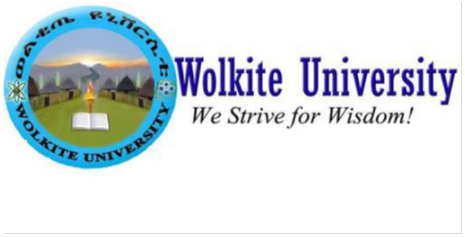
ASSESSING THE EFFECT OF CORPORATE GOVERNANCE ON THE INDEPENDENCY OF INTERNAL AUDIT FUNCTION: A CASE STUDY ON ETHIOPIAN PRIVATE COMMERCIAL BANKS

A thesis Submitted to the Department of Accounting and Finance in Partial Fulfillment of the Requirement for the Degree of Master of Science (MSc.) in Accounting and Finance.

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ABSTRACT

The concept of internal audit independence is an area of concern for all commercial banks, it will continue to be an important issue that must be addressed.. Therefore, the study has established how the independence of internal audit is affected by various corporate governance factors among commercial banks in Ethiopia. Data was collected using structured questionnaires distribute to all internal audit department managers, heads of audit and inspection division and risk and compliance officers/managers of the 16 private commercial banks in Ethiopia. Data collected was analyzed by descriptive statistics aided by SPSS version 20 data analysis tool. A regression model was used to analyze the relationship between internal audit independence and level of corporate governance factors within a test of significance of 95% confidence level. The study has revealed that there is positive linear relationship between independence of Internal audit function and the corporate governance factors; corporate governance setting (CGS), senior management support (SMS),effect of Remuneration committee(ERC),effect of Qualification and Experience of internal audit staff(EQEIAS)), Effectiveness of audit committee (EAC)) and Perception of Internal audit independence (POI) among private commercial banks in Ethiopia.

The results of this study can inform bard of directors on the extent to which important factors factor are considered in the establishments of corporate governance they help the independency of internal audit.

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My deepest gratitude is also to my family for their continuous support. Words are not enough to describe my indebtedness to my sister. She has sacrificed so much and helped me become who I am now and placed me on the path where I am today. To the above-mentioned people and to those who have not been mentioned, your sacrifice and encouragement are greatly appreciated and will always be in my memory. This thesis would not have been possible without constant support from all of you.

CHAPTER ONE

1. INTRODUCTION

1.1 Background of the Study

Corporate governance can be defined as the process and structure used to manage the organizations and it can be referred to as how those organizations are directed, controlled; how policies, laws are designed; and how control environment affect the overall performance of entrepreneurial activities in an economy. Effective and good corporate governance is important to the proper functioning of the corporation and it improves economic efficiency and growth as well as enhances investor confidence (Alem, 2011).But poor corporate governance can be brought by lack of integrity on the selection criteria for choosing leaders and managers who run corporations, lack adequate remuneration system to the management, inappropriate balance between executive and non-executive members of the board. These leaders may lack experience, appropriate training and proper qualifications. Recent change in ownership structure results in increasing ownership of equity shares by institutional investors in forming corporation or share companies (Jensen and Meckling 1976).

The standards of corporate governance set the nature of the relationship among shareholders, members of board of directors, managers, employees and other corporations and persons with whom the company has business links. It mainly protects the rights of the company and its participant groups and specifies their obligations (Massie, 2000).

During the last decade, new approaches of the corporate governance, totally confirmed the board's responsibility for ensuring effectiveness of their organization’s internal control framework. These theories stressed the key role that internal audit can play in supporting the board in ensuring adequate oversight of internal controls and in doing so form an integral part of an organization’s corporate governance framework. The key role of internal audit is to assist the board and/or its audit committee in discharging its governance responsibilities. (Radu& Ramona, 2013)

Internal Auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations(The Institute of Internal Auditors IIA, (2004). Internal auditors are employees of the organization and work exclusively for the organization. They assist staff of an organization in performing their responsibilities by furnishing them with analyses, appraisals, recommendations, and counsel. A widely accepted definition of internal audit published by the Institute of Internal Auditors (IIA) is "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."(Institute of internal auditors).

The term 'independence' as "an expression of professional integrity of the individual. Independence requires avoidance of situations which would tend to impair objectivity or permit personal bias to influence delicate judgment" (Hemraj (2003).

Corporate governance concerns the way a company is operated Sand directed and in particular encompasses the operations of the board and audit committee, as well as the overall control and risk management framework (Association of Chartered Certified Accountants, 2005, p.71).

1.2 Statement of the Problem

The standard of corporate governance sets the nature of the relationship among shareholders, members of board of directors, managers, employees and other stakeholders with whom the company has business links. It mainly protects the rights of the company and its participant groups which are mentioned above and specifies their obligations. Therefore, corporate governance principles are important in terms of setting the rights and obligations of the said groups and ensuring investor confidence.

The private commercial banks are corporations that have a dominant position in developing economic financial systems, and they are important engines of economic growth of a country (Levine, 1997). Banking failure would affect the entire financial system and economy of a country. Therefore, in order to ensure the improvement of the company performance, economic

efficiency and growth, and to enhance investors‟ confidence; strong, effective and good corporate governance has to be developed and implemented.

Banking industry in Ethiopia is in a rudimentary and fragile state. It is small, relatively undeveloped, closed and characterized by a large share of state ownership (Admassu & Asayehgn, 2014). The state- owned commercial banks account for nearly two-thirds of the banking sector assets. However, the contribution of the private banking is showing growth. The banking industry, unlike other sectors is tightly controlled one and corporate governance framework is highly dictated by the National Bank of Ethiopia (NBE). While there is strong evidence that independence of internal audit is very important corporate governance tool, in most organizations the corporate governance systems are not designed in such a way that internal audit can maintain its independence and add value to the organization.

Ethiopian private banks have not been without these corporate governance shortcomings. This study assessed whether the corporate governance affects independence of internal audit function of private commercial banks in Ethiopia. Similar thesis is prepared previously by some researcher. Hence I try to sought to show selected variables which have been uncovered by those researcher.

When we see developing countries specifically in Ethiopia some studies on corporate governance have been conducted previously. But corporate governance mechanisms were not covered sufficiently by those studies. And the number of observations was limited in those studies. To mention some of the observations' limitations: Using narrow period or number of years and small sampling size. Methodology of data gathering and analyzing focused by some of the studies were limited only on secondary data. In addition, this study focuses on the privately owned commercial banks since majority of banks in Ethiopia are those banks and they are significantly differs on some aspects as compared to the government owned commercial banks. And most of our private commercial banks are almost at the same size, level or category and may help in order to reach on reasonable results. This also could help to see their linkage with the corporate governance mechanisms. Previously there were no studies conducted by focusing only on privately owned commercial banks. Therefore, it is difficult to generalize the same result from the findings of the studies that were done in developed countries, for relatively small size

Ethiopian private commercial banks' governance mechanisms. Ethiopian banking sector's corporate governance is characterized by the absence of an organized share market and the country has different rules, regulations, practices, and economic features which needs to conduct a separate study using various perspectives, meaning they were concentrated on agency theory which is the central need to cooperate governance are to protect the interest of shareholders only have not been conducted within a well-organized corporate governance mechanism. This study has been conducted to provide empirical evidence particularly on the *Corporate Governance and its Effect on Financial Performance of the Ethiopian Private Commercial Banks*.

Effect of corporate governance mechanisms on privately owned commercial bank's financial performance.

To come up with a better insight; this study covers by assessing and including selected corporate governance mechanisms major areas of board of director characteristics, regulation aspects, shareholder and depositor related issues (specifically the independent variables: board gender diversity, directors educational qualification, number of board sub-committee, meeting frequency of board, board ownership, regulations of legal reserve and liquidity and depositor influence). Hence this paper sought to determine the relationship between selected corporate governance mechanisms, which have been sufficiently uncovered variables in the previous studies in order to further be explained and financial performance of the private commercial banks with in the given period of time which was measured by the return on asset (ROA).

This study fills the gaps and serves as points of reference for further research in corporate governance and provides empirical evidence on the effect of corporate governance mechanisms on financial performance of the banks by taking in to consideration the variables, observations and sampling methodologies related to the realities of the banks 'governance mechanism in Ethiopia.

1.3 Objective of the Study

1.3.1 General objective

The core objective of this study is to examine the effect of corporate governance on the independence of internal audit function in Ethiopian private commercial banks.

1.3.2 Specific objectives

More specifically, the objectives of this study are as follows:-

- To identify the effect of existing corporate governance setting on independence of internal audit function
- To investigate the effect of effectiveness of audit committee on independence of internal audit function

- To analyze the effect of senior management support as corporate governance mechanism on independence of internal audit function
- To assess the effect of qualification and competence on independence of internal audit function
- To investigate the effect of effectiveness of remuneration committee on independence of internal audit function
- To analyze the effect of nomination committee on independency of internal audit function

1.4. Research Hypothesis

In order to achieve the objectives of the study, a number of hypotheses were tested regarding the effect of corporate governance on the independence of internal audit function in Ethiopian private commercial banks based on different empirical research and theoretical reviews. These testable hypotheses were stated as follows;

- Hypothesis1: Corporate governance setting has a positive significant effect on independence of internal audit function in Ethiopian private commercial banks
- Hypothesis2: Effectiveness of audit committee has a positive significant effect on independence of internal audit function in Ethiopian private commercial banks
- Hypothesis3: There is a positive relationship between senior management support as corporate governance mechanism and independence of internal audit function
- Hypothesis4: There is a positive relationship between Qualification and competence, and independence of internal audit function in Ethiopian private commercial banks
- Hypothesis5: Effectiveness of remuneration committee has a positive significant effect on independence of internal audit function in Ethiopian private commercial banks
- Hypothesis6: Nomination committee has a positive significant effect on independence of internal audit function in Ethiopian private commercial banks

1.5 Significance of the Study

As mentioned above in the main objective of the research, the aim is to examine the relationship between corporate governance factor and independency of internal audit function on private

commercial banks and it will contribute to commercial banking firms by identifying relevant corporate governance factor and how these governance factor affect internal audit function on private commercial banks in Ethiopia. The result of this study contributes to the existing literature by providing evidence on the relation between corporate governance factor and private commercial banks 'internal audit function. The empirical results would also be the general indicators of corporate governance mechanisms useful for regulators, managers and business people in making policies and decisions. The study may serve as a reference material for other researchers who need to make a research on this area at larger scale to carry out comparison among other banks. And also, this study may contribute to practitioners by providing proper responses to the questions.

The study documented important findings on the corporate governance practices in Ethiopian banking industry that may affect internal audit independence for future exploration.

The study may serve as a reference material for other researchers who need to make a research on this area at larger scale. And also, this study may contribute to practitioners by providing proper responses to questions

1.5 Structure of the Thesis

This thesis has five chapters. Chapter one introduces the background of the study by providing the background information, statement of problem, objective of the study, the research question, scope of the study and significance of the study high lights of the methodology and limitation of the study. Chapter two deals with a review of the relevant literature on the related topics while, chapter three outlines the methodology and tools used in the study. Chapter four provides the interpretation and analysis of findings. Chapter five deals with summary, conclusions and recommendations.

CHAPTER TWO

LITERATURE REVEW

2.1 Theoretical Literature review

Definition and Theory of Corporate Governance

"Corporate Governance is the process and structure used to direct and manage the business and affairs of the corporations with the objective of enhancing shareholder value, which includes ensuring the financial viability of the business (Toronto Stock Exchange, annex II).

The process and structure define the division of power and establish mechanisms for achieving accountability among shareholders, the board and management."

There is no single model of good corporate governance. However, work carried out in both OECD and non-OECD countries and within the Organization has identified some common elements that underlie good corporate governance. The Principles are non-binding and do not aim at detailed prescriptions for national legislation. Rather, they seek to identify objectives and suggest various means for achieving them. Their purpose is to serve as a reference point. They can be used by policy makers as they examine and develop the legal and regulatory frameworks for corporate governance that reflect their own economic, social, legal and cultural circumstances, and by market participants as they develop their own practices (OECD 2004, P 14)

Corporate governance comprehends that structure of relationships and corresponding responsibilities among a core groups consisting of shareholders, board members and managers designed to best foster the functioning of the banking sector and the economy as a whole (The Organization for Economic Co-operation and Development (OECD)

Banks' safety and soundness are key to financial stability, and the manner in which they conduct their business is central to economic health. Governance weaknesses at banks that play a significant role in the financial system can result in the transmission of problems across the

banking sector and the economy as a whole. (Basel Committee Guideline for Banking Supervision 2014).

2.2 Corporate Governance in Ethiopia

Fekadu Petros (2010) as cited by Hussein Ahmed Tura underlined the growing separation between ownership and control in Ethiopia and he provided some empirical evidence in this regard. Relying on the data and literature on corporate governance, he discussed the deficiency of the Commercial Code in protecting the rights of minority shareholders in the context of publicly held companies. He raises crucial issues such as: "what power does the board have? Who is it accountable to? How is it organized? What are its standards of liability?" among others. In his book titled 'Ethiopian Company Law' (2011),. Fekadu further addresses most of the issues in corporate governance related to board of directors (Hussein Ahmed Tura, 2012).Tewodros Meheret (2011) discussed the legal regime applicable to governance of share companies in Ethiopia. He explored the theoretical background and legal framework of corporate governance and examined the rules of governance in light of available standards. In particular, he discussed the structural choices, appointment and removal, powers, duties and responsibilities, remuneration, and the working methods and mechanism for controlling the boards of directors. Tewodros stated, "a share company is managed by its board which is composed of directors appointed by the general meeting of shareholders."

(Hussein Ahmed Tura 2012) further enlightened that there are a number of companies that are being formed by sale of shares to the wider public unlike most share companies in the past, which were formed among founders. The emergence of publicly held share companies in Ethiopia give rise to a multitude of issues on corporate governance.

Typically, ownership separates from the control of dispersed shareholders and goes into the hands of few managers, which in turn creates the principal-agent relationship. In such situations, agents (managers) may misappropriate the principals' (shareholders') investments as they have more information and knowledge than the shareholders do. Where there exist few block holders in share companies, minority shareholders could be exploited in the hands of such block holders

(Hussein Ahmed Tura 2012) concluded that the agency problems that could occur between dispersed shareholders and managers and/or bloc holders of share companies in Ethiopia, have necessitated good corporate governance laws and institutions.

It is generally accepted that the correlation between internal auditing and corporate governance affects all kinds of economic activity and that the perceived implications and consequences of this interaction have changed considerably in the recent years. Internal auditing and corporate governance have now become a matter of major public concern. In this concept, international guidelines perceive that effective cooperation of corporate governance and internal auditing improves performance, and is a source of competitive advantage. The contribution of internal auditing to corporate governance is depicted via demarcating the relationship between internal audit and key elements of corporate governance. It is also a fact that the Board of Directors has been recognized as the key player in corporate governance by regulators and governance committees around the world (US Congress, 2002; ASX, 2003, *Drogalas, Gotzamani &Tampakoudis 2010)*

This chapter presents review of literature related to independence of internal audit function and corporate governance. It consists of general overview about internal audit function, corporate governance and effect of corporate governance on independence of internal audit function. In general, this chapter attempts to synthesize existing empirical research in the area of internal audit independence and corporate governance and ends up by summarizing the review and identifying the gap in the existing literature.

2.3 Definition and Theory of Internal Audit

Historically, internal audit has been considered as a monitoring function, the "organizational policeman and watchdog" (Morgan, 1979) and is tolerated as a necessary component of organizational control but deemed subservient to the achievement of major corporate objectives Drogalas (2010). However, Institute of Internal Auditors, IIA, (1991); Taylor and Glezen, 1991; Konrath, (1996) defines internal auditing as "an independent appraisal function, established within an organization to examine and evaluate its activities as a service to the organization".

By measuring and evaluating the effectiveness of organizational controls, internal auditing, itself, is an important managerial control device (Carmichael et al., 1996), which is directly linked to the organizational structure and the general rules of the business (Cai,1997).

The new definition of internal auditing focus on corporate governance especially the board of directors; this definition emphasizes internal audit's role in aiding the entity to achieve its objectives. Because of the fact that the board of directors is ultimately responsible for the entity's accomplishment of its objectives, the internal auditor's contribution is providing information to that group (Colbert, 2002). Apart from the above, internal audit's role is crucial in assisting the board of directors in its governance self-assessment.*(Drogalas, Gotzamani &Tampakoudis 2010)*

2.4 Independence of Internal Audit Function

The concept of independence is generally used to mean the ability of the auditor to be fair and objective in his/ her review and appraisal and not to be under undue pressure from any party to the extent that this could bias his /her opinion (Wahid AbuAzza (2012). The IIA's Standards for Professional Practice of Internal Auditing glossary) defines independence of internal auditors as:

> *'The freedom from conditions that threaten objectivity or the appearance of objectivity. Such threats to objectivity must be managed at the individual auditor, engagement ,functional and organizational levels'(Institute of Internal Auditors 2011b)'*

Independence of IA has been identified by the IIA, the American Institute of Certified Public Accountants (AICPA) and others as crucial to the viability of the IA function. The IIA has issued a number of attribute standards under which the IIA explored the issue of independence in the ISPPIA, more specifically, the Standard 1100 Independence and Objectivity. This standard states the internal audit activity should be independent in performing their work'. The standard 1100 states:

'Independence is the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner'(Institute of Internal Auditors 2011d'

To achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the chief audit executive has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship. Threats to independence must be managed at the individual auditor, engagement, functional, and organizational levels. (IIA Guide1100)

It is still an on-going discussion on the reporting roles for the internal audit function. Some authors suggest that in order to secure internal auditor's independence it is best to give the entire reporting role to the audit committee (Abbott et al., 2012; Haron et al., 2012), but IIA's definition includes consulting and adding value because internal auditors can help the organization to reach the goals (Ali" and Rusjan, 2009).

The IIA (1999) for definition of internal auditing saying, "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes" is now familiar and well accepted.

This definition highlights the independence and objectivity of internal auditing with respect to both assurance services and consulting. Independence and objectivity are closely related and are sometimes used within the IIA Standards in a somewhat circular manner. Indeed, the IIA (2001) acknowledges that the terms have been used interchangeably and with a lack of clarity. However, the Glossary to the IIA Standards distinguishes between the two concepts in the following way:

"Independence: – The freedom from conditions that threaten objectivity or the appearance of objectivity.

"Objectivity: – An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made. Objectivity requires internal auditors not to subordinate their judgment on audit matters to that of others."

(a) Independence of Mind

The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

(b) Independence in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that affirms, or a member of the audit team's, integrity, objectivity or professional skepticism has been compromised. (Canadian Perspectives-Auditor Independence Discussion Paper September2012).

2.5 Objective and Function of Internal Audit

The internal audit function is responsible for evaluating, and commenting on the effectiveness of risk management, control and corporate governance process.(According to Association of Chartered Certified Accountants (2005 p. 77),

2.6 The Need for Independence of Internal Audit Function

Auditor independence and objectivity are the cornerstones of the profession. The assurance services provided by auditors derive their value and credibility from the fundamental assumptions of independence of mind and independence in appearance. (Stewart and Subramaniam, 2008)

Prior research on auditor independence and objectivity has been undertaken predominantly in the context of external audit. However, in more recent years, there has been heightened interest in issues associated with the independence and objectivity of internal audit. However, studies by Travis P. Holt (2009) in the context of internal audit emphasize the need for Information asymmetry and governance transparency by citing the scholarly recommendations of Jensen and

Meckling (1976) model in agency relationship between the managers of a firm and the shareholders of a firm.

There are inherent problems (e.g., moral hazard and information asymmetry) in contractual relationship between managers and shareholders because the managers of the firm have inside information and may not always make decisions that are most advantageous for the firm shareholders (e.g., Jensen and Meckling 1976; Eisenhardt 1989). As a result, shareholders and rule-making bodies implement corporate governance mechanisms to monitor firm activities to ensure that the managers of a firm are acting as proper stewards of firm assets. These accounting, auditing and governance mechanisms are a critical part of the capital markets system (Travis P.Holt 2009; P 7.).

2.7 Internal Audit in Banking Business

Internal audit will normally produce an annual plan of work to be performed, concentrating on areas of higher risk. Structured timetables and work programs (e.g. audit programs) will then be designed for each assignment. At the end of each review, an audit report will normally be prepared for senior management attention and action. Ad hoc assignments may also be performed at the request of senior management where problems or irregularities require further investigation. Further, there are real advantages in ongoing internal audit involvement in major projects, including systems developments. In this way audit concerns can be addressed up-front and action taken before the problem becomes too entrenched (Basel Committee report 2012)

2.8 Overview of Banking Industry in Ethiopia

The banking industry differs fundamentally from other industries in any country. An apparent area of variation is in the products and services it provides. Banks mainly deal with the liquid and largely risky assets of business, cash and cash equivalents. Two key differences distinguish the governance of banks from that of non-financial firms. The first is that banks have many more stakeholders than non-financial firms. The second is that the business of banks is opaque and complex and can shift rather quickly. (Hamid Mehran Alan Morrison June 2011).

Banks lie at the heart of the world's financial system. They represent the source we often visit to find a loan to purchase a home or automobile, start a new business, or finance a college education etc. (Peter and Sylvia, 2008).

For the fact that the banks have differences in the scale, diversity, complexity and geographical coverage, each bank is adopting different management structures. Of particular significance is the functioning of the internal audit unit in the various banks. Each bank is subject to different degrees and types of risks. The internal audit function is therefore tailored in such a way as to manage the risk exposure of the banks (Mahama, 2009) As discussed by (Admassu Bezabeh and Asayehgn Desta 2014) banking history in Ethiopia like any share companies has passed through several stages of state systems. Banking institutions have been springing up in all corners of the country during the past few years of Ethiopia's economic history private commercial banks being introduced into the country.

The banking sector in Ethiopia has been dominated by the state-owned Commercial Bank of Ethiopia (CBE). The level of financial intermediation in Ethiopia was low in part due to the public's lack of confidence in the banking sector. This in turn is due to a very weak supervisory framework, dominant state ownership, and its widespread lending directed by the National Bank of Ethiopia (NBE) (Admasu Bezabeh & Asayegn Desta, 2014).

2.9 Corporate Governance in Private Banks of Ethiopia

the Voluntary Code of Corporate Governance for Ethiopia" was adopted on 3 June 2011 under the patronage of AACCSA the adoption of the Code, without doubt, can be taken as a good step towards introducing standards of good corporate governance in Ethiopia in a detailed and comprehensive manner According to Hussein Ahmed Tura, (2012). The industry comprises one state-owned development bank and 18 commercial banks, two of which are state-owned, including the dominant Commercial Bank of Ethiopia (CBE), with assets accounting for approximately 70 percent of the industry's total holdings. The National Bank of Ethiopia (NBE) as the country's central bank was first established in 1963. On May 1991, a new Monetary and Banking Proclamation No.83/1994 was enacted and reorganized the bank according to the market-based economic policy so that it could foster monetary stability, a sound financial system and such other credit and exchange conditions conducive to the growth of the country's economy (Ayele, A.G 2013).

Implementing good corporate governance practices in the banking sector clearly facilitates the NBE's most important goal of fostering monetary stability and a sound financial system in the country (Ayele A.G (2013). Moreover, in order to give teeth to the powers of the NBE, the law has empowered it to supervise compliance of rules by banks through onsite and offsite supervision mechanisms and to impose various sanctions on a non-complying bank. As stated by Hussein Ahmed Tura (2012), the definition of 'corporate governance' is not provided under the Ethiopian company law. For the purpose of this study, it is thus important to adopt a working definition for corporate governance as a system of rules and institutions that determine the control and direction of a company and that define relations among the company' primary participants including board of directors, managers, shareholders and other stakeholders.

This combines the narrow and broad definitions and it considers corporate governance as a system of rules and institutions which determine the control and direction of a company. It recognizes not only shareholders but also stakeholders that should be involved in the governance of share companies.

2.10 Relationship between Independence of Internal Audit Function and Corporate Governance

Internal audit function to raise its organizational stature, it was critical that it forge a strong relationship with "those charged with organizational governance," and communicates directly to the audit committee (The Institute of Internal Auditors Research Foundation (IIARF) (2013. There is much evidence today that such a reporting relationship is being widely viewed as a best practice in the most progressive corporations committed to enhancing governance structure and processes. Principle 13 of the Basel Committee on internal audit function explains internal audit function as third line of defense next to other operational and risk management controls. However, an internal audit function could be viewed as a first line of defense against inadequate organization governance and financial reporting. (Njeru M.Edwin, 2011). With appropriate support from the board and audit committee, the internal audit is in the best position to gather intelligence on inappropriate accounting practices, inadequate internal controls and ineffective corporate governance (Zekele, 2007). It is therefore an integral and necessary part of an effective

corporate governance framework. Alongside the board, executive management and external audit, internal audit is one of the cornerstones of good corporate governance.

For organizational independence to be effectively achieved the chief audit executive reports functionally to the board Institute of Internal Auditors (2011). Monitoring, assessing, and analyzing organizational risks and controls; and reviewing and confirming information and compliance with policies, procedures, and laws. Working in partnership with management, internal auditors provide the board, the audit committee, and executive management assurance that risks are held the organization's corporate governance is strong and effective.(Hermanson and rittenberg,2003) from the Institute of Internal Auditors Research. When there is room for improvement anywhere within the organization, the internal auditors make recommendations for enhancing processes, policies, and procedures (Hermanson and Rittenberg,2003) The literatures here above indicate the existence of relationship between internal audit function and corporate governance factors of the organizations.

2.11 Corporate Governance Factors Affecting Independence of Internal Audit Function

One of the cornerstones of corporate governance theory is internal auditors are expected to work with audit committees, boards and senior management to help set the right "tone at the top". They also help to ensure that ethical behavior flows down through the ranks to lower level employees (IIA, 2003; Brown etal, 2003; Bailey et al., 2003).

2.11.1 Corporate Governance Setting

The International Standards of Supreme Audit Institutions (ISSAI), the Institute of Internal Auditors (the IIA) and International Standards for the Professional Practice of Internal Auditing

(Standards), have presented general terms to allow adoption in different national contexts with the understanding that implementation will be governed by the environment in which the internal audit activity carries out their responsibilities and in accordance with the applicable laws and regulations. The IIA's Standards are universal and are intended to apply to all members of the internal audit profession. The IIA's Standards and Code of Ethics recognize the importance of internal auditor maintaining their independence and objectivity when performing their work,

irrespective of whether the internal auditors are engaged in public or private sector audits. In addition, the IIA Standards advocate a strong system of internal control that is monitored by a well-resourced internal audit activity as a fundamental feature of good governance. In the public sector, a strong system of governance is essential in ensuring adequate service delivery to the public at large. Legislative requirements to establish an internal audit activity helps protect the funding and independence of the internal audit activity and recognize internal audit as an important function in the public sector.

There is still lack of well-developed internal audit standards to guide and govern the relationship with the corporate governance. The Government of Ethiopia has emphasized internal auditing in the country post 1991(Mihret, Mula & James 2009) as well. The Ethiopian Prime Minister established in 1994 a taskforce to propose recommendations to upgrade internal audit in government offices .They also discussed the recommendations of the taskforce that had become basis for legal backing which was granted to internal audit by issuing the Councils of Ministers Financial Administration Regulation (CMFAR) (Federal Government of Ethiopia 1996) which provided the Ministry of Finance and Economic Development (MoFED) with the responsibility to monitor and regulate internal audit in the public sector and to develop an internal audit manual for use by all internal audit departments of public bodies. (Mihret, James & Mula 2012)

With respect to the bank internal audit, Basel Committee on banks supervision on Internal audit function, Principle 2 states that the bank's internal audit function must be independent of the audited activities, which requires the internal audit function to have sufficient standing and authority within the bank, thereby enabling internal auditors to carry out their assignments with objectivity. Therefore, this research will be designed to assess the effect of corporate governance settings such as Governance guidelines if any, External compliance requirements and internal bank policy requirements for the independence of internal audit function in the context of Ethiopian private banks.

2.11.2 Senior Management Support

The majority of employees perceived the internal audit department to have the support of senior management, which is in line with the Standards for the Professional Practice of Interna Auditing (SPPIA).

More high-level employees had a perception that internal audit had the support of management than the employees on lower levels. In reality, internal audit does have the support of senior management, yet the majority of employees perceived internal audit to be not independent. Therefore, it would seem that in the eyes of employees, senior management support does not enhance internal audit's independence.

For the professional development of employees, Hepworth & Noel (2002) argued that staffing professional employees increase effectiveness of internal auditing, and that an internal auditor should pursue continual professional development by seeking membership at professional auditor and accountant associations both nationally and internationally and obtain world-class accreditation, All in all, this will help improving effectiveness of the internal auditing process. On the other hand, Shahrori (1999) advised recruiting competent and well-qualified staff to support internal auditing activities and departments. *(Seif Obeid ALshbiel & Hussein Ali AL-Zeaud 2012)*

The research in this area focused on identifying the factors that potentially influence independence and assessing their effect upon internal audit independence. These include Response to findings, Training and Development Support and Recruitment and Training of internal auditors. All these were tested within Ethiopian private banks through this research.

2.11.3 Effectiveness of Audit Committee as Corporate Governance Tool

Study by Ramadili & Karbhari (2009) indicates that audit committee could significantly safeguard auditor independence if members are truly independent, knowledgeable and are committed to improve good governance without fear and favor. There is an urgent need for the committee to go beyond procedural compliance, which address issues on good governance, internal control structure over financial reporting, internal audit issues and the role of the head of

accounting and finance division with internal audit (monitoring) division (Ramadili & Karbhari 2009)

An effective audit committee should strengthen the position of the internal audit function by providing an independent and supportive environment where the chief internal auditor (CIA) can\ raise matters affecting management (Braiotta, 1999; Goodwin and Yeo, 2001; Goodwin, 2004).

One of the essential elements in determining the effectiveness of internal audit is the reporting structure, which requires direct reporting to the audit committee (Krishnamoorthy, 2008; Owolabi & Dada, 2011).As quoted by Mu'azu Saidu Badara & Siti Zabedah Saidin June (2014); recent concern over the audit committees as one of the mechanisms of corporate governance has received tremendous attention especially when considering audit committee members. Constituting people with high caliber that have some degree of independence, qualification, experience and knowledge as indicated by (Alkdai & Hanefah, 2012; Nimer et al, 2012; wolabi & Dada, 2011; Quigley 2012, Owolabi and Dada (2011) revealed that effective audit committee will definitely enhance reliable, dependable, effective and efficient corporate governance; this is because its establishment in the corporate governance has led to reduction of corporate ineffectiveness (*Mu'azu Saidu Badara & Siti Zabedah Saidin June 2014).*

Audit Committee has the responsibilities of measuring performance of the internal audit function, appointment and dismissal of the heads of internal audit, recommending the appointment and dismissal of external auditors, support and promote the audit function within various organizations such as independence and objectivity (Davies, 2009). BCBS (2012) states the main areas of responsibility of the audit committee with respect to bank internal audit function as:

a. monitoring and reviewing the effectiveness of the bank's internal audit function;
b. approving the internal audit plan, scope, cycle (if any) and budget;
c. reviewing and discussing internal audit reports;
d. ensuring that the internal audit function maintains open communication with senior management, external auditors, the supervisory authority, and the audit committee;

e. reviewing discoveries of fraud and violations of laws and regulations as raised by the head
f. of the internal audit function;
g. approving the audit charter and the code of ethics of the internal audit function;
h. **g**. approving, or recommending to the board for its approval, the annual remuneration of the internal audit function as a whole, including the head of the internal audit function;
i. reviewing the assessment by senior management of the head of the internal audit function and of the key internal auditors; and
j. Approving, or recommending to the board for its approval, the appointment, reappointment or removal of the head of the internal audit function and the key internal auditors.

This research assessed how effective is audit committee as corporate governance tool affects the independence of internal audit function. This was tested on the data collected within Ethiopian private commercial banks.

2.11.4 Perception of Independence (Mind and Appearance)

Auditor independence and objectivity are the cornerstones of the profession. The assurance services provided by auditors derive their value and credibility from the fundamental assumptions of independence of mind and independence in appearance' (Paape, 2007).

The IFAC distinguishes between independence of mind and independence in appearance (Quick & Warming-Rasmussen, 2005:138). The appearance of independence is an important facet of the regulation of auditor independence (Geiger et al., 2002). The importance of auditor independence, both actual and as perceived by others, has been widely recognized both in theory and by regulato Srs (Geiger et al. 1999:3) (Mathose, 2013) independence of mind is defined as the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism (Mathose (2013),.

Independence in appearance is defined as the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would reasonably conclude that the integrity, objectivity or professional skepticism of an internal audit function was compromised (Quick & Warming-Rasmussen, 2005:138). It was indicated concluded that the area of the perceived independence of internal audit is relatively unexplored compared to the perceived independence of external audit.

This research focused upon identifying the factors that potentially influence independence, and assessing their effect upon perceived independence, since independence in fact is unobservable (Beattie et al., 1999:2). In essence, there are a number of independence aspects that had to be tested in this research. These include the freedom of internal audit to determine its own scope, the reporting structure (arrangements) of internal audit and the role conflict in its work with the management. All these aspects were tested on the data collected within Ethiopian private commercial banks through this research.

2.11.5 The Basel (supervisory) Committee

Is issuing this revised supervisory guidance for assessing the effectiveness of the internal audit function in banks, which forms part of the Committee's ongoing efforts to address bank supervisory issues and enhance supervision through guidance that encourages sound practices within banks. The document replaces the 2001 document *Internal audit in banks and the supervisor's relationship with auditors*. It takes into account developments in supervisory practices and in banking organizations and incorporates lessons drawn from the recent financial crisis.

2. The Committee's *Principles for Enhancing Corporate Governance1* states that banks should have an internal audit function with sufficient authority, stature, independence, resources and access to the board of directors. Independent, competent and qualified internal auditors are vital to sound corporate governance.

3. A strong internal control system, including an independent and effective internal audit function, is part of sound corporate governance. Banking supervisors must be satisfied as to the effectiveness of a bank's internal audit function, that policies and practices are followed and that management takes appropriate and timely corrective action in response to internal control weaknesses identified by internal auditors. An internal audit function provides vital assurance to a bank's board of directors and senior management (and bank supervisors) as to the quality of the bank's internal control system. In doing so, the function helps reduce the risk of loss and reputational damage to the bank.

4. This document addresses supervisory expectations for the internal audit function in banking organisations, the relationship of the supervisory authority with the internal audit function and the supervisory assessment of that function. This document seeks to promote a strong internal audit function within banking organisations and to provide guidance for the supervisory assessment of this function.

5. This document also encourages bank internal auditors to comply with and to contribute to the development of national and international professional standards, such as those issued by The Institute of Internal Auditors, and it promotes due consideration of prudential issues in the development of internal audit standards and practices.

6. This document refers to a management structure comprised of a board of directors and senior management. The Committee recognises that significant differences exist in legislative and regulatory frameworks between countries. These national frameworks shape the role and function of management and governance structures. In some countries the board of directors has the main, if not exclusive, function of overseeing the executive body, often referred to as senior management, and ensuring that it fulfils its responsibilities. For this reason it is sometimes known as a supervisory board that has no executive functions. In contrast, in other countries the board has a broader remit in that it lays down the general framework for the management of the bank. Owing to these differences, the concepts of the board of directors and senior management are used in this document not to identify legal constructs but rather to label two decision-making functions within a bank. The internal audit function in banks

7. The principles set out in this document should be applied in accordance with the national legislation and corporate governance structures applicable in each country.

8. For large banks and internationally active banks, an audit committee (or its equivalent) is typically responsible for providing oversight of the bank's internal auditors. Such a committee is established within the board of directors. Annex 2 of this document provides more details about the responsibilities of audit committees. In this document, references to the board of directors presume appropriate involvement of its audit committee, when one exists. In line with the Committee's *Principles for Enhancing Corporate Governance*, paragraph 50, this document assumes that large and internationally active banks have an audit committee or its equivalent. Other banks are strongly encouraged to establish such a committee.

9. This guidance applies to all banks, including those within a banking group, and to holding companies whose subsidiaries are predominantly banks and to those holding companies subject to prudential supervision whose subsidiaries are predominantly banks. All of these structures are referred to as banks or banking organisations in this document. The extent of application of this guidance should be commensurate with the significance, complexity and international presence of the bank (principle of proportionality).

Overview of the principles

Principles relating to the supervisory expectations relevant to the internal audit function

Principle 1: An effective internal audit function provides independent assurance to the board of directors and senior management on the quality and effectiveness of a bank's internal control, risk management and governance systems and processes, thereby helping the board and senior management protect their organisation and its reputation.

Principle 2: The bank's internal audit function must be independent of the audited activities, which requires the internal audit function to have sufficient standing and authority within the bank, thereby enabling internal auditors to carry out their assignments with objectivity.

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

Principle 4: Internal auditors must act with integrity.

Principle 5: Each bank should have an internal audit charter that articulates the purpose, standing and authority of the internal audit function within the bank in a manner that promotes an effective internal audit function as described in Principle 1

Principle 6: Every activity (including outsourced activities) and every entity of the bank should fall within the overall scope of the internal audit function.

Principle 7: The scope of the internal audit function's activities should ensure adequate coverage of matters of regulatory interest within the audit plan.

Principle 8: Each bank should have a permanent internal audit function, which should be structured consistent with Principle 14 when the bank is within a banking group or holding company. The internal audit function in banks 3

Principle 9: The bank's board of directors has the ultimate responsibility for ensuring that senior management establishes and maintains an adequate, effective and efficient internal control system and, accordingly, the board should support the internal audit function in discharging its duties effectively.

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

Principle 11: The head of the internal audit department should be responsible for ensuring that the department complies with sound internal auditing standards and with a relevant code of ethics.

Principle 12: The internal audit function should be accountable to the board, or its audit committee, on all matters related to the performance of its mandate as described in the internal audit charter.

Principle 13: The internal audit function should independently assess the effectiveness and efficiency of the internal control, risk management and governance systems and processes created by the business units and support functions and provide assurance on these systems and processes.

Principle 14: To facilitate a consistent approach to internal audit across all the banks within a banking organisation, the board of directors of each bank within a banking group or holding company structure should ensure that either:

(i) the bank has its own internal audit function, which should be accountable to the bank's board and should report to the banking group or holding company's head of internal audit; or

(ii) the banking group or holding company's internal audit function performs internal audit activities of sufficient scope at the bank to enable the board to satisfy its fiduciary and legal responsibilities.

Principle 15: Regardless of whether internal audit activities are outsourced, the board of directors remains ultimately responsible for the internal audit function.

Principle relating to the relationship of the supervisory authority with the internal audit function

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

Principles relating to the supervisory assessment of the internal audit function

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

Principle 18: Supervisors should formally report all weaknesses they identify in the internal audit function to the board of directors and require timely remedial actions.4 The internal audit function in banks

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

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

A. Supervisory expectations relevant to the internal audit function

Principle 1: An effective internal audit function provides independent assurance to the board of directors and senior management on the quality and effectiveness of a bank's internal control, risk management and governance systems and processes, thereby helping the board and senior management protect their organisation and its reputation.

1. The internal audit function

10. The internal audit function plays a crucial role in the ongoing maintenance and assessment of a bank's internal control, risk management and governance systems and processes – areas in which supervisory authorities have a keen interest. Furthermore, both internal auditors and supervisors use risk based approaches to determine their respective work plans and actions. While internal auditors and supervisors each have a different mandate and are responsible for their own judgments and assessments, they may identify the same or similar/related risks.

11. The internal audit function should develop an independent and informed view of the risks faced by the bank based on their access to all bank records and data, their enquiries, and their professional competence. The internal audit function should be able to discuss their views, findings and conclusions directly with the audit committee and the board of directors, thereby helping the board to oversee senior management.

2. Key features of the internal audit function

12. The key features described below are essential for the effective operation of an internal audit function.

(a) Independence and objectivity3

3 Both "independence" and "objectivity" have a specific meaning in an internal audit environment. The Glossary of The Institute of Internal Auditors refers to independence as the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. Objectivity is referred to in the Glossary as an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgement on audit matters to others.

Principle 2: The bank's internal audit function must be independent of the audited activities, which requires the internal audit function to have sufficient standing and The internal audit function in banks 5 **authority within the bank, thereby enabling internal auditors to carry out their assignments with objectivity.**

13. On the basis of the audit plan established by the head of the internal audit function and approved by the board of directors, the internal audit function must be able to perform its assignments on its own initiative in all areas and functions of the bank. It must be free to report its findings and assessments internally through clear reporting lines. The head of internal audit should demonstrate appropriate leadership and have the necessary skills to fulfil his or her responsibility for maintaining the function's independence and objectivity.

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

15. Continuously performing similar tasks or routine jobs may negatively affect an individual internal auditor's capacity for critical judgement because of possible loss of objectivity. It is therefore a sound practice, whenever practicable and without jeopardising competence and expertise, to periodically rotate internal audit staff within the internal audit function. In addition, a bank may rotate staff from other functional areas of the bank to the internal audit function or from the internal audit function to other functional areas of the bank. Staff rotations within the internal audit function and staff rotations to and from the internal audit function should be governed by and conducted in accordance with a sound written policy. The policy should be designed to avoid conflicts of interest, including the observance of an appropriate "cooling-off" period following an individual's return to the internal audit staff before that individual audits activities in the functional area of the bank where his/her rotation had been served.

16. The independence and objectivity of the internal audit function may be undermined if the internal audit staff's remuneration is linked to the financial performance of the business lines for which they exercise internal audit responsibilities. The remuneration of the head of the internal audit function should be determined in accordance with the remuneration policies and practices of the bank. Remuneration to reward the performance of the head of internal audit or internal audit staff members should be structured to avoid creating conflicts of interest and compromising independence and objectivity.

(b) Professional competence and due professional care

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

17. Professional competence depends on the auditor's capacity to collect and understand information, to examine and evaluate audit evidence and to communicate with the stakeholders of the internal audit function. This should be combined with suitable methodologies and tools and sufficient knowledge of auditing techniques.

18. The head of internal audit should be responsible for acquiring human resources with sufficient qualifications and skills to effectively deliver on the mandate for professional competence and to audit to the required level. He/she should continually assess and monitor the skills necessary to do so. The skills required for senior internal auditors should include the abilities to judge outcomes and make an impact at the highest level of the organisation.6 The internal audit function in banks 19. The head of internal audit should ensure that the internal audit staff acquires appropriate ongoing training in order to meet the growing technical complexity of banks' activities and the increasing diversity of tasks that need to be undertaken as a result of the introduction of new products and processes within banks and other developments in the financial sector.

20. Internal auditors collectively should be competent to examine all areas in which the bank operates. Alternatively, when outsourcing4 arrangements are in place, it is the responsibility of the head of internal audit to maintain adequate oversight and to ensure adequate transfer of knowledge from external experts to the bank's internal audit staff. The head of internal audit should ensure that the use of those experts does not compromise the independence and objectivity of the internal audit function.5

4 Outsourcing is the engagement of experts from outside the banking organisation to perform internal audit activities to support the internal audit function.

5 If internal experts from within the bank (so-called guest auditors) are used in lieu of or in addition to external experts, the head of internal audit has the same responsibilities for oversight, knowledge transfer, independence and objectivity.

6 The Institute of Internal Auditors (The IIA) and the International Ethics Standards Board for Accountants (IESBA) have each issued a code of ethics. Both codes emphasise the importance of the principle of integrity.

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

(c) Professional ethics

Principle 4: Internal auditors must act with integrity.

22. Integrity establishes trust as it requires the internal auditor to be straightforward, honest and truthful. This provides the basis for reliance on the internal auditor's professional judgement.

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

24. The head of the internal audit function and all internal auditors should avoid conflicts of interest. Internally recruited internal auditors should not engage in auditing activities for which they have had previous responsibility before a sufficiently long “cooling off” period has elapsed. Moreover, compensation arrangements should not provide incentives for internal auditors to act contrary to the attributes and objectives of the internal audit function.

25. Internal auditors should apply the bank’s code of ethics (when there is one) or should adhere to an established international code of ethics for internal auditors, such as that of The Institute of Internal Auditors.6 A code of ethics should at a minimum address the principles of objectivity, competence, confidentiality and integrity. The internal audit function in banks 7

3. The internal audit charter

Principle 5: Each bank should have an internal audit charter that articulates the purpose, standing and authority of the internal audit function within the bank in a manner that promotes an effective internal audit function as described in Principle 1.

26. The charter should be drawn up and reviewed periodically by the head of internal audit and approved by the board of directors. It should be available to all internal stakeholders of the organisation and, in certain circumstances, such as listed entities, to external stakeholders.

27. At a minimum, an internal audit charter should establish:

- The internal audit function's standing within the bank, its authority, its responsibilities and its relations with other control functions in a manner that promotes the effectiveness of the function as described in Principle 1 of this guidance;
- The purpose and scope of the internal audit function;
- The key features of the internal audit function described under Section A.2 above;
- The obligation of the internal auditors to communicate the results of their engagements and a description of how and to whom this should be done (reporting line);
- The criteria for when and how the internal audit function may outsource some of its engagements to external experts;
- The terms and conditions according to which the internal audit function can be called upon to provide consulting or advisory services or to carry out other special tasks;
- The responsibility and accountability of the head of internal audit;
- A requirement to comply with sound internal auditing standards;
- Procedures for the coordination of the internal audit function with the statutory or external auditor.

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

4. Scope of activity

Principle 6: Every activity (including outsourced activities) and every entity of the bank should fall within the overall scope of the internal audit function.

29. The scope of internal audit activities should include the examination and evaluation of the effectiveness of the internal control, risk management and governance systems and processes of the entire bank, including the organisation's outsourced activities and its subsidiaries and branches. 8 The internal audit function in banks 30. The internal audit function should independently evaluate the:

- Effectiveness and efficiency of internal control, risk management and governance systems in the context of both current and potential future risks;
- Reliability, effectiveness and integrity of management information systems and processes (including relevance, accuracy, completeness, availability, confidentiality and comprehensiveness of data);
- Monitoring of compliance with laws and regulations, including any requirements from supervisors (see the following sub-section for more details); and
- Safeguarding of assets.

31. The head of internal audit is responsible for establishing an annual internal audit plan that can be part of a multi-year plan. The plan should be based on a robust risk assessment (including input from senior management and the board) and should be updated at least annually (or more frequently to enable an ongoing real-time assessment of where significant risks lie). The board's approval of the audit plan implies that an appropriate budget will be available to support the internal audit function's activities. The budget should be sufficiently flexible to adapt to variations in the internal audit plan in response to changes in the bank's risk profile.

Principle 7: The scope of the internal audit function's activities should ensure adequate coverage of matters of regulatory interest within the audit plan.

32. Internal audit should have the appropriate capability regarding matters of regulatory interest and undertake regular reviews of such areas based on the results of its robust risk assessment. These include policies, processes and governance measures established in response to various regulatory principles, rules and guidance established by the relevant authorities. In particular, the internal audit function of a bank should have the capacity to review key risk management

functions, regulatory capital adequacy and liquidity control functions, regulatory and internal reporting functions, the regulatory compliance function and the finance function.

(a) Risk management

33. A bank's risk management processes support and reflect its adherence to regulatory provisions and safe and sound banking practices. Therefore, internal audit should include in its scope the following aspects of risk management:

- the organization and mandates of the risk management function including market, credit, liquidity, interest rate, operational, and legal risks;
- evaluation of risk appetite, escalation and reporting of issues and decisions taken by the risk management function;
- the adequacy of risk management systems and processes for identifying, measuring, assessing, controlling, responding to, and reporting on all the risks resulting from the bank's activities;
- the integrity of the risk management information systems, including the accuracy, reliability and completeness of the data used; and
- the approval and maintenance of risk models including verification of the consistency, timeliness, independence and reliability of data sources used in such models.

The internal audit function in banks 9 When the risk management function has not informed the board of directors about the existence of a significant divergence of views between senior management and the risk management function regarding the level of risk faced by the bank, the head of internal audit should inform the board about this divergence.

(b) Capital adequacy and liquidity

34. Banks are subject to the global regulatory framework for capital and liquidity as approved by the Committee and implemented in national regulation. This framework contains measures to strengthen regulatory capital and global liquidity. The scope of internal audit should include all provisions of this regulatory framework and in particular the bank's system for identifying and

measuring its regulatory capital and assessing the adequacy of its capital resources in relation to the bank's risk exposures and established minimum ratios.

35. Internal audit should review management's process for stress testing its capital levels, taking into account the frequency of such exercises, their purpose (e.g., internal monitoring vs. regulator imposed), the reasonableness of scenarios and the underlying assumptions employed, and the reliability of the processes used.

36. Additionally, the bank's systems and processes for measuring and monitoring its liquidity positions in relation to its risk profile, external environment, and minimum regulatory requirements, should fall within the audit universe.

(c) Regulatory and internal reporting

37. In addition to the matters identified above, internal auditors should regularly evaluate the effectiveness of the process by which the risk and reporting functions interact to produce timely, accurate, reliable and relevant reports for both internal management and the supervisor.

38. This includes standardized reports which record the bank's calculation of its capital resources, requirements and ratios. It may also include public disclosures intended to facilitate transparency and market discipline such as the Pillar 3 disclosures and the reporting of regulatory matters in the bank's public reports.

(d) Compliance7

7 To be read in conjunction with the Committee's *Compliance and the compliance function in banks,* April 2005.

39. The scope of the activities of the compliance function should be subject to periodic review by the internal audit function.

40. Compliance laws, rules and standards include primary legislation, rules and standards issued by legislators and supervisors, market conventions, codes of practice promoted by industry associations, and internal codes of conduct applicable to the staff members of the bank.

41. The audit of the compliance function should include an assessment of how effectively it fulfils its responsibilities. 10 The internal audit function in banks

(e) Finance

42. A bank's finance function8 is responsible for the integrity and accuracy of financial data and reporting. Key aspects of Finance's activities (e.g. calculations, profit and loss valuations and reserves) have an impact on the level of a bank's capital resources and therefore associated controls should be robust and consistently applied across similar risks and businesses. As such, it is important that these controls are subject to periodic internal audit review, using resources and expertise to provide an effective evaluation of bank practices.

8 Finance includes valuation, modelling, product control and financial control.

43. Internal audit should devote sufficient resources to evaluate the valuation control environment, availability and reliability of information or evidence used in the valuation process and the reliability of estimated fair values. This is achieved through reviewing the independent price verification processes and testing valuations of significant transactions.

44. Internal audit should also include in its scope (the list is not intended to be exhaustive):

- The organisation and mandate of the finance function;
- The adequacy and integrity of underlying financial data and finance systems and processes for completely identifying, capturing, measuring and reporting key data such as profit or loss, valuations of financial instruments and impairment allowances;
- The approval and maintenance of pricing models including verification of the consistency, timeliness, independence and reliability of data sources used in such models;
- Controls in place to prevent and detect trading irregularities;
- Balance sheet controls including key reconciliations performed and actions taken (e.g. adjustments).

5. Corporate governance considerations

45. Annex 1 provides an illustrative overview of relevant principles and standards with respect to the internal audit function, corporate governance structure, and communication channels within a generic bank's governance model.

(a) Permanency of the internal audit function

Principle 8: Each bank should have a permanent internal audit function, which should be structured consistent with Principle 14 when the bank is within a banking group or holding company.

46. In fulfilling its duties and responsibilities, senior management and the board should take all the necessary measures to ensure that the bank has a permanent internal audit function commensurate with its size, the nature of its operations and the complexity of its organization. The internal audit function in banks 11.

47. Internal audit activities should normally be conducted by the bank's own internal audit staff. When internal audit activities are partially or fully outsourced, the board of directors remains ultimately responsible for these activities and for maintaining an internal audit function within the bank. Outsourcing of internal audit activities is further addressed in principle 15 and related paragraphs.

(b) Responsibilities of the board of directors and senior management

Principle 9: The bank's board of directors has the ultimate responsibility for ensuring that senior management establishes and maintains an adequate, effective and efficient internal control system and, accordingly, the board should support the internal audit function in discharging its duties effectively.

48. At least once a year, the board of directors should review the effectiveness and efficiency of the internal control system based, in part, on information provided by the internal audit function. Moreover, as part of their oversight responsibilities, the board of directors should review the performance of the internal audit function. From time to time, the board of directors should

consider commissioning an independent external quality assurance review of the internal audit function.

49. Senior management is responsible for developing an internal control framework that identifies, measures, monitors and controls all risks faced by the bank. It should maintain an organisational structure that clearly assigns responsibility, authority and reporting relationships and ensures that delegated responsibilities are effectively carried out. It is an established practice for senior management to report to the board of directors on the scope and performance of the internal control framework.

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

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

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

(c) Responsibilities of the audit committee in relation to the internal audit function

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

53. This principle applies when the board of directors has established an audit committee. In cases where no audit committee exists, the responsibilities described below should be assumed by the board itself. As explained in paragraph 50 of the Committee's *Principles for Enhancing Corporate Governance*, large banks and internationally active banks should have an audit committee or its equivalent. Other banks are encouraged to establish an audit committee.

54. The oversight function of the audit committee includes ensuring that the internal audit function is able to discharge its responsibilities in an independent manner, congruent with

principle 2. It also includes reviewing and approving the audit plan, its scope, and the 12 The internal audit function in banks budget of the internal audit function. It reviews key audit reports and ensures that senior management is taking necessary and timely corrective actions to address control weaknesses, compliance issues with policies, laws and regulations and other concerns identified and reported by the internal audit function.

55. Annex 2 of this document gives an overview of the responsibilities of an audit committee.

(d) Management of the internal audit department

Principle 11: The head of the internal audit department should be responsible for ensuring that the department complies with sound internal auditing standards and with a relevant code of ethics.

56. The head of the internal audit department should ensure compliance with sound internal auditing standards, such as The Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*. In addition, auditors should adhere to a relevant code of ethics (see paragraph 25).

57. The audit committee should ensure that the head of the internal audit function is a person of integrity. This means that he or she will be able to perform his or her work with honesty, diligence and responsibility. It also implies that this person observes the law and has not been a party to any illegal activity. The head of internal audit should also ensure that the members of internal audit staff are persons of integrity.

(e) Reporting lines of the internal audit function

Principle 12: The internal audit function should be accountable to the board, or its audit committee, on all matters related to the performance of its mandate as described in the internal audit charter.

58. The Internal audit function should be accountable to the board of directors or its audit committee. It should also promptly inform senior management about its findings.

59. Senior management is responsible for implementing and maintaining an adequate and effective internal control system and processes. Therefore, the internal audit function should inform senior management of all significant findings so that timely corrective actions can be taken. Subsequently, the internal audit function should follow up with senior management on the outcome of these corrective measures. The head of the internal audit function should report to the board, or its audit committee, the status of findings that have not (yet) been rectified by senior management.

(f) The relationship between the internal audit, compliance and risk management functions

Principle 13: The internal audit function should independently assess the effectiveness and efficiency of the internal control, risk management and governance systems and processes created by the business units and support functions and provide assurance on these systems and processes.

60. The relationship between a bank's business units, the support functions and the internal audit function can be explained using the *three lines of defence* model. The business units are the first line of defense.

2.11.6 External Auditors works

Corporate governance aims to resolve problems which arise from the principal-agent relationship, whereby owners have an interest in maximizing the value of their shares –whereas managers tend to be more interested in "the private consumption of firm resources and the growth of the firm" It addresses such problems through the contract drafting process and others measures which are developed. One measure which could contribute to corporate governance efforts in addressing the agency problem is the external auditor's involvement, the engagement of the external auditor as a means of addressing agency problems will be considered. Even though monitoring costs – unlike agency costs, cannot be avoided (as is the case with 100% owner management scenarios), they could be minimized. The external auditor would facilitate a situation whereby managers are encouraged or compelled to be held more accountable. Through an appropriate application of accounting policies, the external auditor could help facilitate a position whereby creative accounting practices and hyper inflation/inflation of figures are

discouraged. Penalties could be imposed on managers and directors who intentionally or recklessly inflate or manipulate accounting figures and financial statements. Such penalties could arise in the form of a reduction of such managers' (and directors') annual bonuses , remuneration or even pensions. The likelihood of a qualified audit opinion (as regards the auditor's findings on the financial statements) is considered to be less effective as a deterrent to such managers – particularly where an individual manager or few managers are responsible for fraudulent related acts. Apportionment of liability on a proportionate basis would also produce a more equitable result – than is the case where a qualified opinion is issued by the auditor. The financial audit remains an important aspect of corporate governance that makes management accountable to shareholders for its stewardship of a company. In this regard, attention is drawn to the importance of audit committees. Audit committees do not only serve as internal monitoring devices which support good corporate governance, they are also considered to be mechanisms of ensuring that an appropriate relationship exists between the auditor and the management whose financial statements are being audited.27 Prior to corporate governance reforms in many jurisdictions, the pressures faced by external auditors from directors in many firms constituted the focus of several major issues. Furthermore "creative accounting" practices were widespread. The audit serves as a signaling mechanism to shareholders of a company that information provided by the company's.

So availability of external auditor in the corporate governance setting may an indirect effect on the independency of internal auditors.

2.12 Special Nature of Bank Corporate Governance

Banks play an important role in the allocation of capital for productive uses. If banks are well managed and allocate capital to their most productive use, this contributes to growth (Levine 2005). Because of the opaque nature of banks and heavy government regulation, corporate governance works differently in the banking sector. Banks are generally more opaque than nonfinancial firms are and evidence suggests that informational asymmetries are larger in banks than in other sectors. The true value of a bank's loan portfolio is not readily observable and can be hidden for long periods. Moreover, banks can change the risky nature of their assets more

quickly; they can hide problems by extending loans to clients that cannot service previous debt obligations. (Ayele, A.G.2013)

Ayele A.G further elaborated that the unique nature of the banking firm requires the legal protection of depositors equally as that of shareholders. For this reason, the government provides explicit deposit insurance and the implicit guarantee of bailing out of large banks to avoid bankruptcies and hence maintain financial system stability to this end, independent auditor verification is needed.

2.13 Regulatory Framework in Ethiopian Banking Industry

The government issued Proclamation No. 591/2008 dated August 11, 2008, in order to increase the autonomy of the National Bank of Ethiopia, which among other things clarified the role of the National Bank as the regulator and supervisor of the banking sector. Despite improvements in the regulatory framework, the supervisory capacity of the National Bank of Ethiopia remained weak largely due to an acute shortage of qualified banking supervisors. In recent years however, the NBE has made a concerted effort to develop its capabilities over time. Consequently, the public has gained greater confidence in the banking sector, which has led to strong growth in financial intermediation from levels that it was among the lowest in Africa (Admassu & Asayehgn 2014)

Among the global guidelines, further initiatives are set by the Basel Committee, which views banking supervision from two perspectives; First, sectoral "good practices" must be indicated, taking into account the specificities of the banks. General rules intended to improve corporate governance in banks were updated by the current version of the document which contains 14 rulesin 6 areas Basel committee for banking supervision. (BCBS, 2010, October):

2.15 Summary and Gap in the Existing Literature

The board of directors has been recognized as the key player in corporate governance by regulators and governance committees around the world (Cadbury Committee, 1992; United States (US) Congress, 2002; Australian Stock Exchange Corporate Governance Council, 2003).

As a sub-committee of the board, the audit committee, in particular, plays an important role enhancing the quality of financial reporting (McMullen and Raghunandan, 1996; Davidson et al.,2005). An effective audit committee should also strengthen the position of the internal audit function by providing an independent and supportive environment where the chief internal auditor (CIA) can raise matters affecting management (Braiotta, 1999; Goodwin and Yeo, 2001;

Goodwin, 2004) Thuweba Ndunge Kimotho, (2014) has studied factors affecting independence of internal audit such as limitation of scope, reporting structure and the involvement of internal audit in managerial activities. With respect to reporting structure, it is recommended that internal audit should report directly to the audit committee.

Basel committee on Bank supervision on Internal audit (2012) requires internal audit to perform various duties and without any limitations from electronic information to testing of reliability and timeliness of regulatory reporting and caring out of special investigations.

There are various literatures discussing the relationship of internal audit and independence and the corporate governance. IIA (2003) discusses consideration of the ethical decision of internal auditors that the ethical decisions depend on the corporate governance framework which determines the relationship of four cornerstones; the audit committee, senior management, Internal audit and external audit.

that the effectiveness of audit committee in terms of support it provides the internal audit function by providing independent support environment and review effectiveness of internal audit function therefore & Karagrorgos et.al (2010).

The independence of internal audit in Ethiopian government ministries was clearly stated in the manual issued by Ministry of Finance and Economic Development (MOFED) in 2004. In their study based on Ethiopian context and interview with directors Internal audit function, (Terdpaopong & Miheret, 2012) also indicated that only Banks and insurances are required by regulatory body NBE to maintain internal audit function.

While there are studies in such areas as effectiveness of internal audit function, the role of internal audit on corporate governance (KPMG 2008), (Carl Gabrini 2013) and Factors Affecting

Internal Audit Independence Thuweba Ndunge Kimotho, (2014). In the studies discussed, there seems to be interrelationship and interdependence between corporate governance and independence of internal audit function. However, there is dearth of empirical study that examines the effect of corporate governance on independence of internal audit function. Mesert womdmu also clearly showed the effect of corporate governance on the independency of internal audit function by talking major factor of corporate governance such as senior management support, audit committee, corporate governance setting and auditors perception of mind. But she did not covered other factors of corporate governance such as effectiveness of remuneration and nomination committee and the qualification and experience of internal audit staff I considered them have significant impact on the independency of internal audit function

CHAPTER THREE

RESEARCH MEHODLOGY

3.1 Introduction

This chapter contains a discussion of the approach used in carrying out the research. The areas covered include the population, sample and sampling technique, data collection instruments, type of data collected and sources, administration of the questionnaires, method of analysis and scope and limitation. The survey was conducted with the objective of evaluating the extent to which the independence of internal audit function is affected by corporate governance factors in the private commercial banks of Ethiopia.

3.2 The Population

The population of the research comprises all managers of internal audit department, heads of inspection and audit divisions and Risk managers. All sixteen private banks were targeted for the study. Moreover, the questionnaires were also serve to the bank supervision directorate of the national bank of Ethiopia (NBE) specifically to private bank desk officers to solicit information on regulatory input on internal audit independence in private commercial banks.

3.3 Sample and Sampling Technique

The researcher used the purposive sampling to accesses a particular subset of population. At present, there are sixteen private commercial banks in Ethiopia; each having one internal audit department as one unit. Thus, structured questionnaires are serve to all internal audit managers of private banks and the heads of inspection and audit divisions as is in most of the banks. The questionnaires are also serve to the risk managers as key informants who have relation with the governance issues and users of the internal audit reports.

Therefore, 64 questionnaires were distributed to private commercial bank manager and 10 questionnaires were administer to National Bank of Ethiopia (NBE) bank super division directorate managers and desk offers; total of 74 questionnaires were distributed to collect primary data.

3.4 Data Collection Instruments

The questionnaires are adopt and design from various targeted employee of the banks, However, the questions area adapt for the respondents to rate the extent to which they agree or disagree on a five point likert scale with the following ratings. Strongly agree, Agree, Neutral, Disagree and Strongly Disagree. On this scale score of 5 or 4 indicates that the item is perceived to be essential while a score of 3 or 2 indicate that the item is perceived to be fairly important, but not essential, while a score of 1 indicates that the item could be disregarded for being un important. The questionnaires containing six parts comprising general information about the respondents, independence of internal audit function, corporate governance setting, perception on independence of internal audit function, Effectiveness of audit committee, effectiveness of audit committee, internal audit function and senior management support were administered to the internal audit managers, risk managers, heads of audit and inspection divisions or equivalents. sixty four (64) questionnaires were administered in all sixteen (16) private banks. The other ten questionnaires with the same content were administered to National Bank of Ethiopia (NBE) desk officers to the private banks with the objective to solicit and balance regulatory view on the same questions.

3.5 Type of Data and Sources

Survey was conducted by collecting mainly primary data, through questionnaires, from key informants of the private banks. Secondary data was included in the study through references to authoritative books and web pages, which include relevant literature such as newsletters, textbooks, standards for the professional practice of internal auditing and ethics for internal auditors by the Institute of Internal Auditors (IIA).

3.7 Data Analysis and Presentation

The primary data obtained from the questionnaires were summarized and analyzed by using descriptive statistics such as proportions, percentages, means and frequency distributions tables. Data was analyzed using Statistical Package for Social Sciences (SPSS Version 20.0) program.

The analysis employ regression model to analyze the relationship between internal audit independence and level of effect of corporate governance factors within the private commercial banks within a test of significance of 95% confidence level.

3.7.1 Conceptual Model

The following conceptual model were adopted in the study where Independence of Internal audit Function (IIAF) is a function of Corporate Governance Setting (CGS), Senior Management Support (SMS), Effectiveness of Audit Committee (EAC), effectiveness of Rumeration committee, Qualification and Experience of internal audit staff (QEIAS):

IIAF = f (CGS, SMS, EAC, ERC, ENC,QEIAS)----------(1)

Where;

IIAF = Independence of Internal Audit Function;

CGS = Corporate Governance Setting;

SMS = Senior Management Support;

EAC = Efficiency of Audit Committee;

ERC= effectiveness of Remuneration committee

ENC= effectiveness of Nomination committee

QEIAS = Qualification and Experience of internal audit staff (

3.7.2 Analytical Model

The following regression model will use to perform data analysis

Y= Represents the dependent variable that measure level of corporate governance factors'

influence. To minimize multi-co linearity effect, the dependent variable Y is determine based on the average score for main independent variables

CHAPTER FOUR

4. Data Analysis, Results and Discussions

This chapter deals with data analysis and interpretation of the data based on the data collected from the participants and results or findings of the study as set out in the research purpose is to give answer for the research questions and discussions on the results. The study findings have presented assessing the effect of corporate governance on the independency of internal audit function (A case study on private commercial banks of Ethiopia). The data gathered from private banks through questionnaire, interviews and observation as the data collection instrument. Analysis related to response rate, profile of the respondent and assessment of the corporate governance on the independency of internal audit function has presented in this chapter on the bases of related factors measurements.

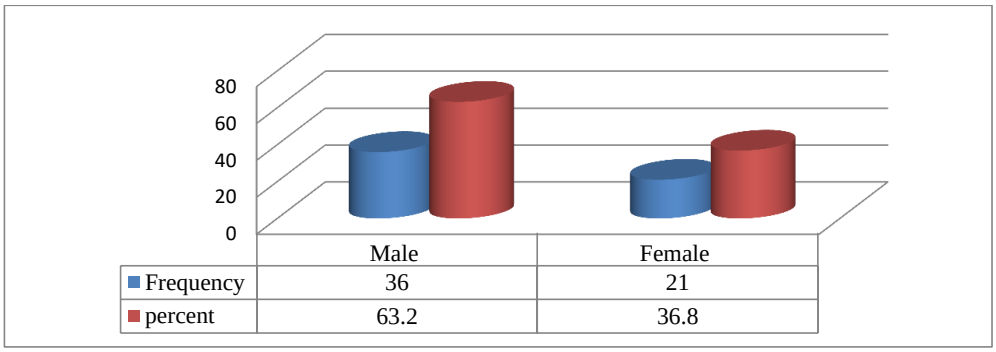
4.1 Response Rate Analysis

The questionnaires were distributed to the auditors of private banks. Total of 74 questionnaires were delivered to each that have direct relation with the audit activity in the organization. From distribution of 74 questionnaires, 57 questionnaires were collected and the remaining 5 absent in the hand of respondents 13 were discarded due to not properly filled.

4.2. Socio- Demographic Characteristics of Respondent

In this section of the study deals with socio demographic characteristics of respondents socio demographic characteristics of the study include sex, age, educational background of the study, work experience and field of the study.

Figure 4.1. Sex of the Respondents

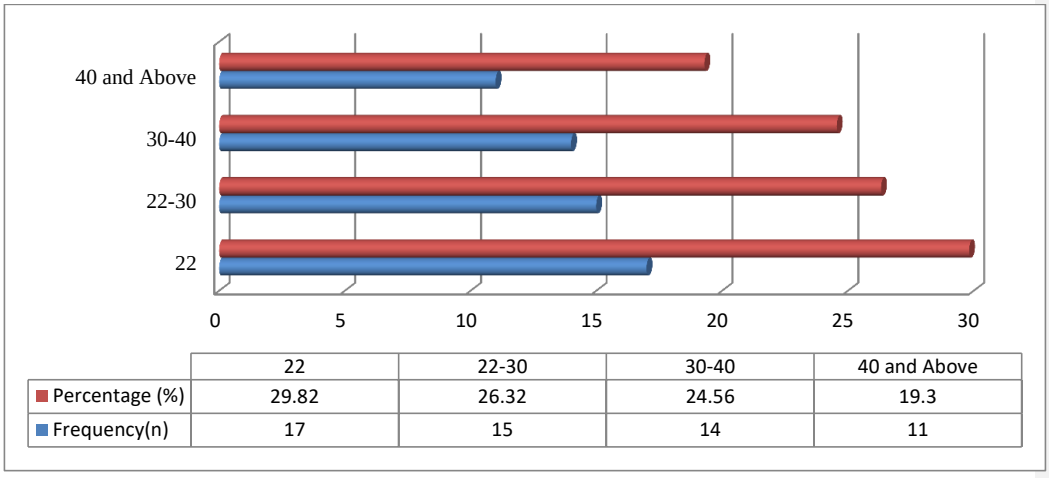


	Male	Female
Frequency	36	21
percent	63.2	36.8

Source: Questionnaire results (2020)

As observed from the above response figure 4.1. showed that the numbers of 36 (63.20%) male respondents and 21(36.8%) female respondents. This analysis results show that majority of the organization employees were male auditors so an organization expected to proportion the number of female auditors with male auditors.

Figure 4.2. Ages of the Respondents



	22	22-30	30-40	40 and Above
Percentage (%)	29.82	26.32	24.56	19.3
Frequency(n)	17	15	14	11

Source: Questionnaire results (2020)

The given above figure 4.2 illustrate that numbers most of the respondents is young. The Respondents of 17(29.82%) were 22 years old, 15(26.32%) were 22-30 years old, 14(24.56%) were 30-40 years old, and 11(19.30%) were ages of 40 and above.

The age and the experience of auditors have an inverse relationship the number of auditor decrease when they become elder. The table showed that most of the auditors in the organization are between in the age of 22 more energetic auditors are found in the organization this enable to perform their activity more effectively.

Table 4 .1. Educational background of the respondent

Educational background	Frequency(n)	Percentage (%)
Diploma	0	0
Bachelor's Degree	49	85.9
Master’s Degree	5	8.80
PhD	3	5.3
Total	57	100.00

Source: Questionnaire results (2020)

In the following table 4.3 the demographic information no respondents with Educational background under diploma. The respondents of 49(85.9%) were Bachelor's Degree holders, 5(8.80%) were master degree, and 3(5.30%) were Ph.D. The analysis results show that respondents are educated and their Educational background can help them to respond with good understanding of the questions and help to some extent to complete their responsibility more effectively and most of them are degree holder need to improve their Educational background to the next stage to be more skilled and knowledgeable auditors.

Table 4.2. Working Experience of Respondent

Working Experience	Frequency(n)	Percentage (%)
Below 2 years	18	31.60
2-8 years	15	26.30
8-15 years	13	22.80
15 years and above	11	19.30
Total	57	100.00

Source: Questionnaire results (2020)

From the above table 4.4 the majority of the respondents are in the range of below 4 years, the respondents of 18(31.60%) were below 2 years, 15(26.30%) were 2-8 years, 13(22.80%) were 8-15 years, and 11(19.30%) were 15 years and above respondents of work experience in the organization. So that more of the employees of the organization have no longer experience in this organization.

Table 4.3. Work Position of the Respondent

Work position	Frequency(n)	Percentage (%)
Director	1	1.75
Manager	1	1.75
Audit	15	26.30
Senior Auditor	17	29.80
Junior Auditor	23	40.40
Total	57	100.00

Source: Questionnaire results (2020)

In the above table 4.3 from the respondents 1(1.75%) were Directors, 1(1.75) were manager, 15(26.30%) were Auditors, 17(29.80%) Auditors were Senior and 23(40.40%) Auditors were Junior. This analysis results show that majority of the organization employees are auditors and

junior auditors so from the organization expected to qualified and trained them to have a competent and skilled auditor.

Table 4.4. Field of study the respondent

Field of study	Frequency(n)	Percentage (%)
Accounting	51	89.50
Management	4	7.00
Other related filed	2	3.50
Total	57	100.00

Source: Questionnaire results (2020)

From the table 4.4 show that the respondents of 51(89.50%) were accounting, 4(7%) were management, and 2(3.50%) from other related filed. from the above table, we can conclude that the auditors in the organization have related field of study with the profession of audit. to be an auditor accounting department is preferable than that of other department and the majority auditors in the organization is Field of study accounting.

Table 4.5. Corporate Governance Setting

Items	Responses	Frequency	Percent	Mean	STD.
There is established applicable law and regulations to carry out auditors responsibilities independently.	strongly Disagree	11	19.3	2.32	.97
	Disagree	26	45.6		
	Neutral	11	19.3		
	Agree	9	15.8		
	Total	57	100.0		
There are standards and code of ethics recognize the importance of internal Auditors to maintain the independence and objectivity when performing the work	strongly Disagree	1	1.8	3.84	.96
	Disagree	6	10.5		
	Neutral	7	12.3		

	Agree	30	52.6		
	Strongly Agree	13	22.8		
	Total	57	100.0		
There are strong system of internal control which is monitored by well-resourced independency of internal audit activity as a fundamental feature of corporate governance.	Disagree	5	8.8	4.02	.81
	Neutral	3	5.3		
	Agree	35	61.4		
	Strongly Agree	14	24.6		
	Total	57	100.0		
There is well developed internal audit standards to guide the relationship with corporate governance.	strongly Disagree	14	24.6	1.93	
	Disagree	35	61.4		
	Neutral	6	10.5		
	Agree	2	3.5		
	Total	57	100.0		
There is the responsibility of board directors is insuring the intensity of the composition's accounts and financial reports system of internal auditors independency.	strongly Disagree	17	29.8	2.14	
	Disagree	22	38.6		
	Neutral	13	22.8		
	Agree	3	5.3		
	Strongly Agree	2	3.5		
	Total	57	100.0		

Source: Questionnaire results (2020)

Table 4.5 deals with corporate governance setting. The first tem was there is established applicable law and regulations to carry out auditors responsibilities independently. Regarding to this 26(45.6%) of the respondents said disagreed the mean was 2.32 and the standard deviation was .97. The second item was “there are standards and code of ethics recognizes the importance of internal auditors to maintain the independence and objectivity when performing the work. Against this questions 30(52.6%) of the respondents said agree. The mean was 3.84 and the standard deviation was .96. The third item was “there are strong

system of internal control which is monitored by well-resourced independency of internal audit activity as a fundamental feature of corporate governance". Regarding to this questions, 35(61.4%) of the respondents said disagree. The mean was 4.02 and the standard deviation was .81. The fourth item was "there is well developed internal audit standards to guide the relationship with corporate governance. Against this question 35(61.40%) of the respondents said disagreed the mean was 1.93 and the standard deviation was .70. The fifth item was there is the responsibility of board directors is insuring the intensity of the composition's accounts and financial reports system of internal auditors' independency. Against this, 22(38.6%) of the respondents said disagree. The mean was 2.14 and the standard deviation was .1.02. the highest means was 4.02 which was explained by :There are strong system of internal control which is monitored by well-resourced independency of internal audit activity as a fundamental feature of corporate governance.: from the above information it is possible to conclude that Corporate Governance Setting has strong system of internal control which is monitored by well-resourced independency of internal audit activity as a fundamental feature of corporate governance in the selected banks.

Table 4. 6. Effectiveness of internal Audit Committee

Item	Responses	Frequency	Percent	Mean	STD
There is an audit committee which is independent, objective assurance and consulting activity designed to add value and improve the independency of auditors.	strongly Disagree	10	17.5	2.75	1.21
	Disagree	14	24.6		
	Neutral	19	33.3		
	Agree	8	14.0		
	Strongly Agree	6	10.5		
	Total	57	100.0		

There is audit committee helps the bank to accomplish its objective by bringing systematic, disciplined approach to evaluate and improve the effectiveness of risk management control and governance process of internal auditors	strongly Disagree	14	24.6	2.47	1.26
	Disagree	19	33.3		
	Neutral	13	22.8		
	Agree	5	8.8		
	Strongly Agree	6	10.5		
	Total	57	100.0		
The Audit committee contributes to the bank compliance with applicable laws and regulations facilitate the work of Auditors	strongly Disagree	13	22.8	2.47	1.26
	Disagree	11	19.3		
	Neutral	18	31.6		
	Agree	8	14.0		
	Strongly Agree	7	12.3		
	Total	57	100.0		
The Audit committee enhance corporate governance structure	strongly Disagree	17	29.8	2.21	1.15
	Disagree	24	42.1		
	Neutral	5	8.8		
	Agree	9	15.8		
	Strongly Agree	2	3.5		
	Total	57	100.0		

Source: Questionnaire results (2020)

Table 4.6 deals with effectiveness of internal audit committee. The first tem was there is an audit committee which is independent, objective assurance and consulting activity designed to add value and improve the independency of auditors. Against this 19(33.3%) said neutral, the mean was 2.75 and the standard deviation was 1.21. The second item was there is audit committee helps the bank to accomplish its objective by bringing systematic, disciplined approach to evaluate and improve the effectiveness of risk management control and governance process of internal auditors. Against this 19(33.3%) of the respondents said disagree; the mean was 2.47 the standard deviation was 1.26. and the third item The Audit committee contributes to the bank compliance with applicable laws and regulations facilitate the work of Auditors. Regarding to the issue 18(31.6%) of the respondents said neutral. The mean was 2.47 and the standard deviation was 1.26. The fourth item was the Audit committee enhances corporate governance structure. Regarding to this,24(42.1%) of the respondents said disagree. The mean was 2.21 and the standard deviation was 1.15. There is an audit committee which is independent, objective assurance and consulting activity designed to add value and improve the independency of auditors. . from the above information it is possible to conclude audit committee which is independent, objective assurance and consulting activity designed to add value and improve the independency of auditors. Effective Audit committee provided independent, objective assurance and consulting activity designed to add value and improve the independency of auditors.

Table 4 7. Effectiveness of Remuneration

Statements	Responses	Frequency	Percent	Mean	Stan dev.
There is sufficient payment for internal Auditors	strongly Disagree	27	47.4	1.77	.93
	Disagree	21	36.8		
	Neutral	4	7.0		
	Agree	5	8.8		
	Total	57	100.0		
There is internal regulatory and supervision of managing benefits of internal Auditors	strongly Disagree	22	38.6	2.04	1.15
	Disagree	22	38.6		
	Neutral	5	8.8		

	Agree	5	8.8		
	Strongly Agree	3	5.3		
	Total	57	100.0		
There are audits and risk sub-committee, Remuneration sub-committee, main board management subcommittee to follow up and monitor internal auditors' remuneration.	strongly Disagree	12	21.1	3.42	1.57
	Disagree	7	12.3		
	Neutral	2	3.5		
	Agree	17	29.8		
	Strongly Agree	19	33.3		
	Total	57	100.0		
There are sub -committee to align managers and shareholders' interests, mitigating agency costs and providing a link between managerial action and performance of internal Auditors	strongly Disagree	6	10.5	2.04	1.15
	Disagree	8	14.0		
	Neutral	17	29.8		
	Agree	14	24.6		
	Strongly Agree	12	21.1		
	Total	57	100.0		
The management dully recognizes the audit finding reports as tools which give a clue on the current financial performance and internal control mechanisms.	strongly Disagree	17	29.8	2.51	1.28
	Disagree	11	19.3		
	Neutral	17	29.8		
	Agree	7	12.3		
	Strongly Agree	5	8.8		
	Total	57	100.0		

Source: Questionnaire results (2020)

Table 4.8 deals with effectiveness of remuneration. Regarding to this, statements were designed and the result summarized as follows.

The first item was there is sufficient payment for internal Auditors. Regarding to this, 27(47.4%) of respondents said strongly disagree the mean was 1.77 and the standard deviation was .93.The second item There is internal regulatory and supervision of managing benefits of internal

Auditors. Concerning to this, 22 (38.6%) of the respondents said disagree. The mean was 2.04 and standard deviation was 1.15. The third item was there are audits and risk sub- committee, Remuneration sub- committee, main board management subcommittee to follow up and monitor internal auditors' remuneration. Regarding to this 19(33.3%) 0f the respondents said Strongly Agree. The mean was 3.42 and the standard deviation was 1.57.The fourth item was there are sub -committee to align manager s and shareholders' interests, mitigating agency costs and providing a link between managerial action and performance of internal Auditors. Against this, 17(29.8%) of the respondents said neutral and the mean was 2.04 and the standard deviation was 1.15.The fifth item was the management dully recognizes the audit finding reports as tools which give a clue on the current financial performance and internal control mechanisms. Regarding to this, 15(26.3%) of the respondents said neutral. The mean was 2.98 and standard deviation was 1.35. There are audits and risk sub- committee, Remuneration sub- committee, main board management subcommittee to follow up and monitor internal auditors' remuneration. from the above information it is possible to conclude that Remuneration has audits and risk sub-committee, Remuneration sub- committee, main board management subcommittee to follow up and monitor internal auditors' remuneration.

Table 4 .9. Senior Management Support

Items	Responses	Frequency	Percent	Mean	Stan. Dev
Independency of internal Audit is supported by senior management support.	strongly Disagree	22	38.6	2.16	1.31
	Disagree	17	29.8		
	Neutral	10	17.5		
	Agree	4	7.0		
	Strongly Agree	4	7.0		
	Total	57	100.0		
Senior management support enhances internal auditor's	strongly Disagree	23	40.4	2.16	1.31
	Disagree	18	31.6		

independence recruiting competent and well qualified staff to support internal auditing activities and departments.	Neutral	5	8.8		
	Agree	6	10.5		
	Strongly Agree	5	8.8		
	Total	57	100.0		
Senior management safeguards auditor independence.	strongly Disagree	8	14.0	3.40	1.41
	Disagree	8	14.0		
	Neutral	11	19.3		
	Agree	13	22.8		
	Strongly Agree	17	29.8		
	Total	57	100.0		
Senior management members are truly knowledgeable, skilled and committed to improve good governance without fear and favor for the proper function of Auditors.	strongly Disagree	7	12.3	3.49	1.44
	Disagree	12	21.1		
	Neutral	2	3.5		
	Agree	18	31.6		
	Strongly Agree	18	31.6		
	Total	57	100.0		
Senior management has the responsibilities of measuring performance of the Audit function, appointment and dismissal the heads of internal Audit	strongly Disagree	11	19.3	2.70	1.24
	Disagree	17	29.8		
	Neutral	11	19.3		
	Agree	14	24.6		
	Strongly Agree	4	7.0		
	Total	57	100.0		

There is senior management which is definitely enhancing reliable, dependable, effective and efficient corporate governance	strongly Disagree	7	12.3	3.67	1.38
	Disagree	6	10.5		
	Neutral	6	10.5		
	Agree	18	31.6		
	Strongly Agree	20	35.1		
	Total	57	100.0		

Table 4.9 deals with senior management support**.** The first tem Independency of internal Audit is supported by senior management support. Regarding to this, 22(38.6%) of the respondents said strongly disagree. The mean was 2.16 and the standard deviation was 1.31. The second item was senior management support enhances internal auditor's independence recruiting competent and well qualified staff to support internal auditing activities and departments. Concerning to this 23(40.4%) of the respondents said strongly disagree. The mean was 2.16 and the standard deviation was 1.31. The third item was senior management safeguards auditor independence regarding to this 17(29.8%) of the respondents said strongly agree. The mean was 3.40 and the standard deviation was 1.41. The fourth item was senior management members are truly knowledgeable, skilled and committed to improve good governance without fear and favor for the proper function of Auditors. Regarding to this 18(31.6%) of the respondents said agree. the mean was 3.49 and the standard deviation was 1.44.The fifth item was Senior management has the responsibilities of measuring performance of the Audit function, appointment and dismissal the heads of internal Audit. Regarding to this 17(29.8%) of the respondents said disagree. The mean was 2.70 and the standard deviation was 1.24. The sixth statement was there is senior management which is definitely enhancing reliable, dependable, effective and efficient corporate governance. Concerning to this 20(35.1%) of the respondents said strongly agree. The mean was

3.67 and the standard deviation was 1.38. There is senior management which is definitely enhancing reliable, dependable, effective and efficient corporate governance. From the above information it is possible to concluded that senior management support help in enhancing reliable, dependable, effective and efficient corporate governance.

Table 4.10. Effectiveness of Nomination committee

Statements	Responses	Frequency	Percent	Mean	Stan dev.
There is delegation of highly qualified and quality managerial personnel who able to monitor, support and follow up the internal Auditors	strongly Disagree	7	12.3	3.68	1.40
	Disagree	6	10.5		
	Neutral	6	10.5		
	Agree	17	29.8		
	Strongly Agree	21	36.8		
	Total	57	100.0		
The assigned personnel has better position that can timely addressed critical problem of independency of internal Auditors	strongly Disagree	6	10.5	3.70	1.35
	Disagree	7	12.3		
	Neutral	5	8.8		
	Agree	19	33.3		
	Strongly Agree	20	35.1		
	Total	57	100.0		
In consultative workshop and meeting is constantly organized by inviting representative who able to manage the issues discussed or presented refreshments and handle payment of internal auditors	strongly Disagree	30	52.6	2.38	1.67
	Disagree	5	8.8		
	Neutral	2	3.5		
	Agree	10	17.5		
	Strongly Agree	10	17.5		
	Total	57	100.0		

Source: Questionnaire results (2020)

Table 4.10 illustrated that effectiveness of nomination committee. The first item There is delegation of highly qualified and quality managerial personnel who able to monitor, support and follow up the internal Auditors. Against this, 21(36.8) said strongly agree the mean was 3.68 and the standard deviation was 1.40. The second item was the assigned personnel has better position that can timely addressed critical problem of independency of internal Auditors, regarding to this 20(35.1%) of the respondents said strongly agreed the mean was 3.70 and the standard deviation was1.35. and The third item was In consultative workshop and meeting is constantly organized by inviting representative who able to manage the issues discussed or presented refreshments and director's meeting fee. Against this 30(52.6.8%) said strongly disagree. The mean was 2.38 and the standard deviation was 1.67 30.

Table 4 .11. Qualification and competency

		Frequency	Percent	Mean	Stan Dev.
Board directors were qualified at education qualifications of the board directors help them to make decisions	Yes	26	45.6	3.70	1.35
	No	31	54.4		
	Total	57	100.0		
The qualification of the board directors help to create diverse perspective to make a decision?	Yes	23	40.4	1.60	.50
	No	34	59.6		
	Total	57	100.0		
Directors qualifications are central to effectively interpreted and utilize the information generated by management	Yes	18	31.6	1.68	.47
	No	39	68.4		
	Total	57	100.0		
The directors are qualified and they are innovative	Yes	29	50.9	1.49	.50
	No	28	49.1		

creative and produce better strategy of decision making The directors are qualified and they are innovative creative and produce better strategy of decision making Because of the qualification of directors help to increase internal Auditors performance to promote corporate image and demonstrate accountability and credibility with in the management team..	Total	57	100.0		

Source: Questionnaire results (2020)

Table 4.11 shows that qualification and competency. Board directors were qualified at education qualifications of the board directors help them to make decisions. Regarding to this 31(54.4%) of the respondents said no. The mean was 3.70 and standard deviation was 1.35. The second item the qualification of the board directors help to create diverse perspective to make a decision. Regarding to this 34(59.6%) of respondents said no. The mean was 1.60 and the standard deviation was .50. The third item was The directors are qualified and they are innovative creative and produce better strategy of decision making The directors are qualified and they are innovative creative and produce better strategy of decision making Because of the qualification of directors help to increase internal Auditors performance to promote corporate image and demonstrate accountability and credibility with in the management team.. Regarding to this 39(68.4%) of the respondents said no. The mean was 1.68 and standard deviation was .47.

4.3. Inferential Statistics

4.3.1. Correlation analysis

The study sought to establish the relationship between **independent variables and dependent variables**. Pearson Correlation analysis was used to achieve this end at 95% confidence level (α = 0.05). Correlation analysis is **one of the most widely used in research**, it is often used to determine **a relationship between two different variables**, if so how significant or how strong is the association between variables. And also a very useful means to summarize these relationships between the variables with a single number that falls **between -1 and +1 .A** correlation analysis with Pearson´s correlation coefficient (r) was conducted on all variables in this study to explore the relationships between them. The correlation coefficient r is statistics used to measure the degree or strength of this type of relationship.

To interpret the strengths of relationships between variables in the classification of the correlation efficient (r) is as follows**:≤ 0.35** is considered to represent low or weak correlation; 0.36 – 0.67 is modest or moderate correlation; **0.68-0.89 is strong or high correlation and a correlation with r coefficient ≥0.90** is very high correlation. Again if the correlation result lies between -1 and 0, the two variables are negatively related. However, the result is interpreted and discussed using this criterion in each dependent and independent variables. The result presented as follows.

Table 4 .12 . Correlations

Correlations							
		Independency of Internal Audit function	Corporate Governance setting	Effectiveness of Audit committee	Senior Management support	Effectiveness of Remuneration	Qualification and Competency
Independency of Internal Audit function	Pearson Correlation	**1**					
	Sig. (2-tailed)						
	N	**57**					
Corporate Governance setting	Pearson Correlation	**.909****	1				
	Sig. (2-tailed)	**.000**					
	N	**57**	57				
Effectiveness of Audit committee	Pearson Correlation	**.878****	1				
	Sig. (2-tailed)	**.000**					
	N	**57**					
Senior Management support	Pearson Correlation	**.957****	.904**	1			
	Sig. (2-tailed)	**.000**	.000				
	N	**57**	57	57			
Effectiveness of	Pearson Correlation	**.954****	.907**	.972**	1		

Comment [AS1]: To describe independent variable relation ship with dependant variable.

Comment [AS2]: Statistical significant value should be less than 0.05.

Remuneration	Sig. (2-tailed)	**.000**	.000	.000			
	N	**57**	57	57	57		
Effectiveness of Nomination committee	Pearson Correlation	**.927****	.929**	.925**	.925**	1	
	Sig. (2-tailed)	**.000**	.000	.000	.000		
	N	**57**	57	57	57	57	
Qualification and Competency	Pearson Correlation	**.882****	.753**	.830**	.824**	.794**	1
	Sig. (2-tailed)	**.000**	.000	.000	.000	.000	
	N	**57**	57	57	57	57	57
**. Correlation is significant at the 0.01 level (2-tailed).							

Source: Questionnaire results (2020)

There is positive and statistical significant relationship between Corporate Governance setting and independency of internal audit function at r= .909 and P<.01.There is positive and statistical significant relationship between Effectiveness of Audit committee and independency of internal audit function at r= .957 and P<.01. There is positive and statistical significant relationship between Senior Management support and independency of internal audit function at r= .954 and P<.01.There is positive and statistical significant relationship between Effectiveness of Remuneration and independency of internal audit function at r= .927 and P<.01. There is positive and statistical significant relationship between qualification and competency and independency of internal audit function at r=.882 and P<.01.

4.3.2. Regression Analysis

The study sought to establish how dependent variables and would influence independent variables using linear regression analysis. The regression model was:

$$Y= \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + \beta_6 X_6 + \varepsilon$$

Whereby Y is independency of internal audit function, β_0 is regression constant, $\beta_1 - \beta_5$ regression coefficients, X_1 is corporate governance setting , X_2 is Effectiveness of Audit committee, X_3 is Senior Management support, X_4 is Effectiveness of Remuneration, X_5 is Effectiveness of Nomination committee, X_6 is qualification and competency is and ε model's error term.

Table 4 1**Model Summaries**

Model Summary			
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.977[a]	.955	.951	.23523
a. Predictors: (Constant), corporate governance setting, Effectiveness of Audit committee, Senior Management support, Effectiveness of Remuneration, Effectiveness of Nomination committee, qualification and competency				

Comment [AS3]: The dependent variable is 95 % explained by the independent variable.

Comment [AS4]: Should be less than R squqre

Source: Questionnaire results (2020)

Table 4.13. Showed that the dependent variable is explained by independent variable at .955. The remaining percent can be filled by further research.

Table 4 2**ANOVA**

ANOVA[a]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	60.160	5	12.032	217.451	.000[b]
	Residual	2.822	51	.055		
	Total	62.982	56			
a. Dependent Variable: independency of Internal Audit function						
b. Predictors: (Constant), corporate governance setting, Effectiveness of Audit committee, Senior Management support, Effectiveness of Remuneration, Effectiveness of Nomination committee, qualification and competency						

Comment [AS5]: Need to be greater than 0.05. and to test statistical significance of the research paper

Comment [AS6]: Should be less than 0.05. to assure the used model fitness

Source: Questionnaire results (2020)

Table 4.14.showed that ANOVA analysis. The F- value was 217.451 which is greater than 0.000. Moreover, p- value was .000 which is less than 0.05. The model is significant.

*Table 4 3**Coefficients***

Coefficients [a]						
Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	-.156	.132		-1.178	.244
	Corporate Governance Setting	.150	.091	.142	1.650	.105
	Effectiveness of Audit committee	.130	.089	.139	1.550	.101
	Senior Management support	.240	.113	.286	2.120	.039
	Effectiveness of Remuneration	.205	.118	.233	1.735	.089
	Effectiveness of Nomination committee	.090	.080	.109	1.126	.265
	Qualification and competence	.555	.116	.259	4.797	.000
R^2– 955						
a. Dependent Variable: independency of Internal Audit function						

Comment [AS7]: To

Source: Questionnaire results (2020)

The regression Equation was

Thus, from the above finding the equation would be

$Y= -156 + .150X_1 + .140X_2 + .240X_3 + .205X_4 + .090X_5 + .555X_6$

From the finding, corporate governance setting, Effectiveness of Audit committee, Senior Management support, Effectiveness of Remuneration, Effectiveness of Nomination committee, qualification and competency a constant zero, independency of internal audit function would be -.156. A unit increase of corporate governance setting would lead to .150 increases in independency of internal Audit function, a unit increase of Effectiveness of Audit committee would lead to .130 increases in independency of internal audit function, a unit increase of Senior Management support would lead to .240 increase in independency internal audit function, a unit increase of Effectiveness of Remuneration would lead to.205 increases in independency of internal audit effectiveness, a unit increase of effectiveness of nomination committee would lead to .090increase in independency of internal audit function and a unit increase of qualification and competency would lead .555 increases in independency of internal audit function effectiveness.

CHAPTER FIVE

5. CONCLUSIONS AND RECOMMENDATIONS

5.1. Conclusions

Internal audit play important role in an organization success, the existence of effective internal audit is critical. Organizations with effective and efficient internal audit function are able to detect fraud more than those that have not such a function within their organizations. By taking this aspect into consideration, this study was identified factors that determine the corporate governance and independency of internal auditor

The finding of the study regarding to corporate governance setting. There is established applicable law and regulations to carry out auditors responsibilities independently. There are standards and code of ethics recognize the importance of internal Auditors to maintain the independence and objectivity when performing the work. There are strong system of internal control which is monitored by well-resourced independency of internal audit activity as a fundamental feature of corporate governance. There is well developed internal audit standards to guide the relationship with corporate governance. There is well developed internal audit standards to guide the relationship with corporate governance. There is the responsibility of board directors is insuring the intensity of the composition's accounts and financial reports system of internal auditors independency.

Regarding to effectiveness of Internal Audit committee. There is an audit committee which is independent, objective assurance and consulting activity designed to add value and improve the independency of auditors. There is audit committee helps the bank to accomplish its objective by bringing systematic, disciplined approach to evaluate and improve the effectiveness of risk management control and governance process of internal auditors. The Audit committee contributes to the bank compliance with applicable laws and regulations facilitate the work of Auditors. Internal audit effectiveness increase when audit committee involved in the internal auditor’s activities.

Concerning to

There is sufficient payment for internal Auditors. There is internal regulatory and supervision of managing benefits of internal Auditors. There are audits and risk sub- committee, Remuneration sub- committee, main board management subcommittee to follow up and monitor internal auditors' remuneration. There are sub -committee to align managers and shareholders' interests, mitigating agency costs and providing a link between managerial action and performance of internal Auditors. The management dully recognizes the audit finding reports as tools which give a clue on the current financial performance and internal control mechanisms.

Regarding to senior management support. Independency of internal Audit is supported by senior management support. Senior management support enhances internal auditor's independence recruiting competent and well qualified staff to support internal auditing activities and departments. Senior management safeguards auditor independence. Senior management members are truly knowledgeable, skilled and committed to improve good governance without fear and favor for the proper function of Auditors. Senior management has the responsibilities of measuring performance of the Audit function, appointment and dismissal the heads of internal Audit. There is senior management which is definitely enhancing reliable, dependable, effective and efficient corporate governance.

Concerning to effectiveness of nomination committee. There is delegation of highly qualified and quality managerial personnel who able to monitor, support and follow up the internal Auditors. The assigned personnel has better position that can timely addressed critical problem of independency of internal Auditors. In consultative workshop and meeting is constantly organized by inviting representative who able to manage the issues discussed or presented refreshments and handle payment of internal auditors.

Regarding to qualification and competency. Board directors were qualified at education qualifications of the board directors help them to make decisions. The qualification of the board directors help to create diverse perspective to make a decision. Directors qualifications are central to effectively interpreted and utilize the information generated by management. The directors are qualified and they are innovative creative and produce better strategy of decision

making The directors are qualified and they are innovative creative and produce better strategy of decision making Because of the qualification of directors help to increase internal Auditors performance to promote corporate image and demonstrate accountability and credibility with in the management team..

The existence of effective internal audit activity in the office links with improves organizational efficiency and effectiveness, reduces information asymmetry during decision making and ensures reliability of financial reporting process. Based on the findings some main points the researcher has concludes as follows. The Questionnaire results showed that majority of the auditors are not get any form of training from this can conclude the auditors can't perform effectively their activity every auditor should be enough trained on the audit area and majority of the respondent respond that there is no enough materials, equipment and technologies for training this shows the facility for training materials is poor this lead to ineffective training. The training system is very important for auditors to make them knowledgeable and competent.

Prepare of audit program as the respondent said that they prepare audit program it is a major activity in auditing this will helps them to identify risk area to fulfill the working paper properly and it also help for detail planning activities. Lack of due professional care- the other reason that the respondents disagreed up on as a core cause for internal audit effectiveness of due professional care. The auditors are doing through their experiences rather than trained how they practiced their professions in the audit activity. Majority of the respondents state that there is no any educational opportunity to skilled and to make competent them self. Education is key for updating them self's. Majority of the responds respond that they can get audit evidences and information without any restriction of access this will lead that the internal audit to be effective because it's a major source for audit reports.

5.3. Recommendations

As per the findings from the analysis of the collected data; the following recommendations are forwarded in order to achieve internal audit effectiveness

- I recommended the bank the boards work on corporate governance setting for the independency of internal audit function. Moreover the bank better to hire appropriate

number of auditors to equally share burden of work, auditors should be **adequately paid**, need motivation from the above managers and directors, auditors must be collect information without any restriction, the auditor should perform their activity based on the responsibility and rights fairly according to position held in the audit manual and need to qualified employee secure their retention. Internal auditors face different problems due to lack of financial resources so appropriate budget should be assigned to eliminate this problem. The benefit of the auditors should be measured & compared with good standard level.

- The management should consider internal audit staff experience has become one of the factor to be consider when it comes to independency of internal audit function, because it enable the achievement of good quality auditing and thereby leads to the provision of good recommendation.
- The bank management, the boards and concerned bodies should organize effective audit committee by conducting study to identify the audit committee weakness.
- The bank management, the boards and concerned bodies should formulate or guidelines which enable the senior management to support the independency of internal audit function. Because senior management support play decisive role to promote independency of internal audit function.
- The bank management, the board and concerned bodies should work on remuneration and nomination committee by formulating applicable rules and regulations to promote corporate governance which can able create conducive environment of independency of internal audit functions.

WOLKITE UNIVERSITY

COLLGE OF BUSSINESS AND ECONOMICS

PROGRAMM OF ACCOUNTING AND FINANCE

RESEARCH QUESTIONNAIRE

The purpose of this questionnaire is to primary data and secondary data for conducting a study on the topic **"ASSESSING THE EFFECT OF CORPORATE GOVERNANCE ON THE INDEPENDENCY OF INTERNAL AUDIT FUNCTION A STUDY ON ETHIOPIAN PRIVATE COMMERCIAL BANKS "** as partial fulfillments of the requirements for the Masters of **ACCOUNTING AND FINANCE**, Wolkite University . This study is purely for academic purpose and in no ways that affects the respondent's personality this questionnaire is crafted to collect data on Corporate Governance and its effect on **THE INDEPENDENCY OF INTERNAL AUDIT FUNCTION**. The data to be collected through the questionnaire is highly valuable to meet the objectives of this study. Therefore you are kindly requested to extend your cooperation honestly by providing relevant information and filling out the following questionnaires that are prepared for this intention.

Note: No need to write your name

Thank you, for your cooperation and timely response in advance

Part I: Demographic Information about the Respondents

The following questions concern about your personal information. Completion of this information is voluntary and its confidentiality is assured. No individual data will be reported.

1. Age: -

A. 18-25 years ☐ **B**. 26-35 years ☐ **C**. 36-45 years ☐

2. Sex

A. Male ☐ **B.** Female ☐

3. Educational level: -

A. Diploma B. Degree ☐ C. Masters ☐ D. PhD ☐

4. Your work experience at in the Bank

A. 1-2 years ☐ **B**. 3-4 Years ☐ **C**. above 4 years ☐

Part II: General Questions

Key SD= strongly Disagree D= Disagree N= Neutral A= Agree SA= strongly agree

For the following statement put your level of agreement By putting (X) on the space provided.

No	Statements	SD	D	N	A	SA
	Corporate Governance Setting					
1	There is established applicable law and regulations to carry out auditors responsibilities independently.					
2	There are standards and code of ethics recognize the importance of internal Auditors to maintain the independence and objectivity when performing the work					
3	There are strong system of internal control which is monitored by well-					

	resourced independency of internal audit activity as a fundamental feature of corporate governance					
4	There is well developed internal audit standards to guide the relationship with corporate governance.					
5	There is the responsibility of board directors is insuring the intensity of the composition's accounts and financial reports system of internal auditors independency.					
	Effectiveness of Internal Audit committee					
6	There is an audit committee which is independent, objective assurance and consulting activity designed to add value and improve the independency of auditors.					
7	There is audit committee helps the bank to accomplish its objective by bringing systematic, disciplined approach to evaluate and improve the effectiveness of risk management control and governance process of internal auditors.					
8	The Audit committee contributes to the bank compliance with applicable laws and regulations facilitate the work of Auditors					
9	The Audit committee enhance corporate governance structure					
10	Internal audit effectiveness increase when audit committee involved in the internal auditor's activities.					
	Senior Management Support					
11	Independency of internal Audit is supported by senior management					
12	Senior management support enhances internal auditor's independence recruiting competent and well qualified staff to support internal auditing activities and departments.					
13	Senior management safeguards auditor independence.					
14	Senior management members are truly knowledgeable, skilled and committed to improve good governance without fear and favor for the proper function of Auditors.					
15	Senior management has the responsibilities of measuring performance					

	of the Audit function, appointment and dismissal the heads of internal Audit					
16	There is senior management which is definitely enhancing reliable, dependable, effective and efficient corporate governance.					
	Effectiveness of Remuneration					
17	There is sufficient payment for internal Auditors					
18	There is internal regulatory and supervision of managing benefits of internal Auditors					
19	There are audits and risk sub- committee, Remuneration sub-committee, main board management subcommittee to follow up and monitor internal auditors' remuneration.					
20	There are sub -committee to align manager s and shareholders' interests, mitigating agency costs and providing a link between managerial action and performance of internal Auditors					
	Effectiveness of Nomination committee					
21	There is delegation of highly qualified and quality managerial personnel who able to monitor, support and follow up the internal Auditors					
22	The assigned personnel has better position that can timely addressed critical problem of independency of internal Auditors					
23	Frequent meeting create and strength cohesive boards among directors					
24	Frequency of meeting is constantly in the form managerial time travel expenses, refreshments and director's meeting fee					
	Qualification and competency					
25	Board directors were qualified at education qualifications of the board directors help them to make decisions					
26	The qualification of the board directors help to create diverse perspective to make a decision					
27	Directors qualifications are central to effectively interpreted and utilize the information generated by management					

28	The directors are qualified and they are innovative creative and produce better strategy of decision making Because of the qualification of directors help to increase internal Auditors performance to promote corporate image and demonstrate accountability and credibility with in the management team.					

Thank you

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