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A STUDY ON ASSESSING THE EFFECTIVENESS OF INTERNAL AUDIT PRACTICE IN PUBLIC DEVELOPMENTAL AGENCIES IN ETHIOPIA WITH REFERENCE TO DEVELOPMENT BANK OF ETHIOPIA

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ABSTRACT

Despite audit is required for all organizations to survive grow and remain prosperous. It has not received the degree of concern it deserves in public developmental agencies (PDAs) in Ethiopia. This study is conducted under a title of Assessing the effectiveness of internal audit practice of Public developmental agencies in Ethiopia in case of Development bank of Ethiopia. "The major objective of the research was to evaluate the effectiveness of internal audit practice in Development bank of Ethiopia by studying audit as a process, assessing the perceptions of employees towards the effectiveness of internal audit. To achieve this objective, both primary and secondary information were obtained via questionnaires and from its documentation using both descriptive and explanatory research design with quantitative and qualitative methods, the type of sampling techniques applied is census and the information gathered was analyzed according using SPSS. Data from 30 internal auditors and 85 Accountants. The study revealed that the internal auditors receive management support and majority of the internal auditors did have requisite skills and experience. The Development bank of Ethiopia also experienced inadequate resources allocation and trainings on the required professions. This suggests that the internal audit in the bank is effective as existed limitations. To enhance more the effect of the bank internal audit practice the study recommended that the bank should have to strive hard in order to improve their internal audit effectiveness by developing and implementing internal audit trainings periodically and adequate resources which will best suit their specific needs. The findings of the study have important implication for the bank, other public organizations and future research by academics, consultants and researches.

KEYWORDS

public developmental agencies, internal audit effectiveness, development bank of Ethiopia.

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INTRODUCTION

INTRODUCTION ABOUT TOPIC

The issues of globalization transparency, integrity and improvement of service delivery increase the need for governance and accountability. Consequently, this phenomenon leads the increasing interest of internal audit function in organization Dittenhofer (2001) and Goodwin in (2004) have both shown that internal auditing is promising as an important component of management and a control mechanism both private and public sectors. Still, Montondon and Fischer (2005.) have both asserted that the credibility of the internal audit function is significantly important especially in public entities as they are held responsible to diverse stakeholders compared to private entities.

Therefore, the nature of the service sought from the internal auditor has been transforming over the years from an emphasis on compliance audit where independence has been the core paradigm, to both compliance and consulting role where partnering with management is accorded greater significance (Trulea and Stefanescu, 2009; Nagy and Cenker 2002.). The government of Ethiopian as part of its development strategy to stop various corrupted officials and other criminal activities, it is becoming, obvious that addressing the problem of economic crime is vital. Due to this, issuing proclamation no 68/1997 and the issuance of internal audit procedure manual for public sectors back the relevance of Internal audit functions (IAF). Moreover the issuance of proclamation no- 235/2001 to establish the federal ethics and anticorruption commission and the implementation of the civil service reform plan are clean indicators of governments concern to embed good governance system in the public sectors of Ethiopia.

STATEMENT OF THE PROBLEM

Internal audit is a cornerstone of good public sector governance and it is essential for ensuring the operation and appropriateness of controls. According to Zeleke (2007) the internal audit activities help to prevent corruption, misappropriation of funds and other financial irregularities and ensure effective and efficient utilization of resources to achieve the objectives of the organization. Misappropriation of funds and corruption are now the order of the day in the public developmental agencies in all countries due to weak internal control systems (Van Gansberghe, 2005) and internal audit implemented in Developmental Bank of Ethiopia were also challenged by problems like lack of obtaining proper attention from managers, resistance from staffs and increasing number of customer complaints. Internal auditing also is handicapped by a critical shortage of appropriately trained and skilled manpower, inadequate organizational status, and a lack of professional independence.

OBJECTIVES

This paper focuses on to assessing the effectiveness of internal audit practice in public developmental agencies in Ethiopia with reference to Development bank of Ethiopia.

RESEARCH QUESTIONS

This research has tried to give answers to the following research questions.

1. What does implementation and effectiveness of internal audit look like in Development Bank of Ethiopia?
2. How do employees perceive the effectiveness of internal audit practice in Development Bank of Ethiopia?
3. What factors make the internal audit units effective?
4. What is the strength and direction of the relationship between effectiveness of internal audit practice with process of internal audit?

SPECIFIC OBJECTIVES

1. To investigate implementation of internal audit in Development bank and to see whether these Banks adhere to theoretical guidelines for managing internal audit or not.
2. To analyze and determine the level of internal audit practice effectiveness based on factors common for successful internal audit.
3. To determine whether Development Bank have any formal policy on internal audit or not.
4. To examine the relationship between effectiveness of internal audit practice and factors of effective internal audit practice.

SCOPE

The scope of the study covers the conceptual, geographical and the time scope.

Conceptual Scope - the study was focus on examining issues related to identify on impact of the effectiveness of internal audit practice in public developmental agencies in Ethiopia with reference to Development bank of Ethiopia.

Geographical Scope -the research was carried out geographically Ethiopia.

Time Scope -The study used the most recent year data from the fiscal year of 2009 up to 2010 e.c

METHODOLOGY

This paper focuses on to assess the effectiveness of internal audit practice in public developmental agencies in Ethiopia with reference to Development bank of Ethiopia.

RESEARCH DESIGN

The study was employed by using both descriptive and explanatory research design with quantitative and qualitative methods. The quantitative aspect of the data focused on description of the state of affairs related with implementation and effectiveness of internal audit practice as it exists currently in Development bank of Ethiopia and analysis of a relationship among the dependent and explanatory variables of the Bank.

POPULATION AND SAMPLING TECHNIQUE

Currently the total numbers of the study comprised all Development bank of Ethiopia internal auditors and Accountants. The type of sampling techniques applied is census method, the structure of this population enabled the researcher to collect objective and detailed information from internal auditors and Accountants who are responsible for ensuring the effectiveness of the internal audit. The Accountants were chosen because they deal with the financial affairs of the banks and implementation of internal audits which help them to have enough exposure to the internal audit practice of their bank. The total number of the targeted population was at 115 (which constituted 30 internal auditors, 85 Accountants).

METHODS OF DATA COLLECTION

Data were collected using primary data gathering tools of questionnaire and the researcher's onsite observation. Questionnaires that contain both open and closed ended questions are prepared and distributed to all staff members of the bank. The researcher ratings summarized by likert with a five-point scale from strongly agree to neutral to obtain information on attitudes and to examine the effectiveness of internal audit practice.

Primary data

This is system of data collection tool that was got directly from the field. It was collected using questionnaires.

Secondary data

The researcher was read related literature relevant to the subject before and during the study (internal audit) in public developmental agencies, obtained from previous studies, text books, internet, journals and reports from the bank itself.

METHODS OF DATA COLLECTION AND INSTRUMENTS

Administered questionnaires were given to a selected internal auditors and accountants who are currently working in the bank, the questionnaire investigates opinions on the effectiveness of internal audit based on factors and how the audits were carried out as experienced and perceived by respondents.

DATA ANALYSIS METHOD

It is the most important component of this study. The responses of the respondents that have been collected using the above methods were organized, analyzed, and interpreted in a sensible way. To meet the objectives of the research correlation analysis and regression analysis as well as descriptive statistics have been used to analyze findings.

Regression analysis is a statistical tool for the investigation of relationships between dependent and independent variables. Usually, the investigator seeks to ascertain the causal effect of one variable upon another to examine the relationship between effectiveness of internal audit practice and factors of effective internal audit practice. The investigator also typically assesses the "statistical significance" of the estimated relationships, that is, the degree of confidence that the true relationship is close to the estimated relationship.

In multiple linear regression there are P explanatory variables and the relationship between the dependent variable and the explanatory variables is represented by the following equation:

$$Y_i = \beta_0 + \beta_1 X_{1i} + \beta_2 X_{2i} + \dots + \beta_p X_{pi} + \epsilon_i$$

Where:

Y_i is the dependent variable and X_1, X_2, \dots, X_p are the independent variables

β_0 is the constant term and β_1 to β_p are the coefficients relating the p explanatory variables to the variables of interest. The term 'linear' is used because in multiple linear regressions we assume that y is directly related to a linear combination of the explanatory variables.

MODEL ASSUMPTIONS

Dependent variables Y

Independent (explanatory) variables: X_1, X_2, \dots, X_n

Assumptions

- The true model is $Y_i = \beta_0 + \beta_1 X_{1i} + \beta_2 X_{2i} + \dots + \beta_p X_{pi} + \epsilon_i, i = 1, 2, \dots, n$
- Homoscedasticity: $\text{Var}(\epsilon_i) = E(\epsilon_i^2) = \sigma^2$ for all i
- No error autocorrelation: $\text{cov}(\epsilon_i, \epsilon_j) = E(\epsilon_i \epsilon_j) = 0$ for all $i \neq j$
- Each of the explanatory variables X_1, X_2, \dots, X_n is non-stochastic.
- No multicollinearity: No exact linear relationship exists between any of the explanatory variables.
- Normality: ϵ_i are normally distributed with mean zero and variance σ^2 for all i ($\epsilon_i \sim N(0, \sigma^2)$)

Correlation Analysis

It deals with the measurement of the closeness of the relationship which is described in the regression equation. We say there is correlation when the two series of items vary together directly or inversely.

TYPES OF DATA COLLECTED

This study was mainly based on primary data and supported by secondary data when available. The sources of primary data are the employees; Secondary data are collected from the banks, personal files, websites and reports.

ANALYSIS & FINDINGS

This research sought to assess the effectiveness of internal Audit practice in the development bank of Ethiopia, according to the total respondents 0% of them lies between an age of 21-25,48.6% of them are between 26-30 years,42.2%of them are between 31-40 years and the rest 8.3% of the respondents are aged above 40.

The occupation of respondents can contribute a lot towards the effectiveness of internal audit practice. As it is depicted in the table 26% of the respondents are engaged in internal auditors and 74% Accountants within the bank, also reveal that 75% of the respondents are males and 25% of the respondents are females, Regarding the educational level of the respondents 45% of them are BA(BSC) holders,55% of the respondents are MA(MSC) holders.

From the respondents evident that the majority of respondents 30% have been employed in their current position for 1-3 years, 60% of them have an experience of 4-6 years, 7% of them have an experience of 7-10 years and the rest 3% of them has an experience of above 10 years. Statistical evidence showed the internal audit department is given low status in the bank management structure,10% strongly agree,12.% agree,23.9% disagree and 54.1%) strongly disagree and the audit

have policies and procedures are not clearly defined for the internal audit department,0%)of the respondents agreed,11.7% disagree 0% of them strongly agree and 88.6%) respond strongly disagree this showed us the bank have clear policies and procedures for internal audit departments, management also perceived internal auditors as fault-finders rather than adding value to promote good corporate governance from the total of the respondents 8% agreed,0% strongly agree,14.7% disagree and 77.3% strongly disagree

The respondents also agreed that there is no regular in-service training for them. the respondents representing 89% agree 11.0%)strongly disagree. The internal auditors are not allowed pre-transaction audit, the respondents representing 70.6% agreed,15.6% disagree,11.0% strongly agree and 2.8% representing strongly disagree and didn't free to choose any transaction of their choice 4% agreed,25.5% disagree,5% strongly agree and 65.5% strongly disagree. The respondents also agreed that no opportunity to seek the assistance of experts during audit process especially when assessing value of a contract, property 9.3%) strongly agree, 62.4% agree,10% disagree and 19.3% strongly disagree.

As to whether the units have adequate resources including utilization and availability of appropriate technology the respondents representing 21.1% strongly agreed that they have no adequate resources including appropriate technology and 78.9% also agreed that the resources available are not adequate. Evidence from the study showed that 59.6% of the respondents expressed that the number is inadequate while 21.1% of them stated the number is somehow adequate, 10.1% adequate,6.4% very adequate and 2.8% very inadequate.

The respondents also respond and a review of audit reports reveal that the internal auditors concentrated and Accountants agreed on compliance of law 76.4%), checking budget implementation 85.3%,assessing reliability and soundness of financial information 77% of accounting errors and fraud detection 82(75.2),evaluating management's efforts to the recovery of receivable, taxes and other collectables 79(72.5%),examine use of organization resources and safeguard of assets 86(78.9%),assessing unethical behavior of management and recommend best practice 71(65.1%). The internal auditors also agreed to risk management 85.1%, evaluation of project and productivity 94%, examine and assess the polices, procurers, and manuals 86.2%), test the organizations conformity with objective requirement 79.7%. The documents that the internal auditors draw their powers, functions, mandate and administrative lines include Financial Administration Act, 2003(Act 654), Public Procurement Act, 2003 (Act 663), Internal Audit Charter and Internal Audit Manual. 82.6% of the Development bank of Ethiopia do have Internal Audit Charter and the internal auditors relied on Internal Audit Agency Act. This Act defined the responsibilities and duties of the internal auditors and to define the scope of internal work and powers of internal auditors. The internal audit charter binds management to allow internal auditors to execute their work without any restrictions and implement internal audit recommendations. From the responses 84.4% of the respondents expressed agreed about the implementation of internal audit recommendations by management and the respondents agreed that the relationship with management that is 80.7%. On commitment of management in supporting budgetary status of the internal audit units representing 76.1% of the respondents stated agreed. Management sometimes interferes with the work of the internal auditors as 76.1% indicated agreed about management interference.

The evidence suggests that the internal audit units receive management support in the Development bank of Ethiopia.

The researcher wanted to know the extent to which the external auditors rely on internal auditors in the bank. The external Auditors indicated that they occasionally rely on the internal auditors 65.9%. They explained that the internal auditors do have necessary expertise and experience. It can be deduced that, there is collaboration between internal auditors and external auditors in the bank. In this regard, there would be effective auditing.

From the statistical evidence showed that the internal auditors play advisory roles in the bank. The internal auditors agree to advise management on good corporate governance systems 74.3%, Ethical practice and anticorruption 72.5%. They also agree management on effective risk management 75.2% and management on designing and implementing internal control systems 78% and sound business practice 75.2%. From the above analysis, one can say that the internal audit units in the bank are meeting the modern definition of internal audit by IIA, 2009 as consulting activity and adding value to an organization. These advisory services are necessary to ensure good corporate governance in the bank. It is important to add that the internal audit units may have good advisory services to offer, but the benefits of it may depend on the quality of the service and how relevant is it to the bank. The expertise and the experience of the internal auditors would determine the quality of advisory services they can offer.

As it has been shown the mean score for the effectiveness of internal audit practice in Development bank of Ethiopia was 4.04 and the standard deviation was 0.44 with maximum and minimum values of 4.92 and 2 respectively.

The respondents agreed that, approved internal audit standards, Act or charter 69.7%, Organizational independence 62.4%, Management support 57.8% Implementation of audit recommendations 64.2, No adequate resources 67.9%, Unrestricted access to records 60.6%, Quality leadership of chief internal auditors 65.1% and No regular training of internal audit staffs 64.2% make the internal audit units effective. The respondent also agreed that Rotations of internal audit staffs 60.6%, Job satisfaction 64.2%and Opportunity to take part in the decision making 65.1% could make internal auditors effective.

REGRESSION ANALYSIS

A regression analysis was conducted and Pearson product-moment correlation (*r*) were calculated in order to establish whether or not there was any statistically significant relationship between effectiveness of internal audit practice and important factors of effective internal audit practices, which provides a correlation coefficient that indicates the strength and direction of the linear relationship.

Here we have the dependent variable (effectiveness of internal auditing (EIA)) and independent variables (Organizational setting (OS), internal audit quality (IAQ), Existence of Formal Mandate (EFM), Management Support (MS), Adding Value and Advisory Role of Internal Audit (AVARIA)). Therefore, we have to do a correlation and regression analysis between the EIA and OS, IAQ, MS, and AVARIA. Let us star with correlation analysis or to test the correlation/ association between the dependent and independent variable.

TABLE 1: PEARSON CORRELATION BETWEEN IMPORTANT FACTORS OF EFFECTIVE INTERNAL AUDIT PRACTICE AND INTERNAL AUDIT EFFECTIVENESS (CORRELATION OUTPUT FOR EIA WITH OS, IAQ, MS, AND AVARIA)

		OS	IAQ	EFM	MS	AVARIA
EIA	Pearson Correlation	.726**	.699**	.596**	.704**	.808**
	Sig. (2-tailed)	.000	.000	.000	.000	.000

Source: SPSS

As we have seen in the above table, all P value 0.00 which is less than the 5% level of significance. Therefore, it is highly significant meaning that is strong and positive correlation between EIA and OS, IAQ, MS, and AVARIA.

REGRESSION ANALYSIS

In this part we are going to describe the relationship between EIA and OS, IAQ, MS, and AVARIA in mathematical equation. To do this, let us start with the overall significance of the regression model test.

TABLE 2: ANOVA TABLE

Model	Sum of Squares	df	Mean Square	F	Sig.	
1	Regression	16.906	5	3.381	87.907	.000
	Residual	3.962	103	.038		
	Total	20.868	108			

Source: SPSS

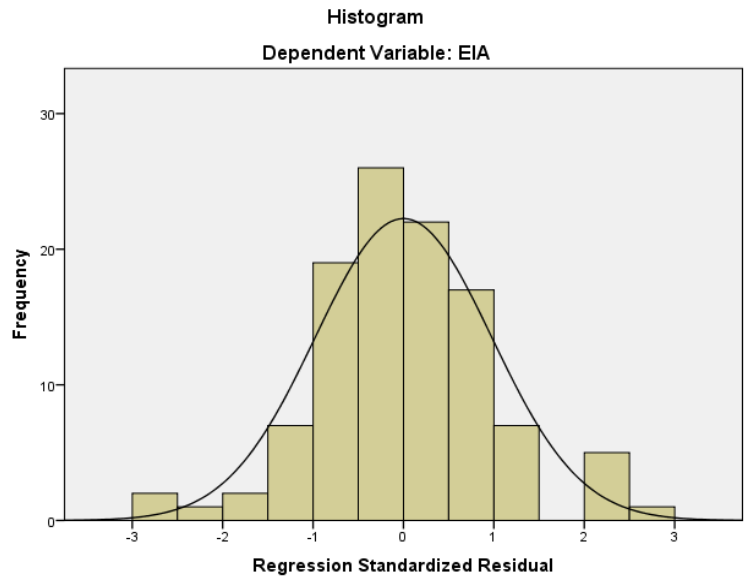
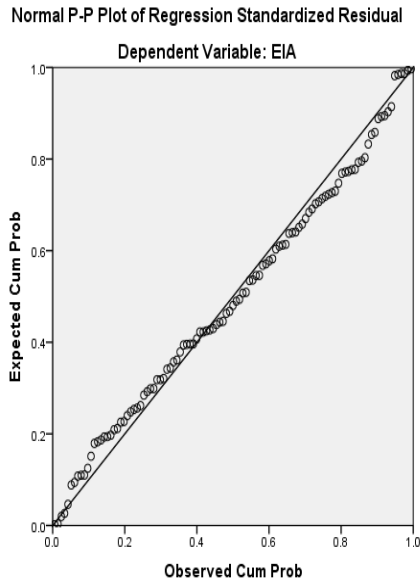
As we see from the above ANOVA table the P value is 0.000 which is less than the level of significance or 0.05. Therefore, the overall regression model is significant. The value of R² is 0.810 which implies that about 81 % of variation in EIA is expressed by the variation in OS, IAQ, MS, and AVARIA. But the remaining around 19 % is unexplained variation this is due to the non-inclusion of other variables.

TABLE 3: MODEL SUMMARY

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.900 ^a	.810	.801	.19612

Source: SPSS

FIGURE 1: NORMAL P-P PLOT



Source: SPSS

FIGURE 2: SCATTER PLOT

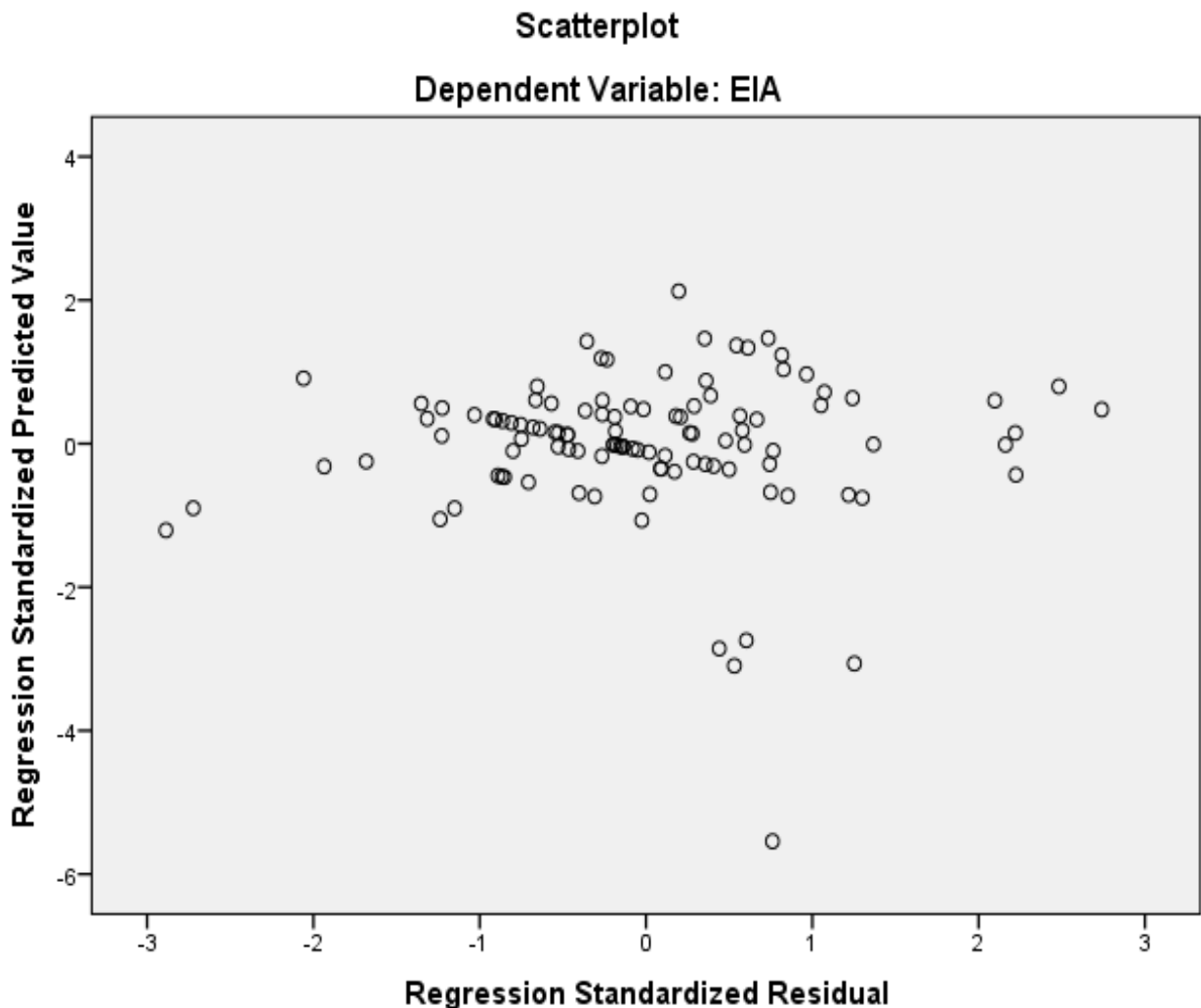
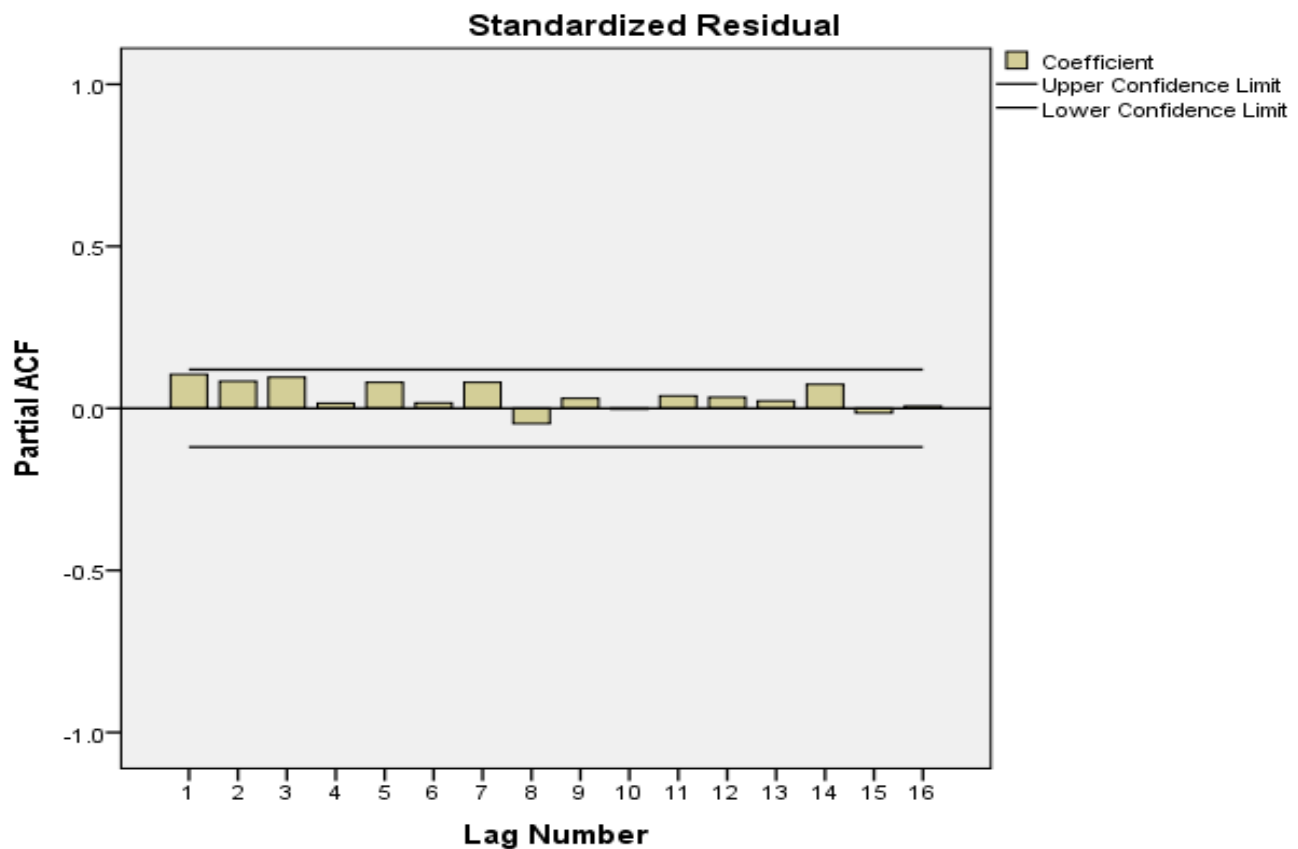


FIGURE 3: PARTIAL AUTOCORRELATION FUNCTION (PACF)



Source: SPSS

As we have seen the assumption of multicollinearity, normality, heteroscedastic, linearity and autocorrelation, there is no any kind of problem or all assumptions are full field. Then after let us come to the individual variable coefficient that is whether it is significant or not on the basis of P value. The following table 4 shows the coefficient of individual independent variable with corresponding to its P value.

TABLE 4: COEFFICIENTS OF THE SELECTED VARIABLE

	Unstandardized Coefficients		Sig.	Collinearity Statistics	
	B	Std. Error		Tolerance	VIF
(Constant)	1.065	.259	.000		
OS	.384	.069	.000	.562	1.780
IAQ	.120	.086	.016	.410	2.440
EFM	.062	.067	.035	.559	1.789
MS	.174	.084	.041	.440	2.274
AVARIA	.533	.065	.000	.536	1.866

Source: SPSS

As we stated in the methodology part Y is the dependent variable (EIA) and the independent variables are denoted by X letter and X₁= OS, X₂= IAQ, X₃= EFM, X₄= MS and X₅= AVARIA. Based on the above denotation we can fit the multiple linear regression as follows:

$$Y_i = 1.065 + .384X_{1i} + 0.120X_{2i} + 0.062X_{3i} + 0.174X_{4i} + 0.533X_{5i}$$

From the above simple linear regression model, all the coefficient of independent variable is positive and we can recognize that if we improve OS, IAQ, EFM, MS and AVARIA inside automatically the dependent variables EIA is also improved by some extent.

CONCLUSION AND RECOMMENDATION

Based on the already concluded information, it is possible to make recommendations to correct deficiencies in existing internal audit practices of Development bank of Ethiopia.

The internal control activities of the internal audit unit in the Development bank of Ethiopia internal audit functions that focuses on compliance with laws and regulations, evaluating accounting errors and fraud, addressing risk management and productivity. Management do give the internal auditors the necessary support. The internal audit recommendations are implemented even though the units lack adequate resources and technology to employ auditing lack of manpower and there is no regular in-service training for them.

In general, the internal auditors have experience. The Development bank of Ethiopia do have well-defined and clear policies, procedures and programs for internal audit units. The structure and the organizational settings of the Development bank of Ethiopia are not restricting the roles of the internal auditors in delivering their services. The Development bank of Ethiopia have clear policies and procedures for internal auditors. Management perceived them as not fault-finders and the units are given high status in the Development bank of Ethiopia. The internal auditors play advisory roles such as good corporate governance, unethical practices and corruption, designing and implementing internal controls, risk management and sound business practice. The factors identified as ensuring effective internal audit in the Development bank of Ethiopia are expertise and experience of internal auditor, management support, approved internal audit mandate and standards, unrestricted access to records, implementation of audit recommendations, organizational independence, and quality of leadership of chief internal audit staff. It can be concluded from these evidences that; the Development bank of Ethiopia internal audit is effective.

Based on the already concluded information, it is possible to make recommendations to correct deficiencies in existing internal audit practices of Development bank of Ethiopia:

- The internal audit units need to be adequately resourced including the use of appropriate technology. The availability of resources would enable the internal auditors to do quality work within the timeframe.
- The Development Bank of Ethiopia had limitations in development of skilled, certified, and professional auditors. In this regard, give a chance and opportunity to take Certified Public Accountant or other Internal Audit related certification can be considered as a good solution. Similarly, extending in-source trainings can have a great contribution in the competence of Internal Audit teams especially to new comers.
- In the modern audit, using Internal Audit soft wares is not luxurious instead inelastic item. In the process of advancing the Internal Audit process; Internal Audit soft wares play the crucial role through making the audit activity simple. Therefore, ECBs are recommended to work in using Internal Audit soft wares to enhance the quality Internal Audit work. Correspondingly, provide trainings related with such soft wares are under consider.

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