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ADDIS ABABA UNIVERSITY

SCHOOL OF BUSINESS AND PUBLIC ADMINISTRATION

DEPARTMENT OF ACCOUNTING AND FINANCE

(GRADUATE PROGRAM)

Internal Audit Function and Corporate Governance: in Commercial Banks

By:

Abraham Gebregiorgis

June 2011

Addis Ababa

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DEPARTMENT OF ACCOUNTING AND FINANCE
(GRADUATE PROGRAM)

Internal Audit Function and Corporate Governance: in Commercial Banks

A Thesis Submitted to the School of Graduate Studies of Addis Ababa University in Partial Fulfillment of the Requirements for the Degree of Master of Science in Accounting and Finance

By:

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Advisor:

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Abstract

This research paper examined the role of IAF in corporate governance effectiveness in the case of 13 purposely sampled commercial banks by adopting concurrent mixed research approach. Quantitative methods were used through survey of internal auditors, and interviews and documentary sources taken under the qualitative methods. From the total of 105 questionnaires were distributed to internal auditors, 78 had collected and 8 interviews were conducted with vice-presidents of 8 banks.

The main findings of the study were that the rates of implementation to audit recommendation by management, attributes of IAF (or the policy for hiring and training, experience and professional certification of internal auditors), and use of IAF working papers by external auditors in the banks were low. Thus, an IAF of the banks don't possess quality and its positive impact on corporate governance effectiveness is questionable, though IA practices were maintaining independence and it is value-added activity. Management of the banks need to take corrective action to audit recommendations and have to afford adequate attention to the proficiency of internal auditors to better equip an IAF quality and its role in corporate governance effectiveness. This finding indicated that extensive research should be taken in the quality of IAF and its role in corporate governance mechanisms and their interrelationships.

Key words: Internal audit; internal audit function; quality internal audit function; corporate governance; commercial banks

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Acronyms

AC	Audit Committee
BoD	Board of Directors
BPR	Business Process Reengineering
CG	Corporate Governance
EA	External Auditor
ECIIA	European Confederation of Institutes of Internal Auditing
EU	European Union
IA	Internal Audit
IAF	Internal Audit Function
IC	Internal Control
ICS	Internal Control System
IIA	Institute of Internal Auditors
ISPPIA	International Standards for the Professional Practice of Internal Auditing
NBE	National Bank of Ethiopia
OECD	Organization for Economic Cooperation and Development
RA	Risk Assessment
SPPIA	Standards for Professional Practice of Internal Auditors

Chapter One: Introduction

1.1. Background of the Study

The business environment has experienced rapid and revolutionary change with for reaching consequence for organizations worldwide. Management responses to fierce global competitive have included improved quality and risk management initiatives, reengineered structures and process, and generate accountability, all needing more timely, reliable and relevant information for decision making. Organizations are also scrambling to put in place more effective governance structures and processes. In such a climate it is no surprise that an Internal Audit Function (IAF) is viewed as the most qualified group of professionals to help with such experimentations with improved governance as well as support key governance processes: for monitoring the controls over, and for evaluating the operational effectiveness of these management strategies and initiatives (Hermanson & Rittenberg, 2003; Ramamoorti, 2003). Moreover, an IAF has become a major support function for management, audit committee, the board of directors, the external auditors, and other key stakeholders. When properly designed and implemented, an IAF can play a key role in promoting and supporting effective organizational governance (Ruud, 2003). [1]

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[1] Internal audit can contribute to effective governance in several ways. First, it can assist in the identification of risk factors, the analysis of the consequences, as well as in assisting management in the prioritization of risk management and control systems. Internal audit can add assurance that the risk management processes in fact are functioning as intended. Through consulting services, the internal audit function can furthermore assist management and the board by improving risk management and control processes.

Rossiter (2007) noted that effective IAFs help financial services companies to accomplish key business objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of governance, risk management and control processes.

According to Barac and Staden (2009), there is no correlation exist between the defined soundness of the corporate governance structure and the perceived Internal Audit (IA) quality of participating companies in South African context which contradicts with the theoretical and existing literature that an IAF is a critical corporate governance mechanism which plays an important role in organizational risks and assessing controls (Anderson, 2003; Anderson & Dahle, 2009; Hermanson & Rittenberg, 2003; Mihret, *et al.*, 2010; Paape, *et al.*, 2003; Ramamoorti, 2003; Rossiter, 2007; Ruud, 2003; Sarens, 2009; Sarens & De Beelde, 2006). Further, the role of IAF in corporate governance effectiveness is unexplored area in Ethiopian context.

This study attempted to examine the role of IAF in corporate governance effectiveness in the case of Ethiopian Commercial Banks through adopting concurrent mixed method research approach to convergence across qualitative and quantitative methods (triangulating data sources). Employing this approach used to neutralize or cancel the biases (limitations) of applying any of a single approach and a means to offset the weaknesses inherent within method with the strengths of the other method (Creswell, 2003; pp. 15 & 217).

The study found that IA practices of commercial banks are maintained independence and objectivity, and value-added activity that contribute to the effectiveness of governance process.

The main findings of this study were that attributes of IAF (or experience as internal auditors, policy for hiring and training, and professional certification)

and rate of implementation to audit recommendation by management were low. Furthermore, use of internal audit working papers by external auditors in conducting their duties was low. Hence, IAF has not positive impact on corporate governance effectiveness for the reason of that an IAF doesn't possess quality.

The researcher recommended that management of the banks needs to afford enough attention to IAF recommendations to equip the role for corporate governance effectiveness. Further, it has to give consideration to the policy of internal auditing regarding to hiring and training, and experience and professional certification of internal auditors to possess quality IAF.

This study opens future research possibilities. The quality of IAF requires future attention and researchers can also focus on IAF role in corporate governance effectiveness in other sectors.

1.2. Statement of the Problem

According to Hermanson and Rittenberg (2003), an effective IAF is an important "frontline player" in two fundamental governance activities; monitoring of risks and providing assurance regarding controls. Moreover, IAF plays a key role in compliance work and may also spend considerable time on consulting or operational-oriented work, with the objective of enhancing the organization's effectiveness and efficiency; and all these elements map directly in to organizational governance.

Barac and Staden (2009) had conduct a research on the correlation between perceived IA quality and defined corporate governance soundness compliance with ten disclosures of the king II report of South Africa. The main finding of the research was that no correlation found between the defined soundness of the corporate governance structure and the perceived IA quality of participating

companies which contradicts to the theoretical perspective and existing literature that an IAF is a critical corporate governance mechanism which plays an important role in organizational risks and assessing controls (Anderson, 2003; Anderson & Dahle, 2009; Hermanson & Rittenberg, 2003; Paape, *et al.*, 2003; Ramamoorti, 2003; Rossiter, 2007; Sarens, 2009; Sarens & De Beelde, 2006).

This study consists of international researches, because the role of IAF for corporate governance effectiveness represents an unexplored area in Ethiopia. Exceptions that closed to this study are the research of Mihret and Yismaw (2007), Mihret and Woldeyohannis (2008), Mihret (2010) and Mihret, *et al.* (2010), in which IA effectiveness, Value-added role of IA in the Ethiopian public sector case study, factors associated with attributes of IA departments, and antecedents and organizational performance implications of IA effectiveness respectively were explored.

The researchers concluded respectively that IA services is limited to regular activities, and recommended that extending the scope of services by widening the range of systems and activities audited with appropriate risk analysis would improve audit effectiveness. Furthermore, in their value-added role of IA research, Mihret and Woldeyohannis (2008) concluded that goals and strategies pursued and the level of risk faced by organizations to which IA provides service, appear to shape the attributes of a value adding internal audit department; and they recommended that better strategic planning by the internal audit department may enhance internal audits ability to build up a value adding profile by helping identity strategic issues and find solutions to any hurdles that are considered to exist on the way to achieving a value-added profile.

Mihret (2010) in his research on factors associated with attributes of IA department concluded that in organization that are exposed to high risk

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management tends to appreciate internal auditors assistance in managing risk and thus strengthens IA. Moreover, Mihret, *et al.* (2010) revealed that IA effectiveness is influenced by the dynamics prevailing in an IA setting.

In addition, Belay (2007) suggested that well performing IAF is one of the strongest means to monitor and promote good governance systems in an organization.

Despite the recent four related exceptional research articles which had conduct by the above researchers and one conference paper by Belay (2008), an IAF as a critical corporate governance mechanism is totally unexplored in Ethiopian context.

1.3. The Purpose Statement

The intent of this research is to examine the role of IAF in corporate governance effectiveness through adopting concurrent mixed research approach to better understand a research problem by converging both quantitative (broad numeric trends) and qualitative (detailed views) data.

In the study, survey (quantitative instruments) was used to examine the role of IAF in having effective corporate governance. At the same time, an IAF explained its role in sound corporate governance using semi-structured interview with president (or vice-president) of the purposely sampled commercial banks. Furthermore, documents were analyzed to strengthen the findings of the research.

1.4. Research Questions

This research paper attempted to explore the role of IAF in corporate governance effectiveness in the case of 13 purposely sampled Ethiopian commercial banks. The researcher addressed the following questions via undertaking this study;

Q1. What are the services that an IAF provides?

Q2. What is the role of IAF in the fundamental governance activities; risk management and internal control systems?

Q3. What role that an IAF plays in corporate governance effectiveness?

1.5. Scope and Limitation of the Study

Initially this study confined itself to surveying, interviewing and documentary analysis of the purposely sampled banks; and it excluded other financial institutions to explore the intent of the study.

All statistical procedures have limitations; so also do research strategies, such as survey or grounded theory studies (Creswell, 2003; pp. 148). Moreover, the purposive sampling procedure decreases the generalizability of findings and this study might not be generalizable to all areas of financial institutions (or banks). Moreover, For the reason that, the researcher was unable to access most banks IA report on account of confidentiality issues, the researcher assessed only some banks documentary sources which might affect the findings of the research.

1.6. Contribution of the Study

This research contributes to IAF literature by providing empirical evidence that increase the body of knowledge in understanding the role of IAF in corporate governance effectiveness. Moreover, the role of IAF is being widely debated (Hermanson & Rittenberg, 2003) and this study might fill the gap by examining the practices of internal audit services in the case of commercial banks in Ethiopian context.

In addition, this study might be use to the financial institutions particularly banks to understand the services which provides and its overall roles of IAF in corporate governance effectiveness. Individual internal auditors of an IAF could compare their own contributions to the quality of their IAF to the study. The other members of corporate governance (or board of directors, audit committee and external auditors) could use these findings in to account in their interactions to better equip IAFs for their role in corporate governance effectiveness.

1.7. Organization of the Paper

This research report divided into five chapters. Chapter one is the introduction part which contains background of the study, statement of the problem, the purpose of statement, research questions, scope and limitation, contribution of the study, and organization of the research paper.

Chapter two presents a discussion on the IAF's role in corporate governance effectiveness which included corporate governance mechanisms, IAF quality and IAF in financial institutions based on the most recent academic literatures. Chapter three outlines the methodology followed in this study. This chapter embraces the research strategies used and their justification, specific research methods, and analysis section. Chapter four reports the results and a discussion thereon. In the final chapter findings and conclusions are summarized, recommendations are forwarded and suggestions for further research are given.

Chapter Two: Literature Review

2.1. Introduction

Corporate governance is extended to consideration of all business risks – operational, financial and compliance – which may prevent an organization from achieving its objectives. In other words, internal control must now include risk management. To meet this responsibility, organizations require adapting and combining the expertise of existing internal audit with that of risk management functions and relate the resulting effort to the business and operational needs of the organization (Crawford & Stein, 2003).

The overarching rational of this study is that a quality IAF plays a critical role in corporate governance effectiveness which conforms to the concept that IAF has play an active role in effective governance and controls (Anderson & Dahle, 2009; Hermanson & Rittenberg, 2003). The literature review therefore focused on the two components of the rational: an effective corporate governance and quality IAF. Moreover, the researcher has discussed the contribution of IAF in each corporate governance mechanisms in discharging their responsibilities.

2.2. Effective Corporate Governance

In this part of the literature, effective corporate governance and implication of IAF in general and existing literatures and other available sources regarding the title in Ethiopian context are discussed.

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate

governance also provides the structure thorough which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence (OECD, 2004; see also Jesover & Kirkpatrick, 2005[2]). Therefore, it is self evident that having quality corporate governance is crucial to the well-being of an individual organization and stockholders, particularly its shareholders and creditors. Sound corporate governance is an essential element of a strong risk management process. Practicing good corporate governance involves many players; each with specific assigned responsibilities to ensure that the systems as a whole is capable of supporting the business strategy and maintaining the effectiveness of internal control (Hyatt, 2003).

According to ISPPIA (2010)[3], the internal audit activity must assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

- Promoting appropriate ethics and values within the organization;
- Ensuring effective organizational performance management and accountability;
- Communicating risk and control information to appropriate areas of the organization; and

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[2] Good corporate governance – the rules and practices that govern the relationship between the managers and shareholders of corporations, as well as stakeholders like employees and creditors – contributes to growth and financial stability by underpinning market confidence, financial market integrity and economic efficiency.

[3] The internal audit activity must evaluate and contribute to the improvement of governance, risk management, and control processes using a systematic and disciplined approach.

- Coordinating the activities of and communicating information among the board, external and internal auditors, and management.

Regarding Ethiopia, the commercial code (1960) defined nothing in relation to corporate governance and the national bank of Ethiopia under the banking business proclamation 592 (2008) stated that the national bank may issue directives on the duties, responsibilities and good corporate governance of the board of directors. Likewise, along with National Bank of Ethiopia (NBE) (2011) directives, sound corporate governance is vital for the health of individual banks and the banking sector as a whole to strength internal control and risk management systems of banks to prevent them from exposure to undue reputational, operational, legal and concentration risks that may result from abuse of money launderers and terrorist financiers.

However, corporate governance is not just a single strand in the managerial duties of the board of directors rather in quite contrary the notion of the overall legal, institutional and regulatory framework in which the interests of stakeholders surrounding companies are coordinated and protected (Gebremeskel, 2010). Moreover, Gebremeskel (2010) noted, corporate governance is generally shaped by not only company law, but also other areas of laws and customs such as auditing and accounting practices. Negash (2008) also summarized that the overall corporate governance standard in Ethiopia is insufficient and ineffective. The researcher refers the OECD countries corporate governance standards since the OECD Principles have become the international benchmark for corporate governance, forming the basis for a number of reform initiatives, both by governments and the private sector (Jesover and Kirkpatrick, 2005).

Yee, *et al.* (2003) in their study on the perceptions of the Singaporean manager class regarding the role and effectiveness of internal audit in Singapore noted that one of the key roles of an internal auditor is the identification and evaluation of adequacy and effectiveness of the organization's internal control system. Besides, in her empirical study on internal auditors Role and Authority in Malaysia, Umor (2009) point out, a key part of sound corporate governance is a strong internal control culture and IA plays an important role in evaluating the effectiveness of control systems, and contributes to an ongoing effectiveness of the organization. Moreover, Good governance principles require that audit committees or similar oversight bodies, work closely with internal auditors in fraud risk evaluation and investigations (Asare, 2009). Therefore, IAF plays a unique role in the governance process (Hermanson & Rittenberg, 2003; KPMG, 2003; Zain, *et al.*, 2006).

In the next following sections of the chapter, corporate governance mechanisms are discussed and the roles of IAF in discharging their responsibilities, where appropriate are presented.

2.3. Corporate Governance Mechanisms

Under this section, the four corporate governance mechanisms, as investigative of effective corporate governance mechanisms; i.e., board of directors (or management), audit committee, external auditors and IAF are discussed. The IAFs role in corporate governance effectiveness, where appropriate are emphasized.

2.3.1. Board of Directors

According to OECD principles of corporate governance (2004), one of the responsibilities of board of directors is ensuring the integrity of the corporation's accounting and financial reporting systems, including the independent audit,

and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards (see also Basel Committee on Banking Supervision, 2010). In order to fulfill their responsibilities, board members should have access to accurate, relevant and timely information. Further, it is an important function of the board to oversee the internal control systems covering financial reporting and the use of corporate assets and to guard against abusive related party transactions. These functions are assigned to the internal auditor which should maintain direct access to the board. Where other corporate officers are responsible such as the general counsel, it is important that they maintain similar reporting responsibilities as the internal auditor (OECD, 2004). Another responsibility of the board is recognizing and acknowledges independent, competent and qualified internal and external auditors, as well as other internal control functions (including the compliance functions), are vital to the corporate governance process in order to achieve a number of important objectives (Basel Committee on Banking Supervision, 2010).

Directors and senior management have greater accountability for governance, risk management and control and they are relying on IA to assist in carrying out their responsibilities (Basel Committee on Banking Supervision, 2010; ECIIA, 2005; KPMG, 2003; Rossiter, 2007). Moreover, as ECIIA (2005), IAF provides advices, coaching and facilitation services to the board of directors,[4] and IAF support management by providing assurance and consulting services on the

[4] Good governance requires that the board is responsible for applying high ethical standards; for guiding strategy and risk policy; for monitoring corporate performance; and for ensuring that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control. Executive management is responsible for implementing these systems. A professional internal audit activity will support both the board and executive management in carrying out these responsibilities.

effectiveness of risk management and internal control process, two important aspects of corporate governance (Sarens, 2009).

While an organization's policies for effective corporate governance can be delegated to appropriate levels of subordinate management, the responsibility for carrying them out remains at the top, i.e., with the board of management. This board must seek the right advice and find the right solutions for its organization's Particular circumstances and ensure that policy is implemented and the expected results are achieved. Part of that advice may come from the board's own audit committee (AC), which, in turn, could be advised by its internal auditors (Paape, *et al.*, 2003). In her study of Role and Authority: an empirical study on internal auditors in Malaysia, Umor (2009) revealed that management often benefits from IA as a benchmarking source for the effectiveness and efficiency of their risk assessment and internal control practices. Yee, *et al.* (2007) also point out that internal audit may provide ways to develop and implement improvements to the existing processes; and management can use the findings to ensure conformity with established standards, contract and regulatory requirements and to achieve management goals and objectives.[5] Hence, the presence of the IA department ensures that the organization is continually reviewed and improved for higher effectiveness and efficiency.

Fadzil, *et al.* (2005) noted that senior management (represented by executive directors on the board of directors) normally expects that the IAF perform sufficient audit work and gather other information so as to form a judgement about the adequacy and effectiveness of the control processes. If an IAF is not

[5] Internal audit exercise has been beneficial to add assurance and protection for the employees and management. It may also provide ways to develop and implement improvements to the existing processes.

available, the management needs to apply other monitoring processes in order to assure itself and the board that the system of control is functioning as intended. Furthermore, Yee, *et al.* (2008) in their study of perceptions of Singaporean internal audit customers regarding the role and effectiveness of internal audit suggested that both Singaporean senior and junior managers appreciate internal auditors that serve in the business partner role.

2.3.2. Audit Committee

The audit committee is empowered to function on behalf of the board of directors by assuming an important oversight role in the corporate governance intended to protect investors and ensure corporate accountability. In addition, the audit committee has oversight responsibility over corporate governance, the financial reporting process, internal control structure, IAFs, and external audit activities (Hermanson & Rittenberg, 2003; Rezaee, *et al.*, 2003). Rezaee, *et al.* (2003) point out that the more effective approach is the audit committee work diligently with management and auditors to identify the most complex business activities; assess their relative risks, determine their accounting treatments and obtain complete understanding of their impacts on fair presentation of financial performance and conditions. The audit committee should obtain independent advice on these business activities and related transactions, associated risks and proper accounting treatments. Moreover, as Okeahalam and Akinboade (2003), Audit Committee plays a vital role in financial and operational controls in the whole system of corporate governance by making recommendations to the board concerning the appointment and remuneration of external auditors, reviewing auditors' evaluation of the system of internal control and accounting, and considering and making recommendations on the conduct of any aspect of the business of the company which should be brought to the notice of the board.

By offering expanded assurance and consulting services to the organization, i.e. in particular to the audit committee of the board of directors, IAF effectively contributes to improve risk management, control and organizational governance (Hermanson & Rittenberg, 2003; Ramamoorti, 2003; Sarens & De Beelde, 2006). Internal auditors play an intermediary role and assist in the discharge of the oversight function of audit committee (Fadzil, *et al.*, 2005; KPMG, 2003; Yee, *et al.*, 2007; Zain & Subramaniam, 2007) and it is difficult for audit committees to be effective without the support of IAF (Goodwin & Kent, 2006).

Goodwin and Yeo (2001) examined the two factors affecting IA independence and objectivity from Singapore evidence and found that there exists strong relationship between the audit committee and IAF; and the findings of Goodwin (2003), support this relationship between audit committee and internal auditor.

2.3.3. External Auditors

An annual audit should be conducted by an independent, competent and qualified, auditor in order to provide an external and objective assurance to the board and shareholders that the financial statements fairly represent the financial position and performance of the company in all material respects (OECD, 2004).

Haron, *et al.* (2004) noted on the study in the reliance of external auditors on internal auditors that external auditors can rely on the work of internal auditors in many respects in carrying out their external audit duties as both auditors are concerned that proper controls are in place. Internal auditors can assist external auditors to understand the internal control system that has been set up before any compliance or substantive work is being carried out.[6] Moreover, Zain, *et al.*

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[6] External auditors often rely on other professional evaluations in examining clients' financial statements (examples include those of attorneys, actuaries, computer specialists, property valuers and so on). Much of the work of internal

(2006) suggested that external auditors are potentially able to utilize assistance from internal auditors via two approaches. The first is to have the internal auditors work as assistants under their direct supervision; the second approach is to rely on relevant work completed by the IAF on its own. Such assistance, in turn, is likely to save external auditors' time and effort in their audit engagement.

Mihret, *et al.* (2010) point out in the literature review theory type research on the antecedents and organizational performance implications of IA effectiveness that IA may gain some feedback and improve its effectiveness when internal and external audit linkages are strong. Based on survey of 25 companies' management perception on the role and effectiveness of IA in Singapore, Yee, *et al.* (2007) revealed that external auditors are likely to examine the tests of the system of accounting controls conducted by the IA and they test a sample of items checked by internal auditors.

On their study of reliance of external auditors on IA work a corporate governance perspective Mihret and Admassu (2011) suggested that organizations can enhance corporate governance effectiveness by strengthening IA and fostering internal-external auditor coordination.[7] Thus, IAF is crucial to external auditors in order to give an opinion on the fairness of financial statement of an organization and in discharging other duties and this reliance of external auditors in IAF saves external audit time and audit fees (Haron, *et al.*,

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auditors may be useful to external auditors in assisting them in determining the nature, timing and extent of their audit work.

[7] The reliance of external auditors on internal audit work considered as an area where internal audit adds value through reduced fees and arguably endangers interest of the other two components of corporate governance (i.e., board of directors and management) to promote internal and external audit cooperation.

2004; Mihret, 2010; Mihret & Admassu, 2011; Mihret, *et al.*, 2010; Yee, *et al.*, 2007; Zain, *et al.*, 2006).

2.3.4. Internal Audit Function (IAF)

Internal auditing is a profession and activity involved in advising organizations regarding how to better achieve their objectives through managing risks and improving internal control (Asare, 2009). According to KPMG (2003), the key role of internal audit is to assist the board and or its audit committee in discharging its governance responsibilities (see also Dittenhofer, 2001; Yee, *et al.*, 2007) by delivering:

- A review of the organization's control culture, especially the "ton at the top".
- An objective evaluation of the existing risk and internal control framework.
- Systematic analysis of business processes and associated controls.
- Reviews of the existence and value of assets.
- A source of information on major frauds and irregularities.
- Ad hoc review of the other areas of concern, including unacceptable levels of risk.
- Reviews of the compliance framework and specific compliance issues.
- Reviews of operational and financial performance.
- Recommendations for more effective and efficient use of resources.
- Assessments of the accomplishment of corporate goals and objectives.
- Feedback on adherence to the organization's values and code of conduct or code of ethics.

Goodwin and Seow (2002) noted that auditors may regard the existence of an IAF as an indication that directors and management are committed to strong

corporate governance. Further, in their study on the relationship between the IAF and Corporate Governance in the EU – a Survey, Paape, *et al.* (2003) revealed, in the slipstream of current developments-legislation, rules, regulations and guidelines coming from many directions outside organizations, rather than the individual decisions of this or that company, board or committee, IA is most likely going to be viewed as an important, and even integral, element of the corporate governance system. Likewise, Hermanson and Rittenberg (2003) suggested that an effective IAF is an important "frontline player" in the two fundamental governance activities i.e. monitoring of risks and providing assurance regarding controls.

Barac and Staden (2009) carried out a research on the correlation between perceived IA quality and defined corporate governance soundness of 30 large companies in compliance with ten disclosures of the king II report of South Africa. The main finding of the research is that no correlation was found to exist between the defined soundness of the corporate governance structure and the perceived IA quality of participating companies that contradicts to the theoretical perspective and existing literature that an IAF is a critical corporate governance mechanism which plays an important role in organizational risks and assessing controls (Anderson, 2003; Anderson & Dahle, 2009; Coram, *et al.*, 2008; Hermanson & Rittenberg, 2003; Paape, *et al.*, 2003; Ramamoorti, 2003; Rossiter, 2007; Sarens & De Beelde, 2006; Sarens, 2009). Furthermore, by providing assurance on the risk management, control and governance processes within an organization, internal auditing can fulfill its role as one of the cornerstones of effective organizational governance.

The unique value that a professional internal audit activity can provide to an organization is objective assurance on the effectiveness of the governance, risk

management and internal control processes (ECIIA, 2005; ISPPIA, 2010). Further, management often calls upon internal auditors to help provide them with assurance that risks are effectively identified and monitored, organizational process are effectively controlled, and organizational process are efficient or effective (Hermanson & Rittenberg , 2003). They also suggested that IAF has evolved in many organization implement, assess, or conceptualize risk management and control process within an organization. In other words, internal audit has played an active role in implementing effective governance and controls while being asked to assess the effectiveness of management's control practices.

This study consists of mainly international researches, because the role of IAF for corporate governance represents an unexplored area in Ethiopia. Exceptions that closed to this study are the researches of Mihret and Yismaw (2007), Mihret and Woldeyohannis (2008), Mihret (2010) and Mihret, *et al.* (2010) in which, internal audit effectiveness, Value-added role of internal audit in the Ethiopian public sector case study, factors associated with attributes of internal audit departments and antecedents and organizational performance implications of internal audit effectiveness were explored respectively.

Mihret and Yismaw (2007) concluded that internal audit services is limited to regular activities, and recommended that extending the scope of services by widening the range of systems and activities audited, with appropriate risk analysis would improve audit effectiveness. Furthermore, in their value-added role of IA study, Mihret and Woldeyohannis (2008) concluded that goals and strategies pursued and the level of risk faced by organizations to which internal audit provides service, appear to shape the attributes of a value adding internal audit department. Based on their findings, they recommended that better

strategic planning by the internal audit department may enhance internal audits ability to build up a value adding profile by helping identity strategic issues and find solutions to any hurdles that are considered to exist on the way to achieving a value-added profile.

Regarding factors associated with attributes of internal audit department, Mihret (2010) noted that internal audit proficiency, scope of internal audit work and quality of internal audit planning and executions are higher in organizations where organizational policy authorizing internal audit is clearly defined. He advocated, in organizations that are exposed to high risk, management tends to appreciate internal auditor's assistance in managing risk and thus strengthens internal audit. In addition, Mihret, *et al.* (2010) revealed that internal audit effectiveness is influenced by the dynamics prevailing in an IA setting.

In addition, Belay (2007) suggested that well performing IAF is one of the strongest means to monitor and promote good governance system in an organization. The intention of the paper was to assess and evaluate to what extent the current and planned IAF is positioned to contribute towards one of the major objective of the Civil Service Reform Program (CSRP) of ascertaining good organizational governance system in public sector for public accountability and service delivery improvement. However, this research paper attempted to examine the role of IAF in corporate governance effectiveness in the case of 13 purposely sampled commercial banks. The main findings of the paper was that the existing IAF in the public sector has less satisfactory involvement to assess the effectiveness of governance structure due to lack of resources, poor leadership for IAF, absence of appropriate frame work to measure IAF performance and lack of competent personnel.

Despite the recent four exceptional related researched areas and one conference paper by Belay (2007) on effective implementation of IAF to promote good governance in the public sector, an IAF role in corporate governance effectiveness is totally unexplored in Ethiopian context. Hence, this study aims to fill the gap to the existing knowledge by exploring the IAF practices and its role in corporate governance effectiveness in the case of commercial banks of Ethiopia through adopting concurrent mixed research approach.

2.4. Internal Audit Function Quality

In the above sections of the chapter, it has discussed concerning the effective corporate governance and the role of IAF in each governance parties. Sarens (2009) noted that IAF is effective when IAF quality contributes to the effective corporate governance and the higher IAF quality is the higher the internal control will be. So far, in this section, the indicators of quality IAF are discussed.

Mihret and Yismaw (2007) explored internal audit effectiveness in the Ethiopian Public sector and suggested that if internal audit enhances quality to the extent it elicits management's interest, management support would be a natural quid pro quo because the management would realize the contribution of internal audit to the achievement of organizational goals.

This research paper attempted to explore the role of IAF in corporate governance effectiveness in the case of 13 purposely sampled Ethiopian Commercial Banks (head offices only). The four indicators (independence of IAFs, value added by IAFs, attributes of IAFs and recommendations made by IAFs) which influence an IAF quality (Barac & Staden, 2009; Sarens, 2009) are presented below.

2.4.1. Independence

Internal auditors are potentially important providers of independent evaluations of the risk management and internal control system (assurance), eventually combined with more practice-oriented management assistance (consulting) in the area (Allegrini, *et al.*, 2006; Barac, *et al.*, 2009; Cooper, *et al.*, 2006; Hass, 2006; Hermanson & Rittenberg, 2003; Mihret, *et al.*, 2010; Sarens & De Beelde, 2006). Yee, *et al.* (2007) point out that without independence, the internal auditor simply becomes a part of the management team, losing the ability to offer a fresh perspective through an objective evaluation.

Brody (2000) revealed that while it is important for internal auditors to add value to their organization, it is critical that they remain independent and objective members of the organization. Regular contacts with audit committee are important for the independence of IAF, as they allow internal auditors to discuss their work with independent party, which often is necessary to initiate the appropriate corrective action (Christopher, *et al.*, 2008). Moreover, Mihret and Yismaw (2007) point out that independence of paramount value in providing effective internal audit service to the management, for it affords an atmosphere of objective and uninhibited appraisal and reporting of findings without influence from the units being audited; and independence of individual auditors is essential to the effectiveness of the IAF. As well, Mihret (2010) revealed that IA's independence and objectivity trait its effectiveness.

According to Goodwin and Yeo (2001) evidence from Singapore on the two factors affecting internal audit independence and objectivity, audit independence affecting the organizational independence of the IAF. This independence of an IAF in turn contributes to its quality (Barac & Staden, 2009). The literature supports the importance of an IAF's functional reporting relationship with the

audit committee (Barac & Staden, 2009; Goodwin & Yeo, 2001; Paape, *et al.*, 2003), as it enhances the quality of an IAF.

2.4.2. Value Added by IAFs

Al-Twaijry, *et al.* (2004), Barac, *et al.* (2009), Brody (2000), and Mihret, *et al.* (2010) noted, IA is considered effective when it is value-adding regardless of whether its role is assurance or consulting oriented, and as Mihret and Woldeyohannis (2008), in a value-adding paradigm, the main function of the internal audit work is to assist its major stakeholders, i.e. the board, the management and employees to achieve organizational goal. This stresses the necessity of IA's value-adding role as well as its contribution to accomplishment of organizational objectives. Sarens (2009) also noted that *"we talk about an effective IAF when IAF quality has a positive impact on the quality of corporate governance"*.

The lower effectiveness of internal auditing might be an indication of low value-added. By attuning its strategies to the mission and vision of the corporation, internal audit could play a significant value-adding role through its contribution in the risk management (Barac, *et al.*, 2009; Mihret & Woldeyohannis, 2008; Yee, *et al.*, 2007). Further, in a value-adding paradigm, the main function of the internal audit work is to assist its major stakeholders to achieve organizational goals and a rational for the existence of IA is apparently its role in assisting organizations to achieve objectives. What is more, Umor (2009) on the empirical study on internal auditors' role and authority in Malaysia noted, internal audit can play a vital role in adding value to the business. Accordingly, its value-adding role of IA is an indication of IAF quality.

Better strategic planning by IA department may enhance internal audits ability to build up a value-adding profile by helping identify strategic issues and find

solutions to any hurdles that are considered to exist on the way to achieving a value-added profile (Mihret & Woldeyohannis, 2008).

2.4.3. Attributes of IAFs

Mihret, *et al.* (2010), in their study of antecedents and organizational performance implication of internal audit effectiveness suggested, technical competence and training are considered essential for effective IA. Moreover, the researchers noted that the scope and quality of the work is another factor that reflects IA effectiveness. Mihret (2010) also revealed that technical competence, continuous training, and the scope and quality of IA work is an indicator of IAF quality.

In addition, skilled and qualified IA staffs are indicative of IA quality (Mihret & Yismaw, 2007; Sarens, 2009); Fadzil, *et al.* (2005) noted that when they reported that inter alia knowledge, professional certification and training lead to a lower need for monitoring of the internal control system by an IAF, since they are perceived as able to perform audits effectively. Likewise, as Mihret and Yismaw (2007) suggested in the study of IA effectiveness in Ethiopian public sector, IA quality is a function of extensive staff expertise, reasonableness of the scope of service, and effective planning, execution and communication of internal audits. Besides, they noted that the capability of the auditees to meet their objective on audit quality also attributes to its quality.

2.4.4. Rate of Implementation of Recommendations made by IAFs

A sufficient degree of acceptance and appreciation of the IAF is crucial to allow for IA findings and recommendations to have an impact (Christopher *et al.*, 2008); and Mihret and Yismaw (2007) noted that the offices ability to communicate the results of audits is a proxy for audit quality and IA findings and recommendations will not serve much purpose unless management is committed to implement them. Mihret and Woldeyohannis (2008) noted that

non-repeated findings to the total audit findings of an earlier audit period as measure of implementation of IA findings, which they employed as an indicator of IA effectiveness. Hence, the effectiveness of IA measured by the rate of implementation of audit recommendations.

Dittenhofer (2001) in the study on IA Effectiveness: an expansion of present methods revealed that if internal auditing does identify controls that for one reason or another are not functioning as they should in achieving auditee's effectiveness, it could be presumed that the internal auditing itself is effective; and when the IAF is effective, it can significantly enhance the organization's potential for success (Hermanson & Rittenberg, 2003). Also, internal auditing making recommendations that resolves these control problems disclosed, could be another element of internal auditing achieving its objective of assuring that the auditees controls will, in the future, be functioning properly (Dittenhofer, 2001).

Sarens (2009) point out that the frequency of consideration of the recommendations made by the IAF also serves as an indicator of IAF quality. Likewise, Yee, *et al.* (2007) also noted that internal auditor must be able to "sell" the solution to key members of the organization and its normal to follow up on recommendations or agreed upon action points in order to monitor how the issues have been dealt with. Consequently, implementation of internal audit recommendations is an indicator of IAF quality.

2.5. Internal Audit Functions and Financial Institutions

This study attempted to examine the role of IAF in corporate governance effectiveness in the case of 13 purposely sampled Ethiopian Commercial Banks (head offices only) through adopting concurrent mixed research approach. In this specific section, the researcher discussed related literatures with financial

institutions and banks particularly in relation to corporate governance effectiveness and IAF practices.

2.5.1. Corporate Governance of Financial Institutions

As Basel Committee on Banking Supervision (2010), effective corporate governance practices are essential to achieving and maintaining public trust and confidence in the banking system, which are critical to the proper functioning of the banking sector and economy as a whole. Poor corporate governance can contribute to bank failures, which can in turn pose significant public costs and consequences due to their potential impact on any applicable deposit insurance system and the possibility of broader macroeconomic implication. Furthermore, according to NBE (2011) directives, sound corporate governance is vital for the health of individual banks and the banking sector as a whole; and there is a need to strengthen internal control and risk management systems of banks to prevent them from exposure to undue reputational, operational, legal and concentration risks that may result from abuse of money launderers and terrorist financiers (NBE, 2010).

From a banking industry perspective, corporate governance involves the manner in which the business and affaires of a bank are governed by its board and senior management (Basel Committee on Banking Supervision, 2010), including how they:

- Set the bank's strategy and objectives;
- Determine the bank's risk tolerance/appetite;
- Operate the bank's business on a day-to-day basis;
- Protect the interests of depositors, meet shareholder obligations, and take into account the interests of other recognised stakeholders; and

- Align corporate activities and behaviour with the expectation that the bank will operate in a safe and sound manner, with integrity and in compliance with applicable laws and regulations.

While banks are important, this alone does not motivate a separate analysis of the governance of banks. Banks are firms. They have shareholders, debt holders, boards of directors, competitors, etc. This suggests that one can simply think about the governance of banks in the same way that one thinks about the governance of a shoe company, or an automobile company, or a pharmaceutical company (Levine, 2004) because of corporate governance refers to all issues in relation to ownership and control of corporate property, shareholders' rights and treatments, powers and responsibilities of the board of directors, disclosure and transparency of corporate information, the protections of interests of stakeholders in addition to that of shareholders (Gebremeskel, 2010). Banks, however, have two related characteristics that inspire a separate analysis of the corporate governance of banks. First, banks are generally more opaque (more informational asymmetry) than nonfinancial firms. Second, banks are frequently very heavily regulated. Because of the importance of banks in the economy, given that of the opacity of bank assets and activities, and for the reason that banks are a ready source of fiscal revenue, governments impose an elaborate array of regulations on banks (Levine, 2004) see also Basel Committee on Banking Supervision (2010). Furthermore, Caprio, *et al.* (2002) in their examination of the interrelated characteristics of banks and other financial institutions and how these traits affect corporate governance, reveal that virtually all governments energetically regulate and supervise banks due to banks are key players in national system.

Given the important financial intermediation role of banks in an economy, the public and the market have a high degree of sensitivity to any difficulties potentially arising from any corporate governance shortcomings in banks in additions to its complexity. Corporate governance is thus of great relevance both to individual banking organisations and to the international financial system as a whole, and merits targeted supervisory guidance (Basel Committee on Banking Supervision, 2010).

Danescu, *et al.*, (2010) revealed, in the particular case of banking institutions, the quality of banking assets is highly correlated with the management of specific risks. In addition, risks in banking have increased manifold recently due to several phenomena like globalization of banking services, introduction of wide range of complex banking products, complexity in bank operations, and increasing adoption of information technology in banks. Risk management and mitigation techniques have, therefore, acquired paramount importance in bank (Pandit, 2009). As a consequence, the board should recognize and acknowledge that independent, competent and qualified internal and external auditors, as well as other internal control functions (including the compliance functions), are vital to the corporate governance process in order to achieve a number of important objectives. Senior management should also recognize the importance of the effectiveness of these functions to the long-term soundness of the bank (Basel committee on banking supervision, 2010).

2.5.2. Internal Audit Function and Banks

This research study attempted to examine the role of IAF in corporate governance effectiveness in the case of 13 purposely sampled Ethiopian commercial banks (head offices only) through adapting concurrent mixed method research approach. Hence, this particular section emphasized on the

existing empirical evidences regarding IAF role in corporate governance effectiveness in financial institutions particularly banks.

According to Basel committee on banking supervision (2010), the board should recognize and acknowledge an independent, competent and qualified IA since it is vital to the corporate governance. The board and senior management can enhance the ability of the IAF to identify problems with a bank's risk management and internal control systems by:

- Encouraging internal auditors to adhere to national and international professional standards, such as those established by the Institute of Internal Auditors;
- Promoting the independence of the internal auditor, for example by ensuring that internal audit reports and/or has direct access to the board or the board's audit committee;
- Recognising the importance of the audit and internal control processes and communicating their importance throughout the bank;
- Utilising, in a timely and effective manner, the findings of internal audits and requiring timely correction of identified problems by senior management; and
- Engaging internal auditors to judge the effectiveness of the risk management and compliance function, including the quality of risk reporting to the board and senior management, as well as the effectiveness of other key control functions.

Rossiter (2007) noted that effective IAFs help financial services companies to accomplish key business objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of governance, risk management and control processes. Furthermore, the researcher revealed, IAFs

in the banking and financial services industry are responding to new challenges, changes and expectations in today's business environment. They are striving to provide greater value as a key component of their organizations' governance framework. As a result, IA has emerged as an independent, objective assurance and consulting activity designed to add value and improve operations.

A sound IAF plays an important role in contributing to the effectiveness of the internal control system. It provides the management information on the effectiveness of risk management and internal controls including regulatory compliance by the bank (Sharma, 2004). As stated by Basel committee on banking supervision (2010), in order to enhance the sound governance of a banking group, internal audits of individual entities could be complemented with regular assessments of the risks posed by the group's structure. Periodic reports that assess the bank's overall structure and individual entities' activities, confirm compliance with the strategy previously approved by the board, and disclose any possible discrepancies could be useful for the audit and risk committees, senior management and the board of the parent company.

2.6. Summary

The review of the literature in general suggested that IAF contributes a key role to corporate governance effectiveness and it is one of the mechanism (or cornerstone) of corporate governance with board of directors (or management), audit committee and external auditors. Moreover, the researcher has discussed the role of IAF in the three corporate governance mechanisms in discharging their responsibilities. Sarens (2009) said; *"we talk about an effective IAF when IAF quality has a positive impact on the quality of corporate governance"*. Indicators of IAF quality (independence, value added IAF, attributes and rate of recommendation)

are discussed explicitly and their implication on corporate governance effectiveness, where appropriate are emphasized.

This study undertaken based on the findings of Barac and Staden (2009) on their study of the correlation between perceived IA quality and defined corporate governance soundness in 30 South African companies. Their main findings was that no correlations was found to exist between the defend soundness of the corporate governance structure and the perceived internal audit quality of participating companies that opposed to the existing literature that an IAF plays a key role in maintaining effective corporate governance (Goodwin & Seow, 2002; Mihret, et al., 2010; Paape, *et al.*, 2003; Rossiter, 2007; Ruud, 2003; Sarens, 2009; Sarens & De Beelde, 2006). In addition, the researcher attempted to carry out this study for the reason that it is unexplored area in Ethiopia. Therefore, a thorough examining the IAF and its role in corporate governance effectiveness could fill the gap to the literature in general and in Ethiopian context particularly to commercial banks IA practices.

Chapter Three: Research Design

A research design is the logic that links the data to be collected (and conclusions to be drawn) to the initial questions of a study (or a strategy or plan of action that links methods to outcomes) (Creswell, 2003; Yin, 1989). This study examined the role of IAF in corporate governance effectiveness in 13 purposely sampled Ethiopian commercial banks (head offices only). To undertake this research, the researcher employed mixed method research approach. In this chapter, the researcher discussed thorough the rational for using the given strategies of inquiry, specific research methods and ways of collection and analyzing the data are emphasized.

3.1. Strategies of Inquiry

The most important condition for differentiating among the various research strategies is to identify the type of research question being asked (Creswell, 2003; Hair, *et al.*, 2006; Leedy, 1989; McNabb, 2004; Yin, 1989).

We can identify some situations in which all research strategies might be relevant and other situations in which two strategies might be considered equally attractive. We also can use more than one strategy in any given study. To this extent, the various strategies are not mutually exclusive. But we can also identify some situations in which a specific strategy has a distinct advantage (Yin, 1989, p. 20).

The researcher adopted mixed method research approach to examine the role of IAF in corporate governance effectiveness in the case of Ethiopian Commercial Banks (head offices only) to convergence across qualitative and quantitative methods (triangulating data sources). Therefore, employing this approach was used to neutralize or cancel the biases (limitations) of applying any of a single approach and a means to offset the weaknesses inherent within method with the strengths of the other method (Creswell, 2003, pp. 15 & 217).

In addition, adopting of mixed method research approach in this research provided the best understanding of a research problem because it opens the door to multiple methods of data collection and to both generate the findings to a population and develop a detailed view of the meaning of a phenomenon or concept for individuals (Creswell, 2003, pp. 12-22). This research approach posed the researcher to the challenges the need for extensive data collection, the time-intensive nature of analyzing both text and numeric data, and the requirement for the researcher to be familiar with both quantitative forms of research (Creswell, 2003, p. 210).

Concurrent procedure were employed in undertaking this research in which, converges quantitative and qualitative data in order to provide a comprehensive analysis of the research problem. Moreover, the researcher was collected both forms of data at the same time during the study and integrates the information in the interpretation of the overall results (Creswell, 2003, p. 16).

3.2. Research Methods

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.

Survey for the quantitative strategy was used through distributing self-administered questionnaires to all internal auditors of 13 purposely sampled commercial banks (head offices only).

3.2.1. Questionnaires

As indicated in the above, all internal auditors of the purposely sampled 13 commercial banks were included in the survey. 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. Questions present in the form of affirmative statements, relating to the concepts on IAF and its role in corporate governance effectiveness, in such a way as to enable measurement of the respondent's opinions. The respondents were asked to indicate their level of agreement on a five point likert scale with the following ratings. Strongly agree (SA; or 5), agree (A; or 4), neutral (N; or 3), disagree (DA; or 2), and strongly disagree (SD; or 1). The numbers were indicated in the questionnaires to provide a feel of ordinal scale measurement and to generate data suitable for quantitative analysis. The central issue to argue that likert scales produce ordinal data is because of no way at all of knowing whether the differences between the different points on the scale are truly equivalent, and the points on an ordinal scale are not necessary equally spaced as they must be in order for it to be regarded as an interval scale (Hole, 2011). Moreover, Johns (2010) noted that in statistical terms the level of measurement of the likert response scale is 'ordinal' rather than 'interval': that is, we can make assumptions about the order but not the spacing of the response options. Thus, the permissible descriptive statistics that can perform on ordinal data is median (or average response) and mode (or more frequent responses) (Hole, 2011). To elicit additional information, the respondents were requested to provide open-ended responses if they have opinions which they feel the researcher would find

useful. The questionnaires were developed from three researchers; Mihret (2010), research on Factors associated with attributes of internal audit departments: A Canonical Analysis, Paape, *et al.* (2003), on the relationship between the IAF and Corporate Governance in the EU - Survey and Yee, *et al.* (2007), on the perceptions of the Singaporean manager class regarding the role and effectiveness of internal audit in Singapore.

3.2.2. Interviews

In the qualitative strategy, semi-structured interview was employed with 8 vice-presidents of the commercial banks (head offices only) to have sufficient information regarding the research problem. The major purpose of this interview was to corroborate certain facts that the investigator already thinks have been established (Yin, 1989, p. 89). Therefore, the semi-structured interviews have conducted to enhance and supplement the results of questionnaires. Semi-structured interviews was prepared based on pilot test which conducted with one bank's vice president (deputy manager), so as to enhance the internal validity of the instrument.

3.2.3. Documentary Sources

A review of internal audit reports, plans, and policy and procedural manuals serves as documentary sources. The most important use of this documentary source is to corroborate and augment evidence from other sources (Yin, 1989, p. 86). Thus, the document examination was used to corroborate the patterns that evolved from the data collected via questionnaires and interview, so that the validity of the findings could be enhanced. For the reason that, the researcher was unable to access most banks IA report on account of confidentiality issues, the researcher assessed only some banks documentary sources which might affect the findings of the research.

3.3. Survey Design

When the research questions focus mainly on "what" questions; it is justifiable rationale for conducting an exploratory study and more likely to favor survey than others (Yin, 1989, pp. 17-18).

Survey design provides a quantitative or numeric description of trends, attitudes, or opinions of a population by studying a sample of that population. Its purpose is to generalize from a sample to a population so that inferences can be made and it is also economical and rapid turnaround in data collection (Creswell, 2003, pp.153-154); and this method is important for collecting large amounts of raw data using question and answer formats (Hair, *et al.*, 2006). Survey was conducted via self-administered questionnaire from the purposely sampled commercial banks internal auditors, due to questionnaire is a common place instrument for observing data beyond the physical reach of the observer (Leedy, 1989, p. 142).

The main advantage of survey is its ability to accommodate large sample sizes at relatively low costs, ease of administration and ability to tap in to factors that are not directly observable (Hair, *et al.*, 2006).

3.4. Sample Design

Survey sampling is the process of choosing, from a much large population, a group about which wish to make generalized statements so that the selected part represent the total group (Leedy, 1989, p. 158).

Commercial banks have been operated and the additional banks which make an initial public offering to begin their operation were taken as population, and purposely draw a sample from the total to got rich evidence. According to Access

Capital (2010), the total number of Commercial Banks which had been operated in the year 2010 is 12 private banks and 3 state-owned banks. Moreover, looking ahead Ethiopian banking industry enjoying high growth, high profits, and high dividends, there are 6 new entry banks and the total number of commercial banks is 21. However, to undertake this research paper, the researcher was purposely sampled 13 banks which have been operated for the last three fiscal years (NBE, 2009) to get rich documentary sources.

As briefly discussed in the above, questionnaires were distributed only to the head offices of purposely sampled commercial banks internal auditors cross-sectional with the intent of generalizing from a sample to a population, and semi-structure interview was conducted with the vice-president (or deputy manager) of the sampled commercial banks to got more evidence regarding the theme.

The sampling design for the population is single-stage sampling in which the researcher had access to names in the populations and sampled the banks directly (Creswell, 2003, p. 156). The procedure used for drawing the sample from the available lists was the banks service year profile, for the reason that the study intended to use document sources. Thus, this research paper was used purposive sampling method to draw the sample from the population.

3.5. Data Analysis

Data analysis consists of examining, categorizing, tabulating, or otherwise recombining the evidence, to address the initial proposition of a study (Yin, 1989, p. 105).

The researcher was analyzed the data collected through survey to statistical population concerning the role of IAF in corporate governance effectiveness. The data collected via questionnaires were analyzed with descriptive statistics using statistical package for social scientists. Furthermore, Wolcott (1994) as cited in

Creswell (2003, p. 182), suggested that qualitative research is fundamentally interpretative i.e. the researcher was interpreted the qualitative data. Thus, data collected from the interview and reviews of documents were interpreted qualitatively. To sum, the analysis of quantitative data and interpretation of qualitative data combines to seek convergence among the results (Creswell, 2003, p. 222).

Chapter Four: Results and Discussion

4.1. Introduction

As indicated in the preceding chapters, this research study attempted to examine the role of IAF in corporate governance effectiveness. In this section, the results of the study are discussed by triangulating the different sources results: questionnaire results, and interview and document review results; and the role of IAF in corporate governance effectiveness are analyzed.

A total of 105 questionnaires were distributed to all internal auditors of 12 banks out of 13 purposely sampled commercial banks because of that one bank had not accepted the researcher's letter to conduct this study, and 78 useable questionnaires were obtained (74.3 percent response rate). In addition, the researcher was conducted an interview with only 8 vice-presidents for the reason that it was not well-situated to interview all banks vice presidents (or presidents); and reviews some banks documents regarding IA report. The researcher couldn't access all banks IA documents due to the confidentiality issue as raised by Mihret and Woldeyohannis (2008). Descriptive measures of each questions response and an interview and document sources results are presented in the following sections.

4.1.1. Organization Type and Internal Audit Department

IA activity is a department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations. The internal audit activity helps an organization accomplish its objectives by bringing a systematic,

disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes (ISPPIA, 2010).

Table I. Descriptive Statistics of Organizational Type

		Frequency	Percent	Valid Percent
Valid	State-owned	25	32.1	32.1
	Private	53	67.9	67.9
	Total	**78**	**100.0**	**100.0**

Source: Questionnaire results

The study revealed that out of the total 78 questionnaires collected, 25 (32.1 percent respondents) were from state-owned banks and 53 (67.9 percent respondents) from private commercial banks.

According to interview and documents review, all commercial banks have an IA department that conform NBE (2009) regulations and BPR that all banks should establish an IA department, and uses an IAF. This result indicated that all banks have used an IAF services. An IA activity helps the banks accomplish their objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance.

4.1.2. Internal Audit Charter

The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the IA activity's position within the organization; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities (ISPPIA, 2010).

Table II. Descriptive Statistics of Internal Audit Charter

		IA definition	IA standard IIA
N	Valid	77	76
	Missing	1	2
Median		5.00	4.00
Mode		5.00	4.00

Note: N- number of responses; response measurements.....5 - Strongly agree (SA), 4 - Agree (A), 3 - Neutral (N), 2 - Disagree (DA), 1 - Strongly disagree (SD)

Source: Questionnaire results

IA compliance with the standards for professional practice of internal auditors (SPPIA) is an indicator of IA effectiveness and value-adding IA (Mihret, 2010; Mihret, *et al.*, 2010; Mihret & Woldeyohannis, 2008). Moreover, Barac, *et al.* (2009), Brody (2000) and Mihret, *et al.* (2010) revealed that IA is considered effective when it is value adding regardless of whether its role is assurance or consulting oriented. Besides, Sarens (2009) noted that *"we can talk about an effective IAF when IAF quality has positive impact on the quality corporate governance"*. Thus, when purpose and authority of IA is clearly defined and in line with SPPIA formulated by IIA, it has positive impact on the corporate governance effectiveness.

The study revealed that the purpose and authority of IA in the bank is clearly defined, i.e. the median and mode of responses were 5.00. Furthermore, the response to question: "the purpose and authority of IA is in line with SPPIA formulated by the IIA", were median and mode of 4.00. Therefore, according to the results of questionnaires response, the purpose and authority of IA in commercial banks is clearly defined and in line with SPPIA, and this implies that

IAF of the banks were contributed to the quality of IA and has positive impact on corporate governance effectiveness.

4.1.3. Auditee co-operation, Risk and IC practices in the bank

The unique value that a professional internal audit activity can provide to an organization is objective assurance on the effectiveness of the governance, risk management and internal control processes (ECIIA, 2005; ISPPIA, 2010; Umor, 2009). Moreover, based on ISPPIA (2010), internal audit activity adds value to the organization (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management, and control processes.

Table III. Descriptive Statistics of Auditee co-operation, Risk and Internal Control practices

		IA access	IA help	Value-added IA	Enough IC	IA know-how	RA as audit part	Risks program	IA follow-up
N	Valid	78	77	76	78	78	77	78	77
	Missing	0	1	2	0	0	1	0	1
Median		5.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Mode		5.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00

Note: N- number of responses; response measurements.....5 - Strongly agree (SA), 4 - Agree (A), 3 - Neutral (N), 2 - Disagree (DA), 1 - Strongly disagree (SD)

Source: Questionnaire results

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4.1.3.1. Internal auditor's Access and Auditees' Co-operation

The level of auditees co-operation influences the extent to which IA properly accomplishes its objectives and IA performs their job (or to achieve effective audit work) when they have unrestricted access to records and information they need in conducting audits (Mihret & Yismaw, 2007).

Based on the questionnaires result, internal auditors of the banks have full access, i.e. median and mode of 5.00 to perform their duties. Further, internal auditors receive co-operation from auditees while they conducting their jobs; median and mode were 4.00. Hence, when internal auditors have full access to records and receive co-operation from auditees, it contributes unique role to its effectiveness, and it has positive impact on corporate governance effectiveness Sarens (2009).

4.1.3.2. Value-Adding Service

IA is effective when it is value-adding (Barac, *et al.*, 2009; Brody, 2000; Mihret, *et al.*, 2010) and when IAF quality has a positive impact on the corporate governance effectiveness (Sarens, 2009). The results to question; "auditees considered IA as value-adding service", were median and mode of 4.00. This result implies that IA practices of the banks are value-added activity that contributes to the effectiveness of governance process.

4.1.3.3. Risk Management and Internal Control Systems

Hermanson and Rittenberg (2003) noted that an effective IAF is an important frontline player in the two fundamental governance activities; monitoring of risks and providing assurance regarding controls. Responses to questionnaires show that the banks have adequate internal controls; were median and mode of 4.00. Moreover, the competent of internal auditors were high in the bank; were median and mode of 4.00. These results supported by theoretical and empirical

literatures that internal auditors required possessing the knowledge, skills and other competencies needed to perform their responsibilities (ISPPIA, 2010; Mihret & Yismaw, 2007).

Risk assessment in the banks is done as part of audit planning and potential risks relevant to the activity to be audited are identified when setting programs. The median and mode responses to the question regarding the risk assessment were 4.00. This revealed that risk assessment and control assurance are the bulk of IA activity and maps directly in to organizational governance; in view of the fact that these are the main activities of corporate governance (Hermanson & Rittenberg, 2003).

Mihret and Yismaw (2007) noted that follow-up is critical to bring about audit outcomes. The median and mode responses of the questionnaire; "IA follow-up implementation use on improvement of internal control systems", were 4.00. Further, based on the interview and document review, IA is value adding activity and risk management and internal control system are done as part of IA activity. As a result, IAF has a critical role in the layers of corporate governance i.e. risk management and internal control system (Anderson & Dahle, 2009).

4.1.4. Internal Audit's role to External Auditors

Haron, *et al.* (2004) and Mihret and Admassu (2011) noted that external auditors can rely on the work of internal auditors in many respects in carrying out their duties. Further, IA may gain some feedback and improve its effectiveness when internal and external audit linkages are strong (Mihret, *et al.*, 2010). Further, reliance of external auditors in IAF saves external audit time and audit fees (Haron, *et al.*, 2004; Mihret, 2010; Mihret & Admassu, 2011; Mihret, *et al.*, 2010; Yee, *et al.*, 2007; Zain, *et al.*, 2006).

Table IV. Descriptive Statistics of Internal Audit's role to External Auditors

		EA use IA reports	EA use IA working paper
N	Valid	78	77
	Missing	0	1
Median		4.00	3.00
Mode		4.00	3.00

Note: N- number of responses; response measurements.....5 - Strongly agree (SA), 4 - Agree (A), 3 - Neutral (N), 2 - Disagree (DA), 1 - Strongly disagree (SD)

Source: Questionnaire results

The median and mode responses of the questions; "external auditors use IA reports in conducting their audit and external auditors us IA working papers" were 4.00 and 3.00 respectively (i.e. median and mode of the first question was 4.00 and the second question, 3.00). These result implies, external auditors' level of reliance in working papers of IA is low which supported the findings of Al-Twaijry, *et al.* (2004) *"in Saudi Arabia it is very rare to find the external auditors relying on the IAF"*. However, even if the results to the first question was agree (or median and mode of 4.00), based on some respondents view stated in the place for additional comments that IA support to external auditors is so low. One respondent was said;

> *"If external auditors use internal auditors report, they might be biased and to refrain their own findings in doing so".*

Thus, the finding was inconsistent to the literature that IAF is crucial to external auditors and the reliance of external auditors on IAF saves external audit time and audit fees (Mihret, 2010; Mihret & Admassu, 2011; Yee, *et al.*, 2007).

4.1.5. Proficiency of Internal Audit

The IIA's standards for professional practice of internal auditing (1210-proficiency), requires that internal auditors must possess the knowledge, skills and other competencies needed to perform their individual responsibilities (ISPPIA, 2010). Technical competence and continuous training are considered essential for effective IA (Fadzil, *et al.*, 2005; Mihret, 2010; Mihret, *et al.*, 2010). Further, skilled and qualified IA staffs are indicative of IA quality (Mihret and Yismaw, 2007; Sarens, 2009) and the auditors need to gain adequate professional knowledge and their skills should be continuously honed via training (Mihret and Woldeyohannis, 2008). As well, Mihret and Yismaw (2007) noted that the budgetary status of IA affects the effectiveness of IAF.

Table V. Descriptive Statistics of Proficiency of Internal Audit

		IA budget	IA experience	IA policies for hiring & training	IA manual to guide IAF
N	Valid	78	78	77	77
	Missing	0	0	1	1
Median		4.00	4.00	3.00	4.00
Mode		4.00	4.00	3.00	4.00

Note: N- number of responses; response measurements.....5 - Strongly agree (SA), 4 - Agree (A), 3 - Neutral (N), 2 - Disagree (DA), and 1 - Strongly disagree (SD)

Source: Questionnaire results

4.1.5.1. Internal Audit Budget

Responses to the questions; "Internal audit obtains a sufficient budget to successfully carry out its duties and internal auditors have sufficient experience to understand the bank's system" were median and mode of 4.00. These results

revealed that the banks provide sufficient budget to IA to perform its duties; and internal auditors of the banks have sufficient experience to understand the banks system. As a consequence, these have a positive impact on quality of corporate governance.

Table VI. Descriptive Statistics of Level of education

		Frequency	Percent	Valid Percent
Valid	DIP	4	5.1	5.4
	DEG	67	85.9	90.5
	MAS	3	3.8	4.1
	Total	74	94.9	100.0
Missing	System	4	5.1	
Total		**78**	**100.0**	

Note: DIP- Diploma, DEG - Degree, and MAS - Master

Source: Questionnaire results

Table VII. Descriptive Statistics of Years of Experience as Internal Auditor

		Frequency	Percent	Valid Percent
Valid	Less than five	37	47.4	53.6
	Five to ten	24	30.8	34.8
	More than ten	8	10.3	11.6
	Total	69	88.5	100.0
Missing	System	9	11.5	
Total		**78**	**100.0**	

Note: less than five - for less than five years, five to ten - five to ten years, and more than ten - more than ten years

Source: Questionnaire results

Table VIII. Descriptive Statistics of Years of Experience in the bank

		Frequency	Percent	Valid Percent
Valid	Less than five	17	21.8	25.4
	Five to ten	22	28.2	32.8
	More than ten	28	35.9	41.8
	Total	67	85.9	100.0
Missing	System	11	14.1	
Total		**78**	**100.0**	

Note: less than five - for less than five years, five to ten - five to ten years, and more than ten - more than ten years

Source: Questionnaire results

Table IX. Descriptive Statistics of Professional Certification

		Frequency	Percent	Valid Percent
Valid	NO	71	91.0	92.2
	YES	6	7.7	7.8
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

Note: Yes - has professional certification, No - don't have

Source: Questionnaire results

4.1.5.2. Attributes of Internal Audit Function

Based on the questionnaires response in relation to IA's policies for hiring and training of IA's staff was median and mode of 3.00. This entails that the banks policies in relation to hiring and training are low (or not effective); and this

affects negatively the competence of internal auditors and effectiveness of IAF for the reason that continuous training are considered essential for effectiveness of IA (Fadzil, *et al.*, 2005; Mihret, 2010; Mihret, *et al.*, 2010). In addition, skilled and qualified audit staffs are indicative of IA quality (Mihret & Yismaw, 2007; Sarens, 2009) and since IA work requires knowledge and experience on a wide range of systems and operations, it is imperative to deploy auditors with extensive professional skills and to upgrade their skills through continuing professional training and development (Mihret & Yismaw, 2007).

Internal auditors of commercial banks who hold degree qualification were 90.5%; diploma and masters were 5.4% and 4.1% respectively. These results indicated that almost all banks internal auditors possessed first degree and are capable of doing their duties. The responses to the question; "the level of experience as an internal auditor" were 53.6% have less than five years experience, 34.8% have five to ten years experience, and 11.6% respondents have more than ten years experience. This implies that most internal auditors didn't acquired enough experience as internal auditor to perform audit activities, though there is no minimum requirement set by the standard. The levels of experience in the bank were 25.4% less than five years, 32.8% five to ten years, and 41.8% more than ten years. Responses to professional certification of the internal auditors were 92.2% have not any certification and 7.8% have certificate. In general, these results indicated that policy of the banks for hiring and training, level of experience as internal auditors, and professional certification of internal auditors were low; and consequently, contribution of IAF is low to corporate governance effectiveness, given that these are indicators of effective IAF (Mihret, 2010; Mihret, *et al.*, 2010; Mihret & Woldeyohannis, 2008; Mihret & Yismaw, 2007; Sarens, 2009).

According to Mihret and Yismaw (2007), proper planning enables accomplishment of a large number of audits in a given period by improving efficiency. So, there should be a complete IA manual to guide IAF. Questionnaire responses and an examination of audit reports signify that the banks IA practice has a complete IA manual to guide IAF that contributes to its effectiveness. The median and mode responses of the questionnaire were 4.00.

4.1.6. Independence and Objective of Internal Audit

Independence of internal auditor's is one of the indicators of IAF quality that contributes to corporate governance effectiveness (Barac & Staden, 2009; Sarens, 2009). Moreover, Brody (2000) suggested, it is critical that internal auditors remain independent and objective to add value to their organization.

Table X. Descriptive Statistics of Independence and Objective of Internal Audit

		IA intervention	IA feel free to include any	IA reports to BoD (AC)	IA participation
N	Valid	76	76	77	76
	Missing	2	2	1	2
Median		4.00	4.00	4.00	4.00
Mode		4.00	4.00	5.00	5.00

Note: N- number of responses; response measurements.....5 – Strongly agree (SA), 4 – Agree (A), 3 – Neutral (N), 2 – Disagree (DA), and 1 – Strongly disagree (SD)

Source: Questionnaire results

Internal auditors of the banks response to questions under the independence and objective of IA; "IA is free from intervention in performing its audits and internal auditors feel free to include any audit findings in their audit reports" were

median and mode of 4.00, which conforms to the concept that IA must be free to report its findings and appraisals (KPMG, 2003). These results indicated that IAF of the banks enhances for its quality of independence and consequently, has positive impact on the effectiveness of corporate governance.

It is the independent IAF that provides assurance to the board, via the audit committee (Christopher, *et al.*, 2008). Further, internal auditors independence and objectivity maintained when they do not participate in activities they were responsible (KPMG, 2003) and provides their report to audit committee (Barac & Staden, 2009; Christopher, *et al.*, 2008).

The results of questionnaires distributed to internal auditors regarding the questions; "Internal audit provides reports to the board of directors (or audit committee) and Internal auditors do not participate in audit activities for the operation of which they were responsible" under independence and objectivity were median of 4.00 and mode of 5.00. In addition, according to interview with vice-president of the banks, internal auditors reporting responsibility is functionally to board of directors and administratively to the president, that maintained their independence. These results suggested that opinions of internal auditors conform to the concept that IA is an independence and objective activity designed to add value and improve an organization operation (IIA, 2009). In addition, Mihret and Yismaw (2007) noted that independence of individual auditors is essential to the effectiveness of IAF and when it's effective it has positive impact on corporate governance effectiveness (Sarens, 2009).

4.1.7. Scope of Internal Audit Function

Hermanson and Rittenberg (2003) noted that IAF plays a unique role in the governance process; and Paape, *et al.* (2003) added that in the slipstream of current developments, legislations, rules, regulations and guidelines coming

from many directions organizations, rather than the individual decisions of this or that company, board or committee, IA is most likely going to be viewed as an important and even integral element of the corporate governance system. Moreover, along with NBE (2011) directives, sound corporate governance is vital for the health of individual banks and the banking sector as a whole to strengthen internal control and risk management systems of banks to prevent them from exposure to undue reputational, operational, legal and concentration risks that may result from abuse of money launderers and terrorist financiers.

Table XI. Descriptive Statistics of Scope of IAF

		IAF & CG	IA check adequacy	IA financial record	IA operation & financial	IA risk & ICS	IA safeguard
N	Valid	73	78	78	78	78	78
	Missing	5	0	0	0	0	0
Median		4.00	4.00	4.00	4.00	4.00	4.00
Mode		4.00	4.00	5.00	4.00	4.00	4.00

Continued…..

IA frauds	IA comply	IA operation objectives	IA efficient effective	IA achieve goals	IA operation procedure	IA assist mgt risk	IA consults mgt
77	78	78	78	76	77	77	77
1	0	0	0	2	1	1	1
4.0000	5.00	4.00	4.00	4.00	4.00	4.00	4.00
4.00	5.00	5.00	4.00	4.00	4.00	4.00	4.00

Note: N- number of responses; response measurements.....5 - Strongly agree (SA), 4 - Agree (A), 3 - Neutral (N), 2 - Disagree (DA), and 1 - Strongly disagree (SD)

Source: Questionnaire results

The median and mode responses of the internal auditors of commercial banks to the first general question under scope of IAF was generally agree (or 4.00) which indicated that the IAF of the banks evolved towards multi-audit services to strength the corporate governance of the banks and this supported by the interview result that indicated as IAF provides a variety of services to strength the governance process. Moreover, according to interview results, IAF plays a critical role in maintaining corporate governance effectiveness of the banks. Specifically, the vice president of Construction and Business Bank said;

> *"The role of IAF is very high for corporate effectiveness in our bank through delivering multi-service to the parties involved in the system".*

These results conform to the concept that IA has plays an active role in implementing effective corporate governance (Anderson & Dahle, 2009; Hermanson & Rittenberg, 2003).

The questionnaire responses of internal auditors were median and mode of 4.00, which indicated that internal auditors check the adequacy of the auditees' record keeping when appropriate. Besides, the responses of the auditors in relation to verifying accuracy of amounts in financial records were median of 4.00 and mode of 5.00. These questionnaire responses were supported by the interview and document review results that an IA activity checks the adequacy and accuracy of auditees' financial records. These results conform to the concept that IAF reviews the existence and value of assets (KPMG, 2003).

The median and mode responses to four questions under the scope of IAF; "internal auditor review operational and financial performance, evaluate the risk and internal control systems, review the systems of safeguarding the assets, and identify a source of information on major frauds and irregularities" were 4.00. The interviews and document review results also imply that IA continuously checks overall activities of the bank. These results suggested that commercial banks internal auditors evolved in helping the organization by assessing the operational and financial performance, safeguarding of assets and sources of major frauds, and evaluating risk management and internal control processes. Thus, internal auditors assist the board or audit committee in discharging their responsibilities by delivering these services (Basel Committee on Banking supervision, 2010; ECIIA, 2005; KPMG, 2003; Rossiter, 2007; Umor, 2009) and assuring the risk management and internal control systems; the two import aspects of corporate governance (Sarens, 2009).

To question; "internal auditors check compliance with laws and regulations", median and mode responses were 5.00 and this were supported by interviews and documents review result that one duty of internal auditors is checking of activities compliance with laws and regulations. This indicated that IAF exhibited a high profile in checking compliance with laws and regulations which conforms to the concept that IA reviews the compliance framework and specific compliance issues to deliver service to other parties of corporate governance to discharge their governance responsibilities (KPMG, 2003). Moreover, Mihret and Woldeyohannis (2008) in their case study research on the value-added role of internal auditing revealed that compliance auditing shares most of the auditors' time in their audit activity.

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The results of the questionnaires indicated that a median and mode response of 4.00 and 5.00, which would signify, internal auditors ascertain that operating objectives are consistent with organizational goals. In addition, auditors median and mode response to questions; "internal auditors check efficiency and effectiveness of operating results, assess the accomplishment of corporate goals and objectives, and ascertain that operating procedures are consistent with operational goals; i.e. Q10, Q11, and Q12" were 4.00. Supplementary, interview and document review results also revealed that IAF checks the effectiveness and efficiency, and accomplishment of objectives of the banks. These results imply that internal auditors of the banks have key roles in delivering the services to maintain strong corporate governance that corroborate to the literature that IA's key role is to assist the board and/or audit committee in discharging their governance responsibilities by delivering assessments of the accomplishment of corporate goals and objectives, effective and efficient use of resources (Anderson, 2003; Barac, *et al.*, 2009; KPMG, 2003; Mihret & Woldeyohannis, 2008; Yee, *et al.*, 2007).

The median and mode responses of the internal auditors to the last questions under the scope of IAF were 4.00. The questions were on the subject of assurance and consulting services to management where IA has the expertise. Added, based on the interview, IAF provides an assurance services in relation to risk management and consulting services to management regarding internal control system of the banks. These results indicated that IAF assists management and other parties of corporate governance by identifying risk exposures and providing consulting services, and this supported by the existing literature and concept that IA provides a variety of assurance and consulting services to the organization (Anderson, 2003; Hermanson & Rittenberg, 2003; KPMG, 2003;

Mihret, *et al.*, 2010; Mihret & Woldeyohannis, 2008; Mihret & Yismaw, 2007; Rossiter, 2007).

4.1.8. Reporting and Implementation of Recommendations

Mihret and Yismaw (2007) noted that IA findings and recommendations will not serve much purpose unless management is committed to implement them. Likewise, the frequency of consideration of the recommendations made by the IAF also serves as an indicator of IAF quality (Sarens, 2009). Consequently, if IAF possess quality it has positive impact on corporate governance.

Table XII. Descriptive Statistics of Reporting and Implementation of IA Recommendations

		IA report to BoD (AC)	IA makes recommendations	Mgt actions	IA follow-up implementation
N	Valid	77	77	77	77
	Missing	1	1	1	1
Median		4.00	4.00	4.00	4.00
Mode		4.00	4.00	4.00	4.00

Note: N- number of responses; response measurements.....5 - Strongly agree (SA), 4 - Agree (A), 3 - Neutral (N), 2 - Disagree (DA), and 1 - Strongly disagree (SD)

Source: Questionnaire results

The median and mode responses of internal auditors of commercial banks to questions under reporting and implementation of recommendations (or four questions): "IAF provides an overall opinion to board of directors (or audit committee), internal auditors make recommendations for more effective and efficient use of resources, Management takes timely corrective action based on

internal audit recommendations and Internal auditors follow-up implementation of corrective actions relating to audit findings" were 4.00, i.e. generally agree. This results imply that the reporting of audit findings and implementation of recommendations in the banks were good.

The need of the IA department should have clear authority to communicate directly and on his or her own initiative to the board, the chairman of the board, or the chairman and members of the audit committee (KPMG, 2003). Based on the questionnaires, interview with vice-presidents and document reviews results, internal auditors report their findings functionally to board of directors (or audit committees) and administratively to the president. This result supported by the literature that the importance of an IAF's functional reporting relationship with the audit committee (Barac & Staden, 2009; Goodwin and Yeo, 2001; Paape, *et al.*, 2003) as it enhances the quality of an IAF, and in consequent, the higher the internal control will be (Sarens, 2009). As well, internal control system is one fundamental governance activities for internal auditing (Hermanson & Rittenberg, 2003; Sarens, 2009).

From the services that an IA deliver is recommendations for more effective and efficient use of resources (Anderson, 2003; KPMG, 2003). Mihret and Woldeyohannis (2008) revealed that recommendations not repeated in subsequent years audit reports suggest implementation of earlier audit recommendations. Further, they noted that IA's recommendations need to be afforded adequate attention.

Based on the document reviews result, some banks audit recommendations were repeated for three subsequent years, though response to question; "management takes timely corrective action based on IA recommendations" were median and mode of 4.00". This indicated that management of commercial banks didn't

afford adequate attention to IA's recommendations. Therefore, an IAF was not possessed quality and its contribution to corporate governance is low. Moreover, Mihret and Yismaw (2007) noted, offices ability to communicate the results of audits is a proxy for audit quality and IA findings and recommendations will not serve much purpose unless management is committed to implement them.

The banks internal auditors' follow-up implementation of corrective actions concerning audit findings was good (the responses were median and mode of 4.00). This conforms to the literature that internal auditors must be able "sell" the solution to key members of the organization and its normal follow-up on recommendations or agreed upon action points in order to monitor how the issues have been dealt with. This emphasized that follow-up is critical to bring about audit outcomes. If follow-up is weak or absent, the imputes gained by audit recommendations will be lost and the credibility of IA will be suffer (Mihret & Yismaw, 2007). Thus, some banks audit findings that didn't take corrective action by the management will be minimize the credibility of IA, and effectiveness of IA is questionable; and if it is not effective, it doesn't have impact on corporate governance effectiveness.

Chapter Five: Summary of findings, Conclusion and Recommendation

The study examined the role of IAF in corporate governance effectiveness through adopting concurrent mixed research method. This section of the research thesis presented the summary of findings, conclusions and recommendations are forwarded.

5.1. Summary of Findings

Total of 105 questionnaires were distributed to all 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, and 78 useable questionnaires were obtained (74.3 percent response rate). In addition, the researcher was conducted an interview with 8 vice-presidents and reviewed some banks documents regarding IA report.

According to interview, document and results of questionnaires, all banks have an IA department, and the purpose and authority of IA is clearly defined in line with SPPIA. IA is value-adding activity in the banks; and risk management and internal control system are done as part of IA activity in view of the fact that these are the main activities of corporate governance (Hermanson & Rittenberg, 2003).

Based on the questionnaires result, IAF of the banks evolved towards multi-audit services to strength the corporate governance and this was supported by interview result that IAF provides a variety of services to strength the governance process.

The banks provide sufficient budget to IA to perform its duties; and internal auditors of the banks have sufficient experience to understand the banks system. Internal auditors receive co-operation from auditees and have full access to records while they conducting their jobs. Moreover, IAF of the banks maintained independence to add value and improve an organization operation. Internal auditors report their findings functionally to board of directors (or audit committees) and administratively to president that supported by the literature that the importance of an IAF's functional reporting relationship with the audit committee (Barac & Staden, 2009; Goodwin & Yeo, 2001; Paape, *et al.*, 2003) as it enhances the quality of an IAF (Sarens, 2009).

The study indicated that external auditors' level of reliance in working papers of IA was low that supported the findings of Al-Twaijry, *et al.* (2004) *"in Saudi Arabia it is very rare to find the external auditors relying on the IAF"*. However, the result was inconsistent to the literature that IAF is crucial to external auditors, and the reliance of external auditors in IAF saves external audit time and audit fees (Mihret, 2010; Mihret & Admassu, 2011; Yee, *et al.*, 2007).

In addition, results revealed that policy banks for hiring and training, level of experience as internal auditors, and professional certification of internal auditors were low. Moreover, Management of commercial banks didn't afford adequate attention to IA's recommendations. Thus, an IAF didn't possessed quality and its role in corporate governance is questionable for a reason that if IAF not effective, it doesn't have positive impact on corporate governance effectiveness.

5.2. Conclusion

The study examined the role of IAF in corporate governance effectiveness in 12 out of 13 sampled Commercial Banks for the reason that one bank had not accepted the researcher's letter to undertaking this study, through adopting concurrent mixed method research approach to convergence across qualitative and quantitative methods (triangulating data sources) (Creswell, 2003, pp. 15 & 217).

Rossiter (2007) noted that effective IAFs help financial services companies to accomplish key business objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of governance, risk management and control processes.

This study undertaken based on the findings of Barac and Staden (2009) that there is no correlation was found between the defined soundness of the corporate governance structure and the perceived internal audit quality of participating companies that contradicts to the theoretical perspective and existing literature that an IAF is a critical corporate governance mechanism which plays an important role in organizational risks and assessing controls (Anderson, 2003; Anderson & Dahle, 2009; Hermanson & Rittenberg, 2003; Paape, *et al.*, 2003; and Ramamoorti, 2003; Rossiter, 2007; Sarens, 2009; Sarens & De Beelde, 2006). Further, limited literature exists on this unexplored area in Ethiopia.

The study found that commercial banks IAF carry out its activities in line with the standards (IIA). The study also revealed that the quality of IAF indicators; independence of IAF, and value-adding service appeared high which contributes to the effectiveness of corporate governance, since IAF quality has positive impact on quality of corporate governance (Sarens, 2009).

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The main findings of this research paper were 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.

5.3. Recommendation

This study investigated the role of IAF in corporate governance effectiveness in the case of 13 purposely sampled commercial banks through adopting concurrent mixed research approach to convergence across quantitative and qualitative methods (Creswell, 2003, pp. 15 & 217).

Based on the conclusions drawn, recommendations and future research areas are forwarded in this specific section of the chapter.

The findings of the study revealed that IA department of the banks studied needs to enhance the proficiency (or attributes of IAF such as; training, experience and professional certification) so as to foster the quality of IAF and in turn to has positive impact on the corporate governance effectiveness, for the reason that audit quality significantly influences audit effectiveness (Mihret & Yismaw, 2007) and when IA is effective, it has positive impact on the quality of corporate governance (Sarens, 2009).

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. Hence, management of commercial banks needs to improve these issues to have quality IAF and its positive impact on corporate governance effectiveness. Moreover, the researcher recommends that to receive the multi-services which delivered by IAF (or assurance and consulting services) and contribute to the effectiveness of corporate governance, management of commercial banks should recognize and implement IA activities and reports, in view of the fact that that rate of implementation of audit recommendation by management is indicative of IA effectiveness (Mihret & Yismaw, 2007).

This study opens various future research possibilities. The quality of an IAF requires future attention given that when IAF quality has positive impact on quality of corporate governance, it will be effective (Sarens, 2009). Future research should also focus on IAF role in corporate governance effectiveness in other sectors to add to the existing knowledge and to evaluate the practices of IA activity. Reliance of external auditors on IA work: corporate governance perspective explored by Mihret and Admassu (2011). Thus, in particular, the interrelationships between the corporate governance mechanisms (board of directors, audit committee, and IAF) need to be explored, including how the IAF affects the parties and is affected by them.

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Annex I: Questionnaires

Dear Sir/Madam

The intent of this questionnaire is to explore information regarding Internal Audit Functions in Ethiopian commercial banks. The questionnaire will distribute to all internal auditors of 13 purposely selected commercial banks head office. The information you provide in response to the items in the questionnaire will be used as part of the data needed for a study of *Internal Audit Function and Corporate Governance*. The results of the study are anticipated to supply to the understanding of the role of Internal Audit Function in Corporate Governance Effectiveness in commercial banks of Ethiopia in particular and be used to obtain insight in relation to financial institutions in general.

I would like to assure you that the information you provide will be accessible only to the investigator. Your involvement is regarded as a great input to the quality of the research results. Hence, I believe that you will enlarge your assistance by participating in the study.

Your honest and thoughtful response is invaluable

Thank you for your participation

Kind regards,

Abraham Gebregiorgis Berhe, MSc student

Addis Ababa University

School of Business and Public Administration

Department of Accounting and Finance

April 2011

General Instruction

This questionnaire contains 3 pages and is expected to take approximately 10 to 20 minutes to complete. Please provide your responses to the questions based on the instructions under each section. If you have comments or if you want to provide further explanations, please use the space provided at the end of the questionnaire.

Section I: Bank profile

Please indicate the following by ticking (√) on the spaces in front of the response options:

Type of your organization: ( ) state owned ( ) private share company

Section II: Internal Audit Context

Instruction: Below are lists of statements pertaining to internal audit in your organization. Please indicate whether you agree or disagree with each statement by ticking (√) on the spaces that specify your choice from the options that range from 'strongly agree' to 'strongly disagree'.

Note: SA- Strongly Agree
A- Agree DA- Disagree
N- Neutral SD- Strongly Disagree

A. Internal audit charter	**SA**	**A**	**N**	**DA**	**SD**
1. The purpose and authority of internal audit is clearly defined	( )	( )	( )	( )	( )
2. The purpose and authority of internal audit is in line with "Standards for the Professional Practice" formulated by the Institute of Internal Auditors	( )	( )	( )	( )	( )
B. Auditee Cooperation, Risk and Internal control of the Bank					
1. Internal auditors have full access to records and information	( )	( )	( )	( )	( )

they need in conducting audits					
2. Internal auditors receive full cooperation from auditees	( )	( )	( )	( )	( )
3. Auditees regard internal audit as a value-adding service	( )	( )	( )	( )	( )
4. There are adequate internal controls in the bank	( )	( )	( )	( )	( )
5. The competence of internal auditors is high in the bank	( )	( )	( )	( )	( )
6. Risk assessment is done as part of audit planning	( )	( )	( )	( )	( )
7. Potential risks relevant to the activity to be audited are identified when setting audit programs	( )	( )	( )	( )	( )
8. Internal audit follow-up implementation use on improvement of internal control systems	( )	( )	( )	( )	( )
C. Internal audit's role to external auditors					
1. External auditors use internal audit reports in conducting their audit	( )	( )	( )	( )	( )
2. External auditors use internal audit working papers in doing their audit	( )	( )	( )	( )	( )
D. Proficiency of Internal audit					
1.Internal audit obtains a sufficient budget to successfully carry out its duties	( )	( )	( )	( )	( )
2. Internal auditors have sufficient experience to understand the bank's system	( )	( )	( )	( )	( )
3. Internal audit has policies for hiring and training of internal audit's staff	( )	( )	( )	( )	( )
4. There is a complete internal audit manual to guide internal audit function	( )	( )	( )	( )	( )
E. Independence and Objective of internal audit					
1. Internal audit is free from intervention in performing its audits	( )	( )	( )	( )	( )

2. Internal auditors feel free to include any audit findings in their audit reports	( )	( )	( )	( )	( )
3. Internal audit provides reports to the board of directors (or audit committee)	( )	( )	( )	( )	( )
4. Internal auditors do not participate in audit activities for the operation of which they were responsible	( )	( )	( )	( )	( )
F. Scope of internal audit function					
1. Internal audit function evolved towards a multi-audit services to strengthen the corporate governance of the bank:	( )	( )	( )	( )	( )
2. Internal auditors check the adequacy of the auditees' record keeping when appropriate	( )	( )	( )	( )	( )
3. Internal auditors verify accuracy of amounts in financial records	( )	( )	( )	( )	( )
4. Internal auditors review operational and financial performance	( )	( )	( )	( )	( )
5. Internal auditors evaluate the risk and internal control systems of the bank	( )	( )	( )	( )	( )
6. Internal auditors review the systems of safeguarding the assets of the bank	( )	( )	( )	( )	( )
7. Internal auditors identify a source of information on major frauds and irregularities	( )	( )	( )	( )	( )
8. Internal auditors check compliance with laws and regulations	( )	( )	( )	( )	( )
9. Internal auditors ascertain that operating objectives are consistent with organizational goals	( )	( )	( )	( )	( )
10. Internal auditors check efficiency and effectiveness of operating results	( )	( )	( )	( )	( )
11. Internal auditors assess the accomplishment of corporate	( )	( )	( )	( )	( )

goals and objectives					
12. Internal auditors ascertain that operating procedures are consistent with the operational goals	( )	( )	( )	( )	( )
13. Internal auditors assist the management by identifying risk exposures of the bank and other parties of corporate governance	( )	( )	( )	( )	( )
14. Internal auditors provide consulting services to the management where internal audit has the expertise	( )	( )	( )	( )	( )
G. Reporting and Implementation of Recommendations					
1. Internal audit function provides an overall opinion to board of directors (or audit committee)	( )	( )	( )	( )	( )
2. Internal auditors make recommendations for more effective and efficient use of resources	( )	( )	( )	( )	( )
3. Management takes timely corrective action based on internal audit recommendations	( )	( )	( )	( )	( )
4. Internal auditors follow-up implementation of corrective actions relating to audit findings	( )	( )	( )	( )	( )

Section III: Profile

Instruction: The following questions seek general information. Please provide your response by ticking (√) or writing.

1. Level of education: ( ) Diploma ( ) Bachelor's degree ( ) Masters Degree

   ( ) Other (specify) _____

2. Number of years of experience as an internal auditor_____

   Your experience in the bank _____

3. Professional certifications (if any) _____

F. B. E. LIBRARY

Additional comments

Annex II: Interviews

Dear Sir/Madam

The intent of this interview is to explore information regarding Internal Audit Functions in Ethiopian commercial banks to have sufficient response to the research problem in addition to questionnaires distribute to internal auditors of commercial banks. This interview will make with 13 purposely selected commercial banks head offices general managers (or deputy managers). The information obtain in response to the items in the interview will be used as part of the data needed for a study of *Internal Audit Function and Corporate Governance.*

I would like to assure you that the information you provide will be accessible only to the investigator. Your involvement is regarded as a great input to the quality of the research results. Hence, I believe that you will enlarge your assistance by participating in the study.

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Thank you for your participation

Kind regards,

Abraham Gebregiorgis Berhe, MSc student

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Department of Accounting and Finance

April 2011

Interviews

General information in relation to the Internal Audit Functions

1. Does your bank have an Internal Audit department, if not why?
2. How internal audit function supports the parties of corporate governance in discharging their duties (i.e. board of directors, audit committee and external auditors)?
3. Are internal auditors' reporting responsibilities to the audit committee or management?
4. What role an internal auditing and the functions of Internal Audit Department play in relation to internal control system and risk management?
5. What assurance and consulting service does the Internal Audit function provide?
6. Does the presence of the internal audit department ensure that the organization is continually reviewed and improved for higher effectiveness and efficiency? How?
7. In general, how can internal audit assist in developing and maintaining effective corporate governance?

Annex II: Interviews

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Annex III: Questionnaire Results

Note: N- number of responses; response measurements.....5 - Strongly agree (SA), 4 - Agree (A), 3 - Neutral (N), 2 - Disagree (DA), 1 - Strongly disagree (SD)

4.1.1. Organization Type

Table I. Descriptive Statistics of Organizational type

		Frequency	Percent	Valid Percent
Valid	State-owned	25	32.1	32.1
	Private	53	67.9	67.9
	Total	**78**	**100.0**	**100.0**

4.1.2. Internal Audit Charter

Table II. Descriptive Statistics of Internal Audit Charter

		IA definition	IA standard IIA
N	Valid	77	76
	Missing	1	2
Median		5.00	4.00
Mode		5.00	4.00

IA definition

		Frequency	Percent	Valid Percent
Valid	DA	1	1.3	1.3
	N	4	5.1	5.2
	A	31	39.7	40.3
	SA	41	52.6	53.2
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

IA standard IIA

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.3
	DA	6	7.7	7.9
	N	12	15.4	15.8
	A	39	50.0	51.3
	SA	18	23.1	23.7
	Total	76	97.4	100.0
Missing	System	2	2.6	
Total		**78**	**100.0**	

4.1.3. Auditee co-operation, Risk and IC practices in the bank

Table III. Descriptive Statistics of Auditee co-operation, Risk and Internal Control practices

		IA access	IA help	Value-added IA	Enough IC	IA know-how	RA as audit part	Risks program	IA follow-up
N	Valid	78	77	76	78	78	77	78	77
	Missing	0	1	2	0	0	1	0	1
Median		5.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00
Mode		5.00	4.00	4.00	4.00	4.00	4.00	4.00	4.00

IA has full access to records

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.3
	N	1	1.3	1.3
	A	28	35.9	35.9
	SA	48	61.5	61.5
	Total	**78**	**100.0**	**100.0**

IA co-operation (help) from auditees

		Frequency	Percent	Valid Percent
Valid	DA	6	7.7	7.8
	N	6	7.7	7.8
	A	42	53.8	54.5
	SA	23	29.5	29.9
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		78	100.0	

Auditees regard IA as value-added

		Frequency	Percent	Valid Percent
Valid	SD	6	7.7	7.9
	DA	14	17.9	18.4
	N	17	21.8	22.4
	A	22	28.2	28.9
	SA	17	21.8	22.4
	Total	76	97.4	100.0
Missing	System	2	2.6	
Total		**78**	**100.0**	

Adequate (Enough) IC in the bank

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.3
	DA	13	16.7	16.7
	N	12	15.4	15.4
	A	40	51.3	51.3
	SA	12	15.4	15.4
	Total	**78**	**100.0**	**100.0**

IA competence (know-how) is high in bank

		Frequency	Percent	Valid Percent
Valid	SD	4	5.1	5.1
	DA	11	14.1	14.1
	N	19	24.4	24.4
	A	33	42.3	42.3
	SA	11	14.1	14.1
	Total	**78**	**100.0**	**100.0**

RA is done as audit planning part

		Frequency	Percent	Valid Percent
Valid	SD	2	2.6	2.6
	DA	11	14.1	14.3
	N	19	24.4	24.7
	A	27	34.6	35.1
	SA	18	23.1	23.4
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

Risks identify audit program setting

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.3
	DA	6	7.7	7.7
	N	19	24.4	24.4
	A	34	43.6	43.6
	SA	18	23.1	23.1
	Total	**78**	**100.0**	**100.0**

IA follow-up use in ICS improvement

		Frequency	Percent	Valid Percent
Valid	DA	5	6.4	6.5
	N	12	15.4	15.6
	A	38	48.7	49.4
	SA	22	28.2	28.6
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

4.1.4. Internal Audit's role to External Auditors

Table IV. Descriptive Statistics of Internal Audit's role to External Auditors

		EA use IA reports	EA use IA working paper
N	Valid	78	77
	Missing	0	1
Median		4.00	3.00
Mode		4.00	3.00

EA use IA reports

		Frequency	Percent	Valid Percent
Valid	SD	2	2.6	2.6
	DA	10	12.8	12.8
	N	18	23.1	23.1
	A	27	34.6	34.6
	SA	21	26.9	26.9
	Total	**78**	**100.0**	**100.0**

EA use IA working paper

		Frequency	Percent	Valid Percent
Valid	SD	8	10.3	10.4
	DA	15	19.2	19.5
	N	32	41.0	41.6
	A	17	21.8	22.1
	SA	5	6.4	6.5
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

4.1.5. Proficiency of Internal Audit

Table V. Descriptive Statistics of Proficiency of Internal Audit

		IA budget	IA experience	IA policies for hiring & training	IA manual to guide IAF
N	Valid	78	78	77	77
	Missing	0	0	1	1
Median		4.00	4.00	3.00	4.00
Mode		4.00	4.00	3.00	4.00

IA obtain sufficient budget

		Frequency	Percent	Valid Percent
Valid	SD	2	2.6	2.6
	DA	10	12.8	12.8
	N	9	11.5	11.5
	A	42	53.8	53.8
	SA	15	19.2	19.2
	Total	**78**	**100.0**	**100.0**

IA has sufficient experience

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.3
	DA	10	12.8	12.8
	N	10	12.8	12.8
	A	42	53.8	53.8
	SA	15	19.2	19.2
	Total	**78**	**100.0**	**100.0**

IA has policies for hiring and training

		Frequency	Percent	Valid Percent
Valid	SD	4	5.1	5.2
	DA	18	23.1	23.4
	N	26	33.3	33.8
	A	18	23.1	23.4
	SA	11	14.1	14.3
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

Complete IA manual to guide IAF

		Frequency	Percent	Valid Percent
Valid	SD	3	3.8	3.9
	DA	5	6.4	6.5
	N	4	5.1	5.2
	A	39	50.0	50.6
	SA	26	33.3	33.8
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

Table VI. Descriptive Statistics of Level of education

		Frequency	Percent	Valid Percent
Valid	DIP	4	5.1	5.4
	DEG	67	85.9	90.5
	MAS	3	3.8	4.1
	Total	74	94.9	100.0
Missing	System	4	5.1	
Total		**78**	**100.0**	

Note: DIP- Diploma, DEG - Degree, and MAS – Master

Table VII. Descriptive Statistics of Years of Experience as Internal Auditor

		Frequency	Percent	Valid Percent
Valid	Less than five	37	47.4	53.6
	Five to ten	24	30.8	34.8
	More than ten	8	10.3	11.6
	Total	69	88.5	100.0
Missing	System	9	11.5	
Total		**78**	**100.0**	

Note: less than five - for less than five years, five to ten - five to ten years, and more than ten - more than ten years

Table VIII. Descriptive Statistics of Years of Experience in the bank

		Frequency	Percent	Valid Percent
Valid	Less than five	17	21.8	25.4
	Five to ten	22	28.2	32.8
	More than ten	28	35.9	41.8
	Total	67	85.9	100.0
Missing	System	11	14.1	
Total		**78**	**100.0**	

Note: less than five - for less than five years, five to ten - five to ten years, and more than ten - more than ten years

Table IX. Descriptive Statistics of Professional Certification

		Frequency	Percent	Valid Percent
Valid	NO	71	91.0	92.2
	YES	6	7.7	7.8
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

Note: Yes - has professional certification, No - don't have

4.1.6. Independence and Objective of Internal Audit

Table X. Descriptive Statistics of Independence and Objective of Internal Audit

		IA intervention	IA feel free to include any	IA reports to BoD (AC)	IA participation
N	Valid	76	76	77	76
	Missing	2	2	1	2
Median		4.00	4.00	4.00	4.00
Mode		4.00	4.00	5.00	5.00

IA free from intervention

		Frequency	Percent	Valid Percent
Valid	SD	2	2.6	2.6
	DA	10	12.8	13.2
	N	11	14.1	14.5
	A	31	39.7	40.8
	SA	22	28.2	28.9
	Total	76	97.4	100.0
Missing	System	2	2.6	
Total		**78**	**100.0**	

IA feels free to include any audit finding

		Frequency	Percent	Valid Percent
Valid	SD	2	2.6	2.6
	DA	9	11.5	11.8
	N	8	10.3	10.5
	A	34	43.6	44.7
	SA	23	29.5	30.3
	Total	76	97.4	100.0
Missing	System	2	2.6	
Total		**78**	**100.0**	

IA provide reports to BoD or AC

		Frequency	Percent	Valid Percent
Valid	SD	3	3.8	3.9
	DA	2	2.6	2.6
	N	7	9.0	9.1
	A	30	38.5	39.0
	SA	35	44.9	45.5
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

IA do not participate in activities

		Frequency	Percent	Valid Percent
Valid	SD	5	6.4	6.6
	DA	10	12.8	13.2
	N	8	10.3	10.5
	A	26	33.3	34.2
	SA	27	34.6	35.5
	Total	76	97.4	100.0
Missing	System	2	2.6	
Total		**78**	**100.0**	

4.1.7. Scope of Internal Audit Function

Table XI. Descriptive Statistics of Scope of IAF

		IAF & CG	IA check adequacy	IA financial record	IA operation & financial	IA risk & ICS	IA safeguard
N	Valid	73	78	78	78	78	78
	Missing	5	0	0	0	0	0
Median		4.00	4.00	4.00	4.00	4.00	4.00
Mode		4.00	4.00	5.00	4.00	4.00	4.00

Continued…..

IA frauds	IA comply	IA operation objectives	IA efficient effective	IA achieve goals	IA operation procedure	IA assist mgt risk	IA consults mgt
77	78	78	78	76	77	77	77
1	0	0	0	2	1	1	1
4.0000	5.00	4.00	4.00	4.00	4.00	4.00	4.00
4.00	5.00	5.00	4.00	4.00	4.00	4.00	4.00

IAF evolved in CG effectiveness

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.4
	DA	6	7.7	8.2
	N	10	12.8	13.7
	A	31	39.7	42.5
	SA	25	32.1	34.2
	Total	73	93.6	100.0
Missing	System	5	6.4	
Total		**78**	**100.0**	

IA check adequacy of record keeping

		Frequency	Percent	Valid Percent
Valid	DA	2	2.6	2.6
	N	3	3.8	3.8
	A	41	52.6	52.6
	SA	32	41.0	41.0
	Total	**78**	**100.0**	**100.0**

IA verify accuracy of financial records

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.3
	DA	1	1.3	1.3
	N	2	2.6	2.6
	A	36	46.2	46.2
	SA	38	48.7	48.7
	Total	**78**	**100.0**	**100.0**

IA review operational and financial

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.3
	DA	1	1.3	1.3
	N	1	1.3	1.3
	A	41	52.6	52.6
	SA	34	43.6	43.6
	Total	**78**	**100.0**	**100.0**

IA evaluate the risk and ICS of bank

		Frequency	Percent	Valid Percent
Valid	SD	2	2.6	2.6
	DA	4	5.1	5.1
	N	6	7.7	7.7
	A	37	47.4	47.4
	SA	29	37.2	37.2
	Total	**78**	**100.0**	**100.0**

IA review safeguarding of assets

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.3
	DA	2	2.6	2.6
	N	8	10.3	10.3
	A	34	43.6	43.6
	SA	33	42.3	42.3
	Total	**78**	**100.0**	**100.0**

IA identify sources of major frauds

		Frequency	Percent	Valid Percent
Valid	N	5	6.4	6.5
	A	42	53.8	54.5
	SA	30	38.5	39.0
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

IA check compliance with laws and regulation

		Frequency	Percent	Valid Percent
Valid	A	35	44.9	44.9
	SA	43	55.1	55.1
	Total	**78**	**100.0**	**100.0**

IA ascertain operating objectives

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.3
	DA	3	3.8	3.8
	N	10	12.8	12.8
	A	28	35.9	35.9
	SA	36	46.2	46.2
	Total	**78**	**100.0**	**100.0**

IA check efficiency and effectiveness

		Frequency	Percent	Valid Percent
Valid	SD	3	3.8	3.8
	DA	5	6.4	6.4
	N	14	17.9	17.9
	A	33	42.3	42.3
	SA	23	29.5	29.5
	Total	**78**	**100.0**	**100.0**

IA assess accomplishment of goals

		Frequency	Percent	Valid Percent
Valid	SD	2	2.6	2.6
	DA	9	11.5	11.8
	N	14	17.9	18.4
	A	32	41.0	42.1
	SA	19	24.4	25.0
	Total	76	97.4	100.0
Missing	System	2	2.6	
Total		**78**	**100.0**	

IA ascertain operating procedures

		Frequency	Percent	Valid Percent
Valid	DA	5	6.4	6.5
	N	9	11.5	11.7
	A	41	52.6	53.2
	SA	22	28.2	28.6
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

IA assists management by identifying risk

		Frequency	Percent	Valid Percent
Valid	SD	2	2.6	2.6
	DA	6	7.7	7.8
	N	6	7.7	7.8
	A	42	53.8	54.5
	SA	21	26.9	27.3
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

IA provide consulting services management

		Frequency	Percent	Valid Percent
Valid	SD	3	3.8	3.9
	DA	4	5.1	5.2
	N	12	15.4	15.6
	A	39	50.0	50.6
	SA	19	24.4	24.7
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

4.1.8. Reporting and Implementation of Recommendations

Table XII. Descriptive Statistics of Reporting and Implementation of IA Recommendations

		IA report to BoD (AC)	IA makes recommendations	Mgt actions	IA follow-up implementation
N	Valid	77	77	77	77
	Missing	1	1	1	1
Median		4.00	4.00	4.00	4.00
Mode		4.00	4.00	4.00	4.00

IA provide overall opinion to BoD or AC

		Frequency	Percent	Valid Percent
Valid	SD	1	1.3	1.3
	DA	3	3.8	3.9
	N	11	14.1	14.3
	A	34	43.6	44.2
	SA	28	35.9	36.4
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

IA makes recommendations

		Frequency	Percent	Valid Percent
Valid	DA	4	5.1	5.2
	N	7	9.0	9.1
	A	35	44.9	45.5
	SA	31	39.7	40.3
	Total	77	98.7	100.0
Missing	System	1	1.3	
Total		**78**	**100.0**	

Declaration

I, the undersigned, declare that this thesis is my original work, has not been presented for degree in any other university and that all sources of materials used for the thesis have been duly acknowledged.

Declared by:

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Name: Dr. P. Laxmikantham

Signature_____

Date_____

Place and date of submission: Addis Ababa University, June 2011