

Determinants of Internal Audit Effectiveness in Ethiopian Private Banks: The case of selected Private Commercial Banks.

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

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Acronyms

B.O.D.	"Board of Directors"
C.I.A.	"Certified Internal Auditor"
C.A.E.	"Chief Audit Executive"
C.E.O.	"Chief Executive Officer"
E.C.Bs.	"Ethiopia Commercial Banks"
I.A.	"Internal Audit"
I.A.F.	"Internal Audit Functions"
I.F.A.C.	"International Foundation of Accountants"
I.A.D.	"Internal Audit Department"
I.I.A.	"Institute of Internal Audit"
I.P.P.F.	"International Professional Practice Framework"
I.S.P.P.I.A.	"Institute of Standards on the Professional Practice of Internal Audit'
N.B.E.	"National Bank of Ethiopia"
R.B.I.A.	"Risk Based Internal Audit"

Statement of Declaration

I, Tamrat Wubshet, hereby assert that this thesis titled "Determinants of Internal Audit Effectiveness in Ethiopian Private Banks" submitted to “Addis Ababa University in partial contentment of the requirements for the master of degree (MSc)” is entirely my own original work, except where otherwise indicated. All sources used have been duly acknowledged and referenced.

I understand that plagiarism is a serious academic offense and that any instances of plagiarism was dealt with according to the university's academic integrity policies. I also indorse that this exertion has not been surrendered for any other degree or reward.

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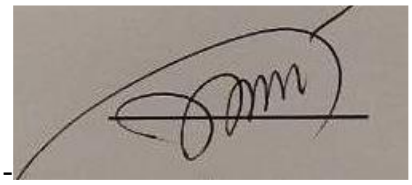
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Statement of Certification

This document certifies that Tamrat Wubshet has conducted research on the topic "Determinants of Internal Audit Effectiveness in Ethiopian Private Banks" in partial fulfillment of the requirements for the “Master of Science (MSc) degree in Accounting and Finance at Addis Ababa University”. This research was carried through my direction and supervision. I confirm that this work is inventive and has not been submitted previously for somewhat degree or award at any other institution. All sources used have been acknowledged and referenced appropriately.

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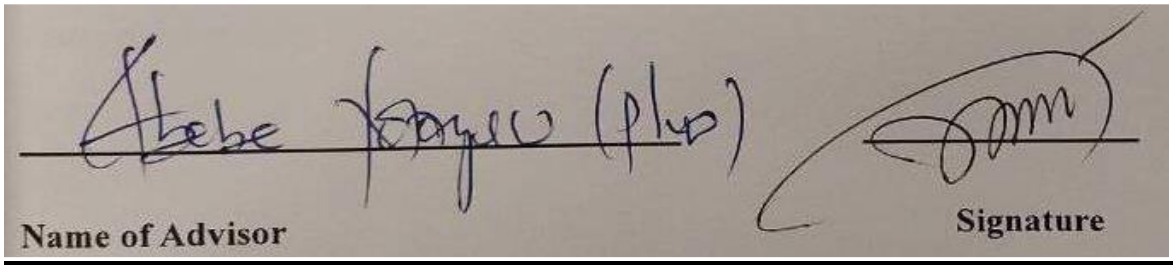
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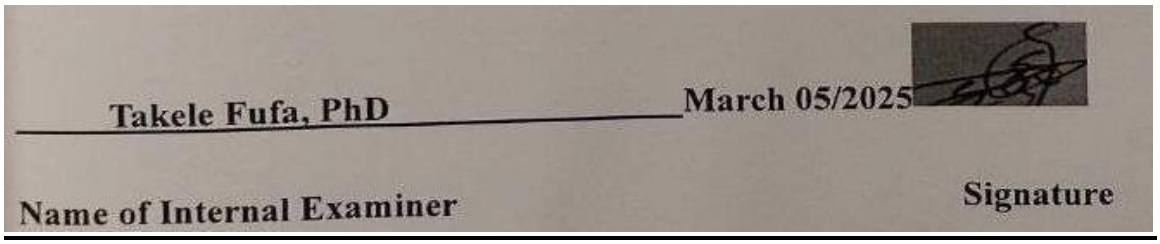
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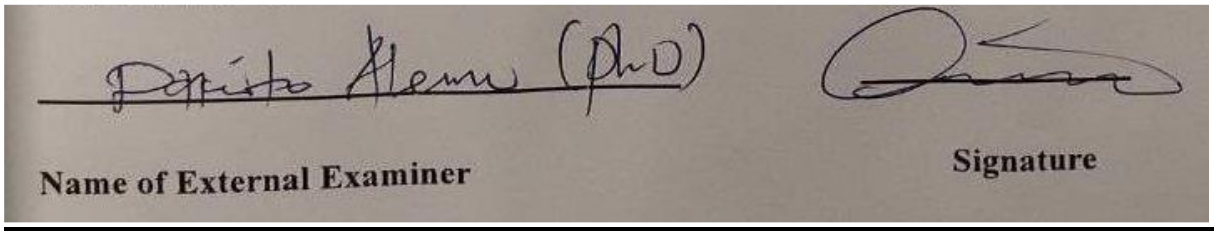
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Abstract

Given the crucial role of internal audit in strengthening internal controls, managing risks, and improving corporate governance, it is essential to investigate the factors that contribute to its effectiveness. The primary goal of this study was to identify the factors that influence the effectiveness of internal audit functions in Ethiopian banks. Then, this study examines the bond between "internal audit effectiveness/success and several key issues". The questionnaires were structured using a Likert-scale and distributed to 199 internal auditors at the selected banks. The collected data was then analyzed using Stata statistical software. Furthermore, "relevant documents were reviewed to gather further insights". Hence, the study findings demonstrate that internal auditor competence, independence and objectivity of audit function, "board & management support", "audit-committee existence", and RBIA methodology are all significant factors influencing the effectiveness of internal audit in Ethiopian commercial banks. The study recommends that Ethiopian commercial banks prioritize the factors identified in the research to improve the efficiency and effectiveness of their internal audit functions. By focusing on these factors, banks can strengthen their management of risk, "internal controls", and "corporate governance practices". In addition, the investigator suggests that future research should explore additional factors that may influence the internal audit effectiveness in Ethiopian banking-industry.

Key Words: -Internal-Audit, Effectiveness of Internal Audit function, Commercial Banks in Ethiopia, Internal Audit Function, Corporate Governance, Risk Management.

Chapter one

1. Introduction

1.1.Background of the study;

The 2008 financial-crisis, also known as the Great Recession, highlighted the critical importance of effective risk management and internal controls in commercial banks. Weak internal audit functions were identified as contributing factors to the crisis, emphasizing the need for strong internal audit practices in the banking industry. Internal audit serves as an independent line of defense within a bank, providing assurance on risk control, governance, and internal controls. An effective internal audit function proactively identifies and assesses risks, detects and deters fraud, and promotes good corporate governance. This, in turn, contributes to the bank's financial stability, operational efficiency, and reputation. Mishkin, F. S. (2010).

The Institute of Internal Auditors (IIA) defines internal auditing as "a dynamic profession focused on helping organizations achieve their objectives". "It involves evaluating and improving the effectiveness of risk management, control, and governance processes within an organization". To achieve this, "internal auditors conduct systematic reviews of structures and operations". These audits aim to assess, "how well risks are managed, whether appropriate strategies are in place, and whether agreed-upon processes are being followed". Additionally, "audits can identify areas for efficiency or innovation. Internal audits are conducted within an ongoing program of assessment and advisory activities that are aligned with the strategic needs of the organization".

According to COSO (2013), internal control is a system implemented by an organization's board of directors, management, and other personnel to provide reasonable assurance about the achievement of objectives relating to operational effectiveness and efficiency, reliable financial reporting, and compliance with applicable laws and regulations".

According to COSO (2013), risk management and internal auditing are integral parts of the five interconnected elements of an organization's internal control system: the control environment, risk assessment, control activities, information and communication, and monitoring activities". "The COSO framework highlights how these components and their activities are interrelated". "While internal audit primarily focuses on the monitoring component, its role is to review and evaluate compliance with established internal control mechanisms".

Internal auditing and risk management, while distinct, both play important roles within the overall internal control system (COSO, 2013). Internal audit is a key part of the internal control framework, providing oversight to the board of directors and audit committee to ensure the integrity of financial reporting". "Internal audit adds value to an organization by providing objective and relevant assurance, and by contributing to the effectiveness and efficiency of its governance, risk management, and control processes". "A strong internal control system, which includes an independent and effective internal audit function, is essential for sound corporate governance (The Basel Committee, 2012)". "The internal-auditing career has evolved alongside advancements in control technology since World War II". "Internal auditing shares some common ground with financial audits performed by public accounting firms, assurance services, and banking compliance activities". "While it has been influenced by both management consulting and public accounting, the field of internal auditing as we know it today was largely shaped by Lawrence Sawyer (1911-2002), often called the "father of modern internal auditing". "The modern thinking, concepts, and practices of contemporary internal auditing, as outlined in the International Professional Practices Framework (IPPF) by the Institute of Internal Auditors, are largely attributed to Sawyer's idea. The Institute of Internal Auditors Bangladesh. (2018)".

Internal-auditors work crossways various zones of an organization". "Similar to central areas of financial management and IT, they evaluate tangible factors of actions, such as supply chains and IT systems, as well as intangible aspects like organizational culture and ethics". Essentially, "any system that affects the effective operation of a company can fall within the scope of internal audit" ("The Institute of Internal Auditors in Australia. (2000)".

Internal-audit is a self-governing assessment role within an association. Unlike external auditors who primarily focus on verifying financial statements, internal auditors examine various aspects of a company's operations. Their goal is to improve the organization by identifying areas for improvement and ensuring smooth operations. Internal auditors act as internal watchdogs, objectively evaluating processes, controls, and risk management techniques. They delve into areas such as financial reporting, compliance, and operational performance. By analyzing these aspects, they identify weaknesses and recommend improvements to help the organization achieve its objectives and avoid future problems.

Internal auditing is an independent assessment and consulting activity designed to add value and improve an organization's operations". "It helps organizations achieve their objectives by using a systematic and disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes". "Internal auditing provides insights and recommendations based on analyses and evaluations of data and business processes". "Dedicated to integrity and accountability, internal auditing provides valuable support to governing bodies and senior management as an objective and independent source of advice". "Organizations employ internal auditors to carry out internal auditing activities". "According to the International Institute of Internal Auditors (IIA, 2019), the scope of internal auditing within an organization is broad and can include areas such as governance, risk management, and controls related to operations, financial reporting, and compliance". "Internal auditing can also involve proactive fraud audits to identify potential fraud, participation in fraud investigations conducted by specialists, and post-investigation audits to pinpoint control weaknesses and assess financial losses". "According to the International Institute of Internal Auditors (IIA, 2019), banks need an internal audit function that has sufficient authority, standing, independence, resources, and access to the board of directors". "Qualified and competent internal auditors are crucial for good corporate governance". "A robust internal control system, which includes an independent and effective internal audit function, is a fundamental element of sound corporate governance". "Banking regulators must be confident in the effectiveness of a bank's internal audit function". "This includes ensuring that the function adheres to relevant rules and practices, and that management takes appropriate and timely corrective action to address any identified internal control weaknesses". "Internal audit provides crucial assurance to a bank's board of directors, senior management, and banking supervisors regarding the quality of the bank's internal control system". "This helps to reduce the risk of financial losses and reputational damage to the bank". "(The Basel Committee on Banking Supervision, 2012)"

Internal auditing has evolved towards a risk-based audit approach. "This approach directly links internal auditing to the organization's core management strategy". "By collaborating with risk management on the risk-based audit plan, valuable perspectives from both sides are combined together, leading to a more comprehensive understanding of the organization's governance and oversight".

1.2.Statement of the problem;

Internal audit plays a critical role in the ongoing maintenance and evaluation of a financial organization's internal controls, risk management, and governance systems". "It focuses on areas of particular interest to supervisory authorities". "The internal audit function should provide an independent and informed perspective on the risks facing the bank, leveraging its access to all bank information, investigations, and professional expertise". "Internal audit should be able to communicate its views, findings, and conclusions directly to the audit committee and board of directors, enabling the board to effectively oversee senior management". "Internal audit should not be involved in designing, selecting, implementing, or operating specific internal control measures. (The Basel Committee on Banking Supervision, 2012)." "An effective internal control system and its proper implementation are essential for commercial banks, given their significant financial, monetary, and social roles".

A thriving financial system depends on the effective functioning of commercial banks. The recent growth in the Ethiopian commercial banking sector is a positive development, but it's essential to implement strong risk management practices to ensure its sustainability. Excessive risk-taking without proper management can lead to financial problems and even bank closures, as emphasized by the National Bank of Ethiopia's 2010 guidelines. As banks are crucial to the economy and handle public funds, they require well-defined and effective risk management frameworks to protect the public's financial well-being. A bank's internal audit department serves as an independent reviewer, providing assurance to the board of directors and senior management that the bank's internal controls are functioning effectively. "The Basel Committee on Banking Supervision. (2012)". "According to the International Internal Auditing Research Foundation (IIARF, 2011), the role of internal auditing in Enterprise Risk Management (ERM) should be to provide assurance to management and the board regarding the effectiveness of risk control". "The Institute of Internal Auditors (IIA) issued the International Standards for the Internal Audit Profession in 2020, offering guidance to internal auditors worldwide". "These standards highlight the importance of internal audit involvement in ERM processes". Internal audit is a crucial element of the corporate governance structure within an organization. This study aims to examine the factors that contribute to the effectiveness of internal audit in Ethiopian commercial banks. Moreover, Internal audit functions play a critical role in safeguarding the financial health and "operational efficiency of commercial-banks". In the context of the evolving regulatory landscape

and increasing complexity of banking operations, “the effectiveness of internal audit functions in Ethiopian commercial banks is paramount”. However, challenges such as resource constraints, limited independence, and lack of a strong risk-based audit approach may hinder their effectiveness. Ethiopian commercial banks face significant challenges related to the effectiveness of their internal audit functions, which lead to substantial financial loss and reputational risks according to the reports of National Bank of Ethiopia 2023/24 FY. Weak internal controls or internal audit function result in financial losses from fraud, embezzlement, errors in financial reporting, and operational failures. Furthermore, public disclosure of these weaknesses can erode customer trust, invite increased regulatory scrutiny, and lead to legal action.

Therefore, this research aims to address this gap by comprehensively investigating the determinants of internal audit effectiveness in Ethiopian commercial banks. By identifying and analyzing these factors, this study will provide valuable insights for banks to strengthen their internal audit functions, enhance their risk management practices, and contribute to the overall resilience and stability of the Ethiopian banking sector. Previous research has identified factors such as competence, independence, board and management support, and methodology as significant influences on internal audit effectiveness.

To achieve this objective, eight non-governmental commercial banks (named, Amhara bank, Bank of Abyssinia, Dashen bank, Tsedey Bank, Nib Bank, Abbay Bank, Hibret Bank and Global Bank Ethiopia) were selected for a case study based on availability of data and willingness to the study. “The study will focus on identifying and analyzing the determinants of effective internal-audit and its roles in internal-control, management of risk, and corporate-governance within these banks”.

1.3.General Objectives of the Study;

The primary goal of this study is to identify and examine the key factors that influence the effectiveness of internal audit functions in Ethiopian commercial banks.

1.4.Specific Objectives;

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

1.4.1. Examine the impact of internal audit staff competence on internal audit effectiveness.

1.4.2. Investigate the impact of board and management support on internal audit effectiveness.

1.4.3. Identify the impact of independence and objectivity on internal audit effectiveness.

1.4.4. Examine if a risk-based internal audit approach influences internal audit effectiveness.

1.4.5. Investigate the "influence of audit-committee existence on effectiveness of internal audit".

1.5.Research Hypotheses;

After diving deep into what other researchers have written, I came up with some testable guesses, called hypotheses, to help answer my big research question.

1.5.1. Competence of internal auditors;

"The results of the study of (Gebrearegawi (2019) and Workneh (2021)) designated that technical competence is the furthermost pertinent aspect for effectiveness of internal audit function". Based on these indication outcomes; the researcher hypothesizes that:

H_1: Internal auditors who are highly skilled and knowledgeable make a real difference in how effective the internal audit process is.

1.5.2. Independence and Objectivity of internal audit activity;

Schoolwork outcome showed that independence and objectivity of internal audit practice plays a vital role in determining the effectiveness of internal audit roles. (Gebrearegawi (2019) and Workneh (2021)). Based on these practical indications, the researcher hypothesizes that:

H_2: When internal auditors are free from bias and can look at things objectively, it significantly boosts how effective their audits are.

1.5.3. Board and management support;

The schoolwork discoveries specify that board and management support have a substantial impact on the effectiveness of internal-audit purposes. Strong management assistance, shown through providing capitals, training, access to new technology, suitable services, and active inspiration of the internal audit process, helps the internal audit function be extra operative. (Gebrearegawi (2019) and Workneh (2021)). Based on these observed indications, the investigator hypothesizes that:

H_3: Board & Management supports have positive and significant impact on the internal-audit effectiveness.

1.5.4. Methodology/Risk-based internal audit approach;

The Institute of Internal Auditors (ISPPIA, 2017) says that the top audit person needs to create a risk-based plan. This plan should tackle the most important things the internal audit team needs to do, and it should align with what the organization is trying to achieve. Essentially, the audit plan needs to reflect the organization's overall strategies, goals, and the specific risks it faces. Based on this best practice for internal auditing, I predict that:

H_4: A well-defined and robust internal audit process is likely to lead to more effective internal audits.

1.5.5. Audit committee existence;

The study performed by DeZoort, Hermanson, Archambeault, and Reed (2002) point outs the substantial influence of audit committee existence on the effectiveness of the internal audit role. The finding specify that the existence of an audit committee plays a critical role in supporting and cooperating with internal audit functions, thereby enhancing Audit Committee Effectiveness (ACE) and dropping the likelihood of financial statement fraud. The audit committee's participation in the appointment and shooting of the chief/director internal auditor, coupled with organized communication plans between internal auditors and audit committees, is shown to expand corporate governance excellence and fortify internal audit effectiveness. Overall, the presence of an audit committee is allied with providing resources, support, and oversight that subsidize to the effectiveness of the internal-audit doings and encourage reliable financial reporting and risk management practices within firms.

H_5: Having an active audit committee significantly improves how effective the internal audit process is.

1.6. Research Questions;

This study work makes an effort to discover the determinants of effectiveness of Internal-Audit in the case of designated private banks of Ethiopia. The investigator planned to address the succeeding research queries via undertaking this study;

1.6.1. What is the impact of internal audit staff competence on internal audit effectiveness?

1.6.2. How does board and management support influence internal audit effectiveness?

1.6.3. What is the connotation between independence & objectivity, and internal-audit effectiveness?

1.6.4. To what extent RBIA approach influence internal audit effectiveness?

1.6.5. How does the "existence of an audit-committee influence internal-audit effectiveness"?

1.7.Significance of the Study:

This research explores what makes internal audits effective, specifically focusing on how they help with business risk management, corporate governance, and internal controls in Ethiopian commercial banks. By examining a selection of these banks, the study aims to provide valuable insights for the participating banks and others like them, in several ways:

This study aims to deepen our understanding of internal audit concepts and pinpoint what makes internal-audits effective in Ethiopian banks. This study will help the participating banks, and other similar commercial banks in Ethiopia, assess the effectiveness of their own internal audit departments. On the other hand, this study will provide the National Bank of Ethiopia (NBE) with insights to evaluate the effectiveness of internal audits in banks as part of their corporate governance oversight. And, this study will be a valuable resource for academics and researchers, who can use it as a starting point for further investigations into other factors influencing internal audit effectiveness.

1.8.Scope of the study:

This research focuses on what makes internal audits effective in Ethiopian commercial banks, using a case study approach with selected banks. Specifically, it examines factors like the competence of internal auditors, their independence and objectivity, the support they receive from the board and management, the audit methodology (including risk-based processes), and the presence and impact of an audit committee. The study will be limited to Ethiopian commercial banks and will primarily involve staff at the head office and district levels who are directly involved in internal audit activities.

1.9.Limitation of the study:

The findings and conclusions of this study have limited generalizability beyond Ethiopian commercial banks and other economic sectors. Cultural and contextual factors specific to the Ethiopian banking environment may also restrict the applicability of these results to other countries with different regulations and cultural norms. Practical limitations arose from the difficulty of reaching all auditors at their offices due to the nature of audit work. A key limitation is the reliance on self-reported data from questionnaires, meaning the study's conclusions are based on the

opinions of those who responded, which could introduce bias. Finally, the study was hampered by a scarcity of current reference materials and literature specifically related to internal-audit practices within the Ethiopian economic and industrial context.

1.10. Organization of the Paper;

This study is structured into five chapters. The first chapter provides a general introduction, covering the study's background, problem statement, objectives (both general and specific), research questions, scope, limitations, significance, and overall organization. Chapter two reviews the relevant literature. Chapter three details the research methodology. Chapter four presents, analyzes, and interprets the data. Finally, chapter five concludes the study and offers recommendations based on the findings.

Chapter Two

2. Literature Review

2.1. Introduction

This section of the study provides an overview of auditing, internal auditing, internal control, the commercial banking sector, and related audit concepts. It begins by exploring the theoretical foundations of auditing and internal auditing, including definitions, the differences between internal audit and internal control, audit classifications, the evolution of auditing, the distinction between internal and external audits, and the role of internal audit in commercial banking. The second part examines existing research (both international and Ethiopian) on the factors believed to influence internal audit effectiveness. The third part outlines the theoretical framework underpinning these factors. Finally, the section concludes with a summary and identifies gaps in the reviewed literature.

2.2. Theoretical review

"The Institute of Internal Auditors (IIA, 1999, pp 64)", defines internal auditing as an independent activity that helps organizations improve their operations by evaluating their risk management, control, and governance processes. Internal auditors provide objective assurance and consulting services to help organizations achieve their goals.

Auditing is the process of examining financial statements to ensure they are accurate and reliable. It involves gathering and evaluating evidence to determine if the financial information aligns with established standards. While internal auditing doesn't directly generate revenue, it is crucial for an organization's success. Unlike external auditors who focus solely on financial statements, internal auditors examine a broader range of issues, including reputation, operations, strategy, environmental impact, and employee treatment (Alarens Al, 1996).

"The Institute of internal auditors, 2020, internal auditors perform various tasks such as evaluating technologies, analyzing opportunities, investigating global issues, assessing risks and controls, and ensuring adequate controls are in place". "They communicate their findings clearly and accurately, providing a valuable perspective to management and boards of directors". Effective internal auditing helps organizations identify risks, improve efficiency, and achieve their objectives.

However, it's essential to monitor the internal audit function to maintain its credibility and effectiveness. In essence, internal auditing provides assurance that an organization's processes and systems are effectively managing risks and contributing to the achievement of its goals “(Norman Marks 2013.)”.

2.2.1. Meanings of Internal Audit, Internal Check and Internal Control

Internal control is a broad system that encompasses various components, including internal checks and internal audits. While closely related, these components are distinct. Internal control involves implementing systems, policies, and procedures to safeguard assets, manage risks, and achieve organizational objectives. It's influenced by the board of directors, management, and other personnel. Internal audit is an independent assessment of a company's operations, internal controls, and information systems. It helps management evaluate the effectiveness of internal controls (Ravinder Kumar, & Virender Sharma. (2005).

Let's examine how these three ideas are distinct from one another: -

Internal auditing is a self-governing assessment process within the firm that examines processes and entries to provide insights to management. It's conducted by specifically assigned staff.

Internal check is a system where the work of one employee is automatically reviewed by another during the process of completing and recording transactions. This helps to minimize or prevent errors, fraud, and irregularities.

Internal control is a comprehensive system that includes not only internal checks and audits but also other financial and non-financial controls established by management. It's designed to ensure efficient business operations, protect assets, and maintain accurate and reliable records. Therefore, internal control is a broad term that encompasses various control mechanisms, including internal checks and audits (“Ravinder Kumar, & Virender Sharma. (2005))”.

Internal auditors shall be impartial and free from influence when reviewing the work of department heads and other executives. However, unlike external-auditors, they are staffs of the corporation they audit and therefore cannot be completely independent in the same sense (Rick, R., Roger, R., Arnold, A., & Philip, P. (2005)).

Internal control is a comprehensive concept that encompasses the entire management system. It ensures efficient and organized business operations by implementing checks and balances across various transactions. These controls can be financial or non-financial. Internal control is crucial for effective management, and it helps organizations adapt to changing environments and evolving needs. As businesses evolve and implement new technologies, management must regularly evaluate their internal controls to ensure their effectiveness and relevance (Federal Managers' Financial Integrity Act of 1982).

Strong internal controls are key to minimizing significant errors, irregularities, and fraud, and they also make it easier to catch any problems quickly. These controls are essential for both management and auditors, and they play a vital role in helping organizations achieve their goals (“Internal Control Comptroller's Handbook. (January 2001))”.

Ineffective internal auditing may suggest that it's not providing significant value. By aligning its strategies with the company's mission and vision, internal audit can contribute substantially to risk management, thereby adding value (Barac, M., et al. (2009); Mihret, A., & Wolde-yohannis, D. (2008); Yee, K., et al. (2007).

According to reports by COSO (1992, 2013) and Basel (1998), “an operative internal-control system is one where the BOD and management accomplish the subsequent standards”:

Clear understanding of organizational objectives: They have a clear grasp of the company's goals.

Accurate and reliable financial reporting ensures that financial statements are properly prepared and presented. And, adherence to all relevant laws and regulations.

The control environment is a fundamental component of an organization's internal control system. It establishes the overall culture and mindset of the organization, influencing the control awareness of all employees. “It helps as the basis for the rest of other elements of the internal-control scheme” (“Ramos, R. (2004)”.

The internal-audit role has become a crucial part of corporate-governance and has evolved significantly. While it was once primarily seen as a "watchdog," it now includes a broader range of activities, such as consulting, risk management, and compliance. This shift is reflected in the updated definition by the IIA (2011), which emphasizes internal audit's role in adding value and

improving operations through risk management and control evaluation. “Despite fluctuations in the meaning, understanding the internal-audit function and its importance can be challenging”. Internal-audit has expanded beyond its traditional role as a tool for internal control and now encompasses a wider range of responsibilities, including risk identification and advising senior management. To fully benefit from the internal audit function, all stakeholders, including management, accountants, and the audit committee, should give it due consideration. (IIA). (2011). & Staciokas, A., & Rupsys, R. (2005).

2.2.2. Commercial banking and Internal audit function

According to Basel Committee on Banking Supervision. (2012).; Principles for the Effective Oversight of Internal Controls in Banks. The banking sector plays a crucial role in the economy, offering a variety of services and handling significant amounts of money daily. Its health and stability are essential for the overall economic well-being. Given its importance, effective internal controls are indispensable in banks. A strong internal control system is crucial for banks. It helps them reach their goals, stay profitable over the long term, and generate trustworthy financial and management reports. It also ensures they follow all the rules, laws, and internal policies, which minimizes the risk of losses and reputational damage. This system supports the board and management in protecting the bank's resources, creating accurate financial reports, and staying compliant. Finally, effective internal controls help prevent and catch errors, irregularities, and fraud.

A solid internal control system, including a strong and independent internal audit team, is vital for good corporate governance in banks. Banking regulators need to be sure that a bank's internal audit function is working effectively, verifying that policies and procedures are being followed and that management fixes any internal control weaknesses. The internal audit function provides essential assurance to the bank's board, senior management, and regulators about the quality of the bank's internal controls, helping to reduce the risk of financial losses and reputational harm. (Source: Basel Committee on Banking Supervision, 2012)

Every bank, regardless of its size, should have an internal audit function. Smaller banks might outsource this function. The internal audit department must operate independently from the areas it reviews and the daily internal control processes. This ensures objectivity and impartiality.

Internal auditors must avoid conflicts of interest. Banks should establish formal guidelines for the internal audit function, outlining its role and authority within the organization. “Basel Committee on Banking Supervision. (2012)”.

2.2.3. The Theory of line of defense in managing risk (ERM)

According to Institute of Internal Auditors (IIA) Publications, the three lines of defense model is a structured approach to managing risk and improving internal controls. Each line has a specific role: -

2.2.3.1. First Line of Defense: Business working and operation Units

The first line of defense consists of departments directly involved in revenue generation, such as sales, trading, and loan origination. They are responsible for identifying and managing risks associated with their daily activities. This includes following policies, procedures, and conducting thorough due diligence. These frontline personnel play a proactive role in risk management by adhering to established guidelines, conducting due diligence, setting and managing credit limits, implementing KYC and AML controls, and monitoring risk indicators. However, the pressure to meet performance targets can sometimes lead to risk-taking behavior within business units. KPMG International (2016).

2.2.3.2. The Second Line of Defense: Risk Management and Compliance function

The next line of protection provides independent oversight and risk management expertise. They create and implement risk frameworks, monitor compliance with policies, and report risk exposures to senior management. Risk management and compliance play a crucial role in overseeing the risk management framework and ensuring its effectiveness. Their key tasks include developing risk management frameworks, monitoring first-line compliance, conducting independent risk assessments, establishing a risk appetite, reporting risk exposures, and collaborating with internal audit. However, the second line must be independent and have sufficient authority to effectively carry out their oversight function. KPMG International (2016). Three Lines of Defense: A Framework for Effective Risk Management.

2.2.3.3. Third Line of Defense: Internal Audit

Internal audit acts as an independent evaluator, assessing the effectiveness of controls implemented by the first and second lines of defense. They identify weaknesses, suggest improvements, and

ensure internal controls are functioning properly. Internal audit provides an objective view of the risk management framework's effectiveness. Their key activities include conducting regular audits, evaluating the second line, identifying control weaknesses, recommending corrective actions, monitoring management's response, and reporting findings to senior management and the board. KPMG International (2016).

Optionally, there may be a fourth line of defense: external auditors and regulators. If included, this line represents external parties who provide independent oversight. External auditors examine financial statements and assess internal controls, while regulators monitor the bank's overall risk management practices and compliance with regulations. Al-Tamimi, A. A. (2017); Djuitaningsih, S. (2018).

The three lines of defense work together to form a comprehensive risk management framework in a commercial bank. Each line has specific roles, but they all contribute to protecting the bank's assets, ensuring financial stability, and complying with regulations. These lines are not isolated; they work together to create a strong risk management system: The first line identifies and manages risks in their daily operations. The second line oversees risk management practices and provides guidance to the first line. The third line independently evaluates the effectiveness of controls implemented by the first and second lines.

By collaborating, the three lines of defense create a comprehensive approach that enhances the bank's capacity to identify, manage, and mitigate risks, ultimately achieving its goals and meeting stakeholder needs. Oliver Wyman. Right Sizing the Three Lines of Defense.

2.2.4. Global Standards of Internal-Auditing

The Institute of Internal Auditors (IIA) sets the bar for internal auditing through its International Standards for the Professional Practice of Internal Auditing (ISPPIA), Code of Ethics, and International Professional Practices Framework (IPPF). These standards apply to all internal audits and provide a framework for how internal auditing should be conducted and improved. These principle-based standards define the essential requirements for professional practice and performance evaluation, applying to both individual internal auditors and the entire internal audit activity. Every internal auditor is expected to follow standards related to individual objectivity, proficiency, due professional care, and their specific job responsibilities. These include:

1000-The internal audit charter should clearly outline the purpose, authority, and responsibilities of the internal audit function. It should align with the overall mission of internal audit and adhere to the mandatory requirements of the International Professional Practices Framework (IPPF).

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

1200- Internal audit activities must be conducted with competence and professionalism. This means auditors should have the necessary skills and knowledge to perform their duties effectively and with care.

1300-The Chief Audit Executive (CAE) or Director should launch and maintain a quality assurance and enhancement program that incorporates all aspects of the internal audit role. This program guarantees the quality and effectiveness of the "internal-audit actions".

2000 - The Chief Audit Executive (CAE) is responsible for effectively managing the internal audit function to ensure it adds value to the organization.

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

2200-Internal auditors must create and document a plan for each audit engagement. This plan should outline the objectives, scope, timeframe, and resource requirements of the engagement.

2300-Internal auditors must gather, analyze, assess, and document enough information to accomplish the goals of the audit engagement.

2400-Internal auditors must report the findings of their audit engagements. This means communicating the results of their investigations to relevant stakeholders.

2500 - The Chief Audit Executive (CAE) needs to establish and maintain a system to follow up on audit findings that have been reported to management, ensuring that management takes appropriate corrective action on identified issues.

2600-If the Chief Audit Executive (CAE) believes that management has accepted a level of risk that could be detrimental to the organization, the CAE must address this issue with senior management. This means discussing the potential risks and recommending appropriate actions.

The purpose of the International Standards for the Professional Practice of Internal Auditing (ISPPIA) is to: -

Outline the fundamental principles guiding internal auditing practices.

They provide a framework for conducting and promoting a wide range of valuable internal audit activities.

They provide a basis for evaluating the effectiveness of internal audit practices.

They contribute to improved organizational processes and operations.

2.2.5. NBE Risk management guideline

In May 2010, the National Bank of Ethiopia (NBE) released risk management guidelines for banks, in line with international standards and best practices. These guidelines set minimum standards for how banks should identify, measure, monitor, and control credit, liquidity, market, and operational risks. The goal is to support risk-based supervision and maintain the stability and health of the banking system. All banks are required to have a dedicated risk management structure, ideally reporting directly to the board or its risk management committee. A complete risk management program should include: -active oversight by the board of directors and senior management, clear policies, procedures, and limits for managing risks, a robust risk monitoring and management information system. And, effective internal controls.

Risk management responsibilities: -

Board oversight: the BODs are ultimately accountable for the quantity of hazard their banks undertake. Therefore, they should: -

The board should "approve the organization's overall corporate strategies and key policies, especially those concerning risk management." “They also need to make sure senior management has the resources and skills needed to run the bank effectively”.

“The board is responsible for understanding the key risks the organization faces and ensuring management is actively working to identify, measure, monitor, and control those risks”. “While the level of technical expertise required may differ, directors must have a solid grasp of their bank's risk exposure and receive regular risk reports”. “They should actively seek to understand these risks, perhaps through briefings from auditors or other experts”. “Based on this understanding, the board should set clear guidelines for acceptable risk levels and ensure senior management puts procedures and controls in place to follow those policies”.

Senior management oversight: “Senior management is responsible for putting strategies in place that minimize the risks involved in the bank's operations”. Their responsibilities include:

“Senior management should be actively involved in the bank's operations and have a deep understanding of all major business areas”. “This ensures that appropriate policies, controls, and risk monitoring systems are in place, and that accountability and lines of authority are clearly defined”.

“Senior management is responsible for building a strong culture that values effective internal controls and high ethical standards”. “To do this, senior managers need a deep understanding of the financial sector and their bank's specific activities, including the internal controls needed to minimize related risks”.

Risk manager oversight: “Risk management should be handled by an independent Risk Manager at the organizational level, who ideally reports directly to the board's risk management committee”. “This Risk Manager needs to be independent from the bank's business operations to avoid any conflicts of interest”. “Their job is to assess overall risks, define acceptable risk levels, and identify, measure, monitor, and control the bank's risks. The risk management function provides independent oversight”. “While the Risk Manager should be part of the management team, they should not be part of internal audit, which must remain separate and report directly to the audit committee”.

The guideline defines bank risks as follows:

“Credit risk is the possibility that a borrower or business partner will be unable to fulfill their financial obligations as agreed”.

“Liquidity risk is the risk that a bank may be unable to fulfill its payment obligations promptly and efficiently”.

“Market risk is the possibility that changes in market rates or conditions could negatively impact a bank's financial situation. In other words, it's the risk that the bank's earnings or capital position might be affected by fluctuations in interest rates or foreign exchange rates”.

“Interest rate risk is the potential for fluctuations in net interest income and the economic value of a bank's assets, liabilities, and off-balance sheet financial instruments due to changes in interest rates”.

“Foreign exchange risk arises from fluctuations in the exchange rate between the Ethiopian Birr and other global currencies”.

“Operational risk is the risk of financial loss arising from failures or inadequacies in internal processes, personnel, systems, or external events”.

“IT risk is the potential for negative outcomes, damage, loss, breaches, failures, or disruptions in business functions due to technology-related issues. These risks can arise from system flaws, software defects, network vulnerabilities, and other factors”.

“Legal risk is the potential for unenforceable contracts, lawsuits, or adverse judgments to disrupt or negatively impact a bank's operations or financial condition”.

“Regulatory risk is the risk of facing negative consequences, such as being downgraded, fined, suspended, or having a license revoked, due to non-compliance with regulatory requirements or directives”.

“Strategic risk is the potential for negative consequences on a bank's earnings and capital due to poor decision-making or ineffective execution of business strategies”. “These risks can hinder the bank's ability to remain competitive and profitable in the marketplace”.

“Reputational risk is the risk of negative publicity, whether true or false, that could damage a bank's reputation”.

“Systemic risk is the danger that problems in a single financial institution could spread and, in severe cases, disrupt the entire financial system”.

2.2.6. Risk based Internal auditing methodology

“The Institute of Internal Auditors (IIA) defines risk-based internal auditing (RBIA) as a methodology that connects internal auditing to an organization's overall risk management framework. RBIA enables internal audit to assure the board that risk management processes are effectively managing risks in alignment with the organization's risk appetite”. “According to the IIA (2014)”, RBIA internal-audit should be able to conclude that: -

“Management has identified, assessed, and addressed risks that are both above and below the organization's risk appetite”.

“The risk management responses are effective in managing inherent risks within the acceptable risk level and are not excessive”.

“When residual risks are not aligned with the risk appetite, appropriate actions are being taken to address them”.

“Management is monitoring risk management processes to ensure their ongoing effectiveness, including the effectiveness of responses and completion of actions”.

“Risks, responses, and actions are being accurately categorized and reported”.

According to the IIA (2014), implementing and maintaining Risk-Based Internal Auditing (RBIA) involves three stages:

Stage 1: “Assessing Risk Maturity involves gaining an understanding of how the board and management identify, assess, manage, and monitor risks”. This stage has three objectives:

Assess the organization's risk maturity level.

Report the assessment to management and the audit committee.

Agree on an audit strategy based on the risk assessment.

Stage 2: Periodic Audit Planning involves identifying specific audit assignments for a given period, typically annually, by categorizing and ordering/ranking areas where the BOD needs impartial assurance. This includes processes of risk management, management of key risk, and risk footage and reportage. The objectives of this stage are:

“Agree on all risk management responses and processes that need independent assurance from internal audit”.

“Develop an audit plan that details all audits to be performed within a specific timeframe, typically one year”.

Stage 3: “Separate Audit tasks involve conducting specific risk-based audits to give assurance on the effectiveness of the risk management framework, including the mitigation of individual or groups of risks”.

According to the Institute of Internal Auditors (IIA, 2014), RBIA (Risk-Based Internal Auditing) offers the next benefits:

“An operative risk-management agenda improves a firm’s governance and long-term success”.

“RBIA provides valuable assurance and assists management in enhancing the risk management framework”.

“RBIA warrants that internal-audit capitals are focused on the most significant risks”.

“To assess risk management responses and effectiveness, internal auditors may need to involve more senior managers than in traditional audits”.

“RBIA reinforces management's responsibility for risk management and fosters a stronger risk management culture”.

“RBIA is an effective method for achieving internal audit activity targets”.

“RBIA explains the figure of auditors needed and the necessary staff expertise”.

2.2.7. Internal Auditing role in Enterprise risk management (ERM):

“The primary goal of internal-auditing in risk management is to provide assurance and information that helps top management assess the effectiveness of their risk management activities”. “This helps them achieve the organization's overall objectives”. “Institute of Internal Auditors (IIA), (2011)”. “The core role of internal audit in Enterprise Risk Management (ERM) is to provide objective assurance to the board regarding the effectiveness of the risk management process”. According to the IIA (2009), the core internal audit roles in ERM are: -providing assurance on the

effectiveness of risk management processes, providing assurance that risks are accurately assessed, evaluating the design and implementation of risk management processes, evaluating the reporting of key risks to relevant stakeholders, reviewing how management is handling key risks and defining if the processes of risk management are effective involves internal auditors assessing if:

a) Organizational objectives align with the organization's mission.
b) Significant risks are identified and assessed.
c) Appropriate risk responses are chosen that align with the organization's risk tolerance.
d) Relevant risk information is collected and communicated effectively throughout the organization, enabling staff, management, and the board to fulfill their roles and responsibilities.

"The IIA Research Paper (2011) on internal auditing's role in risk management highlights that internal auditors can play crucial roles in risk management, but many areas remain unexplored or proactive". This research paper aims to encourage internal audit activities and Chief Audit Executives (CAEs) to take action. CAEs have opportunities to: - "educate and train audit committees and management on risk and risk management concepts and related matters". "Provide assurance on the core internal audit roles outlined in the IIA's Position Paper on the Role of Internal Auditing in Enterprise-wide Risk Management". "Seek opportunities to provide more risk management consulting services to support those managing the risk management program, and report the results to the audit committee and management". "Evaluate strategic risks by assessing whether management has": "Comprehensively identified key strategic risks". "Developed effective risk management strategies for these risks". "Established sufficient monitoring of strategic risk indicators". And, "invest in developing internal audit teams to ensure they have the necessary risk management skills and experience". "Use third-party and internal resources to supplement the team's risk management capabilities".

2.2.8. Role of Internal auditors in corporate governance

"Corporate governance is the system that guides and controls an organization. It involves the systems, processes, controls, accountability, and decision-making at the highest levels of the organization". "The OECD's 1999 corporate governance vision highlighted its importance in boosting economic efficiency". "Corporate governance defines the relationships between

management, the board, shareholders, and other stakeholders". It outlines how objectives are set and achieved, and how performance is monitored. Effective corporate governance provides incentives for the board and management to pursue the company's and shareholders' best interests, and it facilitates effective monitoring, leading to more efficient resource utilization. Organization for Economic Co-operation and Development (OECD). (1999).

"Internal auditing is a key component of corporate governance, alongside the board of directors, senior management, and external auditing. Internal audit has been actively involved in implementing effective governance and controls while also evaluating the effectiveness of management's control practices".

As per IIA (2014), "the role of internal audit in corporate governance is to assess and recommend improvements to the governance process in achieving the following objectives": - First, promoting ethical behavior and strong values within the organization. Second, ensuring effective performance management and accountability throughout the organization. Thirdly, communicating risk and control information to the appropriate parts of the organization. And at the last, coordinating activities and information sharing between the board, external auditors, internal auditors, and management.

According to Practice Advisory 2110-3, "internal auditors can play various roles in assessing and improving governance practices". "They typically provide independent and objective evaluations of the design and effectiveness of an organization's governance processes". "Additionally, they may offer consulting services and advice on how to enhance these processes. (IIA). (2011). The International Professional Practice Framework".

"Internal auditing plays a crucial strategic role in an organization's governance function". "This role includes providing leadership, evaluating the effectiveness of performance measurement systems, making appropriate recommendations, and assessing the achievement of corporate objectives". "(IIA). (2017). The International Professional Practice Framework".

2.2.9. Types of Internal Audits

Whereas a substantial percentage of internal audits focuses on financial reporting and compliance with Generally Accepted Accounting Principles (GAAP) or IFRS, numerous firms also recognize the importance of further types of audits. These include compliance audits to ensure adherence to

regulations, environmental audits to assess environmental impact, information technology audits to evaluate IT systems and controls, operational audits to assess efficiency and effectiveness, and performance audits to evaluate the achievement of objectives.

2.2.9.1. Compliance Audits

“Compliance audits evaluate an organization's adherence to valid laws, regulations, policies, and procedures”. Part of these regulations can significantly impact a company's financial health. “Non-compliance with certain laws, like the Foreign Corrupt Practices Act (FCPA) or General Data Protection Regulation (GDPR), can lead to hefty fines or prevent a company from operating in specific regions”.

2.2.9.2. Environmental Audits

“Environmental audits evaluate a company's effect on the environment”. “They may also evaluate the company's compliance with environmental rules, laws and regulations that govern the operation compound”.

2.2.9.3. Information Technology Audits

“IT audits assess information systems (IS) and their supporting infrastructure to make sure customer information and intellectual property are processed correctly, kept secure, and remain confidential”. “These audits often cover general IT controls, such as those related to access, change management, system operations, and backup/recovery procedures”.

2.2.9.4. Operational Audits

“Operational audits evaluate an organization's controls to determine how efficient and reliable they are”.

2.2.9.5. Performance Audits

“Performance audits evaluate whether an organization is achieving the goals and objectives established by the board of directors by measuring the organization's progress against the metrics set by management”. “Isaac Clarke. (November 28, 2018)”.

2.2.10. Process of Internal Audit;

Although every audit is different, most follow a similar four-stage process: Planning (sometimes called Survey or Preliminary Review), Fieldwork, Audit Report, and Follow-up Review. Here's a quick look at each stage:

Planning:

“During the planning phase of an internal audit, the team defines the audit's scope and objectives, reviews relevant guidance, analyzes previous audit results, establishes a timeline and budget, creates an audit plan, identifies key stakeholders, and schedules a kick-off meeting. This comprehensive planning ensures a well-structured and efficient audit process”.

Fieldwork:

It is the actual execution of the audit. “During this phase, the audit team will follow the audit plan”. “This typically involves interviewing key personnel to understand processes and controls, reviewing relevant documents, testing controls, documenting work performed, and identifying exceptions and recommendations”.

Reporting:

In the reporting phase, the internal audit team creates the audit report. This report should be clear and concise to avoid confusion and encourage readership. Findings should be paired with practical recommendations that directly lead to process improvements. The report process includes drafting, reviewing it with management for accuracy, and then distributing the final version.

Follow-up:

The follow-up stage is crucial in ensuring that recommendations are implemented to address identified audit findings. This involves monitoring the progress of process owners who are responsible for implementing recommendations and ensuring that the board is overseeing the company's overall efforts to address these findings. “If an organization fails to follow up on recommendations, it's unlikely that the necessary changes will be made”. “Isaac Clarke. (November 28, 2018)”.

2.2.11. Auditing Theories

Auditing theory provides the conceptual foundation for auditing practice, guiding auditors in their work and influencing the development of auditing standards. It encompasses diverse perspectives on the nature and purpose of auditing, evolving over time to reflect changes in the business environment and the needs of stakeholders.

2.2.11.1. Agency Theory

Agency theory suggests that a principal (like shareholders) hires an agent (like management) to manage the company's resources. Because management typically has more information about the company's performance than the shareholders (information asymmetry), conflicts of interest can occur (Jensen & Meckling, 1976). Auditing helps address this agency problem by providing independent assurance on the reliability of the financial information provided by management. This enhances the credibility of the information and reduces the information risk for the principal. Auditors act as a monitoring mechanism, working to ensure that management acts in the best interests of the shareholders.

2.2.11.2. Stewardship Theory

Stewardship theory offers a different perspective from agency theory. It proposes that management acts as stewards of the resources entrusted to them by shareholders, driven by a desire to act in the best interests of the organization (Donaldson & Davis, 1991). This theory emphasizes that management is inherently motivated to achieve organizational success and highlights the importance of trust and cooperation between management and shareholders. While auditing remains relevant, its focus shifts. Instead of primarily acting as a monitoring mechanism, auditing serves to facilitate communication and build trust between stewards (management) and principals (shareholders). The audit provides assurance that management is acting responsibly and transparently, even if there's an underlying assumption of good faith.

2.2.11.3. Information Theory

The information hypothesis proposes that the demand for auditing stems from the need for reliable information to support decision-making (Watts & Zimmerman, 1986). Users of financial statements, like investors and creditors, need credible information to make informed choices.

Auditing enhances the credibility of financial information by providing independent verification of its accuracy and reliability. This theory highlights the role of auditing in reducing information asymmetry and improving the efficiency of capital markets. The audit adds value by increasing the confidence of information users in the financial statements.

2.2.11.4. Insurance Theory

The insurance hypothesis suggests that auditing can be seen as a form of insurance for management against potential liability arising from misstatements in financial statements (May & Sundem, 1976). Auditors, due to their expertise and independence, can assist management in identifying and correcting errors before they result in substantial losses or legal consequences. From this perspective, management might seek audits to protect themselves from potential lawsuits or reputational harm. The audit, in this context, acts as a mechanism to transfer some of the financial risk associated with errors in financial reporting from management to the auditor.

2.2.11.5. Expectation Gap Theory:

The expectation gap theory focuses on the difference between what users of financial statements expect auditors to do and what auditors are actually responsible for (Chua, 1997). Users might expect auditors to provide absolute assurance of financial statement accuracy, detect all fraud, or guarantee a company's future success. However, auditors are only responsible for providing reasonable assurance about the absence of material misstatement, conducting the audit with professional skepticism, and reporting on the financial statements according to auditing standards. This theory stresses the need for clear communication and education to manage user expectations and close the gap between perception and reality.

2.2.11.6. Critical Theory of Perspective

A critical perspective on auditing theory analyzes the role of auditing within the context of power dynamics and social control (Gray, Bebbington, & Collison, 2010). This perspective argues that auditing isn't a neutral, objective process, but rather a social practice that can be influenced by powerful interests. Auditing can be used to legitimize existing power structures and reinforce social inequalities. This perspective encourages auditors to be more aware of the social and political implications of their work and to consider the broader societal impact of auditing. Auditing theory offers a comprehensive and diverse range of perspectives on the nature and

purpose of auditing. Each theory provides valuable insights into the motivations behind auditing, the role of auditors in society, and the challenges faced by the auditing profession. A solid understanding of these theories is crucial for auditors to perform their work effectively and for users of financial statements to properly interpret audit reports.

2.2.12. Standards on internal audit professional practice

2.2.12.1. Independence and objectivity of internal audit activity

“Internal audit activities must be independent, and internal auditors must be objective. Independence means operating without any constraints that could prevent the internal audit team from doing its job impartially”. “To ensure this independence, the Chief Audit Executive (CAE) needs direct and unrestricted access to senior management and the board. The CAE should report to a level within the organization that allows the internal audit team to effectively carry out its responsibilities”. “The CAE must confirm to the board annually that the internal audit activity is organizationally independent”. “The internal audit activity must be free from interference when it comes to deciding its scope, doing its work, and sharing its findings”. “Internal auditors must be impartial and unbiased, avoiding any conflicts of interest”. “A conflict of interest arises when an internal auditor, in a position of trust, has competing professional or personal interests that could prevent them from doing their job impartially”. “(Institute of Internal Auditors (IIA), 2017)”

2.2.12.2. Competence of Internal auditors:

“Internal audit key competencies are essential for conducting effective internal audits”. “These competencies include: interview skills, testing and analysis skills, documentation skills, recommendation skills, communication skills, negotiation skills, and a commitment to learning (Moeller, 2009)”.

Internal auditors must possess the necessary knowledge, skills, and competencies to perform their individual responsibilities effectively. The internal audit activity as a whole must also have or acquire the required knowledge, skills, and competencies. Internal auditors must apply the level of care and skill expected of a reasonably prudent and competent internal auditor. While due professional care doesn't guarantee infallibility, internal auditors must exercise it during consulting engagements by considering factors such as client needs, the nature and timing of engagement results, the complexity and scope of work, and the cost-benefit analysis. “Internal auditors must

continuously develop their knowledge, skills, and competencies through continuing professional development (CPD). Moeller, M. (2009)". "Internal Auditing: A Practical Guide. Institute of Internal Auditors (IIA). (2017)".

2.2.12.3. Board and Management support:

"Board and management support is crucial for a strong internal audit department." "Adams (1994) emphasizes this point". "The Sarbanes-Oxley Act (SOX 2002) defines an audit committee as a body established by the board to oversee accounting, financial reporting, and audits". "The audit committee is responsible for evaluating the independence of the internal audit function and individual auditors, discussing audit reports and findings with the Chief Audit Executive (CAE), examining and approving the annual internal audit plan and budget, coordinating with external audit, and participating in the appointment and dismissal of the CAE". "While the audit committee primarily interacts with the CAE, all internal auditors should understand this important relationship".

2.2.12.4. Methodology/process of internal audit activity:

"The Chief Audit Executive (CAE) needs to develop a risk-based plan to prioritize the internal audit team's work, ensuring it aligns with the organization's goals". "This plan should be based on a documented risk assessment that's done every year, taking into account input from senior management and the board". "The CAE also needs to understand what senior management, the board, and other stakeholders expect from internal audit's opinions and conclusions". "The CAE should only accept consulting engagements that have the potential to improve risk management, add value, and make the organization's operations better". "Any accepted engagements must be included in the audit plan". "For each engagement, internal auditors must create a documented plan that outlines the objectives, scope, timing, and resources needed". "This plan should consider the organization's strategies, goals, and relevant risks". "(Institute of Internal Auditors (IIA), 2017)".

2.2.12.5. Existence of Audit committee;

An audit committee plays a crucial role in supporting and enhancing the effectiveness of the internal audit function. Collaboration between the audit committee and internal audit is essential for effective oversight, reliable financial reporting, and robust internal controls and risk

management. Studies demonstrate that the presence of an audit committee significantly contributes to achieving Audit Committee Effectiveness (ACE) and reducing financial fraud. The audit committee's involvement in the hiring and firing of the director of internal audit, coupled with structured communication programs between internal auditors and the audit committee, is shown to improve corporate governance quality and enhance internal audit effectiveness. In general, the existence of an audit committee provides resources, assistance, and oversight that contribute to the effectiveness of the internal audit function and promote quality financial reporting and risk management practices within firms. The Influence of Audit Committee on Internal Audit Effectiveness: Empirical Evidence from Saudi Arabia" by Al-Zahrani, M. A. (2018).

2.3. Empirical review;

2.3.1. Competency of internal auditors;

The competence of the internal audit team is a crucial factor in the effectiveness of internal audit, alongside independence. “This includes the proficiency of internal auditors, their experience, effective communication with auditees, training and development, and access to information technology”. “Tadiwos, M. (2016)”. “In Ethiopian Commercial Banks (ECBs), common issues related to internal audit team competence include a nonexistence of enough expert employees, restricted expertise in accounting and finance, challenges in communicating with head office level auditees, the need for internal source training for new hires, and a shortage of internal audit software”. “Training and development programs offered within the organization can improve auditors' performance (Wubishet & Dereje, 2014)”. “The existence of suitable and capable internal audit staff in the Construction and Business Bank has positively impacted their relationship with the Internal Audit Executive (IAE) and contributed to the IAE's effectiveness by ensuring timely completion of audit activities and covering the planned scope (Abreham Y, 2015)”.

The capability of internal audit personnels can be measured based on their academic level, experience, efforts towards continuous professional development, and adherence to audit standards. Cohen, J., & Sayag, T. (2010). “The quality of internal audit work is influenced by both the quantity of audit effort and the quality of professional care exercised”. A study by Gebrearegawi (2019) found that the competence of internal auditors is a significant factor affecting internal audit effectiveness. Participants in the study identified potential weaknesses in internal auditors' knowledge, such as an inability to recognize fraud indicators and key information

technology risks. This suggests a need for improvement in the level of expertise or training among internal auditors.

2.3.2. Independence and Objectivity of internal audit activity;

“Independence in internal auditing means being free from any conditions that could compromise the internal audit function's ability to perform its responsibilities objectively”. “This includes being free from interference in setting the scope of audits, conducting work, and communicating results”. “(IIA). (2009). Enterprise Risk Management: A Guide for Internal Auditors”.

Van Peursem (2023) observed that internal auditors may have a close association with management, which can potentially compromise their independence. Sarens and de Beelde (2016) investigated this association in five Belgian companies and found a lack of objectivity and a weak relationship with the audit committee when internal auditors operate in a management support role. Independence in internal auditing means ensuring that internal auditors can perform their duties objectively. “This is tied to the internal audit function's organizational position within the company, its reporting relationships with the board of directors, audit committee, or other governing bodies, and its authority to evaluate information, reports, and other relevant materials”.

Organizational and individual independence is crucial for internal audit to conduct its work without interference. “This independence applies to both assurance services and consulting for the organization”. “Independence is closely linked to objectivity and avoiding significant quality compromises”. “Without independence, internal audit becomes part of the management team, losing its ability to provide a fresh perspective (Yee et al., 2008)”.

Internal audit must be independent from those it audits to conduct its work without interference and be perceived as capable of doing so. This is essential for auditors to access documents related to their work without bias or fear, enabling them to provide objective reports and reliable professional judgments to fulfill their mandate with integrity. Internal auditors are not considered compromised if they don't appear to act as members of client management or employees. In recent years, there has been increased focus on the independence and objectivity of internal audit. “This is crucial for effective internal auditing, as internal auditors may be reluctant to challenge management, even, if necessary, due to the potential consequences (Mary 2007)”.

“Independence, along with objectivity, can be viewed as a form of autonomy. Internal auditors are seen as independent when they can perform their work freely and objectively, without fear of management or other influences compromising their professional judgment on audit matters”. “(Mary, M., 2007)”

“Researchers in Ethiopia and other countries have found positive correlations between the organizational independence and objectivity of internal audit team members and the effectiveness of internal audit”. “These studies suggest that organizational independence has a significant positive impact on internal audit effectiveness”. “Some of these studies include Alemzewud A. (2019), Tadios M. (2016), Gebrearegawi N. (2019), Helladellai and Mohamed Ali (2016) and Workneh (2021)”.

2.3.3. Board and management support;

“Management support is a critical factor in the effectiveness of internal audit, alongside independence and team competence”. “Senior management's awareness of internal audit needs and support through financial and non-financial resources significantly impact internal audit effectiveness in Ethiopian Commercial Banks (ECBs”). “While ECBs generally provide strong financial support to internal audit departments, some issues related to management support include lower bonus and compensation amounts”. “However, ECBs have demonstrated strong financial support by allocating substantial funds to internal audit departments. Gebrearegawi, N. (2019)’. “Management support in providing resources, training, technology, facilities, and encouragement for internal audit processes contributes to the effectiveness of the Internal Audit Executive (IAE)”. “Workneh, D. (2021)”.

Workneh (2021) conducted a case study on internal audit effectiveness in the public sector and found that management support is a significant factor. This support includes the response to audit findings and commitment to strengthening internal audit. “Management's interest in maintaining a strong internal audit department and the implementation of audit recommendations is crucial for internal audit effectiveness”. When top management values the internal audit function, they actively support it by hiring qualified staff/personnel, developing career paths through continuous trainings, and ensuring organizational independence for internal audit work.

2.3.4. Methodology/Risk-based internal audit approach;

The internal audit methodology is the systematic approach and procedures used by the internal audit function to assess and evaluate an organization's risks, controls, and governance processes. A key component of this methodology is the establishment of a risk-based plan by the Chief Audit Executive (CAE). This plan prioritizes internal audit activities based on the organization's goals, strategies, objectives, and relevant risks.

Workneh (2021) suggests that the methodology or process used by the internal audit function is positively linked to the effectiveness of internal audit activities. A well-defined and structured methodology, especially one that is risk-based and aligned with the organization's objectives, can enhance the overall effectiveness of internal audit. By focusing on areas most critical to the organization's success and sustainability, internal auditors can ensure that their activities are targeted towards addressing key risks and providing valuable insights. A robust and well-defined methodology is essential for optimizing and enhancing the effectiveness of internal audit functions and contributing to the organization's risk management, internal control, and governance processes.

2.3.5. Audit committee existence;

Audit committees play a crucial role in enhancing the effectiveness of internal audit by providing support, resources, and oversight. They interact with internal auditors, external auditors, and management to oversee financial reporting, internal controls, and risk management. Factors like authority, influence, and expertise contribute to the effectiveness of audit committees in promoting good governance practices. However, weaknesses in audit committees include limited oversight due to periodic meetings, challenges in measuring diligence, and the need to improve the quality of information provided. Addressing these weaknesses can further strengthen their effectiveness in fulfilling governance responsibilities. The quality of information provided to audit committees is a key area for improvement. By enhancing oversight mechanisms and information quality, audit committees can strengthen their role in governance processes and internal audit effectiveness. Audit committees can strengthen the internal audit function and make it a valuable resource for implementing its obligations. DeZoort, C. T., Hermanson, D. R., Archambeault, W. D., & Reed, J. L. (2002).

2.4. Conclusion and Knowledge Gap;

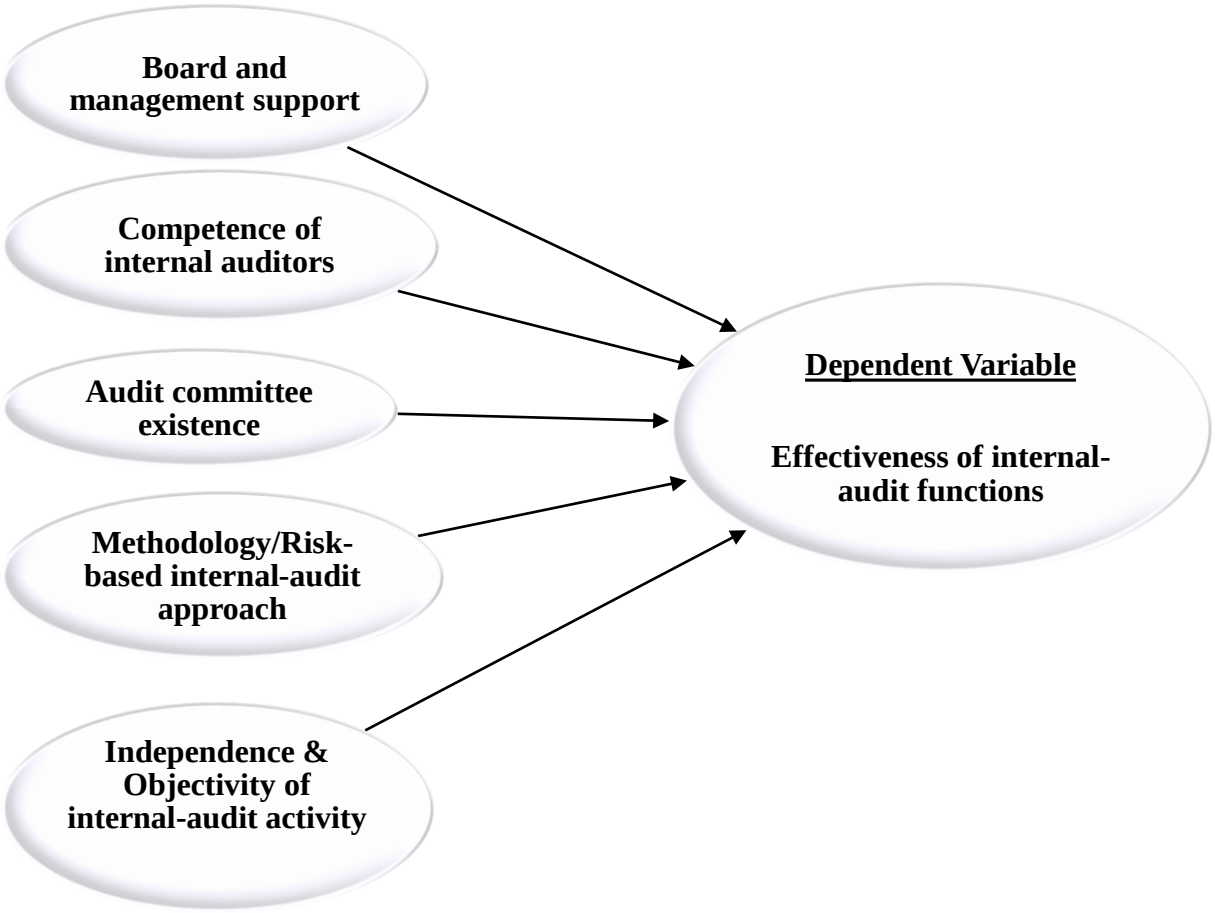
This literature review examines the relationship between internal audit effectiveness and its determinants, drawing on studies conducted both within and outside Ethiopia. “Five main factors are discussed: competence of IA teams, independence and objectivity of IA, top management and board support, methodology/risk-based audit approach, and the existence of a strong audit committee”. “Effective internal audit can contribute to sector value, and enhance departmental and organizational performance”.

The literature review identifies the following gaps: -

There has been a limited amount of recent research on what makes internal audits effective specifically within the context of private commercial banks. Additional factors that should be considered as determinants of internal audit effectiveness include existence of audit committee and the methodology /auditors' use of the risk-based audit approach to test the outcome on IA effectiveness. Besides, the specific ways in which internal audit contributes to corporate governance processes needs more exploration. How does internal audit interact with the board of directors and audit committee to ensure effective oversight? Also, many studies focus on identifying factors associated with internal audit effectiveness, but fewer explore the causal relationships between these factors and outcomes. More rigorous research designs are needed to establish causality. And, the regulatory landscape for businesses, particularly in the financial sector, is constantly evolving. Research needs to examine how these changes impact internal audit's role and its effectiveness in ensuring compliance.

2.5. Conceptual framework;

Based on established internal audit theories and empirical research conducted by various scholars, this research aims to develop its own conceptual framework for the factors that contribute to the effectiveness of internal audit in Ethiopian banks.



Source: "Developed based on the Literature review (2024)".

Figure 2.5: - "Conceptual Framework of Determinants for Effectiveness of Internal Audit in Commercial Banks of Ethiopia".

Chapter Three

3. Research-Methodology and Design

3.1. Introduction;

This section details the research methodology employed in the study. It covers the research design, data collection instrument, study population, sampling techniques, data analysis methods, and the model specification.

3.2. Research Design;

A research design is a framework or plan that guides a study, outlining how data will be collected and analyzed". "It serves as a blueprint for conducting the research (Churchill & Brown, 2007)". "According to Adam and Kamuzora (2008), a research design is a detailed work plan that directs a research study towards achieving specific objectives".

This research study would focus on selected commercial banks in Ethiopia due to time and financial constraints Churchill, G. A., & Brown, J. A. (2007). Despite variations, Ethiopian commercial banks share similarities in internal audit practices, procedure and manuals (Adam, H., & Kamuzora, E. (2008). An explanatory research design was used to investigate the causal relationships between variables. Both quantitative and qualitative research approach was used to collect data through using a cross-sectional survey with a self-administered questionnaire. "The survey focusses on factors determining internal audit effectiveness, including competence of IA teams, independence & objectivity of IA, methodology of IA work, existence of an audit committee, and management and board support. Cooper, D. R., & Schindler, P. S. (2006)".

3.3. Sample size determination;

The target population for this research includes all internal auditors working at the following commercial banks in Ethiopia: - Amhara Bank, Bank of Abyssinia, Dashen Bank, Tsedey Bank, Nib Bank, Abbay Bank, Hibret Bank, and Global Bank Ethiopia. The estimated total population size is approximately three hundred ninety-seven (397) internal auditors working in both head offices and district offices. This number may fluctuate depending on current circumstances; hence staffs may release, change working unit and fired due to different reasons. Detail of the target population is presented in the following table. "**(Refer Table 3.3)"**

Table 3.3. population of the study

Name of the Bank	Position	Quantity
1. Amhara Bank	Director &Divisions Managers	3
	Internal Auditors	20
2. Bank of Abyssinia	Director &Divisions Managers	4
	Internal Auditors	65
3. Dashen Bank	Director &Divisions Managers	5
	Internal Auditors	68
4. Tsedey Bank	Director &Divisions Managers	3
	Internal Auditors	32
5. Nib Bank	Director &Divisions Managers	3
	Internal Auditors	39
6. Abbay Bank	Director &Divisions Managers	3
	Internal Auditors	68
7. Hibret Bank	Director &Divisions Managers	3
	Internal Auditors	59
8. Global Bank Ethiopia	Director &Divisions Managers	3
	Internal Auditors	19
Total Populations of the study		**397**

Sample size: Due to the challenges and costs associated with a census study, the researcher would use a stratified random sampling technique. The sample size was calculated using a statistical formula, targeting a 95% confidence interval and a 5% margin of error. This calculation resulted in a sample size of 199.

$$n=\frac{N}{1+N(E)^2}$$ Where: n= “sample size”; N=” population size”; E=” sampling error”.

$$n=\frac{397}{1+397(0.05)^2}=\frac{397}{1+397(0.0025)}=\frac{397}{1+0.9925}=\frac{397}{1.9925}=\underline{\underline{199}}$$

A total of 199 questionnaires were disseminated. Internal auditors at the head office received their questionnaires directly, while those at district or regional offices were mailed their questionnaires.

3.4. Data Collection;

Both primary and secondary data was used in this study. Primary data was collected through questionnaires administered to the target population of internal auditors in the selected commercial

banks and through slight interviews with the directors of internal audit departments. Secondary data also gathered from various sources, including scholarly literature, “the bank's internal-audit charter”, policies, procedures, and guidelines, and the IIA and “National Bank of Ethiopia websites”.

This research would utilize both primary and secondary data. Primary data was gathered through questionnaires administered to internal auditors and internal audit directors. Secondary data gathered from scholarly literature, bank documents, and the IIA and National Bank of Ethiopia websites. The questionnaires were adapted to measure both independent and dependent variables using a Likert-scale format. The questionnaires were divided into two parts: demographic questions and questions related to internal audit effectiveness. Likert, R. (1932).

3.5. Method of Data Analysis;

Data evaluation contain examining, categorizing, tabulating, and recombining proof to deal with the preliminary studies proposition (Yin, 1989). The researcher used STATA 14.2 software to analyze the collected primary data. After data collection, editing, and processing, the data were entered into STATA for analysis. A reliability test was conducted. “Descriptive statistics, including measures of central tendency (mean) and dispersion (standard deviation), would use to summarize and describe the results”. To examine the relationships between variables and test hypotheses, correlation and regression analysis was employed, ensuring compliance with “the Ordinary Least Squares (OLS) assumptions of the linear regression model”.

3.6. Variables;

3.6.1. Dependent variable

“Internal audit effectiveness”

3.6.2. Independent variable

a) “Competence of internal auditors”

b) “Independence and Objectivity of internal audit activity”

c) “Board and management support”

d) “Methodology/Risk-based internal audit approach” and

e) “Audit committee existence”

3.7. Model Specification

The following econometric model is formulated to test the research, achieve research objectives, and test hypotheses. Econometric models provide numerical measures of the relationships between dependent and independent variables, demonstrating their impact on internal audit effectiveness. "To estimate the magnitude of the effect of the five factors, a standard multiple regression analysis will be performed". "All five independent variables will be entered into the regression equation simultaneously. Multiple R and R^2 will measure the strength of the relationship between the independent variables and the dependent variable".

$$\mathbf{IAE = \beta_0 + \beta_1} CIA + \mathbf{\beta_2} IOIA + \mathbf{\beta_3} BMS + \mathbf{\beta_4} RBIA + \mathbf{\beta_5} ACE+ + \mathbf{\mu}$$

"Internal Audit Effectiveness"	IAE
"Constant representing the effectiveness of internal audit when all dependent variables became zero"	β0
"Competence of internal auditors"	CIA
"Independence and Objectivity of internal audit activity"	IOIA
"Board and management support"	BMS
"Methodology/Risk-based internal audit approach"	RBIA
"Audit committee existence";	ACE
"Coefficient in which every marginal change in variables on internal auditors' effectiveness affects correspondently".	$\beta_{1\text{-}5}$
"Error term"	μ

Chapter Four

4. Data Analysis, Presentation and Discussion

4.1. Introduction:

This section is divided into two parts. The first part provides a statistical overview of the information gathered from the questionnaire responses. The second part delves into inferential statistics, “which involves interpreting the quantitative data collected through the questionnaire and document review”. In essence, this chapter analyzes and discusses the research findings derived from both primary and secondary data sources.

4.2. Descriptive Statistics

4.2.1. Response Rate

The research aimed to survey 199 “internal auditors working at the head office and branches”. Of these, 171 completed and returned the surveys, resulting in a response rate of 86%.

4.2.2. Respondents Profile

The study examined “the respondents' gender, educational background, field of study, years of experience in the banking industry, and years of experience in internal auditing”. “The results showed that 56.73% of the respondents were male, and 43.27% were female”. This indicates a significantly balanced representation of both genders, mitigating potential gender bias. Regarding educational background, 63.74% of the respondents held Bachelor's degrees, while 36.26% of the respondents held Master's degrees. However, none of the respondents held a diploma certification in their educational status. In terms of field of study, the majority 60.23% studied accounting and finance, followed by Management & Economics 25.73%, Marketing & Business Administration 7.6%, and information technology 6.43%. This suggests a strong alignment between the respondents' educational background and the field of internal auditing. The study also analyzed the respondents' work experience. Approximately 15.2% had one to four years of experience in the banking industry, 56.14% had five to ten years, and 28.65% had over ten years. Similarly, in terms of internal auditing experience, 28.65% had one to four years, 52.63% had five to ten years, and 18.71% had over ten years. This indicates that a significant portion of the respondents possess substantial experience in both banking and internal auditing, making them well-suited for this study. **(Refer Table 4.2.2)**

Table 4.2.2.: Profile of Respondents:

Independent Variable	Frequency(n)	Percentage (%)
Gender		
Male	97	56.73
Female	74	43.27
Total	**171**	**100.00**
Educational Background		
Diploma certified	0	0.00
Degree (BA, BSC)	109	63.74
Master's Degree	62	36.26
Total	**171**	**100.00**
Field of Study		
Accounting and Finance	103	60.23
Management and Economics	44	25.73
Marketing & Business Administration	13	7.60
Information Technology	11	6.43
Total	**171**	**100.00**
Work experience in Banking		
One to four years	26	15.20
five to ten years	96	56.14
Above ten years	49	28.65
Total	**171**	**100.00**
Work experience in Internal Auditing		
One to four years	49	28.65
five to ten years	90	52.63
Above ten years	32	18.71
Total	**171**	**100.00**

Source: "Questionnaires and Stata output (2024)"

4.2.3. Competency of Internal Auditors

The first section of the questionnaire "(questions 1-6)" focused on assessing the competence of internal auditors. These questions were designed to evaluate the auditors' individual and collective knowledge and skills needed to perform their duties, their use of due professional care, their commitment to continuous professional development, their application of audit standards, procedures, and techniques, and their understanding of fraud indicators and key IT risks. The results showed a cumulative mean value of 4.25 for this section, indicating a general agreement among respondents regarding the competence of internal auditors. The questions under this category have got high rate as explained by mean scores of each 4.25, 4.14, 4.16, 4.39, 4.41, and

4.13, respectively. Additionally, the low standard deviation (Q1-Q6) of approximately 1.00 indicates some degree of consensus among respondents. "**(Refer Table 4.2.3)"**

These findings align with previous research by Gebrearegawi (2019), Workneh (2021) and Cohen and Sayag (2016), who emphasized the crucial role of internal auditor competence and professional care in ensuring effective internal audit functions. Additionally, the ISPPIA (2017) highlights the importance of possessing the necessary knowledge, skills, and competencies for successful internal auditing.

Table 4.2.3. Internal auditors' competence:

Competency of Internal Auditors:	**N**	**Mean**	**Std. Deviation**
1. "Internal auditors of your bank possess the necessary knowledge and skills to perform their audit-related responsibilities".	171	4.25	0.98
2. "The internal audit staff of your bank collectively possess the necessary knowledge and skills to perform internal audit responsibilities".	171	4.14	1.05
3. "Internal auditors of your bank exercise due professional care when performing their tasks".	171	4.16	1.04
4. "Internal auditors of your bank enhance their knowledge through continuous in-house and professional development training".	171	4.39	0.93
5. "Internal auditors of your bank apply internal audit standards, procedures, and techniques when performing audit engagements".	171	4.41	0.89
6. "Internal auditors of your bank have the knowledge to identify fraud indicators and key information technology risks".	171	4.13	1.15
Cumulative Mean = 4.25			

Source: "Questionnaires and Stata output (2024)"

4.2.4. Independence and objectivity of Internal Audit:

The next part of the "questionnaire (Questions 7-12)" assesses the organizational and individual independence, as well as the objectivity of the bank's internal audit function. The questions in this section are designed to evaluate the functional independence of the bank's internal audit activity. This includes assessing whether the internal audit team can carry out its tasks without management interference, whether the Chief Audit Executive (Director) reports directly to the board of directors (or audit committee), and whether the "Chief Audit Executive has direct and unrestricted access to

senior management and the board". Additionally, the questions examine the internal auditors' unbiased attitude, their freedom from conflicts of interest, their ability to report directly to the Chief Audit Executive, and their freedom to report any potential threats to independence during audit engagements. The results showed that the average response for questions 7 to 12, which assessed the independence of the internal audit activity, was "agree" with a cumulative mean score of 4.04. This indicates that, on average, respondents agreed with the level of independence of the internal audit function. "All the questions under (Q7-Q12) category have got high rate as explained by mean scores of each of 4.09, 3.88, 4.16, 4.16, 3.86 and 4.11 respectively". Additionally, the standard deviation for questions 7 to 12 was 0.94, indicating a high level of agreement among respondents regarding the independence of the bank's internal audit activity. "**(Refer Table 4.2.4.)"**

Consequently, the findings suggest that utmost respondents believe that the "organizational and individual independence", as well as the objectivity of the internal auditors, are maintained within the specified commercial banks.

These findings are consistent with previous studies by "Gebrearegawi (2019), Workneh (2021) and Cohen and Sayag (2010), which concluded that the organizational and individual independence of internal auditors is essential for the effectiveness of internal audit activities".

Additionally, "the Institute of Internal Auditors (ISPPIA) emphasizes that the internal audit function must be independent, and internal auditors must maintain objectivity in their work".

Table 4.2.4. Independence and objectivity of internal-audit activity:

Organizational and individual Independence and objectivity of Internal Audit:	N	Mean	Std. Deviation
7. "In your bank, the Chief Audit Executive (Director) functionally reports to the board of directors (or audit committee)".	171.00	3.88	0.96
8. "In your bank, the Chief Audit Executive (Director) has direct and unrestricted access to senior management and the board".	171.00	4.16	1.31
9. "In your bank, internal auditors functionally report to the Chief Audit Executive (Director)".	171.00	3.86	0.91
10. "In your bank, internal auditors are free from management interference in determining the scope of their assignments".	171.00	4.09	0.75
11. "In your bank, internal auditors maintain an unbiased attitude and avoid conflicts of interest that could	171.00	4.16	0.86

impair their ability to perform their duties and responsibilities".			
12. "In your bank, internal auditors feel free to report to the Chief Audit Executive (Director) any situation in which there is an actual or potential impairment of independence during an engagement".	171.00	4.11	0.86
Cumulative Mean = 4.04			

Source: "Questionnaires and Stata output (2024)"

4.2.5. Board and Management support:

The third part of the questionnaire (Questions 13-16) assesses the level of support provided by the bank's board and management to the internal audit activity. The questions focus on how the board supports the independence of the internal audit function by protecting it from management influence, collaborating with internal audit throughout the audit process, and ensuring the department has adequate human, technological, and financial resources to carry out its activities effectively. All questions in the category (Q13-Q16) received relatively high ratings, with mean scores of 4.54, 3.74, 4.02, and 3.78, respectively. Respondents generally agreed that the board and management support the internal audit function, with a cumulative mean score of 4.02 indicating agreement. This suggests that, on average, respondents agreed that the board and management support the internal audit function. Additionally, the standard deviation of 0.97 for questions 13-16 indicates a high level of agreement among respondents regarding the board and management's support for the internal audit function. **"(Refer Table 4.2.5.)"**

This finding aligns with previous research by Alemzewud, A. (2019) and Cohen and Sayag (2010), which highlights the crucial role of management support in ensuring the effectiveness of internal audit activities.

However, the questions in this section asked for respondents about the board and management's support for the internal audit team have some level of disagreement. Therefore, some respondents disagreed with the level of support provided by the board and management, as indicated by a mean response of 2.81. This suggests that audit clients may not be fully cooperative in providing necessary information or taking timely corrective action on audit findings.

Table 4.2.5. Board and management support

Board and Management Support:	N	Mean	Std. Deviation
13. "The Board of your bank promotes the independence of internal audit by protecting them from management influence".	171	4.54	0.91
14. "In your bank, audit clients (auditees) collaborate with internal audit throughout the entire internal audit process or audit engagements".	171	3.74	1.05
15. "Senior management of your bank ensures that internal audit has sufficient human and technological resources to successfully carry out its responsibilities".	171	4.02	0.88
16. "In your bank, the internal audit department receives a sufficient budget to successfully carry out its responsibilities in accordance with its approved plan".	171	3.78	1.01
Cumulative Mean = 4.02			

Source: "Questionnaires and Stata output (2024)"

4.2.6. The Internal Audit Methodology (RBIA);

The fourth part of the questionnaire (Questions 17-20) assesses the methodology and processes used by the bank's internal audit function. The questions focus on the internal audit methodology and processes, such as whether the department conducts risk-based audits, whether the internal audit plan aligns with the organization's goals, whether individual audits are based on risk assessments, and whether the roles of risk management and internal audit are clearly defined. Most of the questions in this category received relatively high ratings, with mean scores of 3.66, 3.87, 3.78, and 3.64, respectively. The overall assessment of the internal audit methodology and processes, as measured by the cumulative mean score of 3.74, indicates general agreement among respondents. This suggests that, on average, respondents agreed with the internal audit methodology used by the bank. Additionally, the standard deviation for questions 17-20 was less than 1.00, indicating a high level of agreement among respondents of the questionnaires regarding the bank's internal audit methodology and processes or adoption of risk-based audit methodology/process. "**(Refer Table 4.2.6.)**"

This finding aligns with the Institute of Internal Auditors (ISPPIA) 2017 guidelines, NBE risk-based audit guideline which state that the Chief Audit Executive (CAE) or the director should establish a risk-based plan/ methodology to prioritize the internal audit activity in line with the organization's goals, strategy and objectives.

Table 4.2.6. Methodology of internal audit activity:

Methodology of Internal audit Activity (RBIA):	N	Mean	Std. Deviation
17. "Your bank implements a risk-based internal audit approach".	171	3.66	0.88
18. "In your bank, the Chief Audit Executive (Director) prepares a risk-based annual audit plan to prioritize internal audit activities, aligning them with the organization's goals".	171	3.87	0.81
19. "In your bank, internal audit teams perform individual audit assignments based on the risk-based audit methodology".	171	3.78	0.88
20. "In your bank, internal auditors conduct a preliminary assessment of the risks relevant to each engagement".	171	3.64	0.91
Cumulative Mean = 3.74			

Source: "Questionnaires and Stata output (2024)"

4.2.7. Audit committee existence:

The fifth part of the questionnaire (Questions 21-25) assesses the role of strong audit committee existence. The questions assess the role of the audit committee, including its evaluation of the quality of internal audit reports and monitoring of recommendation implementation, its enhancement of internal audit independence and protection from management interference, its regular meetings with the internal audit team, the positive influence of its independence on the internal audit team's work, and the improvement in internal audit report quality through its feedback. Most of the questions in this category received relatively high ratings, with mean scores of 3.85, 3.68, 3.22, 4.14 and 4.40, respectively. The overall assessment of the internal audit methodology and processes, as measured by the cumulative mean score of 3.86, indicates general agreement among respondents. This suggests that, on average, respondents agreed with the internal audit methodology used by the bank. Additionally, the standard deviation for questions 17-20 was became 0.97, indicating a high level of agreement among respondents regarding the bank's internal audit methodology and processes. "**(Refer Table 4.2.7.)"**

This finding aligns with the research conducted by De.Zoort, C. T., Hermanson, D. R., Archambeault, W. D., & Reed, J. L. (2002) which state that by enhancing oversight mechanisms and information quality, audit committees can play a crucial role in corporate governance processes and internal audit effectiveness.

Table 4.2.7. Audit committee existence:

Audit committee existence:	N	Mean	Std. Deviation
21. The audit committee assesses the quality of internal audit reports and monitors the implementation of internal audit recommendations.	171	3.85	1.14
22. The audit committee's enhances independence and protect independence from management interference.	171	3.68	1.01
23. The audit committee meets with the internal audit team frequently or at regular interval.	171	3.22	0.87
24. The audit committee's independence influences your work.	171	4.14	0.86
25. The audit committee's feedback on audit reports improves the quality of our work.	171	4.40	0.96
Cumulative Mean = 3.86			

Source: "Questionnaires and Stata output (2024)"

4.2.8. Effectiveness of Internal Audit:

Questions 26-30 assess the effectiveness of the internal audit activity within the specified banks. "The questions explore whether the competence of internal auditors, the independence and objectivity of the internal audit function, the support provided by the board and management, the internal audit methodology and processes, and the role of the audit committee contribute to the overall effectiveness of the internal audit activity". "The responses to the questions related to the effectiveness of internal audit activity (Q26-Q30) showed a general agreement among respondents". "The individual mean scores for these questions ranged from 3.44 to 3.82, with an overall average of 3.66". "This average falls within the "agree" range on the response scale". "Furthermore, the standard deviation for these questions was less than 1.00, indicating that the respondents' perceptions of internal audit effectiveness were relatively consistent and clustered closely around the mean". "**(Refer Table 4.2.8.)"**

Table 4.2.8. Effectiveness of internal audit activity

Effectiveness of Internal Audit:	N	Mean	Std. Deviation
26. "The competence of internal auditors is a determinant factor for the effectiveness of internal audit activity at your bank".	171	3.44	0.96
27. "Organizational and individual independence of internal audit is a determinant factor for the effectiveness of internal audit activity at your bank".	171	3.82	0.91

28. "Board and management support for internal audit is a determinant factor for the effectiveness of internal audit activity at your bank".	171	3.54	0.95
29. "The methodology/process used by internal audit departments is a determinant factor for the effectiveness of internal audit activity at your bank".	171	3.73	0.93
30. "The existence of an audit committee is a determinant factor for the effectiveness of internal audit activity at your bank".	171	3.75	1.13
Cumulative Mean = 3.66			

Source: "Questionnaires and Stata output (2024)"

4.3. Inferential statistics

4.3.1. Reliability Analysis

To ensure the reliability of the questionnaires, we used Cronbach's Alpha (α). The calculated value of 0.94 exceeds the acceptable threshold of 0.70 (Field, 2009), confirming the reliability of the data collected for analysis. Hence, the Cronbach's alpha coefficients for the individual items range from 0.716 to 0.934. This suggests that all of the items have an acceptable level of reliability. Moreover, Cronbach's alpha coefficient for the overall scale is 0.946, which is considered to be an excellent level of reliability. This indicates that the items on the scale are highly internally consistent.

Table 4.3.1. Reliability Statistics

No.	Dimensions	Number of items	Cronbach's Alpha
1.	Competency of Internal Auditors	6	.934
2.	Independence and objectivity	6	.802
3.	Management & Board Support	4	.716
4.	RBIA approach of Internal audit	4	.744
5.	Audit committee existence	5	.720
6.	Effectiveness of Internal Audit	5	.833
Overall Reliability		**30**	**.946**

Source: "Questionnaires and Stata output (2024)"

4.3.2. Correlation Analysis

Correlation analysis is a statistical method used to measure the strength and direction of the relationship between two or more variables which are the regressor and regressed. The "correlation

analysis was applied to discard or admit research hypothesis in preceding audit investigate in addition to the regression analysis (Cohen and Sayag, 2010)". To examine the relationships between different variables, we used a Pearson Correlation Matrix. As shown in Table 4.3.2, "a high correlation was found between the variables". The study results suggest a strong correlation between the effectiveness of internal audit and all the independent variables, including internal auditor competence, the independence and objectivity of the internal audit function, board and management support, the existence of an audit committee, and the internal audit methodology and processes.

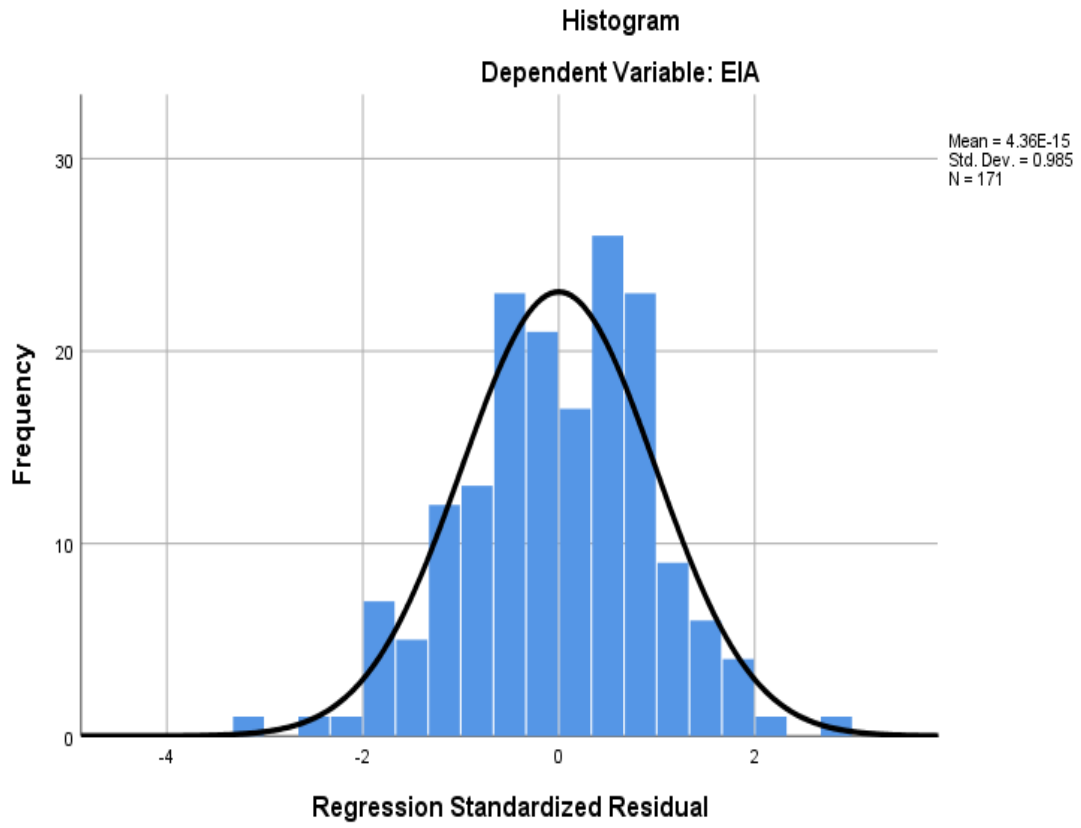
Table 4.3.2. Correlations Matrix

Correlations						
Variables	**CIA**	**OII**	**MIA**	**BMS**	**ACE**	**EIA**
Competency of internal audit	1.0000					
Independence/objectivity of IA	.475	1.0000				
Methodology/process of IA (RBIA)	.435	.531	1.0000			
Board and Management support	.470	.762	.613	1.0000		
Audit committee existence	.606	.709	.410	.637	1.0000	
Effectiveness of IA	.599	.786	.680	.840	.697	1.0000

Source: "Questionnaires and Stata output (2024)"

4.3.3. Normality Assessment:

Normality tests are conducted to determine if a dataset follows a normal distribution. To assess whether the data follows a normal distribution, we employed the Skewness and Kurtosis tests. According to Hair et al. (1998), a Skewness and Kurtosis value within the range of -1 to +1 indicates that the data is normally distributed. Skewness and Kurtosis are statistical measures that describe the shape of a probability distribution and they are often used to assess whether a dataset is normally distributed. The graph visually indicates that the data follows a normal distribution.



4.3.4. Multicollinearity Assessment:

"Multicollinearity is a statistical issue that arises when the independent variables in a regression model are highly correlated with each other (Hair et al., 1998)". It is a statistical problem that occurs when two or more independent variables in a regression model are highly correlated with each other. "This means that when there is a strong correlation between the predictor variables, as indicated by a correlation coefficient (r) greater than 0.80, a tolerance value below 0.10, or a Variance Inflation Factor (VIF) greater than 10 in the correlation matrix (as per Field, 2009), it signifies the presence of multicollinearity". Tolerance is a statistical measure that indicates how much of the variation in a specific independent variable is not explained by other independent variables in the model (Pallant, 2007). A lower tolerance value suggests a higher degree of multicollinearity. As shown in "Table 4.3.2", "the tolerance levels for all independent variables exceeded 0.10, and the Variance Inflation Factor (VIF) values were below 10". This indicates that multicollinearity is not a significant issue in this model. The Correlation Matrix reveals the strength and direction of the relationships between the "dependent variable and the independent variables".

It also demonstrations that the correlation between the “independent variables themselves is less than 0.80, indicating that multicollinearity is not a major concern in this model”. Therefore, based on the correlation values, tolerance levels, and VIF values, it can be concluded that multicollinearity is not a significant issue in this thesis.

Table: 4.3.2. Collinearity Statistics

Model	**Tolerance**	**VIF**
Competency of Internal audit	.590	1.693
Independence/objectivity of Internal audit	.330	3.032
Methodology of Internal audit (RBIA)	.584	1.712
Board & management support	.343	2.915
Audit Committee existence	.390	2.564
Dependent Variable: Effectiveness of Internal Audit		

Source: “Questionnaires and Stata output (2024)”

4.3.5. Analysis result of Multiple Regression:

To determine if “the independent variables (internal auditor competence, internal audit independence and objectivity, board and management support, Audit committee existence and internal audit methodology) significantly influence the dependent variable (internal audit effectiveness), a multiple regression analysis was conducted”. The results of the regression analysis are presented in “Table 4.3.3”. As shown in the model summary “(Table 4.3.3)”, “the appropriate variables were selected to assess the effectiveness of the internal audit activity (IAE)”. The R-squared value is a quick and easy-to-understand measure of how well a regression model fits the data (Reisinger, 1997). A higher R-squared value indicates a better fit, meaning the model can explain a larger proportion of the variation in the dependent variable. While R-squared is a useful measure of model fit, it's important to note that it's not an absolute indicator. It simply measures the proportion of the variation in the dependent variable that is explained by the independent variables (Reisinger, 1997). A higher R-squared value indicates a better fit, but it doesn't necessarily mean the model is perfect or the most accurate. This study heavily relies on the

perceptions of participants, which were gathered through questionnaires. This means that the findings of the study are based on how participants perceive and interpret the questions and the concepts being measured. Therefore, an R-squared value exceeding 25% is generally considered acceptable and indicates a good fit of the model to the data (Reisinger, 1997; Thompson, 2002). Therefore, the R-value of 0.819 indicates the overall correlation between the five independent variables and the dependent variable. This means that 81.9% of the variation in the dependent variable can be explained by the combined influence of the five independent variables. The R-squared value of 0.819 indicates that 81.9% of the variation in the effectiveness of internal audit can be explained by the combined influence of the five independent variables (internal auditor competence, internal audit independence and objectivity, board and management support, audit committee existence and internal audit methodology). This means that the model is a good fit for the data and can accurately predict the effectiveness of internal audit based on these variables. Besides, 18.1% of the variation in the effectiveness of internal audit in the specified commercial banks can be attributed to other factors not included in this study. This suggests that there may be additional variables that influence internal audit effectiveness beyond the five independent variables considered in this research.

Moreover, the adjusted R-squared value of 0.813 (81.3%) indicates that approximately 81.3% of the variation in the effectiveness of internal audit can be explained by the five independent variables, after adjusting for the number of predictors in the model. This adjusted R-squared value suggests that the model is a good fit for the data and that the independent variables are strong predictors of the dependent variable.

Table 4.3.3. Model summary

Model	R	R-Square	Adjusted R-Square	Std. Error of the Estimate
1	.905[a]	.819	.813	.32767
a. **Predictors: (Constant), ACE, MIA, CIA, BMS, OII**				
b. **Dependent Variable: EIA**				

Source: "Questionnaires and Stata output (2024)"

4.3.6. ANOVA Statistics;

ANOVA (Analysis of Variance) is a statistical technique used to compare the means of two or more groups. It's particularly useful in research when you want to determine if there are significant differences between the average values of a dependent variable across different categories of an independent variable. The ANOVA table (Table 4.3.4) shows that the model is statistically significant, with an F-value of 149.211 and a p-value of 0.000. This means that the independent variables, as a group, significantly influence the dependent variable (internal audit effectiveness). In other words, the model is a good fit for the data and can explain a significant portion of the variation in internal audit effectiveness. This indicates a strong relationship between the independent variables and the outcome of the regression analysis, suggesting that the model is a good fit for predicting the effectiveness of internal audit activities in the specified commercial banks.

Table 4.3.4. ANOVA statistics

Model		**Sum of Squares**	**Df**	**Mean Square**	**F**	**Sig.**
1	Regression	80.100	5	16.020	149.211	.000[b]
	Residual	17.715	165	.107		
	Total	97.815	170			
a. **Dependent Variable: EIA**						
b. **Predictors: (Constant), ACE, MIA, CIA, BMS, OII**						

Source: "Questionnaires and Stata output (2024)"

4.3.7. Coefficients of variables

The results in Table 4.3.5 indicate that all the independent variables have a positive impact on the dependent variable (internal audit effectiveness). This means that as the values of these independent variables increase, the effectiveness of internal audit also tends to increase. "In other word, it means that a proportional increase in any of the independent variables will lead to a corresponding proportional increase in the dependent variable". "This finding aligns with the conclusions of several previous studies (Tadiwos, 2016; Abreham, 2016; Gebrearegawi, 2019),

which also highlight the positive impact of these factors on internal audit effectiveness". Consequently," based on the coefficients of the independent variables, all the hypotheses proposed by the researcher are supported". This is since "all five hypotheses, which posited a positive relationship between the independent and dependent variables, were supported by the findings". "The independent variables with a significance level of less than 5% are considered to have a statistically significant impact on the dependent variable". This means that these variables contribute uniquely to predicting the value of the dependent variable. On the other hand, variables with a significance level greater than 5% are not considered statistically significant and do not contribute meaningfully to the prediction of the dependent variable.

Table 4.3.5. Regression of coefficients

Model		**Unstandardized Coefficients**		**Standardized Coefficients**	**t**	**Sig.**
		B	**Std. Error**	**Beta**		
1	(Constant)	-.987	.178		-5.531	.000
	CIA	.129	.037	.149	3.456	.001
	OII	.245	.064	.220	3.808	.000
	MIA	.236	.050	.203	4.680	.000
	BMS	.438	.060	.411	7.265	.000
	ACE	.120	.060	.106	1.995	.048
"P< 0.05, 95% level of Confidence"						
a. Dependent Variable: **EIA**						

Source: "Questionnaires and Stata output (2024)"

The regression coefficients outputs presented in Table 4.3.5 are summarized in the following model:

$$\mathbf{IAE} = \beta_0 + \beta_1 \text{CIA} + \beta_2 \text{IOIA} + \beta_3 \text{BMS} + \beta_4 \text{RBIA} + \beta_5 \text{ACE} + + \mu$$

Where; - CIA (0.129): A one-unit increase in the Competence of Internal Auditors is associated with a 0.129 unit increase in Internal Audit Effectiveness, holding other variables constant, IOIA (0.245): A one-unit increase in the Independence and Objectivity of Internal Audit Activity is associated with a 0.245 unit increase in Internal Audit Effectiveness, holding other variables constant, BMS (0.438): A one-unit increase in Board and Management Support is associated with a 0.438 unit increase in Internal Audit Effectiveness, holding other variables constant, RBIA (0.236): A one-unit increase in the methodology/process or risk-based internal audit activity is associated with a 0.236 unit increase in Internal Audit Effectiveness, holding other variables constant and ACE (0.120): A one-unit increase in the audit committee existence is associated with a 0.120 unit increase in Internal Audit Effectiveness, holding other variables constant. If all the independent variables, such as internal auditor competence, internal audit independence, board and management support, audit committee existence, and internal audit methodology, were to be zero, the internal audit effectiveness would decrease by 0.987 units. However, this interpretation may not be practical in real-world scenarios, as it's unlikely that all these factors would be completely absent. The independent variables (internal auditor competence, internal audit independence and objectivity, board and management support, audit committee existence, and internal audit methodology) have a significant positive impact on internal audit effectiveness. This is because their p-values are less than 0.05, indicating that the observed relationships are statistically significant and not due to chance. Overall, the model suggests that all independent variables have a positive impact on Internal Audit Effectiveness. This implies that improving any of these factors can lead to a more effective internal audit function.

4.3.8. Testing Hypothesis;

The regression outcomes were used to evaluate the hypotheses presented in Chapter One. These hypotheses aimed to determine the significant impact of internal auditor competence, internal audit independence and objectivity, board and management support, audit committee existence and internal audit methodology on internal audit effectiveness.

i. **H_1: "Competences of the internal auditors have positive and significant impact on the internal audit effectiveness".**

The first hypothesis tested whether there was a positive relationship between the competence of internal auditors and the effectiveness of internal audit at the selected private commercial banks.

The regression results strongly support the first hypothesis, indicating a significant positive relationship between the competence of internal auditors and internal audit effectiveness. This is evident from the p-value of less than 0.05 and the positive coefficients ($\beta = 0.129$ and $t = 3.456$). Therefore, the findings suggest that the competence of internal auditors has a statistically significant positive impact on the effectiveness of the internal audit function in the specified commercial banks.

This finding aligns with the "International Standards for the Professional Practice of Internal Auditing, which emphasizes that internal auditors must have the necessary knowledge, skills, and competencies to perform their individual responsibilities". Furthermore, "the internal audit team as a whole must possess or obtain the necessary knowledge, skills, and other competencies to carry out its responsibilities effectively". Knowledge, skills, and other competencies collectively refer to the professional qualifications necessary for internal auditors to effectively perform their duties. These qualifications encompass the knowledge base, practical abilities, and other attributes required to meet professional standards and carry out internal audit responsibilities with competence and integrity. To demonstrate their professional competence, internal auditors are encouraged to obtain certifications and qualifications from recognized organizations like The Institute of Internal Auditors. This includes certifications such as the Certified Internal Auditor (CIA) designation, which validates their knowledge, skills, and ability to perform internal audit responsibilities effectively. If the internal audit team lacks the necessary knowledge, skills, or other competencies to complete an engagement, the "Chief Audit Executive must seek competent advice and assistance from qualified individuals or external experts". This ensures that the engagement is conducted with the required level of expertise and professionalism. While internal auditors should possess sufficient knowledge to assess the risk of fraud and the organization's fraud risk management practices, they are not expected to have the specialized expertise of a fraud examiner. Their role primarily involves identifying and evaluating fraud risks, designing and implementing controls to mitigate those risks, and reporting fraud-related issues to management and the audit committee. Internal auditors must possess adequate knowledge of key information technology (IT) risks, controls, and available IT audit techniques to effectively carry out their assigned tasks. This includes understanding IT systems, networks, security controls, and emerging technologies to assess potential vulnerabilities and ensure the effectiveness of IT controls. By staying updated on the latest IT developments, "internal auditors can provide valuable insights and recommendations

to mitigate IT risks and protect the organization's assets". "Internal auditors are expected to perform their duties with the level of care and skill that would be expected of a reasonably prudent and competent professional in their field". "This means that they should apply their knowledge, skills, and experience to their work in a diligent and thorough manner, taking into account the specific circumstances of each engagement". "To ensure due professional care, internal auditors should consider utilizing technology-based audit techniques and data analysis tools to enhance the efficiency and effectiveness of their work". This may include using data analytics tools to identify trends, anomalies, and potential risks, as well as employing automated audit techniques to streamline the audit process. By embracing technology, internal auditors can improve the quality and timeliness of their audits. "To maintain their professional competence, internal auditors must continuously enhance their knowledge, skills, and other abilities through ongoing professional development". This includes attending conferences, workshops, and training programs, as well as participating in online learning and self-study activities. By staying current with industry trends, emerging technologies, and evolving best practices, internal auditors can ensure they are equipped to meet the challenges of their role and deliver high-quality audit services.

ii. **H_2: "Independence and Objectivity have positive and significant impact on the internal audit effectiveness".**

The second hypothesis examined whether there is a positive relationship between the independence and objectivity of the internal audit function and the effectiveness of internal audit at the selected commercial banks.

The findings indicate a significant positive relationship between the independence and objectivity of the internal audit function and the effectiveness of internal audit at the selected commercial banks. This suggests that a more independent and objective internal audit function leads to improved internal audit effectiveness. "The magnitude of the effect of independence and objectivity on internal audit effectiveness was 0.245, as indicated by the coefficient (β)". This means that for every one-unit increase in independence and objectivity, internal audit effectiveness is expected to increase by 0.245 units, on average. Additionally, the t-value of 3.808 suggests that this relationship is statistically significant, further supporting the positive impact of independence and objectivity on internal audit effectiveness. "The positive coefficient and t-value greater than two (2) indicate a strong positive relationship between independence and objectivity and internal

audit effectiveness (Hair et al., 1998)". "This suggests that a higher level of independence and objectivity is strongly associated with a higher level of internal audit effectiveness". "This finding is supported by the IIA Standard 1110, which states that the Chief Audit Executive must report to a level within the organization that enables the internal audit activity to fulfill its responsibilities effectively". This ensures the independence and objectivity of the internal audit function, allowing it to operate without undue influence or interference. "The Chief Audit Executive (CAE) must annually confirm to the board of directors that the internal audit activity is organizationally independent". "This independence is effectively achieved when the CAE reports functionally to the board". Functional reporting involves the board's involvement in key decisions related to the internal audit activity, such as approving the internal audit charter, risk-based plan, budget, and resource allocation. The board also receives regular communication from the CAE regarding the internal audit activity's performance and other relevant matters. Additionally, the board has the authority to appoint, remove, and remunerate the CAE, and to inquire about any potential limitations to the scope or resources of the internal audit activity.

"The Chief Audit Executive (CAE), while reporting functionally to the board, also reports administratively to the organization's CEO". "This dual reporting structure facilitates the organizational independence of the internal audit activity, enabling the CAE to maintain objectivity and impartiality in carrying out their responsibilities". "The Chief Audit Executive (CAE) must report to an individual within the organization who possesses sufficient authority to promote the internal audit activity's independence and ensure that it has adequate scope and resources to fulfill its responsibilities". This reporting relationship, often referred to as functional reporting, enables the CAE to communicate effectively with the board and senior management, and to obtain the necessary support to carry out their duties. Administrative reporting, on the other hand, refers to the day-to-day operational reporting relationships within the organization's management structure. This may involve reporting to the CEO or another senior executive, but it should not compromise the CAE's functional independence. Direct communication between the Chief Audit Executive (CAE) and the board is crucial for effective internal audit oversight. By regularly attending and participating in board meetings related to audit, finance, governance, and control, the CAE can stay informed about strategic business developments and raise important risk, system, and control issues early on. "These meetings also provide an opportunity for the CAE to share insights into the internal audit activity's plans and progress, and to discuss other matters of mutual interest with

the board". This direct communication fosters a strong working relationship between the CAE and the board, enhancing the effectiveness of the internal audit function.

Internal auditors must promptly report any situations that could potentially compromise their independence or objectivity to the "Chief Audit Executive (CAE)". "If the CAE determines that an impairment exists or is likely, they must reassign the affected auditor(s) to ensure the integrity of the audit process". "This proactive approach helps maintain the internal audit function's independence and objectivity, enabling it to carry out its responsibilities effectively". "A scope limitation is a restriction that hinders the internal audit activity from achieving its objectives and executing its planned activities". This limitation can manifest in various ways, such as: - limiting the scope of work defined in the internal audit charter. This could involve preventing internal audit from examining certain areas or processes within the organization. Limiting access to records, personnel, or physical properties: This could hinder the internal audit activity's ability to gather necessary evidence and information. Restricting the approved engagement work schedule: This could prevent the internal audit activity from conducting timely audits or investigations. Preventing the performance of necessary engagement procedures: This could limit the internal audit activity's ability to gather sufficient evidence to form an opinion on the area being audited. And, restricting the approved staffing plan and financial budget: This could limit the internal audit activity's resources and hinder its ability to carry out its responsibilities effectively.

Scope limitations can significantly impact the effectiveness and efficiency of the internal audit activity, and it's crucial to address and mitigate these limitations to ensure the integrity of the audit process. The Chief Audit Executive (CAE) should communicate any scope limitations, along with their potential impact, to the board of directors, preferably in writing. This communication is essential to ensure the board's understanding of any limitations that may affect the internal audit activity's ability to achieve its objectives. In some cases, "it may be necessary to inform the board about scope limitations that were previously communicated and accepted, especially if there have been organizational changes, changes in board membership, or significant changes in senior management". This helps to ensure that the board remains informed and can provide appropriate oversight.

iii. **H_3: "Board and Management supports have positive and significant impact on the internal audit effectiveness".**

The third hypothesis examined whether there is a positive relationship between board and management support and the effectiveness of internal audit at the selected private commercial Banks. Board support, in this context, "refers to the role in protecting the independence of the internal audit function from undue management influence". "Management support", in this context, refers to the provision of resources, training opportunities, technological advancements, adequate facilities, and a commitment to promote and communicate the value of the internal audit function. "By providing these essential elements, management demonstrates its support for the internal audit activity and enables it to operate effectively".

The findings indicate a significant positive relationship between board and management support and the effectiveness of internal audit at the selected private commercial banks. This suggests that strong support from the board and management is crucial for enhancing the effectiveness of the internal audit function. The coefficient (β) for board and management support is 0.438, indicating that a one-unit increase in board and management support is associated with a 0.438-unit increase in internal audit effectiveness, holding other variables constant. The t-value of 7.265 suggests that this relationship is statistically significant, further supporting the positive impact of board and management support on internal audit effectiveness. The positive coefficient (0.438) and the t-value greater than 2 indicate a strong positive relationship between board and management support and internal audit effectiveness (Hair et al., 1998). This suggests that increased support from the board and management is strongly associated with improved internal audit effectiveness.

Therefore, based on the findings, the researcher accepts the hypothesis that there is a positive relationship between board and management support and internal audit effectiveness in commercial banks.

iv. H_4: "The RBIA function is positively associated with the effectiveness of IA".

The fourth hypothesis examined whether there is a positive relationship between the internal audit methodology and process and the effectiveness of internal audit at the specified commercial banks. According to IIA Standard 2010, the Chief Audit Executive (CAE) is responsible for developing a risk-based internal audit plan. This plan should align with the organization's goals and prioritize areas of highest risk. By following a risk-based approach, the internal audit activity can focus its efforts on the areas that pose the greatest threat to the organization's objectives. This ensures that the internal audit activity is efficient and effective in providing value to the organization. The Chief

Audit Executive (CAE) considers the organization's risk management framework, including the risk appetite levels set by management for different areas of the business. If a formal risk management framework is not in place, the CAE uses their own judgment to assess risks, taking into account input from senior management and the board. “This risk-based approach helps ensure that the internal audit activity focuses on the areas of highest risk and provides value to the organization”. “The Chief Audit Executive (CAE) must regularly review and adjust the internal audit plan to reflect changes in the organization's business environment, risk profile, operations, programs, systems, and controls”. This ensures that the internal audit activity remains relevant and responsive to the evolving needs of the organization.

“IIAS Standard 2200 requires internal auditors to develop and document a detailed plan for each engagement, including its objectives, scope, timeline, and resource allocation”. “This plan should consider the organization's strategic goals, objectives, and relevant risks”. The appointment objectives should be directly linked to the results of a preliminary risk assessment, ensuring that the audit focuses on areas of highest risk. This approach helps optimize the use of resources and maximizes the impact of the internal audit activity.

The findings indicate a strong positive relationship between the internal audit methodology and process and the effectiveness of internal audit at the specified commercial banks. This suggests that a well-defined and effective internal audit methodology and process contributes significantly to improving internal audit effectiveness. The coefficient (β) for the internal audit methodology and process is 0.236, indicating that a one-unit increase in the effectiveness of the internal audit methodology and process is associated with a 0.236-unit increase in overall internal audit effectiveness. The t-value of 4.680 suggests that this relationship is statistically significant, further supporting the positive impact of a well-defined and effective internal audit methodology and process on internal audit effectiveness. Hence, the researcher accepts the study's hypothesis that board and management support is positively associated with the effectiveness of Internal Audit (IA) in Ethiopian Commercial Banks ECBs.

v. **H_5: “Existences of Audit committees have positive and significant influence on the internal audit effectiveness”.**

The audit committee plays a crucial role in enhancing the effectiveness of the internal audit function. By providing oversight and support, the audit committee can help ensure the

independence, objectivity, and effectiveness of the internal audit activity. Audit committees should ideally have at least one member with financial expertise, preferably a CPA. For companies subject to Sarbanes-Oxley, all audit committee members must be independent, and at least one must be a financial expert. Best practices suggest that at least one member should have recent and relevant financial experience. (Sarbanes-Oxley Act of 2002)

According to IIA (2023); audit committees play a critical role in corporate governance by overseeing the annual audit process, ensuring financial reporting accuracy, and monitoring internal controls. Effective audit committees are composed of independent and objective members with financial expertise. They oversee the work of external auditors, manage auditor compensation, and ensure compliance with laws and regulations. Additionally, they play a role in IT security and operational matters.

This finding is consistent with the work of DeZoort et al. (2002) that found a strong positive relationship between the existence of an audit committee and the effectiveness of the internal audit function. The study suggests that audit committees play a crucial role in supporting and cooperating with internal auditors, reducing the likelihood of financial statement fraud, and enhancing corporate governance. Key factors include the audit committee's involvement in the appointment and removal of the chief audit executive, as well as regular communication between the two parties. The findings indicate a strong positive relationship between the existence of an audit committee and the effectiveness of internal audit at the selected commercial banks. This suggests that the presence of an audit committee is significantly associated with improved internal audit effectiveness. The coefficient (β) for the existence of an audit committee is 0.120, indicating that a one-unit increase in the presence of an audit committee is associated with a 0.120-unit increase in internal audit effectiveness, holding other variables constant. The t-value of 1.995 suggests that this relationship is statistically significant, further supporting the positive impact of an audit committee on internal audit effectiveness. Hence, “based on the findings, the researcher accepts the hypothesis that the existence of an audit committee is positively associated with the effectiveness of internal audit in commercial Banks”.

In summary, the study found a positive relationship between the effectiveness of internal audit and the following factors:

“Competence of Internal Auditors”: Well-trained and skilled internal auditors contribute significantly to “the effectiveness of the internal audit” function.

“Independence and Objectivity of Internal Audit function”: An independent and objective internal audit function, free from undue influence, is essential and crucial for effective internal auditing.

“Board and Management Support”: Strong support from the board and management, including adequate resources, training, and recognition, enhances the effectiveness of the internal audit function.

“Methodology or Process of Internal Audit: A well-defined and effective internal audit methodology and process, including risk-based planning and execution, contributes to improved internal audit effectiveness”.

“Existence of an Audit Committee: An active, strong and engaged audit committee provides oversight, support, and guidance to the internal audit function, enhancing its effectiveness at its tasks”.

The regression model indicates that the combined influence of internal auditor competence, independence and objectivity, board and management support, internal audit methodology, and the existence of an audit committee accounts for 81.9% of the variation in internal audit effectiveness. Additionally, “the model demonstrates that a one-unit increase in each of these independent variables is associated with the following increases in internal audit effectiveness, holding other variables constant: Competence of Internal Auditors: 0.129 units, Independence and Objectivity of Internal Audit Activity: 0.245 units, Board and Management Support: 0.438 units, Internal Audit Methodology and Process: 0.236 units and Existence of an Audit Committee: 0.120 units”. These findings suggest that all these factors play a significant role in determining the overall effectiveness of the internal audit function.

Chapter Five

5. Summary, Conclusions and Recommendations

5.1. Introduction

This chapter summarizes the key findings, conclusions, and recommendations of the study, which aimed to assess the factors influencing the effectiveness of internal audit at selected commercial banks. Specifically, the study sought to determine whether "internal auditor competence", "internal audit independence & objectivity", "board and management support", "internal audit RBIA approach", and "the existence of an audit committee" positively impact "internal audit effectiveness".

5.2. Summary of Major Findings

This study identified the most significant variables influencing the effectiveness of internal audit functions in Ethiopian banks and the extent to which they impact risk management, internal control, and corporate governance of such Banks. The following is a summary of the study's findings.

The regression model explains 81.9% of the variation in internal audit effectiveness, indicating that the combined influence of the independent variable's accounts for a substantial portion of the effectiveness observed in internal audits. This high explanatory power suggests that these factors are critical in determining the success of internal audit functions. The R-squared value of 0.819 indicates that 81.9% of the variation in internal audit effectiveness at the selected commercial banks (Amhara Bank, Bank of Abyssinia, Dashen Bank, Tsedey Bank, Nib Bank, Abbay Bank, Hibret Bank, and Global Bank Ethiopia) can be explained by the combined influence of the five independent variables: internal auditor competence, independence and objectivity of the internal audit-activity, board and management support, internal audit methodology, and the existence of an audit committee. The remaining 18.1% of the variation may be attributed to other factors not included in this study.

The analysis quantified the impact of each independent variable on internal audit effectiveness: hence; Competence of Internal Auditors: A one-unit increase in internal auditor competence is associated with a 0.129-unit increase in internal audit effectiveness, Independence and Objectivity of Internal Audit Activity: A one-unit increase in independence and objectivity leads to a 0.245-

unit increase in internal audit effectiveness, Board and Management Support: A one-unit increase in board and management support results in a 0.438-unit increase in internal audit effectiveness, Internal Audit Methodology: A one-unit increase in the effectiveness of the internal audit methodology corresponds to a 0.236-unit increase in overall internal audit effectiveness and Existence of an Audit Committee: A one-unit increase in the presence of an audit committee is linked to a 0.120-unit increase in internal audit effectiveness. These findings highlight the significant impact of each of these factors on internal audit effectiveness.

From the regression outcomes, if all the independent variables "(internal auditor competence, independence and objectivity of internal audit, board and management support, audit committee existence, and internal audit methodology)" were to become zero, the effectiveness of internal audit would decrease by 0.987 units. This interpretation suggests that "the baseline effectiveness of internal audit is influenced by these independent variables". In practical terms, it indicates that if none of these critical factors were present or operational, the internal audit function would be significantly less effective. The negative impact of 0.987 units reflects the cumulative effect of the absence of these factors, emphasizing their importance in maintaining and enhancing the effectiveness of internal audits. This finding underscores the necessity for organizations to invest in and prioritize these areas to ensure a robust internal audit function at the specified commercial Banks.

The analysis suggests that respondents generally perceive internal auditors as competent and diligent professionals. However, there is some variability in these perceptions, indicating potential areas for improvement. While internal auditors are generally seen as possessing the necessary knowledge to identify fraud and IT risks, and as exercising due professional care, there's a need for consistent application of these skills and standards across the team.

The study evaluates the collaboration between internal audit teams and auditees, as well as the adequacy of the internal audit budget. While both areas show generally positive results, with high levels of agreement on collaboration and sufficient budgeting, there is also evidence of variability in perceptions. This suggests that there is room for improvement in both areas to ensure consistent and effective collaboration and resource allocation across all departments and teams.

5.3. The Conclusion on the study

Internal auditing is an impartial and objective process that aims to improve an organization's operations by providing assurance and consulting services. It helps organizations identify and mitigate risks, enhance efficiency, and ensure compliance with regulations and policies. Internal auditing assists organizations in achieving their goals by systematically evaluating and improving their risk management, internal control, and governance processes. This disciplined approach helps organizations identify and address potential risks, ensuring compliance with regulations and enhancing operational efficiency. This study offers valuable insights into enhancing the "role of internal audit in managing risks, internal controls, and corporate governance within Ethiopia's banking industry". "By improving internal audit effectiveness, the study aims to safeguard the interests of all stakeholders, including customers, suppliers, employees, creditors, and government agencies". "This study aimed to identify the key factors that influence the effectiveness of internal audit in commercial banks in Ethiopia". Given the crucial role of banks in the country's economy and their responsibility for managing public funds, understanding the determinants of internal audit effectiveness is essential for ensuring financial stability and accountability. To protect public interest, banks should be subject to rigorous oversight by sovereign bodies, such as "internal and external auditors". Strict government regulation is also necessary to ensure that banks operate ethically, responsibly, and in compliance with all relevant laws and regulations.

The study found strong positive relationships between the effectiveness of internal audit and the following independent variables: internal auditor competence, internal audit independence, board and management support, internal audit methodology, and the existence of an audit committee. This indicates that each of these factors contributes significantly to the overall effectiveness of internal audit. The study found that Board and Management Support is the second most significant factor influencing internal audit effectiveness. Strong support from the board and management is crucial for providing the necessary resources, training, and recognition for internal auditors to perform effectively. This support enhances the ability of internal auditors to conduct thorough and effective audits, leading to improved audit quality. While other factors like internal audit methodology, auditor competence, and the existence of an audit committee are important, board and management support are particularly critical as it directly impacts the operational environment in which internal auditors work. Besides, the study identifies key factors that contribute to internal

audit effectiveness. Following independence and objectivity, board and management support, internal audit methodology, and auditor competence are significant determinants. A well-defined internal audit methodology, skilled auditors, and support from the board and management are crucial for improving audit quality and ensuring the effectiveness of the internal audit function. Additionally, the existence of an active audit committee provides valuable oversight and guidance, further enhancing internal audit effectiveness. This study focused on a limited number of variables (five independent variables). Future research could expand the scope by including additional factors that might influence internal audit effectiveness.

In conclusion, while the study found that the internal audit function in the selected banks is effective and contributes significantly to their operations, there are still areas where improvements can be made. Besides, the analysis indicates that there is significant variability in perceptions regarding the Chief Audit Executive's access to senior management and the board, as well as the internal auditors' knowledge of fraud indicators and IT risks, and their collective knowledge and skills. This suggests that there may be opportunities to improve communication and collaboration between the internal audit function and senior management, and to enhance the knowledge and skills of internal audit staff.

5.4. Recommendations

Based on the findings of this research, the following recommendations are proposed to improve the internal audit function of the selected commercial banks: -

To improve the effectiveness of internal auditors, it is recommended to implement a comprehensive training and development program. This program should focus on both technical and soft skills. Technical training should cover the latest auditing standards, fraud detection techniques, and information technology risks. Soft skills training, such as communication, critical thinking, and problem-solving, should also be included. Additionally, encouraging continuous learning through professional development courses and certifications will help maintain internal auditors' knowledge and skills. In addition to this, to enhance the independence and objectivity of the internal audit function, it is recommended to establish clear policies and procedures. This includes: direct reporting: ensuring that internal auditors report directly to the audit committee bypassing management to minimize potential conflicts of interest, whistleblower protections:

implementing a robust whistleblower policy to encourage the reporting of unethical behavior without fear of retaliation. And regular assessments: conducting periodic assessments, such as anonymous surveys or external reviews, to monitor and evaluate the independence and objectivity of the internal audit function.

To enhance the effectiveness of the internal audit function, it is crucial to foster a culture of support from the board and management. This can be achieved through regular communication between the internal audit team and the board/management, conducting awareness programs to highlight the value of internal audit, and establishing feedback mechanisms to gather input on the level of support provided. By fostering a supportive environment, the internal audit function can operate more effectively and contribute to the organization's overall success. To further strengthen the effectiveness of the internal audit function, Banks should enhance the engagement of the audit committee. This can be achieved by providing training and orientation for audit committee members, scheduling regular meetings between the audit committee and internal audit staff, and implementing a performance evaluation process for the audit committee. By taking these steps, the audit committee can provide more effective oversight and support to the internal audit function.

To improve the consistency and effectiveness of internal audits, it is recommended to standardize internal audit methodologies. “This can be achieved by adopting best practices from recognized frameworks like the International Standards for the Professional Practice of Internal Auditing (IPPF)”. By creating comprehensive documentation of audit processes and methodologies, auditors can follow a consistent approach. Additionally, regular reviews of these methodologies will ensure that they remain relevant and effective in meeting the evolving needs of the organization.

To continuously improve the internal audit function, it is recommended to conduct regular surveys and assessments to gather feedback from internal auditors. Anonymous surveys can provide valuable insights into their perceptions of their competence, independence, and support. Focus groups can be used to delve deeper into specific issues and gather qualitative information. By analyzing the results of these surveys and assessments, organizations can develop action plans to address any identified weaknesses and enhance the overall effectiveness of the internal audit function. Additionally, the researcher suggests that future research should explore other factors that may contribute to the effectiveness of internal audit functions within Ethiopian banks.

By implementing these recommendations, organizations can significantly improve the effectiveness of their internal audit functions. This, in turn, can lead to better governance, risk management, and overall organizational performance. However, it is crucial to continuously monitor and adapt these strategies to keep pace with changing business environments and emerging risks.

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ADDIS ABABA UNIVERSITY

COLLEGE OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND FINANCE

(Questionnaire for Internal Auditors)

Researcher Name: Tamrat Wubshet

Organization: Addis Ababa University, college of business and economics department of accounting and finance

Sir/Madam,

You have been selected to participate in a research study on **"Factors that determine effectiveness of internal audit in commercial banks"**. This study is being conducted with permission from Addis Ababa University, college of business and economics department of accounting and finance. Before agreeing to participate in this study, you must understand why it's being conducted and what you'll be doing. Please take the time to thoroughly read the following information. If there is anything unclear to you, feel free to question the researcher. This research is part of the requirements for a Master's degree in Accounting and Finance. The study will be used purely for academic purposes and thus it does not affect you in any case. You're genuine, frank, and timely response is vital for the success of the study. Therefore, I kindly request that you answer each question carefully and thoughtfully.

Instruction: -

- No need of mention your name.
- Use √ upon given choices options.
- Please return the completed questionnaire promptly. Thank you for your cooperation and timely response.
- The researcher assures you that your responses will remain confidential.
- For further inquiries or clarifications, please contact me at the email address provided below.

With Best Regards,

Tamrat Wubshet

E-mail: tam122119@gmail.com

Addis Ababa, Ethiopia

Part I: - General Information

1. **Gender:** Male ☐ Female ☐

2. **Educational background or Qualification of the Respondents:**

Diploma ☐ Degree (BA, BSC) ☐ Masters (MA, MSC, MBA) ☐

3. **Field of study on your highest educational level:**

Accounting and Finance ☐ Information Technology ☐

Management and Economics ☐ Marketing & Business Administration ☐

4. **Year of experience in banking sector in any position:**

One to four years ☐ five to ten years ☐ Above ten years ☐

5. **Year of experience in internal auditing:**

One to four years ☐ Five to ten years ☐ Above ten years ☐

Part II: - Internal Audit Questionnaire:

Please mark "√" for each line in the labeled columns: if you Strongly agree=5, agree=4, Neutral=3, disagree=2, and strongly disagree=1.					
Factors	**Scales**				
A. Competency of Internal Auditors:	**1**	**2**	**3**	**4**	**5**
31. Internal auditors of your bank have possessed knowledge and skill to perform their audit related responsibilities.					
32. Internal audit staffs of your bank collectively have possessed Knowledge and skill to perform internal audit responsibilities.					
33. Internal auditors of your bank workout with due professional care in performing their tasks.					
34. Internal auditors of your bank enhancing their knowledge through continuous inhouse and professional development trainings.					
35. Internal auditors of the bank were applying internal audit standards, procedures and techniques in performing audit engagements.					
36. Internal auditors of the bank have knowledge to identify fraud indicators and key information technology risks.					

B. Organizational and individual Independence and objectivity of Internal Audit:	1	2	3	4	5
37. In your bank Chief audit executive (Director) functionally reports to the board of directors (or audit committee).					
38. In your bank the chief audit executive (Director) has direct and unrestricted access to senior management and the board.					
39. In your bank Internal auditors functionally reports to Chief audit executive (Director).					
40. In your bank internal auditors are free from interference of management in determining the scope of their assignments.					
41. In your bank internal auditors have unbiased attitude and conflict of interest that impair ability to perform his/her duties and responsibilities.					
42. In your bank Internal auditors feel free to report to the Chief audit executive (Director) any situation in which an actual or potential to impairment of independence during engagement.					
C. Board and Management Support:	**1**	**2**	**3**	**4**	**5**
43. The Board of your bank promotes the independence internal audit by protecting them from management's influence.					
44. In your bank audit customers (auditee) Collaborate with internal audit during the whole internal audit process or audit engagements.					
45. Senior management of your bank ensures the internal audit has sufficient human resource and technological resources to successfully carry out its responsibilities.					
46. In your bank internal audit department obtain a sufficient budget to successfully carry out its responsibilities in accord with its approved plan.					
D. Methodology of Internal audit Activity:	**1**	**2**	**3**	**4**	**5**
47. The bank implements risk-based internal audit approach.					
48. In your bank the Chief audit executive (Director) has prepared risk based annual audit plan to determine priorities internal audit activity, consistent with the organization's goals.					
49. In your bank internal audit teams perform individual audit assignment based the risk-based audit methodology.					
50. In your bank internal auditors conduct a preliminary assessment of the risks relevant to each engagement.					
E. Audit committee existence:	**1**	**2**	**3**	**4**	**5**
51. The audit committee assesses the quality of internal audit reports and monitors the implementation of internal audit recommendations.					

52. The audit committee's enhances independence and protect independence from management interference.					
53. The audit committee meets with the internal audit team frequently or at regular interval.					
54. The audit committee's independence influences your work.					
55. The audit committee's feedback on audit reports improves the quality of our work.					
F. Effectiveness of Internal Audit:	**1**	**2**	**3**	**4**	**5**
56. Competence of internal auditors is a determinant factor for the effectiveness of internal audit activity of your bank.					
57. Organizational and individual independence of internal audit is a determinant factor for the effectiveness of internal audit activity of your bank.					
58. Board and management support to internal audit is a determinant factor for the effectiveness of internal audit activity of your bank.					
59. The methodology/process used by internal audit departments is a determinant factor for the effectiveness of internal audit activity of your bank.					
60. Audit committee existence is a determinant factor for the effectiveness of internal audit activity of your bank.					

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

Thank you for your cooperation!!