



**College of Business & Economics
Master of Business Administration (Distance Program)**

**The Practice and Challenge of Internal Auditing Function of
Privately Owned Commercial Banks of Ethiopia in Light of
International Accepted Auditing Standards and Principles**

A Thesis Submitted in Partial Fulfillment of the Requirements
for the Award of the Degree of Master of Art
In
Business Administration

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June, 2019

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Declaration

I, the undersigned, declare that this thesis entitled “*The Practice and Challenge of Internal Audit Function of Privately Owned Commercial Banks of Ethiopia in Light of International Accepted Auditing Standards and Principles*” is my own original work Prepared under the guidance of Dr. Yohannes Workaferahu (PHD). All sources have been accurately reported and acknowledged, and that this document has not been submitted for a degree in anyother universities.

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Statement of Certificate

This is to certify that **Sheworkie Belete** has completed his thesis entitled “*The Practice and Challenge of Internal Audit Function of Privately Owned Commercial Banks of Ethiopia in Light of International Accepted Auditing Standards and Principles*” is his original work and is submitted for examination with my approval as a thesis.

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Addis Ababa University

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Acknowledgement

First and for most I would like to thank the Almighty God for his help in all walk of my life. I could not be where I am right now without his assistance and unfailing love.

Next, I would like to express my deepest gratitude to my advisor Dr. Yohannes Workaferahu for his encouragement, valuable comment, very prompt response and guidance throughout the preparation of this thesis.

I would like also to thank all the respondents of my research interview, because their kindness to share their very precious time and very valuable feedback was indeed the pillar of this thesis. A very deep sincere gratitude also belongs to my colleagues Workneh Goshu and Desta Kassa who gave me their valuable comments on the draft paper.

Finally, I wish to express my sincere appreciation to my wife Mekdes Seyoum and my son Dawit Sheworkie for their understanding and support during the project.

Abstract

The aim of this study was to examine the practice and challenge of internal auditing function of privately owned commercial banks of Ethiopia in light of international accepted auditing standards and principles on selected 16 Ethiopian privately owned commercial banks. An interview data collection method was used. The study used semi-structured face to face interview to 8 purposely selected head of internal audit departments as a primary data. The findings of the study showed that majority of internal audit activities and responsibilities were practiced by all internal audit departments of commercial banks in line with accepted international auditing standards and principles. However, some internal audit departments faced challenges in the following areas of internal audit independence such as: non-existence of NBE involvement in the removal process of the head internal audit department; lower remuneration of head of internal audit department compared to others having equivalent status; failure to conduct an evaluation on board and sub-committee performance by some banks; the misconception of senior management and board of director/audit committee with respect to penalty imposed by NBE for the non-compliance as the result of internal audit report; not issuing RBIA framework or guidelines by NBE to have uniformity and consistency among all commercial banks; NBE's instruction to widening the audit coverage which is contradictory with RBIA methodology; and branch residence auditors are mainly engaged in routine checking activities of the internal control which is different from risk based auditing. The study recommends that the senior management, the BoD/audit committee of the commercial banks and NBE have to provide the necessary support and the internal audit department has to implement the accepted international auditing standards and principles so as to have effective internal audit functions in all commercial banks.

Keyword: IPPF (PPF) standards, BCBS Principles, independence, RBIA, supervisory bank/NBE, BOD/audit committee, senior management, head internal audit.

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Acronyms and Definition of Key Terms

Acronyms

BCBS – Basel Committee Banking Supervision

BIS– Bank of International Settlement

BoD – Board of Directors

CAE – Chief Audit Executive

CAMEL – Capital adequacy, Asset quality, Management quality, Earning ability and Liquidity

CBE – Commercial Bank of Ethiopia

CEO – Chief Executive Officer

DBE – Development Bank of Ethiopia

GTP – Growth Transformation Period

HIA – Head Internal Audit

IA – Internal Audit

IAD – Internal Audit Department

IAF – Internal Audit Function

IIA – Institute of Internal Auditor

IPPF – International Professional Practice Framework

NBE- National Bank of Ethiopia

OAG – Office of Audit General

OIOS - Office of Internal Oversight Services

PPF - Professional Practice Framework

QA – Quality Assessment

RBIA – Risk Based Internal Audit

SBB – Supervisory Banking Business

VP – Vice President

Definition of Key Terms

Administrative Reporting - is the reporting relationship within the organization's management structure that facilitates the day-to-day operations of the internal audit function, (PPF, 2004)

Auditable unit - an organization, operation, individual, or other discrete entity that can be subjected to an audit. During audit planning, an auditor determines an audit universe of auditable units, and dedicates appropriate levels of auditing resources to each unit, (O'Regan, 2004).

Audit Committee - is a committee of a board of directors that oversees an organization's auditing and financial reporting. Undermost systems of corporate governance, audit committees tend to be comprised of outside directors to encourage independence and to minimize potential conflicts of interest. Typical activities of audit committees include reporting to the board of directors on the oversight of (i) financial reporting, (ii) the internal control environment, (iii) the work of external and internal auditors, (iv) external audit fees, (v) the appropriateness of accounting policies, and (vi) risk management procedures, (O'Regan, 2004).

Basel Committee on Banking Supervision (BCBS) - the BCBS was founded in 1974 as a forum for regular cooperation between its member countries on banking supervisory matters. The BCBS describes its original aim as the enhancement of "financial stability by improving supervisory knowhow and the quality of banking supervision worldwide." Later on, it turned its attention to monitoring and ensuring the capital adequacy of banks and the banking system, (Basel 2014).

Board of Director - it is the highest level governing body (e.g., a board of directors, a supervisory board, or a board of governors or trustees) charged with the responsibility to direct and/or oversee the organization's activities and hold senior management accountable. Although governance arrangements vary among jurisdictions and sectors, typically the board includes members who are not part of management. If a board does not exist, the word "board" in the *Standards* refers to a group or person charged with governance of the organization. Furthermore, "board" in the *Standards* may refer to a committee or another body to which the governing body has delegated certain functions (e.g., an audit committee), (IPPF 2016).

Functional Reporting - the functional reporting line for the internal audit function is the ultimate source of its independence and authority. As such, The IIA recommends that the CAE report

functionally to the audit committee, board of directors, or other appropriate governing authority, (PPF, 2004)

Head Internal Audit/Chief Audit Executive - chief audit executive describes the role of a person in a senior position responsible for effectively managing the internal audit activity in accordance with the internal audit charter and the mandatory elements of the International Professional Practices Framework. The chief audit executive or others reporting to the chief audit executive will have appropriate professional certifications and qualifications. The specific job title and/or responsibilities of the chief audit executive may vary across organizations, (IPPF 2016).

Independence - refers to the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner, (IPPF 2016)

Internal audit - a branch of auditing developed in the twentieth century as a means of monitoring an organization's risks, internal controls, procedures, and management accounting, (O'Regan, 2004).

Internal Audit Charter - is a document that sets out the purpose, authority, responsibilities, and scope of work of an *internal audit function (IAF). The charter is often considered to be an audit function's constitution, and its subject matter typically includes some or all of the following: (i) The IAF's reporting lines within an organization, (ii) the scope of the IAF's work, (iii) the IAF's rights of access to information, (iv) IAF budgetary information, and (v) a formal statement of the IAF's adherence to professional standards. (O'Regan, 2004).

Internal control - refers to is a physical or procedural mechanism that monitors and reduces risk in an organization's financial and operational activities, (O'Regan, 2004).

Internal checker/branch controller/Resident auditor - the commercial banks of Ethiopia are assigning employees designated as "internal checkers" who are mostly involved in pre audit function, and or checking of property, cash transfer, and inventory issuance and receipts. The position and qualifications of the above persons vary from organization to organization. However, internal checkers are slowly changing to internal audit function position, (Johannes and Engida, 2009).

Objectivity - refers to an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality

compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others. Threats to objectivity must be managed at the individual auditor, engagement, functional, and organizational levels, (IPPF 2016).

Remuneration - refers to salaries and wages paid to an organization's employees or fees paid to an individual for the performance of services, (O'Regan, 2004)

Remuneration Committee - refers to a committee of a board of directors (or similar governing body) that oversees an organization's executive remuneration policy. Remuneration committees are often comprised of outside directors to encourage independence and to minimize potential conflicts of interest, (O'Regan, 2004)

Risk Based Internal Audit (RBIA) - is as a methodology that links internal auditing to an organization's overall risk management framework. RBIA allows internal audit to provide assurance to the board that risk management processes are managing risks effectively, in relation to the risk appetite, (Chartered IIA, 2014).

Senior Management - refers to chief executive officer, senior executive officer, and any other official, as may be defined by individual bank, responsible for day-to-day running of a bank, (NBE, 15).

CHAPTER ONE

INTRODUCTION

1.1. Background of the study

The Institute of Internal Auditors - defines internal auditing as “an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes”(Pickett, 2010).

An effective internal audit activity is a valuable resource for management and the board or its equivalent, and the audit committee due to its understanding of the organization and its culture, operations and risk profile. The objectivity, skills, and knowledge of competent internal auditors can significantly add value to an organization's internal control, risk management, and governance processes. Similarly, an effective internal audit activity can provide assurance to other stakeholders such as regulators, employees, providers of finance, and shareholders (IIA Research Foundation, 2004).

The internal auditing activity is guided by the International Standards for the Professional Practice of Internal Auditing. According to the International Standards for the Professional Practice of Internal Auditing, the purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Mission of Internal Audit and the mandatory elements of the International Professional Practices Framework -IPPF (the Core Principles for the Professional Practice of Internal Auditing, the Code of Ethics, the Standards, and the Definition of Internal Auditing). The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval, (IPPF, 2017).

According to the BCBS internal audit paper (2002), there are four principles of internal audit. First is the permanent function-continuity: states that each bank should have a permanent internal audit function. In fulfilling its duties and responsibilities, senior management should take all necessary measures so that the bank can continuously rely on an adequate internal audit function appropriate to its size and to the nature of its operations. These measures include providing the

appropriate resources and staffing to internal audit to achieve its objectives. Second is that an internal audit department should function in accordance with the principles of independence, objectivity and impartiality. Third is professional competence and finally scope of activity and the organization of the internal audit department.

On the other hand, banking supervisors must be satisfied as to the effectiveness of a bank's internal audit function that policies and practices are followed and that management takes appropriate and timely corrective action in response to internal control weaknesses identified by internal auditors. In doing so, the function helps reduce the risk of loss and reputational damage to the bank (BCBS, 2012). Cooperation among the supervisory authority and the external and internal auditors aims to make the work of all concerned parties more efficient and effective. The cooperation may be based on periodic meetings of the three parties (BCBS 2002).

It is a fact that the bank plays an important role in the economic development of the nation by providing different services to the customer. In due courses the bank may face risk that hinders its objective. The internal audit main function is to evaluate risk exposures relating to the organization's governance, operations and control systems. Therefore, the internal auditors are expected to provide recommendations for improvement in the area where opportunities or deficiencies are identified. In view of this, the study has tried to examine the Practice and Challenges of Internal Auditing Function of Commercial Banks of Ethiopia in light of International Accepted Auditing Standards and Principles.

1.2. Statement of the Problem

Commercial banks found in Ethiopia have an internal audit function which provides assurance to the Board of Directors (BoD)/ audit committee and senior management and that adds value to the organization's credibility with investors and creditors. Internal auditors need a mandate that provides the authority they need within a structure that supports their independence and objectivity. This can best be achieved through a written charter for the internal audit function that is aligned with the mandate and needs of the audit committee. The mandate should be compatible with the best current practices and approved by the BoD/ audit committee. Any restrictions by management should be disclosed to and approved by the audit committee. Internal audit should not have any operational accountability or perform functions that would be subject to subsequent internal audit review, (Fraser and Lindsay, 2007).

Internal audit have functional relationship to the BoD/audit committee on the planning, execution and results of audit activities and administrative relationship to management for purpose of resources and related matters. The Chief Audit Executive (CAE) should be sufficiently highly placed to reinforce the organizational status of internal audit and to support its unrestricted access to corporate resources, but must not impair the independence of the internal audit function. CAE reporting lines are also critical to ensuring the appropriate flow of information and access to key executives and managers that are the foundations of risk assessment and reporting of results of audit activities. Conversely, any reporting relationship that impedes the independence and effective operations of the internal audit function should be viewed by the CAE as a serious scope limitation, which should be brought to the attention of the audit committee or its equivalent (PPF, 2004, p.57).

The role of internal audit is both internal and independent. Constructively, evaluating the work of fellow members of the management team and providing advice to them can create tension although this can be healthy when handled professionally by all parties. Relationships with management should be balanced not too friendly but not hostile. Helping achieve this balance is part of the role of the audit committee and the Chief Executive Officer (CEO) (Fraser and Lindsay, 2007).

The supervisory authority should consider the extent to which the board of directors, its audit committee and senior management promote a strong internal control environment supported and assessed by a sound internal audit function. The assessment of the internal audit function should be based on the supervisory expectations. Furthermore, both internal auditors and supervisors use risk based approaches to determine their respective work plans and actions. While internal auditors and supervisors each have a different mandate and are responsible for their own judgments and assessments, they may identify the same or similar/related risks (BCBS, 2012).

Therefore, the purpose of the study was to explore the practice and challenges of internal auditing function of privately owned commercial banks in Ethiopia in light of international accepted auditing practice, standard and principle in connection with internal audit independence (appointment and removal of the CAE; treatment of Remuneration; BoD and board sub-committee performance evaluation); penalty charges for non-compliance of NBE directives; application of Risk Based Internal Audit (RBIA); widening of audit coverage of auditable units; and relationship of resident auditors/controllers with internal audit department.

As to the researcher's knowledge, this is the first study viewing the internal audit practices and challenges in light of international accepted standards and principles in the context of privately owned commercial banks of Ethiopia.

1.3. Research Question

This research paper attempted to explore the practice and challenge of internal auditing function of privately owned commercial banks in Ethiopia in light of international accepted auditing standards and principles on 16 selected Ethiopian commercial banks. The researcher addressed the following questions by undertaking this study;

- Q1. What are the existing practice of internal audit function of privately owned commercial banks in relation to international standards and principles?
- Q2. What are the challenges of internal audit function of privately owned commercial banks in line with the international standards or principles?

1.4. Objective of the study

1.4.1. General Objective

The general objective of this study is to examine the practice and challenge of internal auditing function of privately owned commercial banks in Ethiopia in light of international accepted auditing standards and principles.

1.4.2. Specific Objectives

The specific objectives of the study include:

- To explore the practice of internal audit function of privately owned commercial banks of Ethiopia.
- To appraise the practice of internal audit function with International standard and principles.
- To examine the existing challenge of internal audit function in private owned commercial banks while pursuing International standard and principles.

1.5. Significance of the Study

The researcher believes that the result of this study will help the internal audit departments, senior management, BoD/audit committee of the privately owned commercial banks of Ethiopia to discharge their responsibilities and manage their internal audit functions effectively in line with the international accepted auditing standards and principles. It will also help the banks' supervisory body (NBE) to monitor and follow up as banks will have uniform internal audit activities.

1.6. Scope of the Study

This research paper aims to explore the practice and challenge of internal auditing function of 16 privately owned commercial banks of Ethiopia in light of international accepted auditing standards and principles.

The researcher has tried to cover/contact head internal audit departments of 8 purposely selected privately owned commercial banks found at Addis Ababa in Ethiopia through interview data collection method. However, CBE and DBE head internal audit departments are not considered in this study as they stand in better position in complying and applying the international accepted auditing standards and principles to the best knowledge of the researcher.

1.7. Organization of the study

This paper is divided into five chapters that covered Introduction, Literature Review, Research Methodology, Data Analysis and discussion, and Summary of Findings, Conclusion and Recommendation. The outlines of the five chapters are as below.

Chapter 1: Introduction

This chapter provides an overview of the study. It contains general introduction to the issues with which the study is concerned, statement of the problem, research question, objectives of the study, significance of study, scope of the study and organization of the study.

Chapter 2: Literature Review

This chapter assesses previous literature and studies relevant to the fields and related topics. A literature review also provides a rationale for the proposed study by placing it next to the previous studies.

Chapter 3: Research Methodology

This chapter describes and explains the research methodology used in the study. Key topics of this chapter include the research design, population and sampling design, data types and sources, data collection method, research instrument, sampling design, data collection procedures, and data analysis techniques.

Chapter 4: Research Result

This chapter describes data analysis and interpretation. Results and data analysis are presented in the form of text and tables.

Chapter 5: Summery, Conclusions and Recommendations

And finally summery of findings, conclusions and recommendations are presented under this chapter

CHAPTER TWO

LITERATURE REVIEW

2.1. Introduction

In this chapter detail of the theoretical and empirical review is conducted on each research question. This chapter is divided into two broad sections theoretical and empirical reviews and further the theoretical review classified into four sections. The first section will explore the existing practice of internal audit function in the commercial banks of Ethiopia; the second appraise the practice of internal audit function with International standard and principles; the third examine the existing challenge of internal audit function in commercial banks; and finally it examines challenge of internal audit function while pursuing International standard and principles.

2.2. Theoretical Review

2.2.1 The Practice of Internal Audit Function in the Commercial Banks of Ethiopia

The history and development of internal auditing function in Ethiopia dates back to 1940. According to Samueal, (2008), an internal auditing function has existed for quite a long time in Ethiopia. However, it got legal recognition in late 1980s. The internal Auditing function started in the budgetary public sector as part of internal control. However, the latter part of the 1940s witnessed the establishment of internal audit functions in the Ministry of National Defense, Ministry of Education, and Ministry of Finance. It was also at this time that the Internal Auditing units began to sprout in non-budgetary public sector (public enterprise) like Ethiopian Highway Authority, Ethiopian Airlines, Ethiopian Telecommunication, and financial sector that formed the modern layer of the National Economy (Lemma, Dec 2000).

Internal Auditing in Ethiopia obtained legal recognition for the first time in 1987 through Proclamation No. 13/1987. This proclamation empowered Office of Auditor General (OAG) to direct the internal auditors of government offices and public enterprises in three aspects that are whether accounting records are properly maintained and reliable, whether the assets of the ministries and enterprises are adequately safeguarded and properly maintained; and whether

policies and procedures laid down by top officials/management are complied with that implies less attention was given to operational audit as a service to management.(Lemma, Dec 2000).

In 1994 the civil service reform program organized a task team that was formed by Prime Minister to assess and review the performance of civil service and come with the following findings: absence of internal audit functions in some of the ministries and public enterprises, internal auditors devoted most of their times and efforts on pre-audit, internal auditors neither have the skills needed nor working manuals.

On July 1, 1997 the Financial Administration Regulations No. 17/1997 was issued in which the responsibility of internal audit function was transferred from the Office of the Auditor General to the Ministry of Regulation set out the responsibilities of the Minister of Finance to develop and maintain appropriate standards of work and conduct for application throughout all the public bodies internal audit function and after this financial regulations almost all public bodies established internal audit services; almost all public bodies discontinued pre-audit or pre-checking. (Wolderuphael, 2000).

In 1998 the Ministry of Finance issued an Operational Audit Manual to strength the audit function in the public bodies. According to this manual internal audit services are made to report to the top persons of the organizations.

In May 2007, policy directive was issued to further strengthen the internal audit service function in the public bodies, however, the legal basis laid down by both in the Regulations of Council of Ministers and the Ministry of Finance Directive is applicable only to internal auditing under the auspices of public bodies and does not apply to public enterprises and the private sector, but recently Public Enterprises Supervising Authority has issued policy directive for establishment of audit committees in all public enterprises and an audit manual to maintain uniformity of audit work in all public enterprises. Commercial Bank of Ethiopia is one of the public enterprises engaged in banking sector and run its business with its own budget.

According to Hamdu, Arega and Addisu, (2014), iInternal auditing standards and its practice the case of East Arsi Zone, Ethiopia; the Ministry of Finance and Economic Development has the authority to issue internal audit manuals for use by all organizations that are wholly or partially financed by the government budget (Government of Ethiopia, 1996). The Ministry has issued a manual that contains a code of ethics for internal auditors and procedural guidance on the

conduct of audits (Ministry of Finance and Economic Development, 2004). Internal audit Standards of the Ethiopian Government, specified in the manual, closely match those published by the IIA. As a result of changes in organizational needs, technology and complexity of organizations' activities and systems, the nature of the services sought from the internal auditors has been transforming over the years from an emphasis on traditional/compliance audit where independence has been the core paradigm, to a value adding role where partnering with management is accorded greater significance (Desalegn and Getachew, 2008).

The commercial banks activities are expanding and getting higher in deposit mobilization, accessibility of services, and product diversification. The banking sector operates in a more complex and dynamic environment, which is characterized by the growing demand and bargaining power of customers. The banking industry is marked as attractive and has high profit margin. All these situations induce the internal audit of Ethiopian commercial banks to get lessons by their own effort either from the experiences of others through bench marking from local senior banks; browsing from the internet the best practices of similar businesses or applying the appropriate international standards and principles globally known institutions.

2.2.1.1 Internal Audit Function

The overall objectives of internal audit are to provide assurance to BoD and senior management of the bank regarding the management of key risks and to provide independent and objective assurance and consultancy service to BoD and senior management to assist them in discharging their duties and responsibilities.

The scope of internal audit coverage includes all aspects of the bank's activities in accordance with the internal audit charter approved by the BoD/audit committee. The extent and frequency of internal audits will depend upon varying circumstances such as the results of previous audits, relative risk associated with activities, materiality, the adequacy of the system of internal controls and resources available at the internal audit function. According to Johanneskinfu auditing book, types of audit and reviews could be classified into the following major categories:

- i. Financial Audit** – it reviews accounting and financial transactions to determine if commitments, authorizations, receipts and disbursements are properly and accurately recorded and reported. This type of audit also determines if there is adequate control over cash and other assets and that adequate process controls exist over the acquisitions and use

of resources. Financial audit is historical oriented independent evaluation performed to attest the fairness, accuracy and reliability of financial data.

ii. Operational Audit – it examines the use of resources with a view to determine whether resources are being used in the most effective and efficient manner.

iii. Information Systems Audit- it reviews the internal control environment of automated information processing systems and how people use these systems. The audit usually evaluate system inputs, outputs, processing controls, backup and recovery plans, system security and computer facilities. Information system audit may be carried out in three main categories:

- **General Control Review:** pertains to controls, which govern development, operation, maintenance and security of application systems. It may involve reviewing the data center, the operating system, and procedure for controlling product and program changes.
- **Application Control Review:** involves examination of controls over input, processing and output of the system. Data communication issues, program and data security, system change control and data quality issues are also considered.
- **System Development Review:** evaluation of the system development process as well as the product is fully considered.

iv. Investigative Audit or Reviews: it takes place where is unusual or suspicious activity on the part of an individual, department or branch. It is usually focussed on specific aspect of a work.

v. Compliance Audit: is carried out to determine if entities are complying with applicable laws, regulations, policies and procedures.

2.2.1.2 Audit Process

Generally, the implementation of auditing activities consists of four commonly known procedural steps, which are usually administered by head audit. Knowing about these steps will enable auditors to better monitor the audit process and provide recommendations for its improvement, if needed. These audit process steps include: planning, field work, reporting and

follow-up. The Commercial Bank of Ethiopia Internal Audit Guideline, 2009 clearly follows these audit process steps.

i. Planning

The first task of auditing is planning process which involves:

- **A Strategic Audit Plan;** which is the identification and documentation of auditable areas within an audit universe, and the prioritization of these areas for review based on a predetermined risk assessment methodology. A five-year revolving strategic audit plan, which is derived from the bank's strategic plan, shall be developed.
- **Annual Audit Plan;** is the list of audit engagements to be conducted in the coming year. The strategic audit plan shall be reviewed each year so that it can be amended to reflect changing environment and meet the emerging needs of the bank. The steps to be followed in preparing annual audit plan are depicted herein below.
 - ✓ Establishing/identifying the audit universe/population. The audit universe includes all core and support processes; subsidiaries, affiliates and projects.
 - ✓ Going through the strategic plan of the Bank and collecting customers' feedback. Customer's input/feedback shall be collected via interviews, questionnaires and examining financial/operating data.
 - ✓ Selecting risk factors on the basis of relevance with respect to the nature and objectives of the auditee's.
 - ✓ Scoring each auditable unit/activity on each of the risk factors using a scale of one-to-five on each factor, whereby five points indicates the maximum risk, and one point the minimum risk. Allotting/assigning points ranging one-to-five to the various risk factors might rely on subjective judgment of the auditors.
 - ✓ Once the audit universe/population is determined, the frequency will be based on the level of risk.
 - ✓ Assessing/reviewing and allocating human power, time and other resources to ensure audit coverage of the key areas are within the period of strategic audit plan

- ✓ Presenting the plan to the Board Audit Committee for discussion and approval.
- **IIA Standards 2200 – Engagement Planning** - internal auditors must develop and document a plan for each engagement, including the engagement’s objectives, scope, timing, and resource allocations. The plan must consider the organization’s strategies, objectives, and risks relevant to the engagement.
 - ✓ Forming the team - selects/forms audit teams considering the knowledge, skills and other competencies required to perform the work.
 - ✓ Background study - before the auditors arrive at the audit site, they should gather the appropriate background information. At this stage, the auditors prepare to familiarize themselves with the auditee’s operation.
 - ✓ Audit work program - is a document that lists audit procedures to be followed during an audit. It is designed to achieve the audit plan or audit objectives. Moreover, it is a written plan, which describes how the engagement work schedule set out in the annual plan should be translated into detailed plans for the specific audit assignment/engagement.
 - ✓ Audit procedures - are what auditors do in order to gather audit evidences. So audit procedures must be developed concentrating on those parts of the system that are most critical in achieving the audit objective/s.
 - ✓ Audit program - immediately after background study the auditors prepare an Audit Program and get approval from immediate supervisor. The audit program should consist at least the following: objectives of the audit, scope of the audit, major issues/risks to be checked/validated, audit techniques/procedures to be applied, time schedule of the audit activities, name of the auditors, and name of the approving body of the audit program.

ii. Field Work

According to **IIA Standard 2300 – Performing the Engagement**- internal auditors must identify, analyze, evaluate, and document sufficient information to achieve the engagement's objectives. Internal audit staff will go to the premises of auditee in order to

gain an understanding of the process carried out and will make assurance on the controls in place are works properly or not. The processes in field works are the following.

- **Entrance Conference**

The audit team co-coordinator shall arrange a meeting with his/her team members and the auditee's management. The points to be discussed may include the following:

- ✓ Introducing the participating audit team members;
- ✓ Purpose and approach of the audit;
- ✓ Addressing auditee's concerns;
- ✓ Discussion on the kinds of information needed and the extent of auditee assistance;
- ✓ Discussion on any changes (in staff, systems, operations, etc); and
- ✓ The need for further meetings in the course of the audit and at the end of the audit;

- **Gathering pertinent Information**

Internal auditors should identify, analyze, evaluate, and record sufficient, reliable, relevant and useful information to achieve the engagement's objectives. The procedures (include inquiry, observation, inspection, confirmation, monitoring, etc) used to gather audit evidence vary depending on the information system being audited. Moreover, the extent of information gathering is directly related to the scope of the audit and the degree of assurance to be given.

- **Sampling**

Having thoroughly examined and gathered sufficient background information; audit team shall determine population and select a sample for testing using appropriate sampling techniques.

- **Testing**

The purpose of testing is to confirm that the internal control, risk management and governance systems are operating as intended and to obtain audit evidences. To perform testing, the auditors should use or apply specific audit procedures/techniques like observing, questioning, analyzing, verifying, investigating, evaluating, etc. separately or in combination.

- **Development of Audit Findings and Recommendations**

Audit findings are those conditions identified by internal auditors during the course of their audit work—conditions that require corrective action. Audit findings can be categorized into three groups based on their significance: insignificant findings, minor findings and major findings.

The audit team should properly record all major and minor findings on the write-up sheet. The write-up sheet contains the following items/elements.

- ✓ **Condition/finding:** the factual evidence, which the audit team found in the course of the examination (*what does exist*).
- ✓ **Criteria/standard:** the standards, measures or expectations used in making and evaluation and/or verification (what should exist). The criteria/standard could be policies, procedures, laws, regulations, etc. used to measure the gravity of the difference/gap.
- ✓ **Cause:** the reason for the difference between the expected and actual conditions (why the difference exists). This is important in developing a base for recommending remedial action.
- ✓ **Effect:** the risk or exposure the auditee and/or the Bank encounter because the condition is not the same as the criteria (the impact of the difference).
- ✓ **Recommendation:** the audit team shall make a recommendation that is specific to the condition/finding identified and shall offer alternatives or other advice for solving the problem. If approved standard/criteria already exist, the audit team's recommendation shall be advising the auditee to comply with the standard/criteria.
- ✓ **Auditee's Response:**the audit team shall submit the major and minor audit findings to the auditee's management during the course of the audit and obtain responses. The audit team shall examine each response received and ensure that it satisfactorily addresses all the issues raised. If rectification of the findings is not possible during the audit period, the auditee shall include a target date in its response.

- **Exit Conference Compilation**

After developing audit findings and recommendations, the audit team prepares draft audit report and holds an exit meeting with the management of the auditee to:

iii. Reporting

According to IIA Standard 2400 – Communicating the Result - Internal auditors must communicate the engagement results

- **Audit Report**

At the conclusion of an audit work, the audit team produces objective, clear, concise, constructive, and timely audit report and forwards to the auditee for appropriate corrective actions.

- **Quarterly Progress Report**

Every quarter, the Director Internal Auditor, in his/her part, summarizes major audit works undertaken and communicates to the Board Audit Committee with a copy to the President for appropriate intervention/attention and/or action.

- **Annual report**

A report prepared annually that provides year-end high-lights of internal audit accomplishments in line with the approved plan and other internal audit activities which is going to be delivered to the Board of Directors/Audit Committee or CEO.

iv. Monitoring/Follow-up

It is the responsibility of the management to take an appropriate action in response to the reported audit findings while the Internal Audit is responsible to follow-up and ascertain the adequacy and timelines of action taken by the management on reported audit findings. The follow-up task continues until satisfactory corrective actions are taken.

IIA standard 2500 - Monitoring Progress - the chief audit executive must establish and maintain a system to monitor the disposition of results communicated to management.

2500.A1 - The chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

2.2.1.3 Overview of the Audit Process of the United Nation – Audit Manual

As pointed out in the above section each stage in the audit process is resemble with the United Nations audit manual. The Internal Audit Division (IAD) of the United Nation is one of three divisions of the Office of Internal Oversight Services (OIOS) providing internal oversight services to the United Nations. The Internal Audit Manual (Manual) sets out the policies and procedures that govern the conduct of internal auditing at the United Nations. It describes the underlying principles, standards and code of ethics for the professional practice of internal auditing, and describes the division’s audit management process from planning and preparation to the performance of the audit, reporting of results and follow-up of recommendations. The following describes major tasks of the audit process of the United Nations IAD.

- **Audit Engagement Planning**

The engagement planning phase involves selecting and providing resources for the audit, notifying the audited entity, conducting the entry conference, collecting preliminary information, defining the audit objectives, scope and methodology, and preparing an audit plan and program.

- **Audit Fieldwork**

Audit fieldwork involves executing the audit plan and audit program in accordance with IIA Standards and the Manual. All working papers should be recorded electronically on *Auto Audit*. Activities central to the fieldwork phase include: collecting and analyzing information, developing findings, conclusions and recommendations, discussing issues with the audited entity, and documenting evidence. The fieldwork phase ends with the holding of the exit conference.

- **Reporting Audit Results and Audit Closure**

During the reporting phase, OIOS formally communicates audit results, conclusions and recommendations to audited entities. The audit team prepares the draft and final audit report for management’s review and issuance to the audited entity.

- **Audit Monitoring**

The audit monitoring phase involves conducting a client satisfaction survey, following-up with the audited entity’s management on the status of implementation of audit recommendations and resolving long-outstanding recommendations. During this phase,

PPS also coordinates IAD's segment of the annual and semi-annual reporting of OIOS' activities to the General Assembly and the Secretary-General.

2.2.2 The Practice of Internal Audit Function with International Standard and Principles

All definitions of internal audit contain the word 'independence' and this is an important component of the audit role. It is both a concept and an ideal. One could assume that since internal audit is located within the organization it cannot be independent. The counterargument suggests that internal audit has to be totally independent, or it has little use. The real position falls somewhere in between. There are degrees and a quality of independence that has to be earned to ensure that audit is sufficiently distanced from the particular operation being reviewed (Pickett, 2010, p 340).

2.2.2.1 Independence

According to PPF 2004, IIA standard No. 1110 – Organizational Independence - the chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities.

Internal auditors should consider the following suggestions when evaluating organizational independence.

1. Internal auditors should have the support of senior management and of the board/ board audit committee so that they can gain the cooperation of engagement clients and perform their work free from interference.
2. The CAE should be responsible to an individual in the organization with sufficient authority to promote independence and to ensure broad audit coverage, adequate consideration of engagement communications, and appropriate action on engagement recommendations.
3. Ideally, the CAE should report functionally to the board and administratively to the chief executive officer of the organization.
4. The CAE should have direct communication with the board. Regular communication with the board helps assure independence and provides a means for the board and the CAE to keep each other informed on matters of mutual interest.
5. Direct communication occurs when the CAE regularly attends and participates in meetings of the board, which relate to its oversight responsibilities for auditing, financial reporting, organizational governance, and control. The CAE's attendance and participation at these

meetings provide an opportunity to be appraised of strategic business and operational developments, and to raise high-level risk, systems, procedures, or control type issues at an early stage.

6. Independence is enhanced when the board concurs in the appointment or removal of the CAE.

The internal audit activity should be organized to afford a higher organizational status as its role expands and as more parties inside and outside the organization derive assurance from its work. For example, to provide assurance to the governing body of the organization, such as the board of directors or similar bodies, the CAE should have direct and unrestricted access to that body. This allows the activity to be insulated from possible threats to independence. If the internal audit activity does not have sufficient organizational status and autonomy, the ability to effectively manage the independence of its work and reports is subject to question. For example, the risk that independence will be compromised may be high in situations in which the CAE may be fired by top management without consultation with the organization's governing body. The risk also may be high in situations in which the scope of audit activities or the activity's budget is determined by top management without consultation with the governing body. In these situations, there is a risk that management may inappropriately affect the scope of the audit work, impose bias, or suppress audit findings. When the risk that appropriate and adequate independence will not be achieved is significant, it is difficult to determine how much assurance may be derived from the audit work (IPPF, 2011, p. 4).

Concerning independence of the Internal Audit Department, the researcher will try to give great emphasis on literature review on three issues.

1. Appointment and removal of the CAE;
2. Remuneration of the chief audit executive;
3. Conducting an evaluation on Board and sub-committee performance; and
4. Penalty for non-compliance.

2.2.2.2 Appointment and Removal of the CAE

The standard states that independence is enhanced when the board concurs in the appointment or removal of the CAE. When hiring a CAE, the board and senior management will likely seek

individuals who possess strong management and leadership skills. While strong internal audit knowledge, technical skills and experience at the time of appointment would be an advantage, they are not a requirement if the internal audit staffs collectively have the requisite knowledge, skills and experience to deliver internal audit services in accordance with the Standards. However, it is strongly encouraged that all CAEs, either before appointment or within a reasonable time period after appointment, demonstrate a strong understanding of the roles and responsibilities of internal audit, the IPPF, or audit technical skills through attainment of the Certified Internal Auditor designation. The board may request to meet with the CAE candidates before making a final hiring decision (IPPF, 2010).

- **Appointment**

Before appointment, the CAE candidate may wish to inquire whether the organization has an appropriately constituted board and determine if they have the proper safeguards in place to enable the CAE to carry out the duties of the position. This enables CAEs to fulfill their responsibilities objectively without fear of reprisal and to know that action will be taken by the board if required. Without this safeguard, that CAE could be removed, placed under duress, censored, or have his or her scope and resources reduced inappropriately by senior management (IPPF, 2010).

Apart from the Board approval of the CAE as mentioned above, the National Bank of Ethiopia under Directive No. SBB/62/15 – Bank Corporate Governance Requirement for persons with significance influence in a bank article 2 – clearly indicates that. “Appointment of director, chief executive officer and senior executive officers shall be subject to approval by the National Bank.” In this directive, Article 2 describes the definition of some terms as follows:

“Director” - any member of the board directors of a bank by whatever title he/she may be referred to;

“Chief Executive Officer” – means a person by whatever title that person may be referred to, who is primarily responsible to; for the day to day management of the affaire of the bank;

“Senior Executive Officer” – means a any officer of a bank who,by whatever title he may be referred to, is deputy to the chief executive officer or holds equivalent position to deputy chief executive officer and directly accountable to the board of directors.

- **Removal/Termination**

The termination of the services of the CAE may be voluntary by the CAE or involuntary. Upon termination, the board would likely consider the following issues (IPPF, May 2010).

The CAE Resigns, Retires, or Contract Period Expires

The CAE may resign or retire from the position at any time in accordance with the conditions of the contract (if a contract exists) by providing appropriate notice to the employer. The CAE may wish to resign for a range of reasons, and the employer, through the board, may have in place a process, such as an exit meeting and/or a questionnaire, to identify the reasons for the CAE’s resignation and determine whether there are any issues that require further attention. When a contract exists and the term expires but is not renewed, the board may desire assurance that nonrenewal of the contract is appropriate (IPPF, May 2010).

The CAE is Terminated by the Employer

Generally, the board would oversee the termination of a CAE. Boards will want to determine if termination is justified and appropriate. Identifying sensitive issues or wrongdoing by management are not reasons a board would generally consider for termination of a CAE; whereas, termination that is either voluntary or due to poor performance would be considered acceptable. The board will most likely want to ensure the termination is not voluntary in appearance only, but is genuinely voluntary.

According to Banking in Ethiopia, 2012, the National Bank of Ethiopia has broad powers in the affairs of banks. It can suspend or remove a CEO, director or other senior executives.

2.2.2.3 Remuneration of the Chief Audit Executive

Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board approving the remuneration of the chief audit executive (IPPF, 2016). At least once a year, the

audit committee should review the performance of the CAE and approve the annual compensation and salary adjustment (PPF 2004).

It is true that the internal audit activity should be independent. The chief internal auditors must be independent and objective in performing their work and has freedom from conditions that threaten his ability while carrying out internal audit activity in an unbiased manner.

Remuneration of the head internal audit should be considered in that context, avoiding potentially harmful influences and incentivizing wrong outcomes. The board, where appropriate via an audit and / or remuneration committee, should ultimately determine the structure and size of the head internal auditor's remuneration package alongside tasking and appraisal. This should be the case even where the chief executive officer or chief financial officer has day-to-day responsibility for pay and rations (Chartered Institute of Internal Auditors, 2013).

In considering the level of remuneration for the HIA, boards should have regard to the level at which the head internal audit is required to operate in relation to others in the organization. It should not be set lower than those in equivalent functions, notably in senior executive management. This will be particularly sensitive if the HIA position is staffed from within the organization (Chartered Institute of Internal Auditors, 2018).

2.2.2.4 Conducting an Evaluation on Board and Sub-Committee Performance

Performance evaluation is an important activity which gives a lesson or feedback for board of directors and sub-committee if it is reviewed independently and appropriately. Performance evaluation is a key means by which boards can recognize and correct corporate governance problems and add real value to the organizations. The benefits of performance evaluation to a board are numerous. If conducted properly, board evaluations can contribute significantly to performance improvements on three levels – the organizational, board and individual director level. Boards who commit to a regular evaluation process find benefits across these levels in terms of improved leadership, greater clarity of roles and responsibilities, improved teamwork, greater accountability, better decision making, improved communication and more efficient board operations (Geoffrey and Gavin, 2005).

According to business dictionary definition, the board has the ultimate decision-making authority and, in general, is empowered to (1) set the company's policy, objectives, and overall direction, (2) adopt bylaws, (3) name members of the advisory, executive, finance, and other committees,

(4) hire, monitor, evaluate, and fire the managing director and senior executives, (5) determine and pay the dividend, and (6) issue additional shares, An effective board with appropriate skill mix and competencies can significantly enhance the performance of a bank. Therefore, the performance evaluation is vital to determine the strengths as well as weaknesses of overall board, its committees and individual board members in order to increase their overall effectiveness.

Unless otherwise prescribed by regulations, annual evaluation is the most commonly followed cycle for Board evaluation. Most large corporations make the evaluation cycle consistent with the annual planning cycle adopted by boards; others tie the evaluation to the strategy formulation process. The Boards usually determine the choice of the cycle (IPPF, 2014).

National Bank of Ethiopia under Directive No SBB/62/ 2015, mentioned that assessing semi-annually the effectiveness of the board, its sub-committees, and individual directors in carrying out their responsibilities and reporting the outcomes to the annual ordinary meeting of shareholders and the National Bank.

The board may adopt any of the following approaches for performance evaluation of overall board, committees and individual directors. The evaluation is conducted internally or externally by an independent expert. Internal evaluations have many benefits, but in certain circumstances, engaging an external independent expert or consultant or advisor to facilitate the Board evaluation process may work better. One view favoring independent external evaluation is that the evaluation process becomes more independent and transparent. Internal evaluation tends to become mechanical, while an external evaluator could bring in fresh perspectives and approaches (IPPF, 2014).

In some large international corporations, Board evaluations are usually conducted by the Governance and Nomination Committees with the help of outside experts. However, there are many companies, especially those in Europe and particularly in the UK, who advocate that the exercise should be conducted only by an independent external expert who would be in a better position to make an independent assessment (IPPF, 2014).

Whether the evaluation is conducted internally or externally by an independent expert, the methodology broadly remains the same. Discussions about evaluation of the board and its committees are initiated in the board by the chairperson and the consensus of the board obtained about the need for the evaluation and whether the exercise should be conducted in house or with

the help of an independent external expert. Good evaluations have quantitative and qualitative parts and usually the latter inform the evaluations with rich data, which brings greater objectivity to the evaluation exercise (IPPF, 2014).

2.2.2.5 Penalty for Non-Compliance

The banking business proclamation No. 592/2008 provides for criminal prosecution and penalty for acts which are in contravention to the law. For instance, transacting in a banking business without license, introducing new banking services, merger or takeover, entering into any arrangement or agreement for the sale or disposal, by amalgamation or otherwise, of its business, or effect major changes in its line of business, transfer or otherwise dispose of the whole or any part of its property, whether in or out of Ethiopia without prior approval by the NBE will be punishable with rigorous imprisonment from 10 to 15 years and with a fine of Birr 20,000. Similarly, NBE Directive No. SBB/35/2004 – Article 2 stated about penalty for non-compliance with the Directives: Any bank that fails to comply with the requirements of any of the Directives of the National Bank of Ethiopia, excluding Directive No. SBB/14/96, shall be subject to a penalty of Birr 10,000 (ten Thousand Birr) for each violation.

According to BCBS (2012), Principle 10 – Supervisory reporting: The supervisor collects, reviews and analyses prudential reports and statistical returns from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts. And also Principle 11- corrective and sanctioning powers of supervisors: the supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.

2.2.2.6 Relationship of Internal Audit of Commercial Bank with Board of Director and Banking Supervision

The Institute of Internal Auditor has issued Standard No 2060 on internal audit reporting to the board and senior management, which specifies that “the chief audit executive must report periodically to the board and senior management on the internal audit activity’s purpose, authority, responsibility, and performance relative to its plan. Reporting must also include

significant risk exposures and control issues, including fraud risks, governance issues, and other matters needed or requested by the board and senior management”.

The IIA believes strongly that to achieve necessary independence, the CAE should report functionally to the audit committee or its equivalent. For administrative purposes, in most circumstances, the CAE should report directly to the chief executive officer of the organization.

- **Functional Reporting** - the functional reporting line for the internal audit function is the ultimate source of its independence and authority. As such, The IIA recommends that the CAE report functionally to the audit committee, board of directors, or other appropriate governing authority.

The Institute of Internal Auditors (IIA) recognizes that audit committees and internal auditors have interlocking goals. A strong working relationship with the audit committee is essential for each to fulfill its responsibilities to senior management, board of directors, shareholders, and other outside parties. This Practice Advisory summarizes The IIA’s views concerning the aspects and attributes of an appropriate relationship between an audit committee and the internal audit function. The IIA acknowledges that audit committee responsibilities encompass activities that are beyond the scope of this advisory, and in no way intends it to be a comprehensive description of audit committee responsibilities.

There are three areas of activities that are keys to an effective relationship between the audit committee and the internal audit function, chiefly through the chief audit executive:

- Assisting the audit committee to ensure that the internal audit charter, activities, and processes are appropriate to fulfill its responsibilities.
- Ensuring that the charter, role, and activities of internal audit are clearly understood and responsive to the needs of the audit committee and the board.
- Maintaining open and effective communications with the audit committee and the chairperson.

The CAE should assist the committee in ensuring that the charter, role, and activities of the committee are appropriate for it to achieve its responsibilities. The CAE can play an important role by assisting the committee to periodically review its activities and suggesting enhancements. In this way, the CAE serves as a valued advisor to the committee

on audit committee and regulatory practices. Examples of activities that the CAE can undertake are:

- Review the charter for the audit committee at least annually and advise the committee whether the charter addresses all responsibilities directed to the committee in any terms of reference or mandates from the board of directors.
- Review or maintain a planning agenda for the audit committee's meeting that details all required activities to ascertain whether they are completed and that assists the committee in reporting to the board annually that it has completed all assigned duties.
- Draft the audit committee's meeting agenda for the chairman's review, facilitate the distribution of the material to the audit committee members, and write up the minutes of the audit committee meetings.
- Encourage the audit committee to conduct periodic reviews of its activities and practices compared with current best practices to ensure that its activities are consistent with leading practices.
- Meet periodically with the chairperson to discuss whether the materials and information being furnished to the committee are meeting their needs.
- Inquire from the audit committee if any educational or informational sessions or presentations would be helpful, such as training new committee members on risk and controls.
- Inquire from the committee whether the frequency and time allotted to the committee are sufficient.

➤ **Administrative Reporting** - Administrative reporting is the reporting relationship within the organization's management structure that facilitates the day-to-day operations of the internal audit function. Administrative reporting typically includes:

- Budgeting and management accounting.
- Human resource administration, including personnel evaluations and compensation.
- Internal communications and information flows.
- Administration of the organization's internal policies and procedures.

The supervisory authority will benefit from effective communication about topics of mutual interest with the internal audit function of a bank. When establishing a relationship with the internal audit function of a bank, the supervisory authority should obtain an understanding of the organization and operation of the internal audit function, including its position and remit within the bank. When establishing a relationship with the internal audit function of a bank, the supervisory authority should obtain an understanding of the organization and operation of the internal audit function, including its position and remit within the bank (BCBS, 2012).

Supervisors and internal auditors should each ensure that enhanced communication does not undermine their respective perceived and actual independence and status, as the supervisory authority and the internal audit function each have different roles and responsibilities. Regardless of the supervisor's assessment of the internal audit function, the supervisor should be able to challenge the work of the internal auditors through their continuous supervision process, including through on-site supervision (BCBS, 2012).

The BCBS 2012 initiates principle that described the relationship between the supervisor and the internal audit function.

Principle 16: Supervisors should have regular communication with the bank's internal auditors to (i) discuss the risk areas identified by both parties, (ii) understand the risk mitigation measures taken by the bank, and (iii) monitor the bank's response to weaknesses identified.

Principle 17: Bank supervisors should regularly assess whether the internal audit function has sufficient standing and authority within the bank and operates according to sound principles.

Principle 18: Supervisors should formally report all weaknesses they identify in the internal audit function to the board of directors and require remedial actions.

Principle 19: The supervisory authority should consider the impact of its assessment of the internal audit function on its evaluation of the bank's risk profile and on its own supervisory work.

Principle 20: The supervisory authority should be prepared to take informal or formal supervisory actions requiring the board and senior management to remedy any identified deficiencies related to the internal audit function within a specified timeframe and to provide the supervisor with periodic written progress reports.

Based on the above principles and on site supervision/examination, most often the NBE instructs the commercial banks to implement or perform:

1. Risk Based Internal Audit (RBIA);
2. To widening the auditable units coverage; and
3. To have reporting relationship with branch controller/branch resident auditors

2.2.2.7 Risk Based Internal Audit

Now days, the dynamic environment in banking is in a state of continuous growth and expansion, making its accessibility in all areas of economic growth. “banks have making a shift from prevailing system of full-scale transaction testing to RBIA; i.e. risk identification, prioritization of audit areas and allocation of audit resources in accordance with the risk assessment (Agarwal, 2014). The need to manage risks has become recognized as an essential part of good corporate governance practice. Therefore, the banking supervision, National Bank of Ethiopia has instructed all commercial banks to identify all the business risks they face and to implement RBIA.

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

In most large organizations a suitable risk management framework should be in place, because they are affected by regulations which require the identification, assessment, management and monitoring of risks. Additional work may be required to ensure all significant risks have been identified and to record all risks and score these in order to prioritize them. None of these tasks is the responsibility of the internal audit department, although it could act as champion, and even project manager, for risk management, especially in the early stages of introduction (David, 2015 May 26).

The primary focus of risk-based internal audit will be to provide reasonable assurance to the Board and top management about the adequacy and effectiveness of the risk management and control framework in the Banks operations. While examining the effectiveness of control framework, the risk-based internal audit should report on proper recording and reporting of major exceptions and excesses. Transaction testing would continue to remain an essential aspect

of risk-based internal audit. The extent of transaction testing will have to be determined based on the risk assessment. Illustratively, the bank should undertake 100 percent transaction testing if an area falls in cell "Extremely High Risk" of the risk matrix. The bank may also consider 100 percent transaction testing if an area falls in cell "Very High Risk" and the risks are showing an increasing trend. The Banks may also consider transaction testing with an element of surprise in respect of low risk areas which would be audited at relatively longer intervals (Agarwal, 2014).

According to Agarwal, 2014, the advantages of risk-based approach of the internal audit function in Banks are as follows:

- It appropriately defines the audit universe and identifies the auditable branches within the Bank for which these analyses would be carried out.
- It assists the management in identification of appropriate risk factors to reflect the managements concerns.
- It results in development of an appropriate format for evaluating risk factors so that the more important risk factors play a more prominent role in the risk assessment process than less important risk factors.
- It develops a combination rule for each branch, which will properly reflect its riskiness over several risk factors that have been identified and a method of setting up audit priorities for the branches.
- It results in appropriate audit coverage plan, which provides a roadmap for the management of internal audit staff skills so that they are available to carry out audits of appropriate scope when they are needed the most.
- This RBIA results in a process oriented audit with a risk management perspective, which gives advice to management on the steps to be taken for effective risk management on a bank-wide basis (Agarawal, 2014).

2.2.2.8 To widening the Auditable Units Coverage

The Internal Audit function is not only expected to monitor compliance and transactions but also develop an integrated view of existing and emerging risks and their impact on business. Developments in the macro-economic environment, systemic risks and inter-connectedness in the Financial Services Industry have made it imperative for the Internal Audit function to put a

dynamic audit plan in place. It has also become important that high-risk areas are assessed and reviewed by specialists (Deloitte, 2014)

Currently all commercial banks are aggressively expanded branches in all location of the country. As existing commercial banks are in stiff competition for suitable branch location, the accessibility of various branches in every corner increased. It is also true that the supervisory bank – NBE in its circular instructed all commercial banks to open branches on average 25% growth every year in line with the Second Growth Transformation Period (Submission of Revised strategic for the GTP II, 2015).

In its expanded role, the internal audit function is likely to provide an independent and objective view on both the first (business and operations) and second (risk and compliance) lines of defense. From being a transaction and compliance oriented function, internal audit is expected to become a pre-emptive risk identification and evaluation function. At the same time, Internal Audit is still expected to retain its role as the central point of assurance for transactions and compliance. This dichotomy in role requires the internal audit function to organize itself at two distinct levels. At one level, the internal audit function is expected to evaluate emerging risk areas and perform thematic and targeted reviews with a view to assess not just the efficacy of controls but probability of the risks materializing in the given organizational construct. At the second level, the Internal Audit function is expected to continuously improve the efficacy of transactional and compliance audits to provide the requisite level of assurance to regulators and external stakeholders (Deloitte, 2014)

There is a need for widening as well as redirecting the scope of internal audit to evaluate the adequacy and effectiveness of risk management procedures and internal control systems in the banks. Under risk-based internal audit, the focus will shift from the present system of full-scale transaction testing to risk identification, prioritization of audit areas and allocation of audit resources in accordance with the risk assessment. Banks will, therefore, need to develop a well defined policy, duly approved by the Board, for undertaking risk-based internal audit. The policy should include the risk assessment methodology for identifying the risk areas based on which the audit plan would be formulated. The policy should also lay down the maximum time period beyond which even the low risk business activities/locations should not remain unaudited. (Reserve Bank of India, 2014)

Considering 100% on the auditable area under risk based internal audit policy will cost the internal audit department too much and could not be effective. Thus, the internal audit department is more focused and engaged on risk identification, prioritization of auditable areas and efficient allocation of resources based on risk assessment.

2.2.2.9 To have Rreporting Relationship with Internal Checker/ Branch Resident Auditors/ Branch Controller

The Internal control and internal audit are related, but separate concepts. Internal control involves the systems, policies, and procedures that institutions design to control risks, safeguard assets, and achieve objectives. Internal audits help board of directors and officers evaluate the adequacy of internal control systems by providing independent assessments of internal controls, bank activities, and information systems.

According to BCBS (2001, pp.7), some banks have established separate departments for controlling or monitoring a specific activity or entity of the bank. Such departments are part of the internal control system and therefore their existence does not relieve the internal audit department from examining those specific activities or entities. However, for the sake of efficiency, the internal audit department may, in carrying out its tasks, use the information reported by the various control departments. Nonetheless, the internal audit department remains responsible for the examination and evaluation of the adequate functioning of the internal control of the bank's activity or relevant entity.

The board of directors and senior management are responsible for ensuring internal control systems operate effectively. Internal audits provide a systematic way for institutions to assess the effectiveness of risk-management and internal-control processes. When properly structured and conducted, internal audits provide vital information about risks and controls so management can promptly address any identified weaknesses. Internal checker/ branch resident auditor/ branch controller are synonymous and many commercial banks designate the name differently but their activities are one and the same.

In internal checkers operation of Ethiopia, particularly banks, it is observed that there are a number of persons designated as "internal checkers" who are mostly involved in pre audit function, and or checking of property, cash transfer, and inventory issuance and receipts. The position and qualifications of the above persons vary from organization to organization.

However, internal checkers are slowly changing to internal audit function position (Johannes and Engida, 2009, P.82,).

The practices in most private commercial banks in Ethiopia have auditors at the center/ H.O. and branches. Internal checker/branch resident auditor or branch controller is a kind of internal audit function where auditor responsibility is to review and correct assign bank branch internal control system. Internal checker/branch resident auditor or branch controller is permanently placed in branch like any other branch employees and the bank also allots a separate personal computer to them for their work. This person at a branch level perform audit of branch books, identify branch employee mistakes, ask them to rectify even if they are not directly liable to do so and with all this maintain good relation with bank employees. We must note that this is very routine job until and unless highly interested in banking sector.

2.2.3 Challenges of Internal Audit Function while Pursuing International Standard and Principles

2.2.3.1 Challenge of Internal Audit Function while Pursuing International Standard

According to Mckonly& Asbury (2011), the International Professional Practices Framework and Underlying International Standards for the Professional Practice of Internal Auditing (Standards) provide guidance to the internal audit activity. The standards are applicable to all internal audit departments regardless of size, level of resources, complexity, or objectives and scope. Small audit activities face some unique challenges when implementing the standards.

Standards with a High Degree of Challenge for Small Audit Activities

The practice guide notes highlight the following standards for which small internal audit activities face a high level of challenge when implementing:

- 1100 – Independence and Objectivity
- 1300 – Quality Assurance/Improvement Program
- 2000 – Managing the Internal Audit Activity
- 2200 – Engagement Planning
- 2300 – Performing the Engagement

These challenges are most likely to affect small internal audit activities, but they may affect internal audit activities of any size. This paper will review each of these standards, identify challenges to meeting the standard, and provide guidance to mitigate these challenges.

1100 – Independence and Objectivity

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

Challenge: Auditors may have operational responsibilities such as records management, compliance, IT security, risk management, or other finance and accounting activities. The CAE may report to an individual who has direct responsibility for areas that are subject to audits.

Guidance: Internal audit should explain to the board the difficulties involved with auditing areas where operational responsibilities or chain of command cause independence issues. They should recommend alternatives for audits such as, using external resources, and verifying only auditors that are not involved with the operational activity complete and review the audit. The CAE should discuss any challenges relating to the reporting structure or operational duties with the board and/or senior management when establishing the audit plan. If internal audit issues a report where there is a lack of independence and objectivity, the audit report must disclose this condition along with the related impacts.

1300 – Quality Assurance/Improvement Program

Standard: The CAE must develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity.

Challenge: Lack of financial resources may limit the ability to perform an external or internal quality assessment (QA) in accordance with the Standards. The performance of an internal QA may be challenging due to time and staff constraints.

Guidance: Small organizations may use peer organization reviews or self-assessment with external validation to satisfy the external QA requirement. These approaches will have a lower monetary cost but will require a larger amount of internal audit staff

hours. Organizations may consider utilizing employees outside of the internal audit activity for internal assessments if they have prior audit experience or QA training.

2000 – Managing the Internal Audit Activity

Standard: The CAE must effectively manage the internal audit activity to ensure it adds value to the organization.

Challenge: It may be difficult for the CAE of a small internal audit activity to demonstrate that the activity adds value to the organization if the priorities of the department differ from management's priorities. If the internal audit activity is overworked or has frequent management requests to perform ad hoc engagements, they may not have the resources to fulfill the internal audit charter requirements.

Guidance: The CAE should verify the internal audit charter clearly sets forth the mission of the department, senior management endorses the charter, and the board approves it. In addition, the CAE should obtain feedback to verify the internal audit activity continues to perform value-added audits and the audit plan remains aligned with the strategic objectives and key risks facing the organization.

2200 – Engagement Planning

Standard: Internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing, and resource allocations.

Challenge: Completing a risk assessment is a key component of planning an audit. Internal auditors may not have the skill level or available time to complete a risk assessment. In addition, they may not formally document their engagement planning.

Guidance: The CAE should develop planning checklists for common engagement types. Key components of the planning process include defining engagement objectives, scope, and audience. Internal audit should leverage any available risk documentation relevant to the audit including management's own risk self-assessments, management's risk tolerances or appetites, and findings from prior internal and external audit reports. The higher the associated risk of an engagement, the greater the level of formal documentation required.

2300 – Performing the Engagement

Standard: Internal auditors must identify, analyze, evaluate, and document sufficient information to achieve the engagement’s objectives. In addition, the CAE must assure proper supervision of engagements to achieve objectives, audit quality, and staff development.

Challenge: The CAE may not be able to supervise all engagements and they may perform some engagements. It may be a challenge for audit activities using manual work papers to maintain appropriate evidence of engagement supervision.

Guidance: CAEs are encouraged to have a more involved role in high-risk or complex engagements. If the CAE or another staff member performs a lower risk engagement, an experienced audit staff can review the engagement. If the CAE performs a complex engagement, they should have a peer review performed by someone else in the organization with the suitable audit background and adequate independence. Engagement supervisors should sign off on engagement work papers to document evidence of review. (<https://www.macpas.com/category/riskmanagementcontrol/>)

2.2.3.2 Challenge of Internal Audit Function while Pursuing BCBS Principles

According to BCBS (2011), the Internal Audit function in Banks, the principles are applicable to all internal audit departments. The key features described below are essential for the effective operation of an internal audit function. However, the internal audit activities face some unique challenges when implementing the principles.

- **Independence and Objectivity**

Principle 2: The bank’s internal audit function must be independent of the audited activities. This requires that the internal audit function has an appropriate standing within the bank, enabling internal auditors to carry out their assignments with objectivity.

Challenge - The internal audit function should not be involved in designing, selecting, implementing or operating specific internal control measures. However, the independence of the internal audit function should not prevent senior management from requesting input from internal audit on matters related to risk and internal controls. Nevertheless, the

development and implementation of internal controls should remain the responsibility of management.

The independence and objectivity of the internal audit function may be undermined if the staff's remuneration is linked to the financial performance of the business line for which they exercise internal audit responsibilities or to the financial performance of the bank as a whole.

Principle 3: Professional competence, including the knowledge and experience of each internal auditor and of internal auditors collectively, is essential to the effectiveness of the bank's internal audit function.

Challenge - Internal auditors must apply the care and skills expected of a reasonably prudent and competent professional. Due professional care does not imply infallibility; however, internal auditors having limited competence and experience in a particular area should be supervised by more experienced internal auditors.

- **Professional Ethics**

Principle 4: Internal auditors should act with integrity.

Challenge - Internal auditors should respect the confidentiality of information acquired in the course of their duties. They should not use that information for personal gain or malicious action and should be diligent in the protection of information acquired.

- **The Internal Audit Charter**

Principle 5: Each bank should have an internal audit charter that articulates the purpose, standing and authority of the internal audit function within the bank.

Challenge - The charter should empower the internal audit function, whenever relevant to the performance of its assignments, to initiate direct communication with any member of staff, to examine any activity or entity, and to access any records, files, data and physical properties of the bank. This includes management information and the minutes of all consultative and decision-making bodies.

- **Responsibilities of the Board of Directors and Senior Management**

Principle 9: The bank's board of directors has the ultimate responsibility for ensuring that senior management establishes and maintains an adequate, effective and efficient internal control framework and internal audit function.

Challenge - Senior management should inform the internal audit function of new developments, initiatives, projects, products and operational changes and ensure that all associated risks, known and anticipated, are identified and communicated at an early stage.

Senior management should be accountable for ensuring that timely and appropriate actions are taken on all internal audit findings and recommendations.

Senior management should ensure that the head of internal audit has available the necessary resources, financial and otherwise, to carry out his or her duties commensurate with the approved annual audit plan.

- **Responsibilities of the Audit Committee in Relation to the Internal Audit Function**

Principle 10: The audit committee, or its equivalent, should oversee the bank's internal audit function.

Challenge- The audit committee reviews and approves the audit plan and, if any, the audit cycle. It also reviews key audit reports and ensures that senior management is taking necessary and timely corrective actions to address control weaknesses, compliance issues with policies, laws and regulations and other concerns identified and reported by the internal audit function.

- **Reporting Lines of the Internal Audit Function**

Principle 12: The internal audit function should report to the audit committee or the board of directors and should inform senior management about its findings.

Challenge - Senior management is responsible for implementing and maintaining an adequate and effective internal control framework. Therefore the internal audit function should inform senior management of all significant findings so that corrective actions can be taken. Subsequently, the internal audit function should follow up on the outcome of these corrective measures. The head of the internal audit function should report to the

board, or its audit committee, the status of findings that have not (yet) been rectified by senior management.

Internal Audit within a Group or Holding Company Structure

Principle 14: The internal audit function in a group structure or holding company structure should be established centrally by the parent bank.

Challenge - In a group structure, the board of directors and senior management of the parent company have the overall responsibility for ensuring that an adequate and effective internal audit function is established across the group and for ensuring that internal audit policies and mechanisms are appropriate to the structure, business activities and risks of all of the components of the group.

2.3. Empirical Review

The previous section discussed about the practice and challenges of Internal Auditing Function of Commercial Banks of Ethiopia operate in light of international accepted auditing standards and principles. This section presents reviews of the empirical studies of the various researchers on the internal audit practices and challenge of commercial banks in line with the international standards and principles. The researchers are detected an opportunities or deficiencies in their studies and provide recommendations that required improvements. Among the researchers, the following have studied practices and challenges of internal audit locally and globally.

- **Abrham**, (2011), This research paper intended to examine the role of IAF in corporate governance effectiveness in 13 purposely sampled head offices of commercial banks. To undertake this research, the specific methods employed were survey, semi-structured interview and document sources. Questionnaires were distributed to 105 internal auditors of 12 banks out of 13 purposely sampled commercial banks for the reason that one bank had not accepted the researcher's letter to conduct this study.

The result of the study indicate that the attributes of IAF (policy of banks for hiring and training, experience, and professional certification of internal auditors) and rates of implementation to audit recommendation by the management were low in which, the quality of IAF is low and has not positive impact on corporate governance effectiveness. Furthermore, use of internal audits working paper by external auditors in

conducting their duties was low, in which the quality of IAF and its role in corporate governance effectiveness will be questionable, in view of the fact that IAF is effective when IAF quality has positive impact on quality of corporate governance (Sarens, 2009). Thus, when an IAF quality is questionable its positive impact on corporate governance also questionable and it will be less effective.

The recommendation of the study is to enhance the proficiency so as to foster the quality of IAF and in turn to have positive impact on the corporate governance effectiveness, for the reason that audit quality significantly influences audit effectiveness and when IA is effective, it has positive impact on the quality of corporate governance. Moreover, management's commitment to taking timely corrective action to IA recommendation and hiring of well qualified employees is a proxy for the quality of IAF.

- **Tewodros** (2016) this study is intended to assess and describe the challenges that internal audit department at Dashen Bank faces and how these challenges could be addressed. This study employed a descriptive research design. The study used purposive sampling in identification of 98 respondents as target population which encompasses 94 from internal auditors and 4 from executives of control department residing in Addis Ababa. Structured questionnaire was used to gather data from the respondents of internal auditors while interview has been made with executives.

The study revealed that lack of: management and staff support, shortage of organizational independence, inadequate competency of internal audit staffs and lack of updated audit procedural manuals, lack of BOD attention for internal audit department, feeling of auditee as a fault finder, dispute and misunderstanding auditors face from auditees, inadequacy of time to operate exhaustively, supervisors` rare in person follow up of resident auditors, insufficient auditors knowledge on contemporary banking systems, lack of qualified staff and scarcity of facilities.

The study recommends free access for certification, compilation of updated audit manuals, conducive working environment, awareness creation program to auditees, proactive than reactive audit engagement, revision of existing structure and extensive training program to get decisive value adding output out of internal auditing practices.

- **Juma, Veronica and Irene (2017)**, this study was twofold: 1) to explore the perceived Internal Audit (IA) roles and challenges faced by internal auditors in fulfilling their mandate among listed firms in Uganda and 2) to examine the extent to which internal auditor challenges could inhibit the performance of internal auditor roles. This is an exploratory study with mixed methods design. They collected data from internal auditors of 13 listed firms in Uganda through both the questionnaire and interview guide. Data were analyzed using SPSS and XL STAT 2016 with partial least square modeling because of the small sample used in this study.

The result of the study revealed that the researchers found eight (8) most perceived internal auditor roles in Uganda such as: internal Audit in this entity reports on the system for generating financial information; internal audit in this entity reports on the reliability of financial statements; internal audit in this entity conducts periodic reviews to confirm whether or not management is complying with all applicable legislations and regulations; internal audit in this entity reviews management arrangements for ensuring that objectives of the entity are being achieved; internal audit in this entity evaluates the means of safeguarding company assets; internal audit in this firm verifies the existence of company assets; internal audit in this entity evaluates the operating effectiveness of the governance structures and processes; and internal audit supports the audit committee in performing its duties in this firm. They also found five (5) most perceived internal auditor challenges such as: internal audit recommendations are not worked upon by management; Internal audit is restricted to access of information in this entity; Internal audit cannot compel any officer of the organization to provide information; Internal auditors are not motivated to perform their duties in this organization; and Internal audit staff are not supported by this firm to further their professional careers.

- **ChepKorir (2010)**, this study was to establish the roles of internal auditing and the challenges faced by internal auditors in carrying out these roles. The research design employed in this study was descriptive in nature. The target population in the study was the 43 licensed commercial banks in Kenya. Primary data was collected using a semi-structured questionnaire. The study used the quantitative method of data analysis, that is, mean and mode. To ensure easy analysis, and minimize the margin of errors, questionnaire was coded according to each variable.

The study concluded that the general roles of internal auditing is to provide guarantee that internal controls are efficient, examining and assessing the banks policies, procedures, manuals and recommending best practices and risk evaluation and management. The study further concludes that the challenges faced by internal auditors on their daily operations were those of realigning skills to address new requirements and implementing the new international professional practices framework (IPPF).

The study recommends that the banks should hire auditors from other fields to introduce new techniques in the bank accounts auditing in order to overcome the challenges encountered by the internal auditors in their operations. The study also recommends that there should be continuous training and development of audit staff, in order to enhance their competence and also there should be acquisition of an audit system in all the banks.

- According to Samuel (2008) ‘Internal Audit: Reporting Relationship in Ethiopian Public Enterprises’, he noted that internal audit is facing many challenges, some of the challenges identified by the Ministry of Finance and Development, in internal audit manual are:
 - ✓ Lack of expertise leading to trivial auditing findings;
 - ✓ Lack of opportunity for professional development;
 - ✓ Repetitive audit routines which staffed members can predict, being assigned to tasked such as accounting and pre-control of expenditures with the internal auditor subsequently have to audit (conflict of interest);
 - ✓ Inability to insist on getting significant information because fears of losing promotion opportunities and job security (lack of independence),
 - ✓ Wrong perception of the audit function and auditors by the staff of the public body.

The above-mentioned problems can be classified into two categories with some overlapping. First, the competency of internal auditor that leads to trivial audit finding, lack of professional development, repetitive audit work, and non-value added internal audit report.

Second, structural problem (reporting relationship) in the form of assigned task that impair the auditor independency, and fear of losing promotion, job security , and wrong perception about internal auditors as faultfinders and their task as policing rather than auditing.

Above all, vague reporting relationship brings: -

- ✓ Poorly motivated and frustrated internal audit staff because of limited scope of audit
 - ✓ Lack of independence
 - ✓ Weak organizational governance
 - ✓ Internal auditor can also suffer from low status that leads to inefficient and ineffective internal audit work.
- Agumas - (2015) identified a number of challenges facing the internal audit function in Ethiopia's public sector and these are;
 - ✓ Lack of independence,
 - ✓ Unclear formal mandate,
 - ✓ Restricted access to some areas of government operations,
 - ✓ Insufficient funding,
 - ✓ Incompetent leadership and
 - ✓ Lack of management support.
 - Bame – Aldred et al., (2013) - internal auditors are faced by environmental related challenges such as:
 - ✓ Management support and other factors like budget allocations,
 - ✓ Employment arrangements; and
 - ✓ Audit committee strength which before external auditors relies on their work must evaluate.
 - Similarly, an exploratory study conducted on listed firms in Egypt by Ebaid (2011) reveals that,
 - ✓ The IAF has low levels of organizational independence;
 - ✓ Management support; and
 - ✓ Qualified internal audit staff.

Given the above challenges, the researchers are further motivated to confirm whether these challenges exist in Uganda and if there are any further challenges faced by the internal audit function 6 years later after Ebaid's study of listed firms in Egypt.

The five (5) most perceived internal auditor challenges out of twenty (20) originally identified in Uganda were:

- ✓ Internal audit recommendations are not worked upon by management;
 - ✓ Internal audit cannot compel any officer of the in this entity;
 - ✓ Internal audit is restricted to access of information organization to provide information;
 - ✓ Internal auditors are not motivated to perform their duties in this organization; and
 - ✓ Internal audit staffs are not supported by this firm to further their professional careers.
- Bota (2009) identifies the development of skills as a very important challenge facing internal auditors in today's environment and this can partly be handled by emphasizing continuous professional development programmes that may be costly for the firm.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

Research methodology is a way to systematically solve the research problem. This study assessed the practices and challenges of internal audit in privately owned commercial banks of Ethiopia in light of international standards and principles. In this chapter topics to be covered are research design, population and sampling design, data collection method, interview, interview guide and ethical consideration.

3.2 Research Design

A research design is “the general plan of how the researcher will go about answering the research question (the importance of clearly defining the research question cannot be over-emphasized). It will contain clear objectives, derived from the research question(s), specify the sources from which the researcher intends to collect data, and consider the constraints that will inevitably have (e.g. access to data, time, location and money) as well as discussing ethical issues” (Mark, Philip and Adrain, 2009 p.136).

This study explores the most common methods of data collection used in qualitative research; i.e. interview guide. To address the researcher’s objective, this study examine how the practices and challenges of internal auditing function of private owned commercial banks in Ethiopia operate in light of international accepted auditing standards and principles on 16 privately owned commercial banks. The researcher prepared interview guide related with study objectives that enable to collect data from 8 purposely selected respondents. Before an interview took place, respondents were informed in advance the purpose of the study; given assurance about confidentiality of the information; and arranged suitable time for interview. Finally, the data collected were analyzed to answer the research questions.

3.3 Population and Sampling Design

The population of the study consists of all head of the internal audit department of privately owned commercial banks in Ethiopia. Since there are 16 privately owned commercial banks and all have an internal audit department, the researcher used non- probabilistic sampling – purposive

sampling. According to Saunders et. al 2009 p. 268, Purposive or judgmental sampling enables the researcher to use his judgment to select cases that will best enable the researcher to answer his research question(s) and to meet the objectives. This form of sample is often used when working with very small samples such as in case study research and when the researcher wishes to select cases that are particularly informative.

The population was first divided into two sub-groups who all share a similar characteristic. Accordingly, all 16 privately owned banks are already divided into two groups. Per NBE quarterly CAMEL (Capital adequacy, Asset quality, Management quality, Earning ability and Liquidity) rating evaluation report; private commercial banks are classified as medium and small size. Though there is no written information about the classification, some informal information revealed that the classification earlier was made based on year of establishment and capital of the commercial banks; as the big size (only the Commercial Bank of Ethiopia); the medium size (Awash, Dashen, Absyniya, Wogagen, Nib, and United Banks) and the small size peer banks (Co-operative Bank of Oromiya, Oromiya International, Lion International, Birhan International, Abay Bank, Buna International, Zemen Bank, Addis International, Enat Bank and Debub Global Bank). The researcher selected sample of 50% from each group of privately owned commercial banks and a total of 8 head internal audit departments as representative of the population.

Therefore, the reason why the researcher takes this purposive sampling is because the population is small in numbers, known characteristics and requires intensive study; they are expertise in the area on which information is sought; they have direct functional relationship with audit committee and also have reporting relationship with banking supervision; besides they have better auditing knowledge and information on the discuss matter than other internal audit staff.

3.4 Data Collection Method

This research paper intended to examine the practice and challenges of internal audit of 16 purposely sampled privately owned commercial banks of Ethiopia and how they operate in light of international standards and principles. The study used qualitative research methodology as a primary data collection. To undertake this research, interview data collection method was designed in order to explore feedback from respondents about what their experiences with internal audit function in the banks in terms of internal audit independence and Risk Based Internal Audit methodology.

The approach to record data was audio recording and note taken during interview was on progress. Immediately after the interview has taken place, the researcher compiled the full record and contextual data in order to prevent loss of explanation and mix up of data from different interviews.

3.5 Interview

An interview is one way of data collection method which involves asking open ended question to talk about with interviewees. Interview can help the researcher to gather valid and reliable data that are relevant to the research question(s) and objectives. In the interview data collection method, there are three types of research interview: these are structured, semi-structured and unstructured.

According to (Mark, Philip and Adrain, 2009 pp.320-321), the types of interview research are defined as follows.

Structured interviews use questionnaires based on a predetermined and ‘standardized’ or identical set of questions and the researcher refers to them as interviewer-administered questionnaires. The researcher read out each question and then records the response on a standardized schedule, usually with pre-coded answers.

Semi-structured interviews the researcher will have a list of themes and questions to be covered, although these may vary from interview to interview. This means that the researcher may omit some questions in particular interviews, given a specific organizational context that is encountered in relation to the research topic. The order of questions may also be varied depending on the flow of the conversation. On the other hand, additional questions may be required to explore the research questions and objectives given the nature of events within particular organizations.

Unstructured interviews are informal. The researcher would use these to explore in depth a general area in which he is interested. There is no predetermined list of questions to work through in this situation, although he needs to have a clear idea about the aspect or aspects that he wants to explore.

Therefore, the researcher used semi-structured interview type with purposely selected head internal audit department of the commercial banks to have sufficient information. “In semi-

structured interviews the researcher used a list of theme and questions to be covered, although these may vary from interview to interview. The main purpose of this interview were to substantiate certain facts that the researcher already thinks; to ask more clarification on subject matter; to induce more and through response; and to bring up new issue. Therefore, the semi-structured interviews were conducted to enhance and supplement the results of questionnaires.

Concerning interview method, semi structured or in-depth interviews can be very helpful to ‘find out what is happening or practiced in internal audit function and to probe challenges encountered while performing internal audit activities. In the collection of this primary data face to face interview was conducted with selected head internal auditors. Considering the available time of Head internal audit department, the researcher fixed an appointment with the respondents due to their busy schedule. First permission was requested to use audio recorder which is later to write down the interview into written form. Then a face to face interview was conducted for a period not more than one hour. The interview questions mainly focus on practices and challenges of internal audit independence and Risk based Internal Audit.

3.6 Interview guide

The researcher used interview guide as a main instrument to collect data. Information for the study can be collected by physically meet with the respondents and asking the questions face to face. The interviews are employed in this study primarily to gain an in-depth understanding of the subject matter under study. To develop interview guide, a set of themes that reflect the subject under study or specific questions related to the research topic were derived from theories that the researcher considered in literature review part and the researcher’s experiences in auditing activities. The researcher used this interview guide consisting element of semi-structured interviews for all respondents selected for the study.

Lists of topics and themes that researcher intended to cover in IA practices and challenges in light of international standard and principles were presented here below. Under each theme, respondents were requested their practices by raising the following statements:

3.6.1 Internal Audit Independence and Objectivity

3.6.1.1 Appointment or Removal/Termination of the Head of Internal Auditors

The BoD/Board Audit Committee concurs the appointment of Head Internal Audit; apart from the BoD approval of the head of internal audit, NBE approves final appointment;

the BoD/audit committee concurs the removal/termination of the head internal audit; and removal/termination of head internal audit presented to NBE for final decision like appointment.

3.6.1.2 Remuneration and Benefits of Internal Auditors

BoD/board audit committee approves remuneration of the head internal audit; BoD/board audit committee approves annual salary increment and bonus payment to the head internal audit; board of director approves remuneration of the vice-presidents; the remuneration of internal audit is set in the context of promoting independence and objectivity of internal audit function; and head internal audit remuneration sets lower than those in equivalent functions, notably in senior executive management.

3.6.1.3 Evaluation on BoD and Sub-Committees Performance

Internal Audit Department conducts an evaluation on board and sub-committees performances; NBE instructed each bank to evaluate the board and sub-committees performances; do you have some limitation to evaluate the BoD/ audit-committee performance? and is it acceptable and free of biased if internal audits to objectively analyze and evaluate the performance of the Board/ Board sub-committees.

3.6.1.4 Penalty for Non-Compliance with NBE Directive

Internal audit department sends a copy of the audit report to the supervisory authority/NBE; the supervisory authority/ NBE conducts an onsite examination/ assessment on the bank performances; the supervisory authority/NBE make sanction/penalty for those who violate the directive while conducting onsite examination/assessment; and the board/audit committee or senior management considered the sanction/penalty due to internal audit reporting to NBE.

3.6.2 Risk Based Internal Audit

3.6.2.1 Implementation of Risk Based Internal Audit

NBE instructed each bank to implement Risk Based Internal Auditing; In order to have uniformity among all Commercial Banks, the NBE issued a guidance/framework to implement Risk Based Internal Audit; and do you have Risk Based Internal Audit Charter/Policy and Guide line which is approved by BoD/audit committee.

3.6.2.2 Widen/Increase Auditable Unit Coverage

NBE instructs each bank to widen/increase annual auditable unit coverage; from audit resources perspective, Risk Based Internal Auditing methodology and increasing auditable unit coverage go together; and BoD/audit committee approves Risk Based Internal Audit plan.

3.6.2.3 Internal Checker/Branch Controller or Branch Resident Auditor

Internal checker/branch controller or branch resident auditor be under the domain of internal audit department; internal checker/branch controller or branch resident auditor function mainly involved on routine operational checking activities; and internal checker/branch controller or branch resident auditor reports are included in the internal audit department report and submitted to the board/audit committee.

3.7 Ethical Considerations

The respondents were thanked in advance for their willingness to participate in the interview meeting to provide valuable response. The respondents were also informed about the nature of the output to which the research was intended and their names were not mentioned in the research report. The researcher promised to respondents that confidentiality and anonymity of the recorded data and other information. In addition, confidentiality and privacy was respected and all the information in this study will solely be used for academic purpose only. In general, the researcher will not personalize any of the response of the respondents during data presentation, analysis, and interpretation.

CHAPTER FOUR

DATA ANALYSIS, INTERPRETATION AND DISCUSSION

4.1 Introduction

This chapter presents analysis, interpretation and discussion of data collected through face to face interviews with semi-structured interview questions with 8 head of internal audit respondents. The chapter deals with two sections: first section contains a summarized description of the demographic information of the respondents and the second section shows the contents analyses and discussion of interview questions.

The data are collected and then analyzed in response to the problems posed in the first chapter of this study. The findings are based on the responses of sample head of internal audit departments with the help of face to face interview. The results and analysis of the data gathered are presented below.

4.2 Demographic Information of the Respondents

It is necessary to analyze the demographic information of the respondents to validate reliability of data collected. Accordingly, the respondents were asked to respond to their gender category, educational level and work experience.

4.2.1. Gender

Table 4.1: Gender

Gender	Frequency	Percent
Male	6	75.00
Female	2	25.00
Total	8	100.00

Source; Research Findings and Own Computation

Table 4.1 shows the gender proportion of male respondents is 75.00%, while the female respondents is 25.00%. This high ratio of males reflect the cultural influences that exists in developing countries including Ethiopia that females are not capable of holding and running higher positions in organizations.

4.2.2. Educational Level

Table 4.2: Highest Level of Education

Qualification	Frequency	Percent
Bachelor's Degree	3	37.50
Master's Degree	5	62.50
Total	8	100.00

Source; Research Findings and Own Computation

Table 4.2 shows majority of the respondents' (62.50%) as Masters Degree holders while 37.50 % having Bachelor Degree. This shows that the respondents are having the required educational level to assume the position in the commercial banks.

4.2.3 Field of Study

Table 4.3: Field of Study - Major

Qualification	Frequency	Percent
BA- Accounting	1	12.50
BA- Management + ACCA	1	12.50
MBA	3	37.50
MBA-Executive	1	12.50
MA- Accounting and Finance	2	25.00
Total	8	100.00

Source;Research Findings and Own Computation

According to the above table, the respondents' field of study shows various professions. For BA level respondents have accounting and ACCA which is very helpful for internal auditing profession and those having Masters' with different disciplines helps to visualize conceptually and discuss with top management.

Table 4.3 shows that 25% of the respondents have their BA degree with accounting background while 75.00% of the respondents have masters' degree in different disciplines. This show the respondents in the study area have the required educational background for internal auditing professions.

4.2.4 Work Experience in Managerial/Supervisory Position

Table 4.4: Work Experience in Managerial/Supervisory Position

Age Range	Frequency	Percent
5-10	4	50.00
11-15	2	25.00
16-20	1	12.50
Above 21 years	1	12.50
Total	8	100.00

Source; Research Findings and Own Computation

Table 4.4 shows that the work experience of the respondent's was 50% (between 5 and 10 years); 25.00 % (between 11 and 15 years); 12.50% (between 16 and 20 years) and 12.50% (21 years and above). As it is shown in the table above; the majority of respondents have ample work experience in the managerial/supervisory position for more than 5 years.

In general, from the view point of respondents' educational level, field of study, background and work experience, it can be concluded that all of the respondents have attained the required quality of competency.

4.3 Interview Analysis and discussion

The researcher conducted interview with 8 purposely selected head internal audit department to study the practice and challenges of internal audit in commercial banks in light of International Standards and Principles. The interview was mainly focused on practices and challenges of internal audit in respect of independence and risk based internal audit. The researcher asked eight basic questions with the aim to seek in-depth information and allowing the interviewee to talk freely face to face. The researcher used mobile phone as a recorder and later transcribed the interviews into writing.

The interview questions and responses are presented as follows.

4.3.1. Who is Responsible for Appointment and Removal of Head Internal Audit?

All respondents replied that the board is the responsible organ for appointment of head internal audit. After the board selects the competent candidates, it sends to NBE for final approval by completing the design formats. Concerning removal of head internal audit, all respondents replied

that the board is the right organ to remove the head of internal audit though they had no earlier experiences and some respondents mentioned that their audit charter clearly indicates about audit head removal is done by the board. With regard to NBE role in the removal process, all respondents agreed with NBE's involvement because it is very essential like the approval process in order to maintain the balances. Among eight respondents one said that in practice; as the board and the management have close relationship, the board may be biased and accepts the idea of the management with regard to removal of the head internal audit. In this regard, the involvement of the NBE is critical to have balanced decision incase affinity may occurred between management and BoD.

IPPF (2010, p 5) also described about the CAE termination by employer, "Generally, the board would oversee the termination of a CAE. Boards will want to determine if termination is justified and appropriate. Identifying sensitive issues or wrongdoing by management are not reasons a board would generally consider for termination of a CAE; whereas, termination that is either voluntary or due to poor performance would be considered acceptable. The board will most likely want to ensure the termination is not voluntary in appearance only, but is genuinely voluntary."

According to Banking in Ethiopia, 2012, the National Bank of Ethiopia has broad powers in the affairs of banks. It can suspend or remove a CEO, director or other senior executives.

4.3.2. Who will set and Approve Remuneration of the Head Internal Audit?

All respondents responded that salary of head internal audit is set with the banks' salary scale. Out of 8 respondents; 6 respondents salary scale is one step higher than other department directors but lower than the vice presidents who have equal status per NBE directive. Concerning benefits, all respondents answered that the banks give mobile allowance with limited air time. But two respondents out of eight answered that the mobile allowance is given without apparatus. This allowance is similar with other department directors. Similarly, all respondents answered that fuel with vehicle is provided to head internal auditors with limited litters of fuel which is the same as other department directors.

Furthermore, the researcher has raised question related to annual salary increment and bonus payment where six respondents had similar answers that bonus as well as salary increment approved to all employees including VPs by Board collectively. But two respondents replied that

the board approved exceptionally for VPs. Without any reservation, all respondents confirmed that the president bonus and salary increment was decided exceptionally by board. In addition, the researcher raised question about VP remuneration where all respondents agreed that remuneration for VP is higher than the head of internal audit which has equivalent status in line with NBE directive. As per NBE Directive No. SBB/54/2012, “senior executive officer” means any officer of a bank who, by whatever title he may be referred to, is deputy to the chief executive officer or holds equivalent position to deputy chief executive officer and directly accountable to the BoD.

It is true that the internal audit activity should be independent. The chief internal auditors must be independent and objective in performing their work and has freedom from conditions that threaten his ability while carrying out internal audit activity in an unbiased manner.

Organizational independence is effectively achieved when the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board approving the remuneration of the chief audit executive (IPPF, 2016). At least once a year, the audit committee should review the performance of the CAE and approve the annual compensation and salary adjustment (PPF 2004).

From researcher informal information, in the state owned Commercial Bank of Ethiopia the Chief Internal Auditor has equivalent status with that of the VPs where as in Development Bank of Ethiopia the Head of Internal Audit position is lower than the VPs and other departments. According to Chartered Institute of Internal Auditors, 2018, in considering the level of remuneration for the HIA, boards should have regard to the level at which the head internal audit is required to operate in relation to others in the organization. It should not be set lower than those in equivalent functions, notably in senior executive management. This will be particularly sensitive if the HIA position is staffed from within the organization. Besides, independence and objectivity are key requirements for internal auditors. Boards should manage the internal audit function in ways that preserve and enhance internal audit's independence and objectivity. Remuneration of the HIA should be considered in that context, avoiding potentially harmful influences and incentivizing wrong outcomes.

4.3.3. Does Internal Audit Department make an Evaluation on Board and Sub-Committee Performance?

All respondents replied that NBE has instructed them to conduct an evaluation on board and sub-committee performances. Following the NBE instruction, 50% of the respondents performed the evaluation for the sake of respecting the instruction where as the remaining have not yet started so far. All respondents agreed that making an evaluation do not give confidence and comfort since board members sometimes violates NBE directives and their terms of references. Hence, those who made evaluation have not seen any reaction/conflict from board side but the respondents afraid that making performance evaluation of board and sub-committee may deter their subsequent relationship.

Performance evaluation is an important activity which gives a lesson or feedback for board of directors and sub-committee if it is reviewed independently and appropriately. Performance evaluation is a key means by which boards can recognize and correct corporate governance problems and add real value to the organizations. The benefits of performance evaluation to a board are numerous, (Geoffrey and Gavin, 2005).

The board may adopt any of the following approaches for performance evaluation of overall board, committees and individual directors. The evaluation is conducted internally or externally by an independent expert. Internal evaluations have many benefits, but in certain circumstances, engaging an external independent expert or consultant or advisor to facilitate the Board evaluation process may work better. One view favoring independent external evaluation is that the evaluation process becomes more independent and transparent. Internal evaluation tends to become mechanical, while an external evaluator could bring in fresh perspectives and approaches (IPPF, 2014).

4.3.4. Does the Supervisory Bank make Penalty Charges for Non- Compliance of Directives?

All respondents said that copy of the audit reports sent to NBE and NBE imposed penalty charges on the banks for non-compliance of directives. As a result, some bank's boards and management were not happy for penalty charges made by NBE because they assumed that the causes for penalty were internal audit report and this may result in disagreement with internal audit.

4.3.5. Do You Employ Risk Based Internal Audit Methodology in your Bank?

Now days, the dynamic environment in banking is in a state of continuous growth and expansion, making its accessibility in all areas of economic growth. “Banks have making a shift from prevailing system of full-scale transaction testing to RBIA; i.e. risk identification, prioritization of audit areas and allocation of audit resources in accordance with the risk assessment (Agarwal, 2014). The need to manage risks has become recognized as an essential part of good corporate governance practice. Therefore, the banking supervision, National Bank of Ethiopia has instructed all commercial banks to identify all the business risks they face and to implement RBIA.

Concerning implementation of RBIA methodology, all respondents replied that they have their own RBIA audit charter and guideline. All responded that they got the RBIA resources of material to develop the charter and guideline from the internet. Three of the respondents out of eight mentioned that the NBE was not satisfied in their RBIA methodology. Almost all respondents claimed that the NBE has not issued RBIA framework or guideline to all Commercial banks in order to have a clear direction and uniformity among all banks.

Majority of the banks responded that NBE has instructed to implement RBIA and almost all have prepared their own RBIA policy/charter which is approved by BoD/Auditee Committee. Since each bank has its own RBIA charter and guideline, it followed their own audit methodology. As a result of this all banks confirmed in their response that they did not have uniformity among commercial banks in RBIA implementation. In interview responses almost all banks claimed that Although NBE has started preparing RBIA framework/guideline before two years, however, it has not yet completed and distributed to all commercial banks. As a result of not issuing RBIA framework or guideline to all Commercial banks, there is no clear direction and uniformity among all banks.

4.3.6. Does the Supervisory Bank/NBE Instruct You to Widen-up the Auditable Unit Coverage?

Regarding audit coverage, all respondents answered that NBE has not been satisfied and requested the internal audit to widen up the audit coverage. They responded that 100% audit coverage is difficult from audit resources perspective. Though some respondents mentioned that the bank have

aggressively expanded branch outlets and established head office organs but the NBE demanded to address all branches and organs instead of prioritizing and selecting based on their risk exposures. They also explained that NBE has requested to widen audit coverage in some audit topics such as strategic plan accomplishment, management performance, and loan review, foreclosure & disposal.

Currently all commercial banks are aggressively expanded branches in all location of the country. As existing commercial banks are in stiff competition for suitable branch location, the accessibility of various branches in every corner increased. It is also true that the supervisory bank – NBE in its circular instructed all commercial banks to open branches on average 25% growth every year in line with the Second Growth Transformation Period (Submission of Revised strategic for the GTP II, 2015).

Considering 100% on the auditable area under risk based internal audit policy will cost the internal audit department too much and could not be effective. Thus, the internal audit department is more focused and engaged on risk identification, prioritization of auditable areas and efficient allocation of resources based on risk assessment.

4.3.7. To whom Internal Checker/ Branch Resident Auditors/ Branch Controller should Report to?

Out of eight respondents of the banks, seven banks have assigned resident auditor in the branch but one does not have resident auditors at branch level. Five of the respondents replied that resident auditors at branches are functionally reporting to district or branches. But two respondents answered that auditors at branches are functionally reporting to internal audit department. On the other hand, out of the eight respondent banks; two banks have incorporated the audit report of resident auditors in their periodic internal audit reports. In addition to this, seven respondents answered that the resident auditors are focusing on routine activities or checking of transactions. But this activity is not similar with the risk based internal audit activities being conducted by internal audit departments. It can be said that issues related to residents' auditors are being performed by some banks per the NBE instruction while some others are not implementing.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

This chapter presents the summary of the findings from the analysis and discussion part based on result of the interview guide administered to the respondents, the conclusions and the appropriate recommendations needed to improve the practice and challenge of internal auditing function of private owned commercial banks of Ethiopia in light of international accepted auditing standards and principles. This chapter also discusses about the theories and practices discussed in chapter two and reflect the belief and view of the researcher for the gaps observed in the internal audit department, senior management, BoD/audit committee and NBE to discharge their responsibilities and manage the commercial banks' internal audit activity effectively.

5.1 Summary of Findings

IA Practices and Challenges in light of International Standard and Principles

5.1.1 Internal Audit Independence

5.1.1.1. Appointment or removal/termination of the Head of Internal Auditor

From the interview guide responses, the researcher understood that almost all banks BoD/Audit committees have the responsibility of appointment of head internal auditor and then follow final approval by NBE. With regard to removal/termination, the BoD/audit committees have the mandate to remove but the NBE had no role in such removal process. When we see the interview result, all banks responded that NBE's involvement in the process of termination of HIA is not seen like approval process.

5.1.1.2. Remuneration and benefits of Head Internal Auditor

The result of interview indicated that the remuneration and benefits of head internal auditors lacks uniformity. In some banks remuneration of the head internal auditors are similar with that of the head of other departments. But for the head of other department, NBE approval for recruitment is not mandatory requirement. Likewise, the head of internal audit department remuneration is lower than that of equivalent status i.e. the vice presidents, since the criteria for recruitment of both positions are identical.

5.1.1.3. Evaluation on BoD and Sub-committees performance

Majority of respondents acknowledged that instruction to evaluate BoD and Sub-committee performances were received from NBE. However, some banks do evaluation and others do not. Those who did forcefully were not feeling free and comfortable to evaluate BoD/Sub-committee in line with their terms of reference and NBE directive. Therefore, evaluation of BoD and sub-committee performance is not being conducted by some banks which are deviation from the international practice.

5.1.1.4. Penalty for Non-compliance with NBE Directive

The purpose of imposing penalties is primarily to respect the regulations and prevent employees from committing violations. All banks responded that NBE has conducted on site examination on commercial banks whether banks comply with the directive or not. It is true that all banks sent copy of their report to NBE and all commercial banks conducted assurance that the NBE directives are complied with or not and mention in their audit report. On the other hand, NBE also carried out assessment or on site examination on commercial banks and imposed penalty for non-compliance. From the interview question result, some banks' head internal auditor responded that the source for non-compliance of directives seem by the board and management internal audit report and this may affect internal audit relationship with management and BoD/audit committee.

5.1.2 Risk Based Internal Audit

5.1.2.1. Implementation of RBIA in all Commercial Banks

Currently, banks are increasingly exposed to various kinds of risks both financial and non-financial. Efficiency of every bank depends on how effectively it is managing the risks. Implementing the instruction of NBE for instance RBIA were accepted by all banks but the current practices lacks uniformity among commercial banks. These differences among commercial banks were the result of not issuing RBIA guideline/framework by NBE.

5.1.2.2. Widen/Increase Auditable Unit Coverage

Majority of the respondents replied that NBE has instructed to widen up the audit coverage up to 100%. However, this instruction contradict each other with the statement of widen up audit coverage in auditable areas and employing RBIA methodology. Because RBIA methodology is

more focused and engaged on risk identification, prioritization of auditable areas and efficient allocation of resources based on risk assessment.

5.1.2.3. Internal Checker/Branch Controller or Branch Resident Auditor

All banks responded that branch resident auditor functions are mainly involved on routine operational checking activities of the internal control which is different from risk based auditing. But the NBE while undertaking on site examination, they instruct the commercial banks that resident auditor reporting relationship to be under the domain of internal audit department. This instruction did not have equal awareness by all commercial banks where some banks respect the NBE's instruction and others do not.

5.2 Conclusion

This study has assessed the practice and challenges of internal auditing function in light of international accepted auditing practice, standards and principles on 16 selected privately owned Ethiopian commercial banks. The study also addressed the existing practice of internal audit function of privately owned commercial banks in relation to international standards and principles and also viewed the challenges of Internal Audit of privately owned commercial banks in line with the international standards or principles mainly on internal audit independence and objectivity and implementation of risk based internal audit. The researcher employed face to face interview for 8 purposely selected head of internal audit departments as a primary data.

From the summary of the research findings, all head internal audit department found to be competent enough in terms of educational level, field of study and work experiences in managerial/supervisory position; all banks of internal audit department have exercised the practice of internal audit except internal audit practice and challenges in light of international standards and principles, all banks internal audit department independence and objectivity were respected while performing their duties. However, majority of internal audit departments have faced challenges such as: absence of NBE involvement in the removal process of the head internal audit department; lower remuneration of head of internal audit department compared to others having equivalent status in line with NBE directive; failure to conduct an evaluation on board and sub-committee performance by some banks; and the misconception of senior management and board of

director/audit committee with respect to penalty imposed by NBE for the non-compliance as the result of internal audit report.

On the other hand, implementing the instruction of NBE like RBIA were accepted by all banks but the current practices lacks uniformity among commercial banks. These differences among commercial banks were the result of not issuing RBIA guideline/framework by NBE. Besides, requesting to widening the audit coverage by NBE and enforcing placement of branch resident auditors under the domain of internal audit department were the two challenges confusing the commercial banks and lacks uniformity among the banks. All respondents have confirmed that branch residence auditors are mainly engaged in routine checking activities of the internal control which is different from risk based auditing. Thus, the NBE instruction of widening audit coverage and the reporting relationship of branch resident auditors to be under the domain of the internal audit department contradicts with the principle and concept of RBIA.

The researcher tried to view the practices and challenges of prior researchers' studies and some findings cited in the prior studies are recurring to all internal audit activities. However, to the knowledge of the researcher, these findings are fresh and have never been addressed or discussed in the prior studies.

5.3 Recommendation

The internal audit department helps senior management, BoD/audit committee and NBE to discharge their responsibilities and manage internal audit function of the private owned commercial banks effectively. Based on the conclusion, the following recommendations are proposed for the consideration of internal audit department, senior management, BoD/audit committee and NBE.

1. The appointment and removal of the head of the internal audit function is relevant to the supervisory assessment of the bank. Therefore, NBE has to be notified by senior management or Board/audit Committee in the removal process of the head internal auditor and further the NBE must hold a meeting with the head of internal audit to discuss the reasons for his or her departure.
2. The remuneration to reward the performance of the head of internal audit or internal audit staff members should be structured to avoid creating conflicts of interest and

compromising independence and objectivity. Therefore, the BoD/Audit committee has to decide the remuneration of the head of internal auditor to the position which has equivalent status per NBE directive.

3. Internal audit need to be comfortable and feel free while conducting auditing activities. NBE has to re-consider the instruction of board and sub-committee performance evaluation and to review its appropriateness from international practices perspective.
4. The management as well as the board has to stop attaching the source of penalty with internal audit reports and decide to recover the penalty charge from the responsible persons who commits the violation.
5. NBE has to complete and provide all commercial banks with RBIA framework/guideline in order to have uniformity across the commercial banks and persistently ensure its consistency from bank to bank.
6. The NBE has to consider widening of the audit coverage from RBIA point of view i.e. risk identification, prioritization of audit areas and allocation of audit resources in accordance with the risk assessment instead of auditable unit coverage number and areas.
7. Since branch resident auditors are mainly engaged in routine checking activities of the internal control which is different from risk based auditing, the NBE has to re-consider the instruction that the branch resident auditor to be placed under the domain of internal audit department.

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Annex I: Interview Guide

Dear Sir/Madam

You have been selected to respond to this interview guide with respect to the study of “The practice and challenges of internal audit of privately owned commercial Banks in light of the international standards and principles’.

Thank you very much for your cooperation to take time to respond to this Interview Guide. The research is being conducted by a prospective graduate student of Addis Ababa University MBA program. The intent of this questionnaire is to explore the practice and challenge of Internal Audit function of privately owned commercial banks of Ethiopia in light international accepted auditing standards and principles.

You are assured that any information you provide is solely meant for the research and nothing else. Your response to the questions will be kept confidential to mean that the conclusions of the study will be drawn in aggregate terms, without any reference to specific financial institution or individual respondents. We would also like to assure you that the information you provide will be treated as strictly confidential. The questions are mainly focused on internal audit independence and Risk Based Internal Audit implementation.

Thank you for your participation

Kind regards,

SheworkieBeleteWoldeyes

MBA student

Addis Ababa University

Section I

This section requires your personal information and observation regarding Internal audit function in the bank. Please tick (✓) mark on one of the following boxes. Thank you very much for your cooperation to answer every item

Personal Information:

1. Gender:

- Male
- Female

2. Highest level of education:

- Certificate
- Diploma
- Bachelor Degree
- Masters Degree
- Doctoral Degree
- Other (please specify).....

3. Field of study - major

4. Work experience in a managerial/supervisory position:

- 5 -10 years
- 11-15 years
- 16-20 years
- Above 20 years

Section II - Interview Guide

1. Who is responsible for appointment and removal of Head Internal Audit?

2. Who will set and approve Remuneration (base salary, salary increment, bonus and benefits) of the Head Internal Audit

3. Does Internal Audit Department make an evaluation on Board and Sub-committee performance?

4. Does the supervisory bank make penalty charges for non- compliance of directives?

5. To whom should internal audit department functionally and administratively report to?

6. Do you employ Risk Based Internal Audit methodology in your bank?

7. Does the supervisory bank instruct you to widen-up the auditable unit coverage?

8. To whom Internal Checker/ Branch Resident Auditors/ Branch Controller should report to?
