primary data obtained through the questionnaires and secondary data through document review. The questionnaires were distributed to the internal audit department head and for their internal auditors. To enhance the quality of data through triangulation, multiple data sources were used to collect data on the views of managers on internal audit effectiveness. To attain this objective questionnaire were distributed to Human Resource, Finance and insurance operation department head (i.e underwriting and claim

process). Additionally, the interview was used to corroborate the patterns that evolved from the data collected via questionnaires, so that the validity of the findings could be enhanced.

Therefore, the study was used combination of quantitative and qualitative methods. It is appropriate for this study since IA effectiveness call for both qualitative and quantitative study approach (Mihret, et al., 2010; Abu-Azza, 2012, Tadiwos, 2016). In this strategy, the researcher involves quantitative data to test the relationships between independent and dependent variable (Firestone, 1987). Whereas, qualitative data involves explaining the results which express using quantitative data and used to discuss in detail those data unexpected in quantitative studies (Creswell, 2009).

When combining the method in such section, the researcher has tried to interrelate the two method results. It means the researcher first discussed the quantitative statistical results followed by qualitative results that may or may not support the quantitative results.

### **3.3. Research Methods**

#### **3.3.1. Quantitative Aspect of the Study**

Quantitative aspect of the study is intent to find data needed to generalize the result to the population as stated (Marczyk, et al., 2005). For this purpose data gathered using self-administered survey.

#### **3.3.2. Survey Design**

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

#### **3.3.3. Survey Instrument**

The self-administered questionnaire developed by George, et al., (2015) it used for this study. The questionnaire is related with the research hypotheses and objective of this study. However, the researcher takeout, and modify some questions with regard to their content and to easily describe the statements to the respondents. The questionnaire is organized in two sections. The first part, deals about respondent profile or general information. The general information section includes five questions which are related with the participant's

background and current status or demographic characteristics. The second part holds 20 Likert scale questions those are targeted to analyze research hypothesis in manageable, uniform and objective way. The second part divided into five groups. The first group is composed of five Likert scale questions which are about competence of IA team; the second group is composed of three Likert scale questions which are about independence of IA; the third group is composed of six Likert scale questions which are about quality of IA; the fourth group is composed of three Likert scale questions which is about management support; and the fifth group is composed of three Likert scale questions which is about effectiveness of IA. The language of the questionnaire is English.

Five point Likert-scales followed through indicating scores like as follows: (1) indicated strongly agree (2) agree (3) neutral (4) disagree and (5) indicated strongly disagree. The numbers indicate in the questions provided to feed ordinary scale measurement and to generate data suitable for quantitative analysis (Boone Jr & Boone, 2012).

#### **3.3.4. Qualitative Aspect of the Study**

Qualitative methodology is concerned with qualitative phenomenon (Kothari, 2004). In this aspect, the researcher was gathered the data through document review utilization.

##### **3.3.4.1. Document Review**

This technique is the means of gathering data to make the study rich in information. As written information, it also saves the researcher time in addition of expanding the information (Yin, 2003). It is also used by prior IA researchers (Abu-Azza, 2012; Mihret, et al., 2010). This method of data collection adopted to gather information from documents held in those insurance companies in relation to IA. So, IA reports, plans, programs, working papers, organizational chart, IA department chart, and legislation rule documents were review.

##### **3.3.4.2. Interview**

The qualitative data collection method through interview in this study followed semi-structured interviews. Because to explanatory type of study, using semi-structured interview is best in order to understand the relationship between variables.

Interviews were conducted with, insurance operation, Finance & accounts and Human resource management department head who frequently audited by IA department and NBE. The semi-structured interviews were conducted for 15 minute and it consist eleven questions. During the interview the researcher extensively takes and summary notes of those interviews.

Out of sixteen insurance companies ten insurance companies were selected and conducted interviews with four insurance operation head, three finance & accounts, three Human resource management department in each company. All ten interviewees were told that their responses would be held in strict confidence.

### **3.4. Population and Sampling of the Study**

#### **3.4.1. Population of the Study**

Define the population is the first step in designing the sample (Creswell, 2009). The population of the study is internal auditors of all Ethiopia private insurance company. Nowadays, there were 55 internal audit staffs in 16 insurance companies. Therefore, the population of the study is all internal auditors of Ethiopian insurance companies.

#### **3.4.2. Sampling of the Study**

All Ethiopian insurance companies do not have internal auditors in a branch level and therefore, population unit which refers to the staff of IAD of Ethiopian insurance companies. For meaningful analysis, there is no need to sample from 55 internal audit staffs as they are already few in numbers to collect information. Even though the populations are existed and spread over different area this bring difficulty of reaching in short time. Therefore, only those questionnaires distributed to managers and internal auditors of Ethiopian insurance companies.

### **3.5. Procedure of Data Collection**

First, the researcher requested a recommendation letter from Addis Ababa University, College of Business and Economics, Department of Accounting and Finance for the purpose of getting acceptance and increases the confidentiality of the participants. Then the questionnaires were distributed to internal auditors of EICs.

As Cooper & Schindler, (2006) states participant perception influences the outcome of the research in subtle way; so no one had been participate obligatorily.

### **3.6. Relationship between Specific Objectives, Research Hypothesis, and Data Sources**

The relationship between research specific objectives, hypothesis, and data sources are listed accordingly using a tabular form.

**Table 3.1 Relationship between Specific Objectives, Research Hypothesis, and Data Sources**

<b>Specific Objectives</b>	<b>Research Hypothesis</b>	<b>Data sources</b>
To examine the extent of internal auditor’s competency for the EIA in Ethiopian insurance companies (EIC).	1	Survey question no. 1-4
To examine the extent of internal auditor’s independence to the EIA in Ethiopian insurance companies.	2	Survey question no. 5-8, and documents review
To measure the extent of internal audit quality to the EIA in EICs	3	Survey question no. 9-14 and documents review
To investigate the extent IA operate under adequate management support in achieving of EIA in EICs.	4	Survey question no. 15-17

### **3.7. Data Analysis and Interpretation**

Data analysis is all about examining, categorizing, tabulating, and recombining the data collected, to address the initial objective of a study (Yin, 2003). Data analysis in a mixed method study comprised both quantitative and qualitative method of analysis.

#### **3.7.1. Quantitative Data Analysis**

Data analysis is all about examining, categorizing, tabulating, and recombining the data collected, to address the initial objective of a study (Yin, 2003). In this study the researcher used STATA software to analyze the data which is collected. According to the survey instrument selected which is Likert scale questionnaire model, the researcher used ordinal (ranked) type of categorical data. In this aspect, the data collected using a questionnaire converted to represent the variables in the hypotheses. This is through taking mean values of the item responses for each construct. Mean values are chosen because item responses that ranged from “Strongly Agree” to “Strongly Disagree” generate ordinal data (Mihret, et al., 2010).

After the data were collected, coded and appropriate data analysis techniques used to determine the effectiveness of internal audit in Ethiopian insurance companies. For the purpose of data analysis both descriptive and econometric model has been employed. A descriptive statistics, mainly, frequency count, percentage, measure of central tendency

(mean), measure of dispersions (Standard deviations) has been used to summarize and describe the results of observation. In addition, other statistics like regression were used to identify the determinants of IA effectiveness.

The regression analysis model stated below used to identify the factors determining effectiveness IA.:-

$$EIA = \beta_1 + \beta_2COMP + \beta_3INDP + \beta_4QUA + \beta_5MGTS + e$$

**Where:**

EIA = Effectiveness of Internal Audit in Ethiopian insurance sector;

$\beta_1$  = Constant Term

$\beta_2$  to  $\beta_5$  = coefficients of independent factors and

COMP= Competence of IA teams

INDP= Independence of IA

QUA= Quality of IA Work

MGTS=Management Support and

$\varepsilon$  = error term

### 3.7.2. Qualitative Data Analysis

Qualitative data gathered through interview and documentary review were analyzed qualitatively. Analysis of the data generated from the interviews with auditee (Insurance operation, HR management and Finance and Accounts department) was conducted using Miles and Huberman's three stage process of data reduction, data display and conclusion drawing (Miles & Huberman 1994). Data reduction was conducted by summarizing the responses from the interview transcripts along major subjects that emerged from the data. The reduced data was then displayed in an organized fashion in matrices with rows and columns that represented the concepts in the conceptual model of the study. The cells these matrices indicate summary information that relate to the concepts in the particular columns and rows. Responses from a similar category of organizations were analyzed for common elements and the different categories were compared to identify patterns. The data were displayed in a table for ease of identification of themes in the third stage. In this stage, inferences were drawn by closely identifying the similarities, differences, and relationships among the variables in the study.

## **CHAPTER FOUR**

### **DATA ANALYSIS AND INTERPRETATION**

#### **4.1 Introduction**

The research study attempted to identify the factors determining the effectiveness of IA in Ethiopian insurance companies (EICs). In this chapter, the results of the study are presented through triangulating the different source results. The chapter consists of two sections. The first section deals about the analysis of econometric results which collected through questionnaire. The second section deals about the results and interpretation of quantitative and qualitative results which collected through questionnaire and document review. Therefore, this chapter presents the analysis and discussion of the research findings from primary and secondary sources.

#### **4.2 Econometric Data Analysis**

This section presents the results of econometric data analysis. This section begins with questionnaires response rate and demographic characteristics. This followed by presentation of reliability analysis for data collected using questionnaire. Tests of normality distributions and inter-item correlations are then reported. The questionnaires were distributed to IA staffs and Human resources, Finance and Insurance operation department head of EICs. For these, 102 questionnaires were distributed to 16 EICs. Out of 102 questionnaires 91 have been collected and are usable for analysis. The response rate of administered questionnaire is 89%.

##### **4.2.1. Demographic Characteristics**

Demographic characteristics of the respondents to this regard consist of educational level (academic qualification), field of study, and working experience in insurance sector and specifically in Internal Audit Department. In terms of educational background, the respondents indicated their highest level of education. According to their response, 87.76% of the respondents obtained a bachelor degree as their highest educational level. In other way, 12.24% of the respondents obtained a post graduate degree or masters as their highest level of education. Descriptive statistics of the data are presented in table 4.1. Based on this result, most of IA team members were well educated. They held a bachelor degree in different field of study. This result is consistent with prior IA standards (IIA, 2011) and studies (Al-Twaijry, et al., 2003; Mihret & Woldeyohannis, 2008; Mihret, et al., 2010; Abu-Azza, 2012; George, et al., 2015). In terms of professional certifications, IA team of EICs had not certified personnel such as ACCA, CIA, CPA

and Certified insurance. Professional certifications have great quality in regard of adding value, and enhance department and organizational performance (Bou-Raad & Capitano, 1999).

In addition, it is difficult to be effective without professionally qualified staff (Okafor & Ibadin, 2009; Cohen & Sayag, 2010; Abu-Azza, 2012).

**Table 4.1 Academic Qualification of the Respondents**

Education level	Freq.	Percent	Cum.
Bachelor degree	43	87.76	87.76
Master degree	6	12.24	100.00
Total	49	100.00	

Source: Field Survey, 2018

According to the field of study the participants of study indicated their highest level of education. In this regard 45 respondents (91.84%) had Accounting educational background; 3 respondents (6.12%) had Management background and the remaining 2 respondents (2.04%) had other educational background. Descriptive statistics of the data are presented in table 4.2. Most IA teams had a background in “Accounting”. This shows that IA activity in EICs has limited on financial operation areas. The scope of IA in those Private insurance companies had not expanded to non-financial operation areas. IA team including most “Accounting” background staffs could lack skills, experience, and knowledge in other fields (Paape, 2007).

**Table 4.2 Field of Study**

	Freq.	Percent	Cum.
Accounting	45	91.84	91.84
Management	3	6.12	97.96
Other	1	2.04	100.00
Total	49	100.00	

Source: Field Survey, 2018

Respondents working experiences in the insurance sector ranged from five years and less up to above twenty years. Fourteen respondents (28.57%) had above ten years working experience in a insurance sector, 33 respondents (67.35%) had five years and working experience in the insurance sector and the remaining 2 respondents had between six and ten years working experience in the sector. It shows that respondents had less work experience in insurance sector. Since majority of the respondent (67.35%) had less than five years working experience in a sector. Descriptive statistics of the data are presented in table 4.3. Based on the participants’ response, internal auditors in EICs had Medium levels of experience in insurance sector in different positions. It

shows that auditors in EICs had well experience on the insurance activity and the ability to audit audittee and add value to the organization or department specifically. This finding is not supported by prior studies of (Mihret, et al., 2010; Abu-Azza, 2012). But the finding is in line with George, et al., (2015) and Wubishet & Dereje, (2014) studies which deals adequate and experienced auditors have in their study area.

**Table 4.3 Year of Experience in Insurance Sector**

	Freq.	Percent	Cum.
Less than 5 years	33	67.35	67.35
6 to 10 years	2	4.08	71.43
16 to 20	12	24.49	95.92
Above 20 years	2	4.08	100
Total	49	100	

Source: Field Survey, 2018

Respondents working experiences in IA ranged from two years and less up to above five years. Twenty six respondents (53.06%) had above Two years and less working experience in IA, 14 respondents (28.57%) had above two years less than five years working experience in IA and 9 respondents (18.37%) had above five years working experience in IA. Descriptive statistics of the data are presented in table 4.4. The response indicated that internal auditors in EICs had low levels of experience in the area of internal auditing. It shows that there is high turnover of employees in the department, rotate employees from and to IAD, and auditors transferred to this department frequently and is not stable the department staff size.

**Table 4.4 Year of Experience in Internal Audit Department**

	Freq.	Percent	Cum.
Above five years	9	18.37	18.37
Above two years less than five years	14	28.57	46.94
Two years and less	26	53.06	100.00
Total	49	100.00	

Source: Field Survey, 2018

#### **4.2.2. Descriptive Statistics**

According to the first section of the questionnaire (Q1-Q4) which examines the competence of IA team for all question no. from 1 up to 4 had a mean response less than 3.00. This implies that participants were agreed on the competence of IA teams in EICs. Descriptive statistics of the data are presented in table 4.5. The standard deviations were greater than 1.00. It indicates that the respondents perception were close to one another.

According to the second section of the questionnaire (Q5-Q8) which examines the independence of IA only question no. 8 had a mean response greater than 3.00. This implies that participants were only disagreed on the independence of IA in EICs reports were include any fault, wrongdoing and mistakes without influence from any one. Descriptive statistics of the data are presented in table 4.6. The standard deviation of Q6, Q7, and Q8 were greater than 1.00. It indicates that the respondents perception were far from one another. But, standard deviation for Q5 was less than 1.00. It indicates that the respondents perception were close to one another.

**Table 4.5: Descriptive Statistics for Competence of Internal Audit**

Item	N	Mean	Std. Dev.	Min	Max
1. The audit procedures and evidence collections are completed on time, since enough and skilled internal auditors are available or employed.	49	1.83	1.343	1	5
2. Do you think that the organization audit department or division has progressed in terms of appropriately qualified or professional staff?	49	1.69	1.158	1	4
3. Internal auditors are proactive (creating or controlling a situation rather than just responding).	49	2.24	1.283	1	4
4. Internal auditors undertake continuous professional development trainings or attend educational seminars.	49	2.22	1.327	1	5

Source: Field Survey, 2018

**Table 4.6: Descriptive Statistics for Independence of Internal Audit**

Item	N	Mean	Std. Dev.	Min	Max
5. Internal audit provides reports to the board of directors (or audit committee).	49	2.44	.891	1	3
6. Internal auditors have full access to records and information they need in conducting audits.	49	2.75	1.451	1	4
7. Internal audit participates in the development of the company strategy and system design.	49	2.59	1.352	1	5
8. Internal auditors include in their reports any fault, fraud, wrongdoing and mistakes without influence from any one.	49	3.06	1.390	1	5

Source: Field Survey, 2018

According to the third section of the questionnaire (Q9-Q14) which examines the quality of IA work for question no. from 9 to 14 had mean response less than 3.00. This implies that participants were agreed on the quality of IA work in EICs. Descriptive statistics of the data are presented in table 4.7. The standard deviation of Q9, Q11, and Q14 were less than 1.00. It indicates that the respondents perception were close to one another. But the standard deviation of Q10, Q12, and Q13 were greater than 1.00. It indicates that the respondents perception were far from one another.

**Table 4.7: Descriptive Statistics for Quality of IA Work**

Item	N	Mean	Std. Dev.	Min	Max
9. Examination of reliability and integrity of information, checking working papers quality properly done by internal auditors.	49	1.71	.957	1	3
10. External auditors use internal audit working papers and reports in conducting their audit.	49	2.98	1.145	1	4
11. Internal audit work was efficiently performed according to the audit plan.	49	1.63	.928	1	3
12. Internal audit findings are correctly argued and justified.	49	2.47	1.444	1	4
13. Internal audit recommendations can be easily implemented.	49	2.22	1.295	1	5
14. Internal audit report is accurate (clear and logical).	49	1.98	.9893	1	3

Source: Field Survey, 2018

According to the fourth section of the questionnaire (Q15-Q17) which examines management supports for all questions had mean response less than 3.00. This implies that participants were agreed on the management support in EICs. Descriptive statistics of the data are presented in table 4.8. The standard deviation for Q15 to Q17 was greater than 1.00. It indicates that the respondents perceptions were varied each other.

According to the fifth section of the questionnaire (Q18-Q20) which examines the effectiveness of IA for all questions had mean response less than 3.00. This implies that participants were agreed on the effectiveness of IA in EICs. Descriptive statistics of the data are presented in table 4.9. The standard deviations of all questions were greater than 1.00. It indicates that the respondents perception were far from one another.

**Table 4.8: Descriptive Statistics of Management Support**

Item	N	Mean	Std. Dev.	Min	Max
15. Senior management supports internal audit personnel.	49	2.22	1.279	1	5
16. Internal audit department is large enough to efficiently carry out its duties.	49	2.12	1.285	1	5
17. Senior management is aware of internal audit needs.	49	2.08	1.335	1	5

Source: Field Survey, 2018

**Table 4.9: Descriptive Statistics of Effectiveness of Internal Audit**

Item	N	Mean	Std. Dev.	Min	Max
18. Internal audit ensures that it adds value to the business.	49	2.92	1.455	1	5
19. Internal audit improves department's performance.	49	2.06	1.106	1	5
20. Internal audit improves organizational performance.	49	2.22	1.005	1	4

Source: Field Survey, 2018

### 4.2.3. Reliability Analysis

In a likert-scale questionnaire measuring the consistency or reliability of the questionnaire is essential. Reliability analysis has been employed in prior IA researches those adopt likert-scale questionnaire (Mihret, et al., 2010; George, et al., 2015). To measure such a reliability analysis, Cronbach's Alpha ( $\alpha$ ) is the most common measure of reliability scale. If a reliability analysis value ( $\alpha$ ) greater than 0.600 is acceptable (Cronbach's, 1951). According to Field, (2009) a reliability analysis value ( $\alpha$ ) greater than 0.700 is very acceptable. Based on Table 4.10, the reliability analysis value for Cronbach's Alpha ( $\alpha$ ) of this study shows that 0.677 for all variables. Therefore, the responses generated from all variables in this study were acceptable (reliable) for data analysis.

**Table 4.10 Reliability Statistics**

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	No of Items
0.677	0.692	5

Source: Field Survey, 2018

Inter-item correlations were also examined to assess reliability of the study. According to Table 4.11, some of the variables in the study show more than 0.30. This indicates that sufficient and adequate correlations were among item responses (Hair, et al., 1998; DeVellis, 2003).

**Table 4.11 Inter-Item Correlation Matrix**

	Competency	Independence	Quality of Internal Audit	Management Support	Effectiveness of internal Audit
Competency	1.0000				
Independence	0.2496	1.0000			
Quality of internal audit	0.4811	0.4231	1.0000		
Management Support	0.2274	0.1786	0.1997	1.0000	
Effectiveness of Internal Audit	0.3439	0.4379	0.4266	0.1366	1.0000

Source: Field Survey, 2018

#### **4.2.4. Assessment of Ordinary Least Square Assumptions**

##### **4.2.4.1. Assessment of Normality**

In order to test the normality of data, Skewness and Kurtosis test of normality distribution were used and conducted on STATA 14. The Skewness and Kurtosis tests are showing normality when the result is within the range of +3 and -3 (Aczel, 2008). The results of normality distribution test before transformation is presented below in Table 4.12. According to the table, the result of normality distribution test shows all variables have normal distributions.

**Table 4.12 Assessment of Normality**

	N	Skewness	Kurtosis
Competency of Internal Auditors	49	0.706	2.849
Independence of Internal Auditors	49	-.350	2.008
Quality of internal audit	49	.164	1.813
Management Support	49	.579	2.099
Effectiveness of Internal Audit	49	-.117	1.683

Source: Field Survey, 2018

#### 4.2.4.2. Assessment of Multicollinearity

Multicollinearity is a statistical problem which occurs when the explanatory variables (independent variables) are much correlated with each other (Hair, et al., 1998). It means when the strong correlation among predictors and the existence of r value greater than 0.80, tolerance value below 0.10, and Variance Inflation Factor (VIF) greater than 10 in the correlation matrix (Field, 2009).

Tolerance in this case defined as a statistical tool which used to indicate the variability of the specified independent variables from other independent variables in the model (Pallant, 2007). Based on Table 4.13, the tolerance levels for all variables were greater than 0.10. According to Table 4.14 which shows the correlation between dependent and independent variables, the correlation matrix of all variables among the predictor was also less than 0.80. Therefore, correlation value, tolerance level, and VIF value indicates that there were no Multicollinearity problem in this study. In the relationship between dependent variable (effectiveness of IA) and independent variables (competence of IA team, independence of IA, quality of IA, and management support) some variables are significant.

**Table 4.13 Collinearity Statistics**

<b>Variable</b>	<b>VIF</b>	<b>Tolerance (1/VIF)</b>
Quality of internal audit	1.50	0.667
Competency of Internal Auditors	1.33	0.749
Independence of Internal Auditors	1.23	0.810
Management Support	1.08	0.928

Source: Field Survey, 2018

**Table 4.14 Pearson Correlation Matrix**

		Competency of Internal Auditors	Independence of Internal Auditors	Quality of internal audit	Management Support	Effectiveness of IA
Competency of Internal Auditors	Pearson Correlation	<b>1.0000</b>	0.2496*	0.4811*	0.2274*	0.3439*
	N	49	49	49	49	49
Independence of Internal Auditors	Pearson Correlation	0.2496*	<b>1.0000</b>	0.4231*	0.1786*	0.4379*
	N	49	49	49	49	49
Quality of internal audit	Pearson Correlation	0.4811*	0.4231*	<b>1.0000</b>	0.1997	0.4266*
	N	49	49	49	49	49
Management Support	Pearson Correlation	0.2274*	0.1786*	0.1997	<b>1.0000</b>	0.1366*
	N	49	49	49	49	49
Effectiveness of IA	Pearson Correlation	0.3439*	0.4379*	0.4266*	0.1366*	<b>1.0000</b>
	N	49	49	49	49	49

\*\* . Correlation is significant at the 0.01 level (1-tailed)

Source: Field Survey, 2018

#### 4.2.4.3. Assessment of Heteroskedasticity

For the regression output of the model Breusch-Pagan/Cook-Weisberg test for Heteroskedasticity was conducted on STATA 14 to test for homogeneity of variance and a P-value of greater than 0.05 were acceptable. As the result revealed in table 4.15 below and p value (= 0.5495) for the model is greater than 0.05 the critical value, shows homogeneity of variance across the model.

**Table 4.15** Breusch-Pagan/Cook-Weisberg test for Heteroskedasticity

Breusch-Pagan / Cook-Weisberg test for Heteroskedasticity
Ho: Constant variance
Variables: fitted values of Effectiveness of Internal Audit
chi2(1) = 0.36
Prob > chi2 = 0.5495

Source: Field Survey, 2018

#### 4.2.4.4. Assessment of Autocorrelation

If there are patterns in the residuals from a model, then they can be considered as auto correlated (Brooks, 2008). The Durbin-Watson (DW) is a test for first order autocorrelation (Field, 2009). It assumes that the relationship between an error and the previous of an error. In this type of test, the null hypothesis can't be rejected when DW result is near 2 (Hair, et al., 1998). Because, it shows there is little or no evidence of autocorrelation. Based on Table 4.16 the Durbin-Watson (DW) statistics value of this study is 1.883 and close to 2. Therefore, there is no evidence of autocorrelation among error terms in this study.

**Table 4.16 Durbin Watson Test Model Summary**

Model	R	R Square	Adjusted R Square	Durbin-Watson
1	.343 <sup>a</sup>	.283	.218	1.883

<sup>a</sup> - Predictors: (Constant), Management Support, Independence of Internal Audit, Competency, Quality of Internal Audit

Source: Field Survey, 2018

#### 4.2.5. Regression Results for IAE

The classical linear regression model is the standard procedure for analyzing dependencies between variables that are measured on a metric scale (Thompson, 2002). In the course of model estimation, it is common practice to evaluate the appropriateness of a single descriptive model for the problem under study with the help of the coefficient determination,  $R^2$ . In empirical studies, the most important benefit of  $R^2$  is that it serves as a fast and easily interpretable measure for the goodness of fit of the estimated model (Reisinger, 1997). However,  $R^2$  is not an absolute indicator of goodness of fit. It is just a relative measure of explained variance relative to total variance in the dependent variable (Mayer, 1975; Reisinger, 1997; Nau, 2007; Thompson, 2002). Some authors particularly in social science largely reject the usage of the coefficient of determination (Reisinger, 1997; Thompson, 2002). Further, Cross-sectional studies achieved lesser  $R^2$  value than time-series studies (Reisinger, 1997). Thus, the best value for R-square depends on what the researcher measured. This study depends on participant's perception which collected through questionnaire. Therefore, r-squared value more than 25% can be respectable and good to fit (Reisinger, 1997; Thompson, 2002).

The regression result explores the necessary indicators of IA effectiveness using the variables identified in the model (Hair, et al., 1998). Based on Table 4.16 the appropriate indicators of

the variables used to show the effectiveness of IA were explored. It means the overall contribution of competence of IA teams, independence of IA, quality of IA work, and management support to effectiveness of IA accounted for 28% (0.283) of the variation in the effectiveness of IA.

Based on Table 4.17, the ANOVA shows the significance of the model by the value of F-statistics (P=.000) and F= 4.34 which indicates there were a strong relationship between the predictors and the outcomes of the regression variables. It is at the best fit of the model to predict the effectiveness of IA in EICs.

**Table 4.17 ANOVA <sup>a</sup>**

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	14.706	4	3.676	4.34	.000 <sup>b</sup>
Residual	32.289	44	.847		
Total	51.995	48			

**a.** Dependent Variable: Effectiveness of Internal Audit **b.** Predictors: (Constant), Management Support, Competency, Independence, Quality of Internal Audit

Source: Field Survey, 2018

The beta ( $\beta$ ) sign includes a sign of positive (+) and negative (-). It shows the effect of independent variables over the dependent variable (Field, 2009). Based on Table 4.17 beta sign of all the independent variables shows positive (+). Thus, independent variables (competence of IA team, independence of IA, quality of IA work, and management support) had a positive effect on the predicting dependent variable (effectiveness of IA). Therefore, any increase in independent variables lead to increase in dependent variable. This result is consistent with prior IA literatures (Al-Twaijry, et al., 2004; Arena & Azzone, 2009; Cohen & Sayag, 2010; Mihret & Yismaw, 2007; Ramachandran, et al., 2012; Wubishet & Dereje, 2014).

The independent variable with the level of significance (sig.) value less than 5% can make a significant contribution to the predicted value of the dependent variable. Whereas, a variable beyond this level of significance cannot make a significant contribution to the predicted value of the dependent variable (Brooks, 2008; Hair, et al., 1998). Based on Table 4.18, the statistical significance of the independent variable over the dependent variable at 5% level of significance; three independent variables (competence of IA teams, quality of IA , and

management support) were not significantly contributed for the dependent variable (effectiveness of IA). But the independent variable (independence of IA) was significantly contributed for the dependent variable (effectiveness of IA).

**Table 4.18 Regression Results Coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	Beta	Std. Error	Beta		
(Constant)	.343	.538		0.64	0.53
Competency of Internal Auditors	.212	.193	.162	1.10	0.28
Independence of Internal Auditors	.358	.167	.304	2.15	0.04
Quality of internal audit	.304	.217	.219	1.41	0.17
Management Support	.002	.139	.002	0.01	0.99

Source: Field Survey, 2018

### 4.3. Data Results and Interpretation

This section presents the results of quantitative and qualitative data analysis. The hypotheses testing are used to test a significant influence of independent variables on dependent variable (Field, 2009). In this study, the hypotheses testing used to test a significant influence of competence of IA teams, independence of IA, quality of IA, and management support on effectiveness of IA which was measured in value adding to a business, enhance department performance, and enhance organizational performance. According to Table 4.17 the p-value for competence of IA teams, quality of IA, and management support were statistically insignificant at ( $p < 0.05$ ) which lacks to support for hypothesis 1, 3, and 4. Whereas, the p-value for independence of IA was statistically significant at ( $P < 0.05$ ) which shows a strong support for hypothesis 2. It also reports the results of collected questionnaires from auditee side/groups such as Finance and Accounts, Human Resource and insurance operation Department head and interview, documents review in EICs simultaneously.

In order to ensure the data are telling you what you think and to corroborate research findings within this study the researcher were used data triangulation which refers to the use of independent sources of data techniques at the same. The main objective of this triangulation is to examine the perception of insurance companies' managers towards the factors that affect

the effectiveness of the internal audit functions. 42 questionnaires are successfully collected out of 47 questionnaires distributed.

#### **4.3.1. Competence of Internal Audit Team**

This section discusses the views of participants regarding on the competence of IA team as a factor may impact on IA effectiveness. To this regard, the study examined the competence of IA from proficiency, experience, effective communication, training and development, and access to information technology perspective.

**H 1:** Competence of IA teams is positively associated with the effectiveness of IA in Ethiopian insurance companies (EIC).

The first hypothesis tested competence of IA team positive association with the effectiveness of IA in EICs. The result shows competence of IA team positively associated with the effectiveness of IA in EICs at a statistical insignificance level of ( $P < 0.05$ ). The magnitude ( $\beta$ ) of the effect of this variable on the effectiveness of IA was 0.212 and the t-value of 1.10. The t-value of less than 2 is indicating a weak relationship between the independent and dependent variable (Hair, et al., 1998).

Therefore, the competence of IA team, results in statistically insignificant contribution for the effective internal audit activities in their Companies. Even if this variable have a coefficient of positively related with the effectiveness of internal auditors as a result of its insignificant regression analysis output result leads not to support the proposed hypothesis ( $H_2$ ).

Even though, the above analysis is consistent with previous auditing researches. For instance, Arena & Azzone, (2009) argued that there were no relationship between the overall number of internal auditors (adequacy) and the employment of internal auditor with professional certification (competency) and internal audit effectiveness. In addition, Cohen & Sayag, (2010) concluded that there was no correlation between professional competency and internal audit effectiveness.

A review of document in the study indicates that the Internal Audit department of the some insurance companies does not have specific criterion to select professional audit staff. Instead the companies use ordinary staff recruit and selection criteria with the same fashion with other position in the company. This would make it difficult to effectively assigned competent staff for the position which could not help to apply the strategy of 'assign the right person at the right place'.

Since, internal audit work requires knowledge and experience on a wide range of systems and operations, it is imperative to deploy auditors with extensive professional skills and to upgrade their skills through continuing professional training and development. Continuous skill upgrading is another dimension that deserves attention so as to achieve a high level of technical proficiency. However, most of insurance companies did not plan and provide Long term professional development schemes such as internal audit certification and other relevant continuous training program on Audit Methodology and Internal Audit Standard. The topics on which short term trainings were provided to IA staffs for past year include: “Motor and non-motor insurance underwriting process” “Insurance Claim process” “Insurance Accounting,” and “Re-insurance accounting. These practices might have contribution on the effective accomplishment of internal audit role. In order to the build capacity and enhance the effectiveness of audit function Insurance companies did not use any type automated audit tools such as generalized audit software, test data generators, computerized audit programs, specialized audit utilities and computer assisted audit techniques.

Based on descriptive analysis for the HRM, FAD and insurance operation department managers’ perception toward the effectiveness of internal auditors as provided in Table 4.18, the findings show that the mean for all 4 questions surveyed was above 2.57. This indicates that insurance managers have positive or high level of perception on the Competence of Internal Audit Team.

Insurance underwriting & claim department, Finance & Accounts and Human Resources Management directors were asked to describe Auditors’ necessary knowledge in audited area. The responses indicate that internal audit team lack of adequate understanding on businesses processes and risks because internal auditors are assigned to internal audit without any preparation, experience or training on detail insurance accounting, claim and performance auditing technique. In this point, Participant no. 3 said the impact of this practice as follows:

“We have knowledge gap and understanding on the same issue because of this, auditors personalized audit findings than focus on be part of the solution. And then led to existence of poor audit culture specifically in the insurance company and in the industry at whole ”

The above statement was also supported by Participant no. 7 as follows:

“In my believe IA department staff does not have the right mix and competencies in conducting audit activities on specialist areas such as reinsurance approaches, insurance underwriting and claim matters ”

The second point addressed in the interviews sought to establish whether internal audit staffs maintain a satisfactory relationship with the auditee and whether they experience any difficulties in this relationship. With the exception of three respondents believed that the relationship between internal audit and auditee has positively and there is a good relationship between internal auditors and auditees within their organizations. In other words, internal audit departments manage their relationship with auditees without difficulty. However, Two Finance and Accounts department managers (respondent no. 3 and 7) made the following statement in this regard:

“We understand the internal audit role is eye and ear of the management, important in improving and supporting our work. However, in my recurrent observation the relationship between our department staffs and IA staffs have a weak. The respondent remarked attitude that has been observing from both sides. In one side auditee staff perceived that auditors of the company has shown themselves in the negative manner such as policeman and they look auditors as a fault finder. In other side audit staff they consider themselves as the only major influential person and try to act as boss in the company level instead of having tended to be flexible and helpful rather.”

In this regard respondent no.8, Insurance operation head, replied that limited numbers of internal auditor staff who has close relationships with some the auditees, especially with those who work in the insurance operation department, If he/she finds something wrong, she/he would find it difficult to decide whether to report it or not, feeling that she/he faces the unhappy choice of ignoring an error or losing a friend. This situation is completely might have impact on smooth and close relationship should put the internal auditor under pressure.

Representative of NBE, the governing body of insurance industry, stated those problems and prospective development of internal audit in insurance industry. The interviews indicate that, the NBE is under progress of drafting a directive to determine all necessary conditions on the scope, authority, and responsibility of IA. The interviews also show that NBE monitors the operations and check internal audit in all private insurance companies and provides support in the form of training as well as other guidance as necessary through supervision report. NBE Regular review meetings are conducted in which CEO, BOD, IA directors of all insurance companies. In these meetings

weakness and Gap of IA departments and their achievements highlighted. This situation serves as opportunity for sharing ideas and a source of input for other insurance companies to utilize.

NBE representative person feel that, most IA departments in the Ethiopian private insurance companies are not staffed with well-trained internal auditors. The sector appears not to be sufficiently competitive to attract and/or retain highly qualified internal audit staff and because of lack financial capabilities. As a result, there were shortages of IA staff in most companies. Participants also believe that the pay rates and career prospects are not as attractive in this sector. Such a phenomenon potentially limits the effectiveness of the IA function in the sector. There is flexibility of decision making to strengthen IA because it could hinder infant insurance companies to grow and protected from the stiff international competition.

The participant added on that “Although the insurance market in Ethiopia is a young industry at its early stages of development with limited skill, capacity and management, there are a lot of opportunities to develop the internal audit practices”. Generally, the fact that all private insurance companies establishment of IA department is an indication of the NBE’s high level of attention to IA. Despite this apparent will at NBE initiatives nevertheless, IA services have not been highly appreciated and supported at lower levels in most organizations.

#### **4.3.2. Independence of IA**

Organizational independence was the second proposed hypothesis in this research. As per the regression results organizational independence significantly determines internal auditors' effectiveness ( $p < 0.05$ ). The regression analysis shows very strong support for second hypothesis. Independence of internal auditors was the only variable that was strongly and positively related to the internal auditor's effectiveness dimensions. To this regard, the study examined the independence of IA from existence of effective audit committee, individual internal auditors' independence, and organizational independence of IA function perspective.

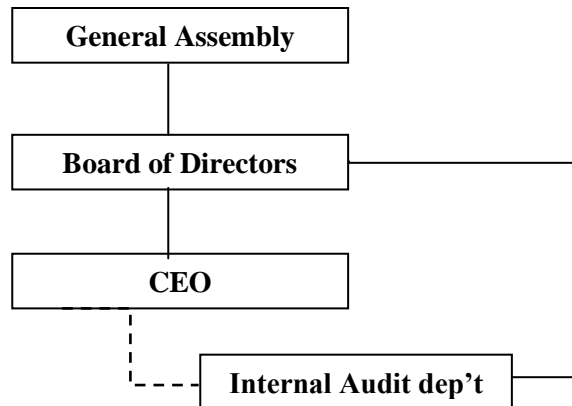
**H 2:** Independence of IA is positively associated with the effectiveness of IA in EICs.

This hypothesis tested independence of IA positive association with the effectiveness of IA in EICs. The result shows independence of IA positively associated with the effectiveness of IA in EICs at a statistical significance level of ( $P < 0.05$ ). The magnitude ( $\beta$ ) of the effect of this variable on the effectiveness of IA was 0.358 and the t-value of 2.15. The positive magnitude sign and t-value of more than 2 are indicating a strong relationship between the independent and dependent variable (Hair, et al., 1998). This result was consistent with previous auditing

researches conducted by Cohen & Sayag, (2010) and Van Peurse, (2005). It implies that internal auditors' become more effective, when they are permitted to freely perform auditing activities.

In the similar manner, on average 2.31 insurance managers agreed for all raised three questions related to independence are factors that could effect on the effectiveness of internal audit. The researcher confirmed that, Ethiopian Private Insurance’s company has Internal Audit Division or department headed by Manger/director (out of 16 insurance companies 11 or 68.7% them has department head). To examine the position of IAD in EICs the researcher reviewed organizational chart of the few insurance companies. Based on the organizational chart of the companies, IADs are independent and at the top level of the organizational hierarchy. This finding is in line with Abu-Azza, (2012) study. The IAD seems to be responsible to Board of Directors (BOD) functionally and Chief Executive Officer (CEO) administratively. This helps with BOD enhance the independence of IAD, unrestricted access to records, personnel, and departments, avoids any conflict of interests and not perform non-audit work. Figure 4.1 shows the organizational chart of Sample EICs.

**Figure 4.1 Sample Insurance Company Chart**



Source: Document Review, 2018

However, the following issues were observed while reviewing documents:-

- All Insurance companies BOD does not implement Risk based audit approach in order to have good auditing system in the insurance industry.
- No audit charter in placed by BOD. Such type of practices might hinder the role of internal auditor in short run and have adverse effect on the quality and effectiveness of audit function in the long run.

- Few Companies IA managers appointment was made by the CEO instead of Audit committee.
- Most of Insurance companies Audit committee does not have transparent and well organized approaches for ensuring an effective internal audit system, staffed with qualified personnel to perform internal audit functions, covering financial, operational and management audit is put in place
- NBE does not design provide detail frame work other than good governance directive.

The first question underlying independence was directed to Human resource management directors, Insurance operation managers and financial and accounts managers to ascertain whether their IA directors communicate and interact directly with the boards of directors. Although the organizational charts of the insurance companies showed that, the position of the internal audit department functionally linked directly to the board of directors and administratively responsible to chief executive officers. Out of 10 interviewers 4 responses indicated that there is no direct link between IA directors and the boards of directors but, rather, their direct contact is with the chief executive officer who can contact the board of directors directly if necessary.

Respondent no. 8 tell that “The communication between IA directors and the board of directors is limited to following up the decisions of the board only, and to sending a copy to the department of internal audit to enable them to monitor the implementation of decisions, and thus prepare reports indicating the extent to which the various departments should implement recommendations.”

As one Human resource management (respondent no. 6) mentioned:

“I understand that IA department does not have communication or meeting with board of directors, but they have regular meetings with the CEO. Because IAD do not attend the board of directors meetings the chief executive officer presents the internal audit department reports on behalf of internal department. Therefore, this practice is subject to affect the degree department independence.”

In the other way respondent no. 4 replied that (Finance and Accounts director) “ There is lack of Board understanding on internal auditors’ role because of this limitations the board doesn’t able to communicate with IA department frequently. Therefore, things could not go in the right track without proper and effective oversight body activities according to NBE good governance directives.”

In addition, one of the insurance operation department head (respondent 3) explained:

“I can say that the Audit committee of our insurance company had less attention and commitment on monitoring and communication over all activities of internal audit department.”

The second question was asked relating to internal audit reporting. Participants were asked to indicate whether or not internal audit departments prepare audit reports and for which management level they submit their audit reports. Among those interviewed, Finance and accounts department heads, human resource management managers, and Insurance operation managers recognized that the internal audit departments prepare and submit audit reports. As noted, from the organizational structure of insurance companies it is clear that the positioning of internal audit departments at the highest levels of the organization impacts on reporting levels. and review of presented internal audit report.

According to the participants' responses with exception of five respondents, internal audit departments are responsible to the chief executive officer and the board of directors, thus reports are submitted to both these levels of management, and discussed with the chief executive officer. But, internal audit reports may be presented in compiled manner in conjunction with overall company performance report and discussions made are not in detail on item-by-item bases by the board four times in a year. One of the respondents stated effects like: “where reports are not presented immediately to board means IA report may be filtered by management such that only what is palatable to management is communicated. This practice might have adverse effect on the company assets and overriding the NBE directives.”

Another question which shows the independence of the internal audit department within the company is the identity of the person who has the right to appoint or remove the IA director. A question directed to human resource management managers related to the decision to appoint or remove the directors of internal audit and focused on who has the right to make such a decision. All three companies' respondents confirmed that the board has the right to appoint or remove the director of internal audit.

According to the participant 4 and 6 responses, the director of the internal department is nominated by the chief executive officer, and the board confirms the decision to appoint her/him. Then a copy of this decision is sent to the director of the human resources department, and the director of human resources informs the IA director of her/his appointment. One of the respondents (HRM department

Head) added comment on this regard he believed that most of appointment IA head in the insurance sector is made using third party recommendation.

Regarding to independency the NBE representative explained that:

“Establishment of internal audit and the function’s reporting status in the sector appears largely attributable. Reporting to the BOD and the role of NBE appear to contribute positively to enhance IA’s independence. However, constraints to auditors’ independence are apparently observed in some insurance companies this is either due to limited management support to IA or inadequate IA acceptance at lower and middle management levels”

### **4.3.3. Quality of Internal Audit**

**H 3:** Quality of IA work is positively associated with the effectiveness of IA in EICs.

The third hypothesis tested quality of IA work positive association with the effectiveness of IA in EICs. The result shows that weak association between quality of IA work and the effectiveness of IA in EICs at a statistical significance level of ( $P < 0.05$ ). The magnitude ( $\beta$ ) of the effect of this variable on the effectiveness of IA was 0.304 and the t-value of 0.167. The positive magnitude sign but t-value of less than 2 is indicating a weak relationship between the independent and dependent variable (Hair, et al., 1998). However the finding of this study is consistent with the finding of Tadiwos (2010).

However on the contrasting the above result the audittee response shows that averagely agreed at 2.45 as factor of internal audit effectiveness in the Ethiopian insurance companies.

Consequently, the researcher also review necessary documents to examine the existence of IA charter, audit manual, comprehensive audit plan, format and content of audit report of EICs (for few companies). During the document review the researcher has been observed the following facts:-

- Three sample audit reports from 2018 fiscal year were examined for this study. Overall, a review shows that the audit reports are prepared by auditors and reviewed & issued by IA head. The content of issued reports are not consistent, is comprehensive basic elements of audit report and unstandardized audit format. If the companies provide proper attention for caption problem could help enhance the quality of audit communications.
- Annual plans for its operations and approved by BOD but company's IAD does not develop a strategic plan, this would not have enabled the audit staff to evaluate risk and

identify high risk areas that deserve audit attention. It could also have been an exercise by which the head of internal audit ensures the appropriateness of resources by projecting requirements in a timely fashion. The study reviewed the annual audit plan of the 2018/2019 budget year as a sample and observed that the plan is not comprehensive enough in terms of audit scope and the approach to identify auditable area.

- Few Companies' BOD does not approve and up to date internal audit manual.

During the interview the researcher also raised questions to ascertain the audit quality matter and to determine the extent of auditees' actions on the findings and recommendations of the internal audit department. According to interview discussion with insurance operation, Finance & account and Human resource management managers, 70 per cent (7 out of 10) agree with the statement that most of the time Audit findings are correctly argued, justified and supported with significant possible recommendations.

In other scenario, respondent 3, 8 and 9 indicated that internal audit findings are not clearly justified, correct and support with convinced evidence and it is not useful in terms of assessing the potential risk which may have an impact on the organization objectives.

In other words, according to interviewee' responses, frequently internal audit department issue audit reports without appropriate recommendations, absence of long lasting recommendation , without adequate documentation for audit evidence, without over all audit opinion and Poor audit report writing practice such content, objectivity and use of appropriate templates. One insurance operation director (respondent 9) commenting on this matter as follows:

“I can say that internal audit recommendation of our insurance company included in internal audit report are not significant and is somewhat unsatisfactory because it focus on pasts events rather than future improvements.”

Additionally, respondents 3 and 8 believed that most internal auditor focused on Incomplete scope of auditing activities (i.e not covers operations, risk exposures etc.), Inspection type of auditing and assuming pre-auditing responsibility, Unable to move away from the previous auditing practices and Undue focus on cash count and routine transactions auditing. However, a prominent example identified by interviews was a fundamental change to give up pre-audit activities in favor of post-audit, of major insurance transactions. Most participants feel that

insurance transactions involve risk from its nature, and that is especially that case in relation to Insurance and reinsurance claims. Since, claims are accepted and paid the decision cannot easily be inverted. As a result, internal auditors in insurances were involved in pre-audits. The interviews show that although IA played little decision making role in the pre-audit approach, the potential for compromising quality of internal audit report was in question. Therefore, the sum of all practice could not able to provide benefit to management with a methodology to identify unforeseen situations in the companies.

#### **4.3.4. Management Support**

**H 4:** Management supports are positively associated with the effectiveness of IA in EICs.

The last hypothesis tested management supports positive association with the effectiveness of IA in EICs. The result shows that weak association between management supports and the effectiveness of IA in EICs at a statistical significance level of ( $P < 0.05$ ). The magnitude ( $\beta$ ) of the effect of this variable on the effectiveness of IA was 0.002 and the t-value of 0.990. The positive magnitude sign and but t-value of less than 2 are indicating a weak relationship between the independent and dependent variable (Hair, et al., 1998).

Consequently, this result revealed that there was no relationship between the effectiveness of internal audit and the management support. Therefore, the forth hypothesis of this research was rejected. The result was inconsistent with the previous auditing research of Mihret and Yismaw (2007) and Cohen & Sayag (2010) find that the top management support was the critical determinant of internal auditors' effectiveness.

Questionnaires results for mangers show a positive response regarding the support of top management for IA function. The mangers agreed to the fact that top management providing support to IA unit is paramount importance to the effectiveness of IA. This variable recorded averagely low ( $M=2.161$ ) in comparison with other three variables.

In the fourth place four questions was raised to know the extent and type of management support provided to internal audit for Human resources management, finance and accounts and insurance department head. The first sub- question is related to training and continuous education programs for new and current. According to the three interviewee' responses, there insurance companies encourage their employees to continue their educational programs and provide free exam leave but In fact insurance companies plan to support internal auditors to continue their educational programs for future especially for studying master degree and

professional certification by covering the cost of study. In other way their insurance companies provide training by outsourcing to Ethiopian institute of financial studied and other selected training center existed in Ethiopia this approach were utilized to enhance internal auditors' understanding of the organization's systems and operations such insurance underwriting process, clam and insurance accounting.

The second sub- question is related to adequacy internal audit staff interms of size, volume and activities of the insurance company. As noted, from the company's internal audit staff size it is clear that out of 16 insurance companies 10 of them (63%) were consist only 3 and less staff size. Regarding to internal auditors staff size Human resource management director respondent 3 commenting on this matter as follows:

“Our internal audit work force focuses on to prevent the probability of significant errors or fraud of day to day activities. In my opinion they have not focused on to cover non-financial operational areas, because the number of internal auditors is so small as compared to the company life, volume and activities of companies. In order to fill this gap we have striven to fill vacant post but still we couldn't get experienced staff from the market.”

## **CHAPTER FIVE**

### **SUMMARY OF MAJOR FINDINGS, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1. Introduction**

This final chapter aims to conclude the study. It includes conclusion of the study results, recommendations based on the study results, and recommendations to future study. In conclusion section of the study; the researcher tried to show the implications and the findings of the study. Finally, the researcher provides a recommendation according to the study result.

#### **5.2. Conclusion of the Study**

IA has an important role in helping a firm to achieve its objective when it is implemented, operated, and managed effectively. Organizations which effectively implemented, operated and managed IA were better able to identify their business risks and system inefficiencies for the sake of taking corrective actions and improvement in the process. The following major findings are noted based on the analysis of IAD staffs, questionnaires with Finance and accounts, Insurance operation and Human resource department managers and reviews of documentary evidence.

A review of document in the study indicates that the Internal Audit department of the some insurance companies did not have designed special criterion to select professional audit staff and did not plan & provide Long term professional development schemes such as internal audit certification and other relevant continuous training program on Audit Methodology and Internal Audit Standard. Additionally, Insurance companies perform its audit activities without using any type of automated audit tools except basic computer application such as word and excel.

In reviewing documents on IA independence and audit quality, all Insurance companies' BOD does not implement Risk based audit approach, Some Companies does not approve and update internal audit manual and audit charter in placed by BOD, company's IAD does not develop a strategic plan, some Companies IA mangers appointment was made by the CEO instead of Audit committee, most of Insurance companies Audit committee does not have transparent and well organized approaches for ensuring an effective internal audit system, staffed with qualified personnel to perform internal audit functions, covering financial, operational and management audit is put in place. From all other thing Paramount importance thing is NBE

does not provide detail frame work for internal audit in addition to Good Governance directive.

The findings of the study reveal that, organizational independence of internal auditors is very important for the effectiveness of internal auditors in Ethiopian private insurance companies regardless adequate competent internal audit staff, quality of internal audit and management support. Internal auditors' activities in improving department, as well as organizational performance and the value-added role to insurance companies would increase, when the organizational independence of internal auditors is more guaranteed.

In other speaking, competence, management supports and quality of IA work are weak association between all three variable and the effectiveness of IA in EICs at a statistical significance level of ( $P < 0.05$ ). But independence of IA is positively associated with the effectiveness of IA in EICs at a statistical significance level of ( $P < 0.01$ ).

### **5.3. Recommendations**

The overall objective of the study is to identify the factors determining the effectiveness of IA in ECBs. In this regard, the data analysis using quantitative and qualitative methods were made. According to the research objective and based on the data analysis, the researcher provides the following recommendations to the concerned bodies

- The effectiveness of internal auditors in private insurance companies will be under question, unless these determinants are appropriately pledged in insurance sectors. To overcome this threat for internal auditors' effectiveness, the country's financial regulatory organ (i.e National bank of Ethiopia) should work more on the ways of ensuring the organizational independence of internal auditors.
- Private insurance companies need to ensuring the effective functioning and changing the audit approach of Audit committee in line with current global to gain the benefit on advancement internal audit standards.
- Possible ways of maintaining independence could be approving and implementing internal audit charter and audit manual in each insurance company. The charter should briefly define the extent of relationship between internal auditors and the management; should smoothly communicate them their accountability and responsibility; should briefly describes the rights and duties of internal auditors and of the employer.

- Audit report should be standardized in terms of content, should define the scope of audit work and approve audit strategy and the audit approach being followed.
- Last but not least, NBE should design detail framework other than good governance directive and Audit committee of insurance companies should have strength transparent and well organized approaches for ensuring an effective internal audit system, staffed with qualified personnel to perform internal audit functions, covering financial, operational and management audit is put in place.

#### **5.4. Suggestion for Future Research**

The researcher encourages further research to extend the results of this study and improve the results by minimizing the limitation of the study. Therefore, the researcher suggests the following future research areas:

- 1) Replicating this study in other setting (in different sector and country) will make this study conclusion validate.
- 2) Replicating this study using other research methodology like tools of data collection and type of research.
- 3) Replicating this study with consideration of Audit committee members or other board of director members, regulatory body such as NBE auditors, external auditors, other audittee with in insurance companies and CEO of the company's reliance in addition of IAD staff will extend the conclusion of this study.

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**Annex 1: Table 4.19 Auditee (Managers) perception toward the effectiveness of internal auditors**

**Source: Field Survey, 2018**

<b>Variables</b>	<b>Obs</b>	<b>Mean</b>	<b>Std. Dev.</b>	<b>Min</b>	<b>Max</b>
Competency of Internal Auditors	42	2.571	.781	1	4.75
Independence of Internal Auditors	42	2.309	.715	1	4.33
Quality of internal audit	42	2.452	.626	1	4
Management Support	42	2.161	.641	1	3.5

## Annex 2 : Questionnaires for Internal Audit staffs

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

*Questionnaires for Internal Audit staffs*

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Dear Participant:

The objective of this Questionnaire is to gather firsthand information that will help to assess the *factors affecting internal audit effectiveness: the case of Ethiopian insurance companies only.*

This study is undertaken as a partial requirement for the completion of **Master's Degree in Accounting and Finance.**

All data and information that will be gathered through this Questionnaire will be used for the sole purpose of the research and remains confidential. Therefore, you are kindly requested to respond to the questions with utmost good faith, freely and to the best of your knowledge. There is no need to write your name on the Questionnaire.

Thank you in advance for your time and kind cooperation.

With best Regards,

**Arefayne Wodajo**

*Should you need further clarification, please contact me at mobile +251911081544 or +251983744114*

**Section I. General Profile**

General Instruction: Please indicate your choice by putting “√” mark in the bracket.

1. Sex/Gender/: Male (\_\_\_) Female (\_\_\_)
2. Age (in year): Below 25 ( ) 25 to 30 (\_\_\_), 31 to 35 (\_\_\_), 36 to 40 (\_\_\_), above 40 years (\_\_\_),
3. Your field of study: Accounting (\_\_\_), Management (\_\_\_), Economics (\_\_\_), other specify (\_\_\_\_\_)
4. Your Current Level of Education: Diploma (\_\_\_\_\_), Bachelor's Degree (\_\_\_\_\_), Master’s Degree (\_\_\_\_\_), other specify (\_\_\_\_\_).
5. Your Service year in the insurance company: Less than 5 years (\_\_\_), 6 to 10 years (\_\_\_), 11 up to 15 (\_\_\_), 16 up to 20 (\_\_\_), above 20 years (\_\_\_),
6. The responsibility you hold in this company (at present) \_\_\_\_\_
7. Number of years of experience you work as an internal auditor (in this company): \_\_\_\_\_

**Section II. The Questionnaires items (questions)**

Please indicate your degree of agreement or disagreement with the following statements by putting tick mark (√) in the appropriate Column.

**Key:** SD= Strongly Disagree; D=Disagree; N= Neutral; A= Agree; SA= Strongly Agree

1→Strongly Disagree; 2→Disagree; 3→Neutral; 4→ Agree; 5→ Strongly Agree.

S/No.	Variables	SD	D	N	A	SA
	<b>Competency of Internal Auditors</b>					
1.	The audit procedures and evidence collections are completed on time, since enough and skilled internal auditors are available or employed.					
2.	Do you think that the organization audit department or division has progressed in terms of appropriately qualified or professional staff?					
3.	Internal auditors are proactive (creating or controlling a situation rather than just responding).					
4.	Internal auditors undertake continuous professional development trainings or attend educational seminars.					
	<b>Independence of Internal Audit Team</b>					
5.	Internal audit provides reports to the board of directors (or audit committee).					

6.	Internal auditors have full access to records and information they need in conducting audits					
7.	Internal audit participates in the development of the company strategy and system design.					
8.	Internal auditors include in their reports any fault, fraud, wrongdoing and mistakes without influence from any one.					
	<b>Quality of Internal Audit</b>					
9.	Examination of reliability and integrity of information, checking working papers quality properly done by internal auditors.					
10.	External auditors use internal audit working papers and reports in conducting their audit.					
11.	Internal audit work was efficiently performed according to the audit plan.					
12.	Internal audit findings are correctly argued and justified.					
13.	Internal audit recommendations can be easily implemented.					
14.	Internal audit report is accurate (clear and logical).					
	<b>Management Support</b>					
15.	Senior management supports internal audit personnel.					
16.	Internal audit department is large enough to efficiently carry out its duties.					
17.	Senior management is aware of internal audit needs.					
	<b>Effectiveness of Internal Audit</b>					
18.	Internal audit ensures that it adds value to the business.					
19.	Internal audit improves department's performance.					
20.	Internal audit improves organizational performance.					

Please suggest if you face any kind of idea in evaluation of internal audit effectiveness in your organization that is not addressed in this questionnaire.

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## **Annex 3: Questionnaire for HR, Finance and Insurance Operation Department/ division heads**

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

### **Questionnaire for HR, Finance and Insurance Operation Department/division heads**

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Dear Participant:

Effective internal audit function is an important management tool to monitor and direct the internal operations of an organization effectively and appropriately. Therefore, the purpose of this questioner is to collect necessary data that are used to identify the *factors determining effectiveness of Internal Audit in Ethiopian insurance companies*. This study is undertaken as a partial requirement for the completion of **Master's Degree in Accounting and Finance**.

In line with this, you are kindly requested to give your response to your personal profile, and to each statement related with factors that determining the effectiveness of internal audit in your companies.

All data and information that will be gathered through this Questionnaire will be used for the sole purpose of the research and remains confidential. Therefore, you are kindly requested to respond to the questions with utmost good faith, freely and to the best of your knowledge. There is no need to write your name on the Questionnaire.

Thank you in advance for your time and kind cooperation.

With best Regards,

**Arefayne Wodajo**

*Should you need further clarifications, please contact me at +251911081544 or +251983744114)*

**Section I. General Profile**

General Instruction: Please indicate your choice by putting “√” mark in the bracket.

1. Sex/Gender/: Male (\_\_\_\_) Female (\_\_\_\_)
2. Age (in year): 20 to 29(\_\_\_\_), 30 to 39(\_\_\_\_), 40 to 49(\_\_\_\_), 50 to 59(\_\_\_\_), above 60 (\_\_\_\_)
3. Your field of study: Accounting (\_\_\_\_), Management (\_\_\_\_), Economics (\_\_\_\_)  
Other specify\_\_\_\_\_
4. Level of education: TVET certificate (\_\_\_\_), Diploma (\_\_\_\_), Bachelor's Degree (\_\_\_\_), Master’s Degree (\_\_\_\_) or others specify\_\_\_\_\_
5. Current position in your company\_\_\_\_\_

**Section II. The Questionnaires items (questions)**

Please indicate your degree of agreement or disagreement with the following statements by putting tick mark (√) in the appropriate Column.

**Key:** SD= Strongly Disagree; D=Disagree; N= Neutral; A= Agree; SA= Strongly Agree  
1→Strongly Disagree; 2→Disagree; 3→Neutral; 4→ Agree; 5→ Strongly Agree.

S/No.		SD	D	N	A	SA
	<b>Competency of Internal Auditors</b>					
1.	Internal auditors possess appropriate knowledge to audit your department /division.					
2.	Internal auditors have appropriate skills to audit your department/division.					
3.	Internal auditors possess adequate experience to understand your department’s operations, procedures and to address corporate risk management problems within the department/division.					
4.	The internal auditors have confidence to issue audit report because they are capable to determine the nature and frequency of noncompliance activities.					
	<b>Independence of Internal Audit Team</b>					
5.	The existing role that the internal audit is playing sufficient enough to address the very purpose for which it is established					
6.	Internal auditors include in their reports any fault, fraud, wrong doing, and mistake without influence from any one.					
7.	Internal auditors in your company are capable of carrying out internal					

	control function under current corporate governance rules.					
	<b>Quality of Internal Audit</b>					
8.	The number of complaints (doubts) about the internal auditors' finding (report) is very low because their report is correct and reasonable.					
9.	Audit findings are supported by sufficient evidence.					
10.	Audit recommendations are constructive					
11.	Internal auditors are not considered as disrupting regular activity					
12.	The non-compliance reports provided by internal auditors are reliable and significant to my department /division.					
	<b>Management Support</b>					
13.	The audit function provides useful service for the management of your department/division.					
14.	The existence of internal audit assists efficient use of resources in the department /division.					
15.	I use the recommendations, criticisms and information provided by Internal auditor for decision making.					
16.	My office/sector has put its confidence on internal audit staffs, because they may face any problems (non-compliance activities).					

Please suggest if you face any kind of idea in evaluation of internal audit effectiveness in your organization that is not addressed in this questionnaire.

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## **Annex 4 Interview with selected Mangers (FAD, HR and Insurance manger's view)**

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*ADDIS ABABA UNIVERSITY  
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DEPARTMENT OF ACCOUNTING AND FINANCE*

### **Interview questions With HR, Finance and Insurance Operation Department/division heads**

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Dear interview participant

The objective of this interview is to gather information that will help to assess the *factors affecting internal audit effectiveness: the case of Ethiopian insurance companies* only. This study is undertaken as a partial requirement for the completion of **Master's Degree in Accounting and Finance**. I am conducting an interview to generate part of the data needed for my MSC.

In this interview, you are being asked the questions attached with this form. During the interview, I will listen to and transcribe your responses. These transcripts will be used to extract some conclusions in aggregate terms, without any reference to your identity. Therefore, your name or any identifier will not appear in any of the outputs of the research.

I would also like to advise that participation in this interview is voluntary and you may choose to withdraw at any time during or after the interview.

Best regard,

Arefayne Wodajo

### Competency

1. Do you appreciate that internal audit teamwork had been proven that has **necessary knowledge in audited area**? Why? Explain?
2. Do the internal auditors maintain satisfactory **relationships with other employees in the organization**? If no, do you or your management staff find any difficulties when you deal with the internal auditors?

### Independence

1. In your opinion does IA department communicate and interact directly with the board of directors? Why? Please explain.
2. To **whom** does the Internal Audit department head **report**? Please Explain.
3. Who has the right to make the **decision to appoint or remove** the director of internal audit (Head of Internal Audit)? Please Explain.

### Audit Quality

1. Do you appreciate that findings are correctly argued and justified?
2. Do you appreciate that internal audit recommendations are significant?
3. Do you consider that internal audit report is clear and logical?
4. Do you believe internal audit can be beneficial to organizations in terms of providing management with a methodology to identify those risks that may prevent the organization from meeting its objectives? Why? Please explain.

### Management support

1. Does the organization have established **training and continuous education programmes for current internal auditors**? Why? If yes, to what extent is there training programmes specifically designed for new members of the internal audit staff? Please explain.
2. As a **manager of human resource management department** does the organization provide adequate internal audit staff interms of size, volume and activities of the company? Why?

## **Annex 5: Discussion points with NBE representative (National Bank of Ethiopia's view)**

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

### **Interview with NBE representative (National Bank of Ethiopia's view)**

---

Dear interview participant

The objective of this interview is to gather information that will help to assess the *factors affecting internal audit effectiveness: the case of Ethiopian insurance companies* only. This study is undertaken as a partial requirement for the completion of **Master's Degree in Accounting and Finance**. I am conducting an interview to generate part of the data needed for my MSC.

In this interview, you are being asked the questions attached with this form. During the interview, I will listen to and transcribe your responses. These transcripts will be used to extract some conclusions in aggregate terms, without any reference to your identity. Therefore, your name or any identifier will not appear in any of the outputs of the research.

I would also like to advise that participation in this interview is voluntary and you may choose to withdraw at any time during or after the interview.

Best regard,

Arefayne Wodajo

General Interview questions:

- 1. How does internal audit context influence internal audit effectiveness in Ethiopia insurance sector on the basis of variables like Competency of internal audit, Independence of internal audit, Quality of internal audit and Management support?*
- 2. What are challenges on the practices of internal audit in Ethiopian insurance companies?*
- 3. How does the status of internal auditing in Ethiopian private insurance companies and map (plan) of onto audit practice and improvement?*