

JIMMA UNIVERSITY
COLLEGE OF BUSINESS & ECONOMICS
GRADUATE PROGRAM IN ACCUNTING & FINANCE

**AN ASSESSMENT OF INTERNAL AUDITING PRACTICES: A CASE
OF SELECTED PUBLIC ENTERPRISES IN EAST ARSI ZONE.**



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**AN ASSESSMENT OF INTERNAL AUDITING PRACTICES: A CASE
OF SELECTED PUBLIC ENTERPRISES IN EAST ARSI ZONE.**

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Research on An Assessment of Internal Audit Practice:
On case of Selected Public Enterprises in East Arsi zone.

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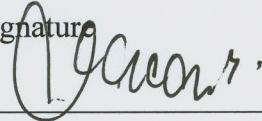
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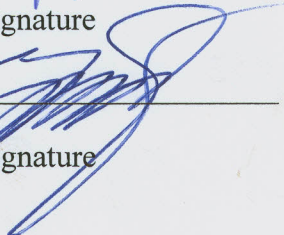
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Declaration

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

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Acronyms

AADE	Arsi zone Agricultural Development Enterprise
AMF	Asella Malt Factory
CAE	Chief Auditors Executive
CBE	Commercial Bank of Ethiopia
CG	Corporate Governance
EEPCO	Ethiopian Electric Power Corporation
ETC	Telecommunications Corporation
IA	Internal Auditing
IAF	Internal Audit Function
IIA	Institute of internal Auditors
ISPPIA	International Standard for professional practice of internal Audit.
OAG	Office of the Auditor General
SPSS	Statistical Package for Social Science

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Abstract

The main purpose of this study was to investigate the internal audit reporting relationships in the selected public enterprises, to see the influence of the internal audit reporting relationship. Internal audit is facing many challenges, some of the challenges identified by the Ministry of Finance and Development, in Internal Audit Manual are: lack of expertise leading to trivial auditing findings, lack of opportunity for professional development & repetitive audit routines which staffed members can predict. To obtain the required information open-and close-ended questionnaires were used as data gathering tools in three (3) public enterprises in East Arsi from where 36 employees were given questionnaires thirty three (33) of them have been properly filled and returned. A sample of 36 respondents was selected purposively. Data was analyzed using statistical package for Social Scientists (SPSS) Version 16.0 Windows Software.

The findings of the study showed that the involvement of IAF in managerial matters is very much limited, the scope of internal audit in all of the surveyed enterprises were very much narrow and not yet set free from the traditional thoughts of what an IAF should be. The study, therefore, recommended that, the public enterprises should revise their reporting lines and separate the functional reporting from the administrative reporting.

Key Words: Internal Auditing, Independence, Reporting Relationship

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CHAPTER ONE

1. INTRODUCTION

1.1 Background of the Study

The issuance of Ministry of Finance directives in 1942, which focused on public sector fund utilization, marked the development of modern auditing in Ethiopia (Kinfu, 1990). The formation of the Office of the Auditor General in 1961 (Government of Ethiopia, 1961) with subsequent refinements of duties and responsibilities in 1979 (Government of Ethiopia, 1979) and 1987 (Government of Ethiopia, 1987) was another significant development in public sector auditing in the country. The Office of the Auditor General undertakes external audits of government ministries and their respective offices to ensure accountability. Public sector organizations are also required to have internal audit functions to support effective management. The Ministry of Finance and Economic Development has the authority to issue internal audit manuals for use by all organizations that are wholly or partially financed by the government budget (Government of Ethiopia, 1996). The Ministry has issued a manual that contains a code of ethics for internal auditors and procedural guidance on the conduct of audits (Ministry of Finance and Economic Development, 2004).

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

In recent years, researchers and practitioners have widely discussed the need for internal auditors of adding more value to their companies' operations, and contributing to the achievement of corporate objectives. This new perspective has focused increasing attention on issues such as performance evaluation and effectiveness of internal auditing. Several parties advocated the need to assess internal auditing (IA) effectiveness, though, at present, there is not a shared framework of reference to this scope. Recently, (Sarens 2009) have raised the question "when can we talk

about an effective IA function?” in his editorial about future perspectives of IA research. Looking at the existing literature, there are many possible answers to this question. Different authors have related IA effectiveness to different issues, focusing on IA processes, outputs and outcomes (Marika and Giovanni, 2004).

According to the Institute of Internal Auditors (IIA), internal auditing reviews the reliability and integrity of information, compliance with policies and regulations, the safeguarding of assets, the economic and efficient use of resources, and established operational goals and objectives. Internal audits encompass financial activities and operations including systems, production, engineering, marketing and human resources (Rupsys, 2005). In addition, the internal audit service is currently being considered as a good contributor to corporate governance. Recently, in developing countries, there has been increased interest and more emphasis is placed on the IAF (Internal Audit Function) as one tool to crisis prevention and enhancing good governance system of the public sector (Zelege, 2007).

In 1991, OAG conducted a brief survey of internal auditing in ministries, commissions, agencies, and public enterprises. Established internal audit units were found in more than 70 percent of the budgetary institutions and 90 percent of public enterprises surveyed. The survey also revealed that most internal audit functions considered their responsibilities in broad terms.

Regarding the current situation of the internal audit scope additionally states that reality is that internal auditing today still focuses on traditional activities, such as financial and compliance auditing (Welde-Ruphael, 1998). Less attention is given to operational audits or the application of modern techniques like flowcharting, statistical sampling, and computer auditing. Internal auditors often must solve day-to-day problems both at the head offices and in branches. However, they spend most of their time ensuring that accounting records are properly maintained and reliable; that the assets of the enterprises are adequately safeguarded and properly maintained; and that the organization is in compliance with established policies and procedures.

Following this, the aim of this study is to conduct an assessment on the internal audit practices with special emphasis on reporting relationships, role of the internal audit function in corporate governance, the scope and independence of internal audit function (service), the challenges, the internal audit practice faced and recommends suitable solutions to the problems.

1.2 Justification of the Study

The main reason for this research is Internal Audit Function and Corporate Governance: in Commercial Banks which is conducted by (Abraham Gebregiorgis, 2011). His finding was: IAF (or experience as internal auditors, policy for hiring and training, and professional certification) and rate of implementation to audit recommendation by management were low. Furthermore, use of internal audit working papers by external auditors in conducting their duties was low. Hence, IAF has no positive impact on corporate governance effectiveness for the reason of that an IAF doesn't possess quality.). This was only on a single public enterprise. And I want to conduct this research by taking three different public enterprises namely Asella Malt Factory (AMF), Commercial Bank of Ethiopia (CBE) Asella branch, and Arsi zone of Agricultural Development Enterprise (AADE). The previous research is based on only its function, but I want to assess what the quality of internal auditing in the above selected public enterprises. Therefore, my research is going to fill these gaps.

The other reason for this research is Internal audit effectiveness: an Ethiopian public sector case study (Dessalegn Getie Mihret & Aderajew Wondim Yismaw, 2007). This case study was conducted by model developed on four factors: internal audit quality; management support; the organizational setting; and attributes of the audit. But there was not assessed the factors affecting the effectiveness of internal auditing in an Ethiopia public sectors. Here under this research the researcher is going to assess the factors affecting the effectiveness of internal auditing of the selected public enterprises in East Arsi zone in addition to the four factors assessed by these researchers.

1.3 Statement of the Problem

Internal audit is facing many challenges, some of the challenges identified by the Ministry of Finance and Development, in Internal Audit Manual are: lack of expertise leading to trivial auditing findings, lack of opportunity for professional development, repetitive audit routines which staffed members can predict, being assigned to tasks such as accounting and pre-control of expenditures with the internal auditor subsequently have to audit (conflict of interest), inability to insist on getting significant information because fears of losing promotion opportunities and job security (lack of independence), wrong perception of the audit function and auditors by the staff of the public body.



As per the report issued by a team that studied the effectiveness of the Ethiopian Civil Service Reform Program (2002 G.C), it is noted that the Internal Audit Function in the public sector of Ethiopia is too weak to contribute towards the government's effort in the process of implementing the reform. Therefore, finding the solution that causes these problems will have tremendous contribution for policy makers and other interested stakeholders in the area (Zelege, 2007).

The Internal Audit practice is highly characterized by its deep devotion to conducting the traditional routines like financial audit, compliance audit, internal control and the like than the modern ones such as risk assessment, consultation to management and recommendations etc. The involvement of the IAF in managerial matters is very much limited. It seems involving for an IA in managerial activities would be trace passing. Generally, the scope of internal audit in all of the surveyed enterprises is very much narrow and not yet set free from the traditional thoughts of what an IAF should be.

The above-mentioned problems can be classified into two categories with some overlapping. First, the competency of internal auditor that leads to trivial audit finding, lack of professional development, repetitive audit work, and non-value added internal audit report. Second, structural problem (reporting relationship) in the form of assigned task that impair the auditor independency, and fear of losing promotion, job security , and wrong perception about internal auditors as fault- finders and their task as policing rather than auditing. Above all, vague reporting relationship brings: -

- Poorly motivated and frustrated internal audit staff because of limited scope of audit.
- Lack of independence.
- Weak organizational governance.
- Internal auditor can also suffer from low status that leads to inefficient and ineffective.

1.4 Research Questions

1. Is the internal auditor's independence in the surveyed enterprise impaired by the existing reporting relationship?
2. To what extent the IAF in the sample enterprises are broad or its scope?
3. Do the existing reporting relationships, the management's perception and responsiveness allow the IA's to contribute to good governance in the enterprises?
4. Does the charter or manual (if any) clearly state the IA's responsibility, duty, and scope of activities?
5. Is the IA's qualification, their size experience sufficient and appropriate?
6. What are the major challenges to the internal auditing in the selected public enterprises?

1.5 Objectives of the Study

The study's general objective is to assess whether the internal audit practice in the selected enterprises is being conducted in conformity with the modern internal auditing assumptions and to identify the gaps and degree of deviations from these assumptions and recommend possible ways to cope up the problems identified from the research result, so as to promote the image of internal audit profession.

1.5.2 Specific Objectives

The study will address the following specific objectives

1. To investigate the internal audit reporting relationships in the selected public enterprises.
2. To see the influence of the internal audit reporting relationship and identify deviations from the ideal standards.
3. To investigate the Internal Audit practice that is escaped from the influence of the traditional auditing practices.
4. To examine whether managers or employees of the selected organizations have proper understanding of internal auditing role in good corporate governance.
5. To identify the challenges to the internal audit function in the selected enterprises.

1.6. Scope of the Study

It will be good if the research can be conducted on all public enterprises throughout the country. But due to the financial and time constraints, the coverage is limited only to East Arsi zone.

There are six public enterprises in East Arsi Zone; namely the Arsi Zone Agricultural Development Enterprise (AADE), the Asella Mat Factory (AMF), and Commercial Bank of Ethiopia (CBE) Asella Branch, Ethiopian Insurance Corporation (EIC), the Ethiopian Electric Power Corporation (EEPCO), and the Ethio Telcom (ET). However, the internal auditing in the ET, EIC and EEPCO is conducted at regional levels and the district offices in Asella simply send documents to the head office and different commercial bank branches in the zone except the Asella branch are below level II.

Based on the above public enterprises in Asella town the coverage is limited only to three selected public enterprises in Assela town. Moreover, the study's specific focus is on the assessment of the internal audit practice with emphasis on investigation on reporting relationships, independence, scope of the internal auditing functions, its contribution to corporate governance, challenges being faced etc. Nonetheless, it does not aim at evaluating the audit reports, reporting techniques and standards. The study was conducted from beginning of January 1 to end of May 2014 G.C.

1.7 Limitations of the Study

A study of this type is expected to address all respondents which are assumed to be appropriate to the study so as to identify the problems, make appropriate analyses, reach at reliable conclusion and recommend suitable solutions. One of the limitations of this study was that it couldn't address the board members as these peoples are Ministers of different ministries where access to them is not that simple. In addition, the other limitation of this study was that the findings, conclusions and recommendations were based on the findings displayed in figures, tables and SPSS (Statistical Package for Social Science) software but, other statistical tools i.e. different models were not used.

1.8. Significance of the Study

The problems that was identified and to which relevant solutions recommended by this research was helpful not only to these specific enterprises, but also to other public enterprises, as the enterprises are governed by the same internal audit manual and same agency.

It was also gave insight to the role and scope of the modern internal audit and its contribution to good corporate governance.

Besides, this research study was a basis for other researchers in similar topic. It is hoped that interested academics were benefited from careful study of the suggested research questions and the lines of inquiry that they open up for future research investigation.

1.9. Organization of the Paper

This research report divided into five chapters. Chapter one the introduction part which contains background of the study, Justifications of the study, statement of the problem, research question, Objectives of the study, Limitation of the study, Significant of the study, and organization of the research paper.

Chapter two presents a discussion on the assessment of internal auditing practice in the selected public enterprises based on the most recent academic literatures. Chapter three outlines the methodology followed in this study. This chapter embraces the research strategies used and their justification, specific research methods, and analysis section. Chapter four reports the results and a discussion thereon. In the final chapter findings and conclusions are summarized, recommendations are forwarded and suggestions for further research are given.

CHAPTER TWO

2.1 Review of Related Literature

2.1.1 Definition and Scope of Internal Audit

In the past, internal auditing was defined as an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. This statement is more an introduction than a definition. It tells little about what internal auditors are responsible for. Accordingly, the new Institute of Internal Auditors (IIA) definition of internal audit is as follows: 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.

This definition states that scope of internal auditors is assurance and consulting activity. Assurance services involve the internal auditor's objective assessment of evidence to provide an independent opinion or conclusions regarding an entity, operation, function, process, system or other subject matter. The nature and scope of the assurance engagement are determined by the internal auditor. Consulting services are advisory in nature, and are generally performed at the specific request of an engagement client. The nature and scope of the consulting engagement are subject to agreement with the engagement client. When performing consulting services the internal auditor should maintain objectivity and not assume management responsibility. However, the work of the auditor is so much bounded up with the detection of fraud in the eyes of the general public that it is necessary that his interest in fraud should be placed in its proper perspective. Internal audit is a long-standing function and an effective tool of management in many organizations. It has been a recognized component of organizations in both the public and private sectors and in most industries for many years. Internal auditing is often seen as an overall monitoring activity with responsibility to management for assessing the effectiveness of control procedures which are the responsibility of other functional managers. The internal audit function is not limited to the operation of any particular function within an organization. Rather, it is all-embracing and accordingly is structured in the organization as a separate entity responsible only to a high level of management.

Internal auditing which is often seen as constituting a large and significant aspect of an organization's financial control system is a vehicle to success and survival. According to

Rittenberg and Schwieger (1997) internal auditing is taking on increased importance in many of today's global organizations by assisting management in evaluating controls and operations and thereby providing an important element of global control. Venables and Impey (1991) also recognized the control role of internal auditing when they stated: It is generally recognized that the proper organization, staffing and methodology of internal audit presents the board with the best means of focusing on its obligation to ensure proper controls in the business. However, the need for an internal audit function will vary depending on company specific factors.

2.1.2 Brief History of Auditing In Ethiopia

The issuance of Ministry of Finance directives in 1942, which focused on public sector fund utilization, marked the development of modern auditing in Ethiopia. Kinfu(1990). The formation of the Office of the Auditor General in 1961 (Government of Ethiopia, 1961) with subsequent refinements of duties and responsibilities in 1979 (Government of Ethiopia, 1979) and 1987 (Government of Ethiopia, 1987) was another significant development in public sector auditing in the country. The Office of the Auditor General undertakes external audits of government ministries and their respective offices to ensure accountability (Desalegn & Aderajew, 2003)

2.1.3 History of Internal Auditing in Ethiopia

Internal auditing' importance in Ethiopia was formally recognized in the early 1930s by the country's first Constitution. This document referred to the proper collection of state revenue and the necessity for procedures to control expenditures. In 1944, another milestone occurred when a proclamation established the Commission for Audit, charged with auditing the Ministry of Finance accounts. The development of state budget practices, an emphasis on fraud deterrence, and growth in trade and industry subsequently added impetus to the growth of the profession (Welde-Ruphael, 1998).

As to Lemma Argaw, the ministry of education, ministry of national defense and the ministry of finance were pioneers in implementing the internal audit practice in Ethiopia. He revealed this fact as follows. 'An Internal Auditing function has existed for quite a long time in Ethiopia; however, it got legal recognition in late 1980s. The internal auditing function started in the budgetary public sector as part of internal control. However, the latter part of the 1940s witnessed the establishment of Internal Audit functions in the Ministry of National Defense,

Ministry of Education, and Ministry of Finance. It was also at this time that the Internal Auditing units began to sprout in non-budgetary public sector (public enterprises) like Ethiopian Highway Authority, Ethiopian Airlines, Ethiopian Telecommunications, and financial sector that formed the modern layer of the National Economy” (Lemma, 2000). Perhaps the most direct impact on the current status of **internal auditing in Ethiopia** came from another important document issued in 1987, Proclamation No.13 (Welde-Ruphael, 1998).

Moreover, Proclamation No. 68/1997 requires that, the Federal Democratic Republic of Ethiopia’s (FDRE) new economic policy be supported by a modern and reliable audit system in order to ascertain proper implementation through effective monitoring of administrative, developmental and service rendering institutions in the Federal Public Sector (Zelege, 2007).

Generally, the history of internal auditing in Ethiopia dated back to the 1940s just about the time the profession was also evolving in Europe and in the United States (Lemma, 2000).

2.1.4 The Development of Internal Audit in Ethiopia

An Internal Auditing function has existed for quite a long time in Ethiopia. Perhaps the most direct impact on the current status of internal auditing in Ethiopia came from another important document issued in 1987. Proclamation No. 13/1987 not only reemphasized the importance of the internal audit function in government departments and public enterprises; it also empowered the Office of Auditor General in three aspects that are whether accounting records are properly maintained and reliable, whether the assets of the ministries and enterprises are adequately safeguarded and properly maintained whether policies and procedures laid down by top officials/management are complied with that implies less attention was given to operational audit as a service to management.(Lemma Argaw, Dec 2000) . On July 1, 1997 the Financial Administration Regulations No. 17/1997 was issued in which the responsibility of internal audit function was transferred from the Office of the Auditor General to the Minister of Finance to develop and maintain appropriate standards of work.

In May 2007 policy directive was issued to further strengthen the Internal Audit service function in the public bodies, however, the legal basis laid down by both in the Regulations of Council of Ministers and the Ministry of Finance Directive is applicable only to internal auditing under the auspices of Public bodies and does not apply to public enterprises and the private sector, but recently Public Enterprises Supervising Authority has issued policy directive for establishment

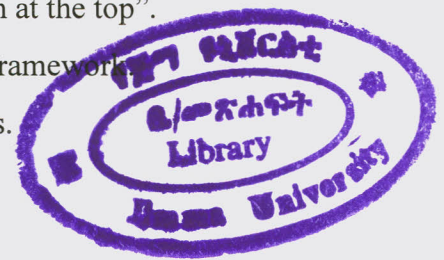
of audit committees in all public enterprises and an audit manual to maintain uniformity of audit work in all public enterprises. (Samuel Mulugeta 2009).

2.1.5. Internal Audit Function (IAF)

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

by delivering:

- A review of the organization’s control culture, especially the “ton at the top”.
- An objective evaluation of the existing risk and internal control framework.
- Systematic analysis of business processes and associated controls.
- Reviews of the existence and value of assets.
- A source of information on major frauds and irregularities..
- Reviews of the compliance framework and specific compliance issues.
- Reviews of operational and financial performance.
- Recommendations for more effective and efficient use of resources.



Goodwin and Seow (2002) noted that auditors may regard the existence of an IAF as an indication that directors and management are committed to strong corporate governance. Further, in their study on the relationship between the IAF and Corporate Governance in the EU – a Survey, Paape, et al. (2003) revealed, in the slipstream of current developments-legislation, rules, regulations and guidelines coming from many directions outside organizations, rather than the individual decisions of this or that company, board or committee, IA is most likely going to be viewed as an important, and even integral, element of the corporate governance system. Likewise, Hermanson and Rittenberg (2003) suggested that an effective IAF is an important “frontline player” in the two fundamental governance activities i.e. monitoring of risks and providing assurance regarding controls.

Barac and Staden (2009) carried out a research on the correlation between perceived IA quality and defined corporate governance soundness of 30 large companies in compliance with ten disclosures of the king II report of South Africa. The main finding of the research is that no correlation was found to exist between the defined soundness of the corporate governance

structure and the perceived IA quality of participating companies that contradicts to the theoretical perspective and existing literature that an IAF is a critical corporate governance mechanism which plays an important role in organizational risks and assessing controls (Anderson, 2003; Anderson & Dahle, 2009; Coram, et al., 2008; Hermanson & Rittenberg, 2003; Paape, et al., 2003; Ramamoorti, 2003; Rossiter, 2007; Sarens & De Beelde, 2006; Sarens, 2009). Furthermore, by providing assurance on the risk management, control and governance processes within an organization, **internal auditing can fulfill its role as one of the cornerstones of effective organizational governance.**

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

This study consists of mainly international researches, because the assessment of IA practice for corporate governance represents an unexplored area in Ethiopia. Exceptions that closed to this study are the researches of Mihret and Yismaw (2007), Mihret and Woldeyohannis (2008), Mihret (2010) and Mihret, et al. (2010), Abraham(2011) in which, internal audit effectiveness, Value-added role of internal audit in the Ethiopian public sector case study, factors associated with attributes of internal audit departments and antecedents, organizational performance implications of internal audit effectiveness and internal audit function and internal audit function and corporate governance were explored respectively.

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

provides service, appear to shape the attributes of a value adding internal audit department. Based on their findings, they recommended that better strategic planning by the internal audit department may enhance internal audits ability to build up a value adding profile by helping identify strategic issues and find solutions to any hurdles that are considered to exist on the way to achieving a value-added profile.

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

In addition, Belay (2007) suggested that well performing IAF is one of the strongest means to monitor and promote good governance system in an organization. The intention of the paper was to assess and evaluate to what extent the current and planned IAF is positioned to contribute towards one of the major objective of the Civil Service Reform Program (CSRP) of ascertaining good organizational governance system in public sector for public accountability and service delivery improvement.

Abraham (2011) revealed that policy banks for hiring and training, level of experience as internal auditors, and professional certification of internal auditors were low. Moreover, Management of commercial banks didn't afford adequate attention to IA's recommendations. Thus, an IAF didn't possessed quality and its role in corporate governance is questionable for a reason that if IAF not effective, it doesn't have positive impact on corporate governance effectiveness.

Despite the recent five exceptional related researched areas and one conference paper by Belay (2007) on effective implementation of IAF to promote good governance in the public sector, an IAF role in corporate governance effectiveness is totally unexplored in Ethiopian context.

However, this research paper attempted to assess the internal auditing practice in the case of selected public enterprises in case of East Arsi Zone. Hence, this study aims to fill the gap to the existing knowledge by exploring the assessment of IA practices and its role in public enterprises effectiveness in the case of Arsi zone of Ethiopia through adopting concurrent mixed research approach.

2.1.6. Reporting Relationship and Internal Audit Scope

Reporting relationships of internal auditing has changed and developed together with the progress of internal audit discipline. At the beginning (when internal auditors mostly were dealing with accounting and financial issues) reporting lines of internal auditors went to the accounting level and external auditors, who saw internal auditors mainly as assistant in financial audits. Accordingly as functions and roles of internal auditing expanded, changed and shifted more to management oriented matters than accounting matters, reporting lines have also been transformed. The change in internal auditing scope is best seen in the definition of internal auditing adopted by The Institute of Internal Auditors. 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. (Irvin Gliem, 2000). This definition recognizes two major pillars of internal audit that are the scope of internal auditors and constituencies or customers of internal auditors. The scope of internal auditors is to provide independent, objective assurance and consulting activity, so that to add value to the organizations in the course of evaluate and improve the effectiveness of risk management, control, and governance processes. At the same time, it recognizes that there are many different constituencies for internal audit services that are: Senior management, who are interested on the accomplishment of the objective of the organization, operational management they focuses on the value added services of internal auditors for the improvement of organization's operations, and audit committees and the board of directors their center of attention are the effectiveness of risk management, control, and governance processes. (IIA Research Department, 2003).

The question that should be raised at this juncture is how internal audit serve these different constituents? And how should be the reporting relationship with those constituents? Because there will be potential conflicts and demands from the various customers, for instance audit committees are primarily interested in assurance services regarding risk and control, operational management is primarily concerned with consultative help regarding the efficiency of operations and adequacy of control mechanisms, senior management is concerned with both consultative advice and assurances regarding risk and control. However, there may be overlap (i.e.

operational management may desire assurance about the effectiveness of controls that has implemented to control the operations for which it is responsible. Audit committees may want consultation regarding risk assessment and control processes.)

According to A.A.A American Accounting Association) analyses on independency and objectivity framework for internal auditors, the above mentioned expansion of internal audit scope and constituents is correlated with the organizational status of the internal audit unit. When there is high-level reporting, the scope of potential engagements is less limiting; when there is lower-level reporting, the reporting universe (i.e. the population of users who could benefit from the audit reports) becomes more limited.

2.1.7 Internal auditing & Corporate Governance

Definition of CG by OECD: – Corporate governance involves a set of relationship between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

Corporate Governance Components

1. Board of Directors & Committees.
2. Laws and regulations.
3. Business Practices & Ethics.
4. Disclosure & Transparency.
5. Enterprise Risk Management.
6. Monitoring.
7. Communication.

1. Board of Directors & Committees

- Assist board of directors in its self-assessment and best practices.
- Assess Audit committee effectiveness and compliance with regulators.
- Review audit committee charter with help of legal counsel.
- Be interactive of the subject of governance, bringing best practices ideas about internal controls and risk management processes to audit committee members.
- Establish accuracy of information used in compensation committee decision making.

2. Laws & Regulations

- Verify that the organization has identified assigned responsibilities and addressed all of the key legal and regulatory requirements.

- Look for opportunities to leverage compliance activities and capabilities to reduce long-term costs and improve performance.

3. Business Practices and Ethics

- Review code of conduct and ethics policies, making sure they are periodically updated and communicated to management and employees

- Perform a behavioral ethics review to assess the understanding and perception and compliance across organizational levels.

- Help management and audit committee hold people accountable (look at the actions not just words).

- Serve in the ethics oversight role or confer with the organizations ethics officer.

- Conduct annual audits and reporting results to the audit committee.

- Assess linkage of ethics to goal setting and performance evaluation process.

4. Disclosure and Transparency

- Conduct testing of financial disclosures and confer with the CFO.

- Understand concern for disclosure and transparency and align risk assessment with stockholder expectations.

- In the annual audit plan, address disclosure and transparency objectives.

- Understand the breadth and depth of disclosure and transparency possibilities and where the organization strives to be or should be on the spectrum.

5. Enterprise Risk Management

- Be proactive in advocating for participating in an organization's ERM efforts , including a commitment to common methodologies and tools.

- Facilitate identification of key risk areas for the organization as well as all key processes.

- Assist in the development of standards and processes flow documentation.

- Assist process owners in understanding assessing, designing and document controls.

- Inventory organizational risk compliance activities and strive to integrate them into a common methodology.

- Evaluate business and process owners on taking responsibility for ERM.

6. Monitoring

- Understand what monitoring activity is taking place in the organization for each of the other component of the governance framework.
- Facilitate the implementation of a common risk monitoring methodology across all corporate governance functions, feeding an integrated reporting system.
- Perform a strategic level corporate governance audit or ensure one is conducted.
- Incorporate tactical level corporate governance aspects into audit plans.

7. Communication

- Participate in ongoing dialogue with general counsel, chief financial officer, and other senior management officers
- Maintain steady communication with audit committee members and oversight executives.
- Include information about corporate governance in audit reports.
- Assist establishing a corporate governance communications calendar and solicit input on needs and articles across the organization.
- When all the components of CG framework operate effectively and are well coordinated, corporate governance provides a platform to improve business performance and enhance stakeholder's value.

2.1.8. The Auditors Role in Managing Risk

Internal auditors play an important role in evaluating the effectiveness of control systems. Within the Committee of Sponsoring Organizations (COSO) Enterprises Risk Management (ERM) framework which is a voluntary private sector organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls, and corporate governance, the role of the auditor does not need to be limited to just auditing controls. During audit engagements, internal auditors assess if control means are effective and adequate in order to mitigate the risk. Auditors not only provide assurance about these controls, but also consult senior management for better improvement of these controls. Auditors may provide substantial aid to the management of the enterprise by identifying possible negative events that may negatively affect enterprise objectives, strategies or business models. Many analysis models may be used at this stage, but SWOT (strengths, weak-nesses, opportunities, threats) model is probably the best known among them. Usually negative events of environment come from

political, legislative, demographical, technological and other environments. Risk in this case is defined as probability that negative event will occur. Internal auditors may assess risk, whereas risk usually has two dimensions: the likelihood and the impact. The likelihood is the probability that event will occur. The impact is expressed by probable event on operations, financial statements and other matters. In this case internal auditors may provide adequate information for management decisions using statistical methods of risk assessment.

2.1.9 Internal Audit Reporting Structure

Theoretically, the Chief Audit Executive should report functionally to the board or audit committee and administratively to the chief executive officer of the organization and functional reporting line for the internal audit function is the ultimate source of independence and authority (Rolandas Rupsys, 2005).

Report functionally means that the governing authority would approve the overall charter of the internal audit function, approve the internal audit risk assessment and related audit plan, receive communication from the C.A.E on the results of the internal audit activities or other matters that the C.A.E determines are necessary, private meeting with the C.A.E without management present, approve all decisions regarding the appointment or the removal of the C.A.E, approve the annual compensation and salary adjustment of the C.A.E, and make appropriate inquiries of the management and the C.A.E to determine whether there are scopes or budgetary limitation that impede the internal audit function to execute its responsibility.

On the other hand, administrative reporting is the reporting relationship within the organization's management structure that facilitates the day to day operation of the internal audit function it typically includes, budgeting and management accounting, human resource administration including personal evaluations and composition, internal communication and information flow, administration of the organization's internal policies and procedures (Irvin N. Gleim, 2002).

2.1.10 Reasons for ineffectiveness of internal auditing in the public sector management.

Lack of Audit Manual: The absence of standard internal audit manual and detailed audit work plan will affect the quality of audit work particularly for internal auditors who are either non-accountants or non-qualified accountants.

On-Career Auditors and Lack of Growth Prospect: Most internal auditors who are professionally qualified accountants have been prevented from ascending to levels or status that are equivalent to those held by their professional colleagues in the finance/accounts department. This gives such colleagues in the accounts department an advantage and a feeling of superiority to the internal auditor hence they stifle with imparity the process of information flow to the auditor and makes available only thing they want the auditor to see.

Reporting Structure and Professional Independence: The internal auditor used to be a unit of the accounts department in the past but to ensure a level of independence, they were made to report directly to the Chief Executive. The change however negatively impacted on Public Sectors as most Chief Executives are political office- holders, having no permanent interests and leading to non-commitment to internal audit reports.

Scope of Work: The absence of a proper definition of the duties, rights, privileges and limitations of the internal auditors also **inhibits** the satisfactory performance of his duties.

Privileges of Office: The lack of adequate remuneration and pre-requisites of office has made some internal auditors to **compromise their positions** in favor of fraud stars.

Hazards of Office: Another **factor**, which impairs internal audit efficiency, is the hazards that stare the honest and principled internal auditor in the face there are reported cases of assassinations, burglary, native medicine and acid attacks on the lives and properties of internal auditors.



CHAPTER THREE

The Research Methodology

This chapter outlines the set of scientific approaches used in gathering information to obtain the relevant data for processing in order to achieve the objective of the study, how it was designed and presented. In addition, it illustrates the area of examination with regards to those interviewed. Furthermore the researchers will also explain how the selected public enterprises in East Arsi zone internal audit practice was chosen, sources of literature, research design, study area and sample size, data collection and data analysis.

3.1 Research Design

To enable the researchers address the objectives of the study, a descriptive research was the preferred since it was meant to present a picture of the specific details of a business setting among other things. Since the focus is on an assessment of internal auditing practice in East Arsi zone public enterprises the data collection was restricted to employees of public enterprises in East Arsi zone. The research was planned to assess internal audit practice and recommend solution to address the challenges of the internal audit unit of public enterprises in East Arsi zone to enable them improve upon their performance in the public enterprises.

3.3 Study Area

East Arsi zone was chosen to be the main area of the study to represent the whole country. The researcher focused on the employees of public enterprises in East Arsi zone specifically those in internal auditing, management and accounting position.

3.4. Sampling Design

Regarding the sampling methods to be used in selecting the respondents and the enterprises, the non probability method of sampling was used in selecting the enterprises in which the research was conducted. There are six public enterprises in Arsi Zone; namely The Arsi Zone Agricultural Development Enterprise (AADE), The Asella Mat Factory (AMF), Commercial Bank of Ethiopia - Asella Branch (CBE), Ethio Telcom (EIC) The Ethiopian Electric Power Corporation (EEPCO), and the Ethiopian Telecommunications corporation (ET).The internal auditing in the

EIC, ET and EEPKO is conducted at regional levels, and the district offices in Asella simply send documents to the head office. Of the total of six public enterprises in East Arsi zone 3 of them were purposively selected. The reason is that 3 public enterprises internal auditing is conducted at head office, the commercial bank of Ethiopia at woreda level are below standard two which are not found for this research.

CBE branches are classified as grade I, II, III, IV.

Structuring

Grade I

1 Branch Manager, 1 Accountant, 3-5 clerical employee

Grade II

1 Branch, manager, 1 Customer service manager, 1 Accountant, 1 Controller,
3-5 Clerical employees.

Grade III

1 Branch manager, 2-3 Customer service managers, 1 Control supervisor, 1 Chief cashier,
1. Customer service officers (CRO), 40-50 Clerical employees.

Grade IV

1 Branch manager, 4 Customer service managers, 1 Control supervisor, 1 Cash supervisor,
2-10 Customer service officer, 50-200 Clerical employees.

Criteria for branch standard are:-

New branches opened initially as grade I (initial grade) according to the size of the city, the economic activity of the city, no of customers, volume of work no. of private and governmental offices, amount of transaction, no of transaction.

CBE Assela branch is grade III due to:-

Large amount of transaction, large no. of customers, the economic activity of the surrounding area, existence of various local government (zone offices) and private organization, the size of the market and large number of merchants, existence of micro finance institutions, to support small branches around the area, to issue cash to other banks and CBE branches, to maintain various documents of various branches to provide foreign banking services, to provide loans to various sectors.

Because of the above CBE standards, different commercial bank branches in the zone except the Asella branch are not found to fit to this study since below standard II. So only the AADE,

AMF, and CBE-Asella branch was selected based on purposive sampling. Similarly, from the selected sample enterprises the respondents were selected purposively from the management team, the finance department, the internal audit function and other employees of the selected public enterprises.

3.5 Sample Size

The ultimate objectives of sampling are to select sample from the total population of 51. A sample size of (36) respondents representing the selected public enterprises in the East Arsi zone were selected based on the appropriateness for the research topic purposively. The total respondents included 3 management staffs, (one from each), 27 accounts officers, (10 from CBE, 8 from AADE and 9 from AMF), 6 internal audit staffs (two from each) i.e. 13 respondents were from CBE, 11 respondents were from AADE and 12 respondents were from CBE Asella branch to make up the 36 respondents.

3.6 Method of Data Collection

The method of data collection includes interviews and administration of questionnaires. Both quantitative and qualitative data were collected using open-ended and close-ended questions. Data was collected from both primary and secondary sources.

3.6.1 Primary Data

Interviews were conducted at the management level to collect data for the study as well as questionnaires. Both structured and unstructured interviews were employed as a tool for collecting data. For the structured interview, a set of prepared questions were administered at different times, the researchers also had other interview with some selected staff to gather more data for the study.

3.6.2 Secondary Data

In this study the researcher adopted qualitative research approach. Qualitative questions are answered using established qualitative procedures (Bogden & Biklen, 1992). Qualitative data were emerge from observed instances during interactions with auditors and accountants and by

using questionnaires, recorded interviews, observational notes, and documented papers. Written questionnaires about the change that has occurred at the enterprises and recorded interviews about internal auditing practices were utilized by asking a number of open-ended questions and the responses obtained through the structured interview that allow for variations (Hoepfl, 1997). Qualitative analysis on the other hand was based on data collected in words than in figures unlike the quantitative analyses. This type of analyses gives a wider and strong explanation about a problem, a process, an event etc. in a specific situation or area.

3.7 Questionnaires Design and Administration

3.7.1 Questionnaires

As indicated in the above, all internal auditors of the purposely sampled 3 public enterprises in East Arsi zone were included in the survey. Questionnaires were distributed to 6 internal auditors of 3 finance managers 27 chief accountants. Of the total of six public enterprises in East Arsi zone 3 purposely selected public enterprises for the reason that 2 public enterprises internal auditing is conducted at head office, the commercial bank of Ethiopia at woreda level are below standard two which are not found for this research. Questionnaires are organized in the form of affirmative statements, relating to the concepts an assessment of internal audit practice in East Arsi zone selected public enterprises. In such a way as to enable measurement of the respondent's opinions. The respondents were asked to indicate their level of agreement on a five point likert scale with the following ratings. Strongly agree (SA; or 5), agree (A; or 4), neutral (N; or 1), disagree (DA; or 3), and strongly disagree (SD; or 2). The numbers were indicated in the questionnaires to provide a feel of ordinal scale measurement and to generate data suitable for quantitative analysis. The central issue to argue that likert scales produce ordinal data is because of no way at all of knowing whether the differences between the different points on the scale are truly equivalent, and the points on an ordinal scale are not necessary equally spaced as they must be in order for it to be regarded as an interval scale (Hole, 2011). Moreover, Johns (2010) noted that in statistical terms the level of measurement of the likert response scale is „ordinal“ rather than „interval“: that is, we can make assumptions about the order but not the spacing of the response options. Thus, the permissible descriptive statistics that can perform on ordinal data is median (or average response) and mode (or more frequent responses) (Hole,

2011). To elicit additional information, the respondents were requested to provide open-ended responses if they have opinions which they feel the researcher would find useful.

3.7.2 Interviews

Interviewing is a meeting of two persons to exchange information and ideas through questions and responses, resulting in communication and joint construction of meaning about a particular topic. Jane sick (2004): 72

In the qualitative strategy, structured interview was employed with 6 internal auditors and 3 finance managers of the public enterprises at east Arsi zone to have sufficient information regarding the research problem. The major purpose of this interview was to corroborate certain facts that the investigator already thinks have been established (Yin, 1989, p. 89). Therefore, the structured interviews have conducted to enhance and supplement the results of questionnaires.

3.8 Data Analysis

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

The researcher was analyzed the data collected through survey to statistical population concerning the assessment of internal auditing practice a case of selected public enterprises in East Arsi zone. The data collected via questionnaires were analyzed with descriptive statistics using statistical package for social scientists. Furthermore, Wolcott (1994) as cited in Creswell (2003, p. 182), suggested that qualitative research is fundamentally interpretative i.e. the researcher was interpreted the qualitative data. Thus, data collected from the interview and reviews of documents were interpreted qualitatively. To sum, the analysis of quantitative data and interpretation of qualitative data combines to seek convergence among the results (Creswell, 2003, page 222).

CHAPTER FOUR

Data Presentation and Analysis

4.1 Introduction

The quality of social research is judged on the basis of how the sample is selected and whether it represents the population or not. Not only that, the size of the sample should be adequate enough to draw descriptive statistics, but the problem arises when the population is infinite where it is not possible to determine the exact size of population and collected data from a large group especially when research is done by individuals. Hence, an attempt is made to analyze the internal audit practice. They are formulated, codified, tabulated and analyzed for the purpose as follows.

The survey has been carried out using the attached questionnaire and structured interview (Annex) with an aim of assessing the internal audit practices in the enterprises selected. The structured questionnaires were distributed to thirty six employees of the enterprises out of which three failed to respond, and 33 useable questionnaires were obtained (91.7 percent response rate). In addition, the researcher was conducted an interview with only 4 internal auditors and 2 finance managers. Descriptive measures of each questions response and an interview results are presented in the following sections.

The questionnaires were distributed to internal auditors, finance manager,& general accountants. The responses were presented and analyzed following the categories and sequences used in the questionnaire. In addition, the responses for the structured interview are analyzed qualitatively in this section. The interview questions were presented to the finance manager and the internal auditors in the selected public enterprises.

4.2 Response Rate

One means through which data is collected from respondents is questionnaire distribution. The degree of responsiveness of respondents for questions asked in different ways determines the level of accuracy and reliability of the analyses and interpretations to be made based on the responses. In this study also structured questionnaires were distributed and an evaluation was made to check whether or not sufficient respondents have replied to the questionnaires. The total

sample population, the number of respondents who have responded and those who did not are summarized in the following table.

4.3 Public Enterprises Type and Internal Audit Department

IA activity is a department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an enterprise's operations. The internal audit activity helps an enterprise to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management and control processes (ISPPIA, 2010).

Table 1 Descriptive Statistics: Response rate & types of selected public enterprises

No.	Selected Enterprises	Sample population	Response	Percent (%)	Valid percent	Cum. Percent
1	Commercial Bank of Ethiopia Asella	13	13	36.11	36.4	36.4
2	Asella Malt Factory	12	11	30.56	33.3	69.7
3	Arsi agricultural Dev't enterprise	11	9	25.0	30.3	100
	Total	36	33	91.67		
	Missing system		3	8.33		
	Total		36	100		

Source: Questioners result

As shown in the table, a very significant portion of the respondents (91.7%) responded to the questionnaires. This huge percent response rate increases the reliability of the data.

The study revealed that out of the total 33 questionnaires collected, 13 (36.11 percent respondents) were from CBE and 11 (33.56 percent respondents) from AMF, and 9 (25.0 percent respondent) from AADE..

4.4 Respondents' Profile

The reliability of the responses given to the questions asked is the function of the clarity of the questions, the relevance of the respondents and their ability to understand the questions and give appropriate answers. To ensure the reliability of the responses in this study, showing the respondents' profile from different angles was thought to be important. Following this, the total

respondents' and the internal auditors' profiles are shown in their educational levels, fields of studies and work experiences. Regarding the educational background, the respondents' literacy level ranges from diploma certificate to Masters Degree. The fields of study are also shown to show the respondents' relevance to the study and the work.

Table 2. Descriptive Statistic: Educational qualification

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Diploma	5	13.9	15.2	15.2
BA/BED/BS C	27	75.0	81.8	97.0
MA/MED/M SC	1	2.8	3.0	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source: Questioners result

The study revealed that, the educational qualification of the total 5 (13.9 percent) of respondents were, diploma, 27 (75 percent) were degree, only 1(2.8 percent) was MSc. From this analysis the researcher indicates the numbers of post graduate from the selected public enterprises were very small nearer to nil. This is show by the graph below.

Table 3 :Descriptive statistics Field of study

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Accountant	25	69.4	75.8	75.8
Management	3	8.3	9.1	84.8
Economics	3	8.3	9.1	93.9
Others	2	5.6	6.1	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source: Questioners result

The responses of the respondents indicates that 25(69.4 percent) of the respondents were accountancy,3(8.3 percent) were management,3(8.3 percent) were economics and 2(5.6percent)were other fields graduated.

Table 4. Descriptive Statistic: Work **experience**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid 0-5	10	27.8	30.3	30.3
6-9	10	27.8	30.3	60.6
Above 10	13	36.1	39.4	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source: Questioners result

As already stated, the scope of the modern internal auditing is broad and is not limited to the traditional practices like financial audits and compliance audits only. To conduct the internal audit practice in its modern sense, the internal auditors' educational levels, their fields of studies and their work experiences are important factors to be considered. In addition, to show the appropriateness of the internal auditors to respond to the questions in this study, the above mentioned factors are highly crucial.

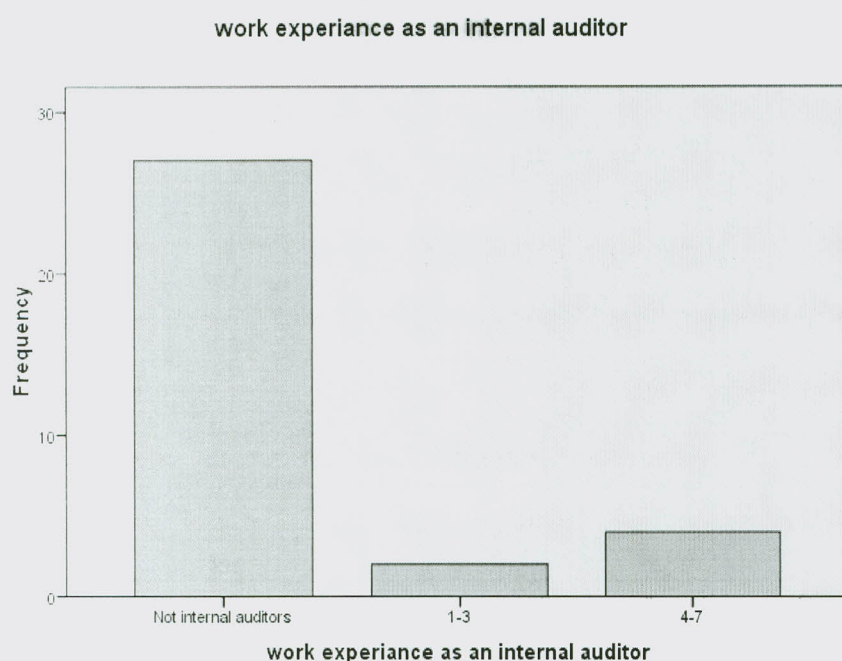
Table 5 Descriptive Statistic :**work experience as an internal auditor**

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Not internal auditors	27	75.0	81.8	81.8
1-3	2	5.6	6.1	87.9
4-7	4	11.1	12.1	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source: Questioners result

As shown in the table, the responses 27(75.0 percent) of the respondents were not internal auditors, 2(5.6 percent) were have 1-3 years experience, 4 (11.1 percent) were have 4-7 years experience. All of the internal auditors are **qualified in accounting in first degree levels** and all of them have less than eight years working experience. None of the internal auditors are from a non accounting area.

This does have a great adverse effect on performing operational audits and IT audit. This is show by the graph below. Fig. 5



4.5 Staffing and Work Environment

4.5.1 Staffing

According to ISPPIA No.1210, internal auditors should possess the knowledge, skills and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should possess or obtain the knowledge, skills and other competencies needed to perform its responsibilities. The internal audit department should have qualified staff to meet the very objective of its existence. This is complemented by the implementation standard No. 1210.A2 that the internal auditor should have sufficient knowledge to identify the indicators of fraud but is not expected to have the expertise of a person whose primary responsibility is

detecting and investigating fraud. In this regard all respondents agreed that their qualification is adequate for financial audit activities. Besides, the audit departments should be composed of fields in a team approach which turn depends on the type of the organization.

For example, a manufacturing organization can increase the number of its audit in terms of more members from engineering and operation management than who is from accounting basis. However, the commercial bank of Ethiopia is financial institution, Hence, their audit team at least should have members from IT field that helps the remaining audit members regarding the technical and related concepts of the computer system.

The study revealed that 1 (2.8 percent) of the respondents was post graduate, 27 (75.0 percent) of the total respondents had a first degree, and 5 (13.9 percent) of them held college diploma qualifications. The majority of respondents were accounting graduates 25 (69.4 percent), which is followed by both management and economics degree 3 (8.3 percent) each and other field of study 2 (5.6 percent) qualifications. A majority of auditors 4 (11.1 percent) served for 4-7 years and 2 (5.6 percent) were served 1-3 years as an internal auditor in the enterprises. The rest respondents 26, (72.1 percent) were not served as internal auditors. The profile of the enterprises in internal audit in the management and economics area was nothing. From this the study indicates that the recruitment of internal auditing is accountancy based.

4.6 Internal Audit Activity Comply With IIA's.

Table 6 Descriptive Statistics: internal audit activity comply with IIA's on mean & std. Deviation

N	Valid	33
	Missing	3
Mean		4.00
Std. Error of Mean		.062
Std. Deviation		.354

Table 7 Descriptive Statistics: internal audit activity comply with IIA's

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly disagree	2	5.6	6.1	6.1
Agree	29	80.6	87.9	93.9
strongly agree	2	5.6	6.1	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source: Questioners result

The study disclosed that, of the total respondents 2 (5.6 percent), strongly disagreed, 29 (80.6 percent), agreed, 2 (5.6 percent), strongly agreed. The above analysis indicated the internal audit activity comply with institute of internal audits. The mean of the above result is 4.00 again this indicated that since the grand mean is 3.12 and the mean is above the grand mean from this the researcher conclude that the internal auditing activity comply with IIA's.

4.7 Internal Audit Reporting Responsibility

As reviewed in the literature part, the chief audit executive (CAE) should functionally report to the audit committee, board of directors, or other appropriate governing authority, and administratively to the chief executive officer (CEO) of the organizations. And, functional reporting line for the internal audit function is the ultimate source of independence and authority. Besides, ISPPIA No.1110 which is attribute standard on organizational independence states that the chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. This is supported by the implementation standard No.1110.A1 that the internal audit activity should be free from interference in determining the scope of internal auditing, performing work and communicating results. Since all respondents stated that their CAE functionally reports were not agreed for detachment of internal auditing from functional area to guarantee its independence that has forced them to lose their independence.

4.8 Organizational Independence and Objectivity

4.8.1 Independence

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. 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.

4.8.2 Objectivity

Is an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in their work product and that no quality compromises are made. Objectivity requires that internal auditors do not subordinate their judgment on audit matters to others. Threats to objectivity must be managed at the individual auditor, engagement, functional, and organizational levels.

Table 8 Descriptive Statistics:

Internal auditing was free from the management to guarantee its independence

N	Valid	33
	Missing	3
Mean		3.85
Std. Deviation		.442

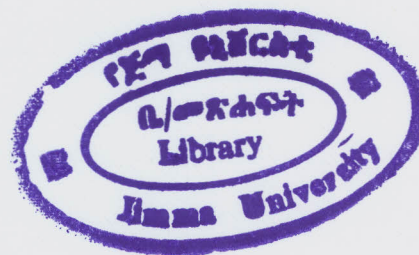


Table 9 Descriptive Statistics:

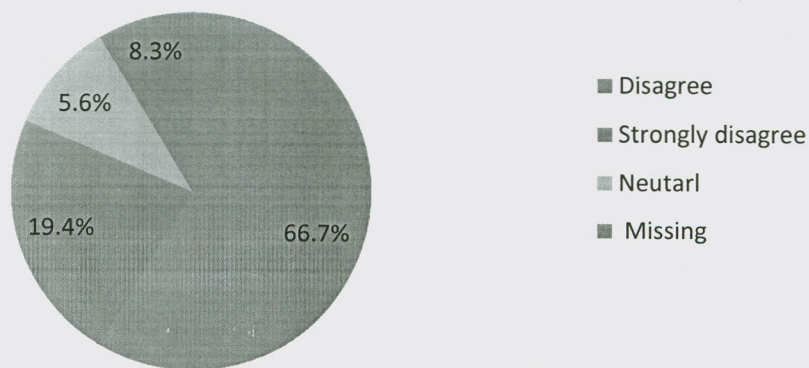
Internal auditing was free from the management to guarantee its independence

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Neutral	2	5.6	6.1	6.1
Disagree	24	66.7	72.7	78.8
Strongly disagree	7	19.4	21.2	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source: Questioners result

From the above table 2(5.6 percent), of the total respondents 2 (5.6 percent) were neutral, 24 (66.7 percent), were disagreed, 7(19.4 percent), were strongly disagreed. The study revealed the selected public enterprise’s internal auditing is not free from the management interference to guarantee its independence, but according to the standard **1110.A1** - The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results. This is show by the graph bellow.

Fig 5 Internal audit detached from functional area to guarantee its independence.



4.9 Internal Audit Role In Risk Management.

ISPPIA No.2110 requires IAF to extend to enterprise wide risk assessment to result in effective risk management and control systems. The study indicated that the selected public enterprises were plan the internal audit based on the enterprise's risk profile in order to eliminate or minimize the existing risk in the enterprise.

Table 10. Descriptive statistics

The internal audit plan based on your organization's risk profile

N	Valid	33
	Missing	3
Mean		3.91
Std. Deviation		.384

Table 11. Internal audit plan based on your organization risk profile.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly disagree	4	11.1	12.1	12.1
Agree	28	77.8	84.8	97.0
Strongly agree	1	2.8	3.0	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source: Questioners result

The study indicated that from the total respondents in the selected enterprises 4(11.1 percent) were strongly disagree, 28 (77.8 percent) were agree, and only 1(2.8 percent) was strongly disagree, in addition to the above analysis the mean was 3.91 which is greater than the grand

mean which is 3.12. From analysis the selected public enterprises internal audit plan based on risk profile.

4.10 IAF's Contribution to Good Corporate Governance.

As reviewed in the literature part, corporate governance involves a set of relationship between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

Well performing internal audit function is one of the strongest means to monitor and promote good governance system in an organization. As a result, in many countries it has received an increasing attention as an important component of government financial management and as a tool for improving the performance of the government sector. (Zelege, 2007).

An internal audit function could be viewed as a first line defense against inadequate corporate governance and financial reporting. With appropriate support from the Board of Directors' Audit Committee, the internal audit staff is in the best position to gather intelligence on inappropriate accounting practices, inadequate internal controls, and ineffective corporate governance. (Barif, 2004)

Although ideally the contribution of the IAF to corporate governance is unquestionable, practice shows that this contribution is not yet being implemented to the desired level in many enterprises. The barriers that limit the IAF's scope are not limited to narrowing the scope only, they also cast shadow on its contribution to good governance. In this study, an attempt is made to identify whether or not the respondents are aware that the internal audit function contributes to good governance. The responses obtained from the respondents are summarized as follows.

Table 12 Descriptive Statistics

Managers or employees proper understanding of internal auditing role in good corporate governance

N	Valid	33
	Missing	3
Mean		3.09
Std. Deviation		.631

Table 12 Descriptive Statistics : understanding of managers and employees about internal auditing.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Disagree	4	11.1	12.1	12.1
Strongly disagree	23	63.9	69.7	81.8
Agree	5	13.9	15.2	97.0
Strongly agree	1	2.8	3.0	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source: Questioner result

The study revealed that, from the total respondents, 23 (63.9 percent), were strongly disagree, 5 (13.9 percent), were agree, 4 (11.1 percent) were disagree, and 1 (2.8 percent) was strongly agree.

The mean from the above analysis was 3.09, however it is less than the grand mean which is 3.12 it is not significant.

This means most of respondents (63.9 percent) inclined that managers and employees were not clearly understood the role of internal auditing in good corporate governance means lack of awareness towards the internal auditor's contribution. However 5 (13.9 percent) of respondents were agreed. This indicates that may the respondents were biased due to their position.

In order to exercise good governance, both the management and employees shall understand and appreciate role of the internal audit. Despite this, however, in the real situation 63.9 % and 11.1 % of the respondents perceive their understanding is very low and low. Moreover, internal auditors are distinguished as negative tinkers, fault finders, low potential and qualified staffs in their organizations.

4.11 Quality Assurance and Improvement Program

According to ISPPA 1300, this program is designed to enable an evaluation of the internal audit activity's conformance with the Definition of Internal Auditing and the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement.

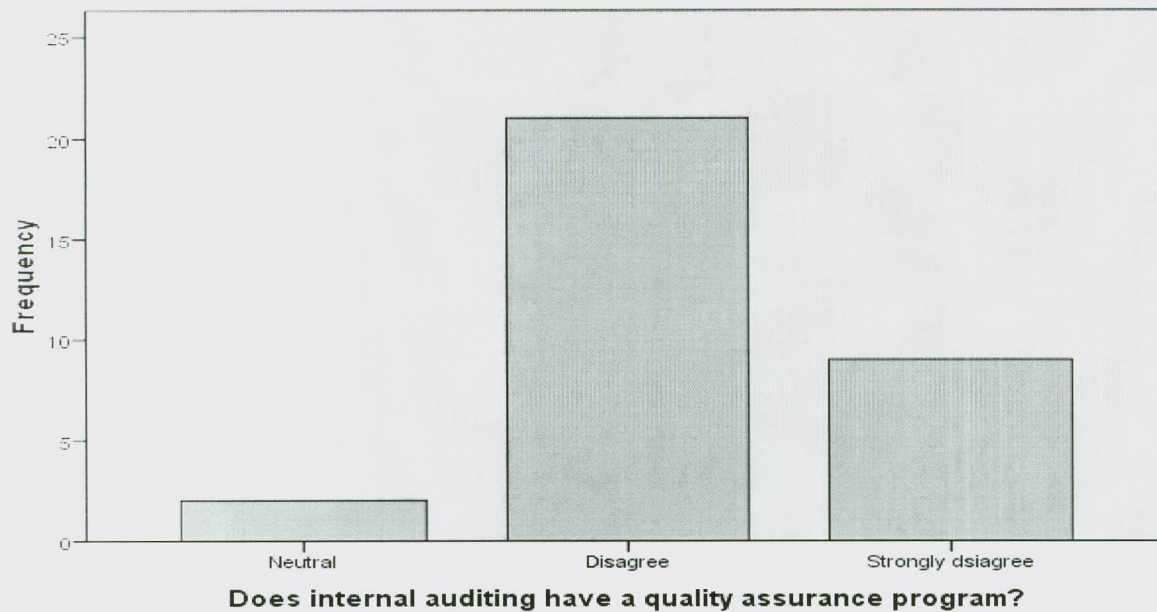
Table 13. Internal auditing as quality assurance program.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Strongly disagree	5	13.9	16.7	16.7
Agree	21	58.3	70.0	86.7
Strongly agree	4	11.1	13.3	100.0
Total	30	83.3	100.0	
Missing System	6	16.7		
Total	36	100.0		

Source: Questioner result

The responses summarized in the table reveal that of the total respondents 5 (13.9 percent) were strongly disagreed that the availability of quality assurance the remaining, 21(58.3 percent) were agree, 4 (11.1 percent), were strongly agree. The above analysis indicates that in the enterprises internal auditing has quality assurance program. Fig.

Does internal auditing have a quality assurance program?



4.12 Composition and Quality of Internal Audit Staff

According to ISPPIA No.1210, internal auditors should have the knowledge, skills and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should possess or obtain the knowledge, skills and other competencies needed to perform its responsibilities. The internal audit department should have qualified staff to meet the very objective of its existence. This is complemented by the implementation standard No. 1210.A2 that the internal auditor should have sufficient knowledge to identify the indicators of fraud but is not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud. In this regard all respondents strongly disagreed that their qualification is adequate for internal audit activities.

Table 14 Qualification and experience of auditors

N	Valid	33
	Missing	3
Mean		3.27
Std. Deviation		.674

Table 15 Qualification and experience of auditors

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Disagree	2	5.6	6.1	6.1
Strongly disagree	22	61.1	66.7	72.7
Agree	7	19.4	21.2	93.9
Strongly agree	2	5.6	6.1	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source questioner result

The study revealed that, 22 (61.1 percent) were strongly disagree, 7 (19.4) were agree, 2 (5.6percent) strongly agree, and 2 (5.6 percent) were disagree. From this the researcher concludes that the qualification and experience of the selected public enterprises internal auditors is not sufficient and appropriate.

4.13 Internal Audit Charter

As indicated in the literature part, the absence of standard internal audit manual and detailed audit work plan will affect the quality of audit work particularly for internal auditors who are either non-accountants or non-qualified accountants.

The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the IA activity's position within the organization; authorizes access to records, personnel, and physical properties relevant

to the performance of engagements; and defines the scope of internal audit activities (ISPPIA, 2010).

Table 16 Descriptive analysis Charter, manual and internal auditors responsibility clearly stated.

N	Valid	33
	Missing	3
Mean		3.82
Std. Deviation		.727

Table 17 Descriptive analysis Charter, manual and internal auditors responsibility clearly stated

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Disagree	3	8.3	9.1	9.1
Strongly disagree	3	8.3	9.1	18.2
Agree	24	66.7	72.7	90.9
Strongly agree	3	8.3	9.1	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source: Questioner result

From the above table the researcher, observed that 24 (66.7 percent) of the total respondents were agree, 3(8.3 percent) were disagree, 3 (8.3 percent) were strongly disagree and in addition to this the mean value is 3.82 which is greater than the grand mean. These indicated that the selected public enterprise have internal audit charter which is clearly stated the internal auditors responsibility, duty and the scope of activity.

4.14 Performance Audit

Performance auditing is an audit of economy, efficiency and effectiveness with which a government organization, a program, a project, an activity or a function uses its resources in carrying out its responsibilities.

Performance audit is intended to be a broad, constructive examination and diagnosis of policies, organization and operations of a government entity. It calls for appraisals of an organization to compare accomplishments with plan, results with standards, and practice with policy. The objective is to arrive at a dispassionate and verifiable basis for comparing what is being done (and how well it is being done) with the plans, policies and standards and, most importantly to understand the reasons for positive or negative variance from those plans, policies and standards.

Table 18 Descriptive statistics: Performance Auditing.

N	Valid	33
	Missing	3
Mean		3.12
Std. Deviation		.545

Table 19 Descriptive statistics: Performance Auditing.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Disagree	3	8.3	9.1	9.1
	Strongly disagree	23	63.9	69.7	78.8
	Agree	7	19.4	21.2	100.0
	Total	33	91.7	100.0	
Missing	System	3	8.3		
	Total	36	100.0		

Source Questioner result

The researcher revealed that, from the total respondents 23(63.9 percent) were strongly disagree, 7(19.4 percent) were agree, 3 (8.3 percent) were disagree and mean value of the above analysis is equal to the grand mean which is equal to 3.12. From the descriptive statistics in the table above, since the sum of strongly disagree and disagree were 26 respondents (72.2 percent) it indicates there was no performance auditing in the selected public enterprises and they were using the traditional auditing system. From the total respondents,7 (19.4 percent), were agreed that as there was performance auditing, this is due to may not giving attention towards the questioner or lack of information towards the performance auditing. This is show by the graph bellow.

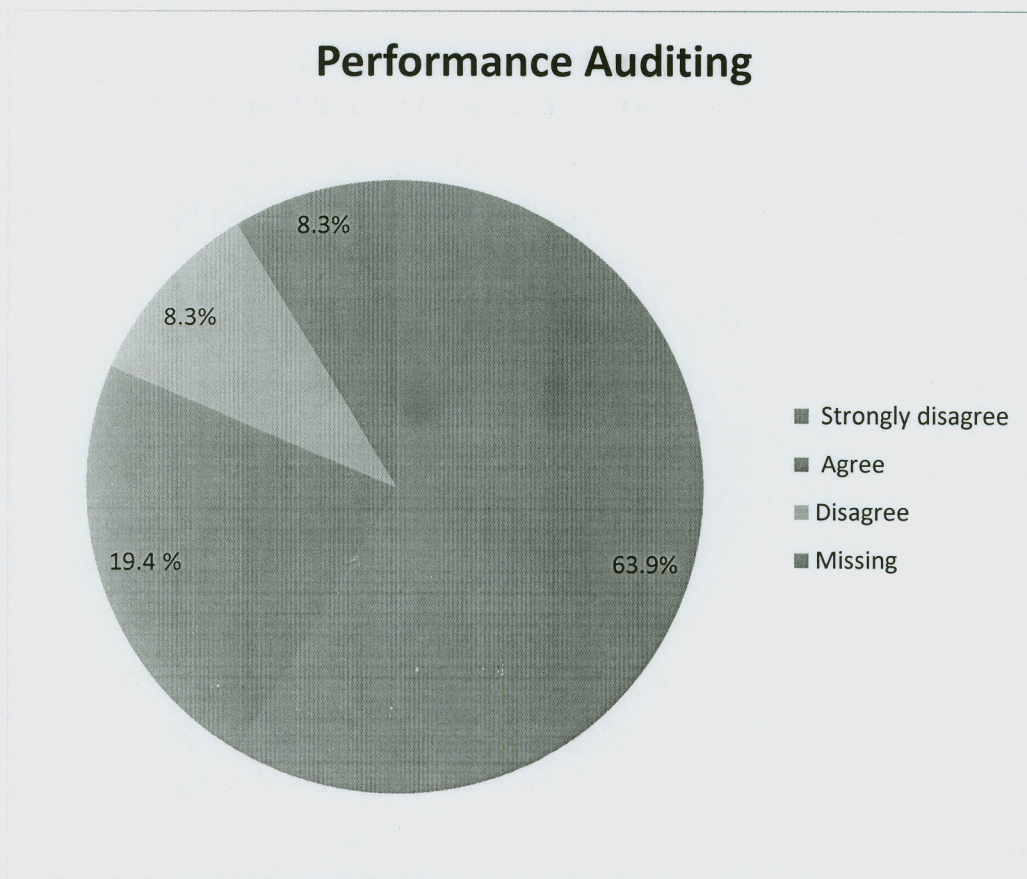


Table 20 Descriptive statistics: an association between the quality of internal audit function and the effectiveness of the audit committee.

N	Valid	33
	Missing	3
Mean		3.70
Std. Deviation		.585

Table 21 Descriptive statistics: an association between the quality of internal audit function and the effectiveness of the audit committee.

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Disagree	2	5.6	6.1	6.1
	Strongly disagree	6	16.7	18.2	24.2
	Agree	25	69.4	75.8	100.0
	Total	33	91.7	100.0	
Missing	System	3	8.3		
Total		36	100.0		

Source: questioner result.

The researcher addressed that 2(5.6 percent) of the total respondents were disagreed, 6(16.7 percent), were strongly disagreed, 25(69.4 percent), were agreed. This descriptive statistics indicates that there is an association between the quality of internal audit function and the effectiveness of the audit committee.

Table 22 Descriptive Statistics: the existing reporting relationships, the management's perception and responsiveness allow the IA to contribute to good governance in your enterprise.

N	Valid	33
	Missing	3
Mean		3.79
Std. Deviation		.545

Table 23 Descriptive Statistics: the existing reporting relationships, the management's perception and responsiveness allow the IA to contribute to good governance in your enterprise.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Neutral	2	5.6	6.1	6.1
Disagree	28	77.8	84.8	90.9
Strongly disagree	3	8.3	9.1	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source questioner result

From the total respondents, 28 (77.8 percent) were disagree, 3 (8.3 percent) were strongly disagree, and two of the respondents were neutral.

Based on the descriptive statistics analysis the study point out that, the existing reporting relationship, the management's perception and responsiveness was not allowed to contribute to good governance in the selected public enterprises. This is supported by the reporting relationship was to general manger which is the cause for lack of independence and the managers

of the selected enterprise were not have proper understanding of internal auditing role in good corporate governance as indicated in the questioner result table 9.

4.15 Audit Committee

Audit committees' involvement in overseeing internal auditing, risk management activities and the effectiveness of internal control is clearly expected and explicitly stated in many countries' rules.

Table 24 Descriptive Statistics: existence of an audit committee in the enterprises.

N	Valid	33
	Missing	3
Mean		3.21
Std. Deviation		.781

Table 25 Descriptive Statistics: existence of an audit committee in the enterprises.

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Disagree	2	5.6	6.1	6.1
Strongly disagree	27	75.0	81.8	87.9
Agree	2	5.6	6.1	93.9
Strongly agree	2	5.6	6.1	100.0
Total	33	91.7	100.0	
Missing System	3	8.3		
Total	36	100.0		

Source questioner result

The data reviled that 27 (75.0 percent), of the respondent were strongly disagree, 2 (5.6 percent) were disagree, 2 (5.6 percent) were agree, and 2 (5.6 percent) were strongly disagree. Based on the above descriptive statistics the study indicate that of the selected public enterprises 27 (75.0

percent) were strongly disagree. This means there was no audit committee at the selected public enterprises in Arsi zone.

Table 26 Descriptive statistics:

Do you agree that the functional auditing report is to board/audit committee

N	Valid	32
	Missing	3
Mean		2.73
Std. Deviation		.839

Table 27 Descriptive statistics:

Do you agree that the functional auditing report is to board/audit committee

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Neutral	5	13.9	15.6	15.6
	Disagree	2	5.6	6.2	21.9
	Strongly disagree	23	63.0	69.7	90.9
	Agree	3	8.3	9.4	100.0
	Total	32	88.9	100.0	
Missing	System	3	8.3		
Total		36	100.0		

Source questioner result

The study revealed that of the total respondents 5 (13.9 percent) were neutral, 2(5.6 percent) were, disagree, 23(63.0 percent) were strongly disagree and 3(8.3 percent) were agree. This research indicates that the reporting lines of the selected public enterprises were not to board/audit committee.

4.16 Analysis of Structured Interview

4.16.1 Qualitative Analysis

Interview (Annex A)was made to the finance manager and the internal auditors in the selected public enterprises. The responses are analyzed qualitatively and the summary of the responses is presented below.

The responses regarding the criterion to recruit internal auditors dispose the fact that in all the selected public enterprises, the recruitment criteria for internal auditors is accountancy back ground and relevant years of experience. From the response it can be concluded that the understanding as to the requirement to be fulfilled by a prospective internal auditor is traditional and consequently it is one of the factors that limits the size of the IA staff and the scope of internal auditing. The involvement of the internal auditors in operational audit is highly limited. The operational efficiencies are measured and evaluated by the employees in the operational areas. There is no much involvement of the IAs in operational (performance) audits. Observations also reveal that the involvement of the IAs in operational audits is highly limited to the extent that urges one to conclude that there is no operational audit. This is due to the accountancy requirement for the IA's employment. As long as the IAs are from an accounting back ground, they are highly restrained from conducting the operational audit because they were not well aware of the operations especially in the non financial enterprises. This however does not concern the CBE where the operations are financial. The relationship of operational departments to the internal audit service is much based on financial matters than on operational.

As to the sufficiency of the internal auditors in the enterprises surveyed, the maximum number of the IA staff is two. It is evident that the whole internal auditing in the enterprises is covered by this size of internal auditors. This small sized staff is the result of the misunderstanding that the IAF is employed in accountancy requirement and the activities are restricted only to financial and compliance audits.

Regarding the availability of an audit charter, all of the enterprises do not have a self developed internal audit charter. They are using the internal audit manual (directive) sent by the agency without the slightest modification to suit to their respective operations.

Towards the quality of internal auditing properly, internal auditors in the selected public enterprises have quality towards financial statement compliance auditing, but it is not as needed.

The major challenges that the public enterprises faced now a days are; there is no training, workshop and seminars in this department, lack of internal auditor's graduates of different fields, especially to perform performance (operational) auditing, the budget allocated for this department is not much with activities to be done.

The enterprises are making different efforts to avoid problems related to IAF. In most of them, different trainings and workshops were conducted especially to explain the scope of internal audit though the behavioral changes brought by the trainings are not as fruitful as the efforts exerted; the reason is the training given was too short this is because of limited budget.

CHAPTER FIVE

Summary of Findings, Recommendations and Conclusion

5.1 Introduction

This section summarized the overall findings from respondents, the problems identified, the researcher's recommendations and conclusion to the whole research.

5.1. Summary of Findings

The modern internal auditing practice is characterized by broader scope and diversified activities than the traditional in many aspects. As shown in the literature review part, internal auditing function has changed from the simplest fraud investigation to the modern value addition service through time. However, changing the perception of people has not yet become simple and remains a major challenge that the IA is facing.

In the enterprises surveyed, the Internal Audit practice is highly characterized by its deep devotion to conducting the traditional routines like financial audit, compliance audit, internal control and the like than the modern ones such as risk assessment, consultation to management and recommendations etc. The involvement of the IAF in managerial matters is very much limited. It seems involving for an IA in managerial activities would be trace passing. Generally, the scopes of internal audit in all of the surveyed enterprises are very much narrow and not yet set free from the traditional thoughts of what an IAF should be.

The IA staff in the surveyed enterprises is composed of and recruited on an accountancy base. All of the internal auditors in the enterprises surveyed are qualified in accounting and none of them are from the operational fields (non accounting) which are relevant to the specific enterprises. It is not surprising if the CBE uses this criterion as its major activities are financial. In other words, the accountancy base requirement is appropriate to CBE than to the other enterprises. But others enterprises the major operations are non-financial auditing like performance (operational) auditing; the accountancy base requirement is still a criterion to recruit internal auditors. This requirement restricts the IAs from involvement in operational audits. The IAs are only from an accounting area means that they do not have sufficient knowledge of the

operations which in turn means that they cannot reliably measure, control and evaluate the efficiency of the operations. Consequently, these functions are performed by other employees of the operational units. This recruitment criterion has become a barrier for the IAs to involve in performance audits. It can then be concluded that the modern approach to IAF is not yet grasped well in the enterprises surveyed and the scope of internal audit is still narrow.

One of the challenges that the IAF is confronting is misunderstanding of its appropriate role. In the surveyed enterprises, the IAF is considered only as a fault finding function than an assistant, a controller and discover over the manager than a consultant. Belief that an IA should involve only in financial matters than other supportive functions is also wide spread. The IAF is also suffering from limited human resource. This wrong perception leads to many of the problems that the profession used to face and still facing. We should not confuse these statements with awareness about the IA. Since the IAF is recognized in the organization chart clearly, recognition of the function is of no question. The problem comes when we come to the proper understanding and implementation of the role of the function.

In addition to the misconception of the IAF, failure to implement the manual properly is another problem. Of course, the misconception has contributed to failure to the proper implementation of the manual. For example some of the problems associated with the reporting lines emerge from failure in proper implementation of the manual. If internal auditors are independent, they can carry out their work freely and objectively. Independence permits internal auditors to render the impartial and unbiased judgments essential to the proper conduct of engagements. It is achieved through organizational status and objectivity. To maintain independence, the reporting lines must be carefully designed in a way that it will not be impaired. The literatures reviewed so far tell us that the functional reporting may sometimes deviate from the theoretical relationships, but the managerial reporting lines do not usually face difficulties of implementation. The reporting lines in the surveyed enterprises were not designed in the way it is described in the theories and according to the internal audit manual. The reporting lines in the selected enterprises were deviating from the ideal relationships in that the IAs both functionally and managerially report to the general manager. This overlapping of the functional reporting lines and the administrative

reporting lines puts the independence of the IA in danger. This is not actually in conformity with the ideal reporting relationships and to the manual.

The other issue in reporting lines is the remoteness of the Board members. These board members are ministers at the federal and regional levels and they are on one hand remote from the enterprises and on the other hand they are highly involved in their regular careers and could not spend sufficient time for the enterprises' matters to the extent desired. Due to this, some important decisions on which fast corrective actions should be made will be delayed.

Though the responses show that the majority of the respondents 28 (77.8 percent) were disagree that the existing reporting relationship contribute to good governance in selected enterprise. Practically the inclination of the CEO's to seek the assistance of the IA's is not seen or it is very much limited. The support for the IA service to contribute to good corporate governance is also not encouraging. The respondents reasoned out that there is no exaggerated defect with the theoretical frame work of the reporting lines that restricts the IA from contributing to good governance. But the CEOs practically are not comfortable with actual implementation of the IAF in value addition and their support in this regard is low.

Regarding the clarity of the manual, 24 (66.7 percent) of the total respondents agree that the reporting lines are specifically and clearly set in the manual as shown in descriptive statistics table 13. This shows us that the problems arising in the reporting relationships do not originate from lack of clarity in the manual.

The size of the IA staff in the surveyed enterprises is limited to two. This is because it is believed that they are conducting only financial and compliance audits and for such an audit this size is sufficient. This thought however originates from the wrong perception developed towards the scope of the IAF. But if the true scope of the internal audit is understood and applied, the current size of the IA in the enterprise is would be found very much insufficient.

5.2 CONCLUSION

From the analysis of findings, the following conclusions can be made on an assessment of internal auditing practice in selected public enterprises in case of East Arsi zone.

The attribute standard No. 1000 as per the IIA states that the purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the standards, and approved by the board including stating of nature of assurance service and consulting service as per implementation standard 1000.A1 and 1000.c1.

In this study the manual that is available in the enterprises is clear and not that much confusing. The problems are not from the clarity of the manual but from the gradually developed misconceptions about the IAF. It is also shown that the functional reporting in selected public enterprises were deviates from the ideal practices, that is not always designed the way the manual and the ideal practices state.. The administrative reporting line however is most of the time designed according to the theoretical assumptions in the selected manufacturing Public enterprises. The independence of the IA is impaired in this case.

Additionally, according to ISPPIA No.1210, internal auditors should possess the knowledge, skills and other competencies needed to perform their individual responsibilities. Besides, ISPPIA No.1230 and IIA's Code of Ethics rule No. 4 on competency requires for development of the proficiency of internal auditors through continuing professional development to enhance their competency.

The study also shows that the relationship of the internal audit section to the production units (operational units) in most cases is on financial and compliance matters than managerial and operational because of the wrong perception developed regarding the internal audit function. This wrong perception on the other hand puts the IA only as a mere fault finder and to be assumed as if playing only a police role.

The scope of the internal audit function in the enterprises surveyed did not yet go far from the traditional practices and much time is devoted in performing financial and compliance audits.

ISPPIA No.2130 requires internal audit active role in corporate governance through supporting management in evaluating and monitoring all processes. Nevertheless 28 (77.8 percent) of the respondents were disagreed. This stated that their contribution to effectiveness of the corporate governance of their organizations is low.

The IAs in the enterprises are all qualified in first degree with three to seven years of experience. But the size of the IA staff is so small due to the wrong perceptions that they are enough for financial and compliance audits. But ideally they are not sufficient. Their field of study is also accounting and this in itself narrows their scope to be limited only to financial and compliance audits.

5.3. RECOMMENDATIONS

The reporting lines in selected public enterprises are deviate from the ideal practice as both functional and administrative reporting are directly to the branch manager which highly impairs the independence of the IA. Based on IIA's no. **1110** – Organizational Independence, the chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. **But in the surveyed public enterprises this IIA's was not implemented.** This leads to not report **actual** facts for fear of the managers' action against him/her. , it is recommended that the **enterprises** are revise their reporting lines and separate the functional reporting from the administrative reporting, because in this way the auditor's independence is under question and may not report **actual** facts for fear of the managers' action against him/her.

The internal audit manual states that the IA staff should consist of at least two members: one CAE and one clerk. In the enterprises surveyed, the size is limited to this minimum number and consequently the audit staff is composed of small number of IAs. This limits the capacity of the IA staff from covering all areas of interest. So, it is recommended that the enterprises increase the size of the IA staff based on the volume of the work and nature of auditors so as to sufficiently involve in any matters of interest.

The accountancy requirement for the IAs employment is a major issue that has shed its shadow on scope and size of the internal audit staff. This requirement is not only believed in the enterprises, but also is stated in the manual. The contradictions in the manual should be solved. So, it is recommended that the internal audit manual be revised and the accountancy background requirement be changed. This means it was not mean that having accounting background was not good, but it was advisable to have auditor from different specialized filed of area to perform all kinds of auditing.. It would be relevant if a statement is added showing that the IA staff should consist of non accounting IAs so as to realize operational audits.

This confines the scope of the activities of the IA staff only to financial matters than managerial and operational matters. So, the enterprises should come to the modern internal audit practice thought where the IA is conducting broader and diversified activities and the recruitment shall not be from an accounting area only. The IAs should be recruited based on educational background which is relevant and appropriate to the operations of the given enterprise. The operational audits should **not** be left alone to the operational team (unit). An effort needs to be made to diversify the composition of the IA staff by including IAs from other areas so that operational effectiveness, efficiency can be measured and evaluated easily.

The management of all the respective public enterprises should take the initiation to coordinate the collaborative efforts to have their individual internal audit charter at hand as per the international standards requirement to add value to their IAF.

The board members of all selected enterprises are ministers and they are on one side remote from the enterprises and on the other side are highly involved in their regular careers and could not devote sufficient time for the enterprises. Consequently, decisions on important matters are delayed which in turn will result in late corrective actions. So, a regular schedule should be arranged where all of the board members could meet and discuss and decide on the findings received from the respective organizations' CAEs.

Regarding quality assurance program, none of the respective public enterprises' audit department has quality assurance programs. Based on IIA's no. **1300** – Quality Assurance and Improvement Program, the chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. Thus, CAE should be able to develop quality assurance programs. As already discussed, the majority of the problems are related to lack of correct understanding of the IAF. So, continuous training and workshops should be conducted to avoid the problems. Based on IIA's no. **1230** – Continuing Professional Development

Internal auditors should enhance their knowledge, skills, and other competencies through continuing professional development.

To conclude, it is important to recognize that internal audit is not a substitute for effective controls, because of lack of understanding by managers, employees and the others were .considered internal auditing as fault finders .The executive management should establish an internal audit function to contribute to internal control, corporate governance and risk management of the respective public enterprises by examining, evaluating and reporting to management on its effectiveness. **Internal audit** activity achieves its objective if only management responses to its findings and opinions.

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Appendix A
JIMMA UNIVERSITY
COLLEGE OF BUSINESS & ECONOMICS
GRADUATE PROGRAM IN ACCOUNTING AND FINANCE

Objective of the Questionnaire:

Dear Sir/Madam

The intent of this questionnaire is to explore information regarding *An assessment of Internal Audit Practice of public enterprises in case of Asella town*” for partial fulfillment of MSc Degree in Accounting and Finance from Jimma University.

The questionnaire will distribute to purposely selected employees of your enterprise. The information you provide in response to the items in the questionnaire will be used as part of the data needed for a study of assessment of *Internal Auditing*. The results of the study are anticipated to supply how to assess internal auditing in your enterprise.

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

Your honest and thoughtful response is invaluable.

Thank you for your participation!

Part One: Background Information

Direction 1: Please, read and complete the following questions with the information that correspond to your background.

1) **Sex:**

A. Male B. Female

2) **Age:**

A. below 24 B. 25-30 C. 31-36 D.37-42 E. 43 and above

3) **Marital status:**

A. Married B. Divorced C. Single D. Widow

4) **Educational Qualification:**

A. Certificate B. Diploma C. BA/Bed/BSC
D. MA/Med/MSC E. PhD

5) **Work Experience:**

A. 0-5 years B.6-9 years C. 10 and above years

6. Field of study

A. Accounting B. Management
 C. Economics D. Human resource management E. others

7. Work experience as an internal auditor in year(s) only for auditor.

A. Less than a year B. 1-3years'
 C.4-7 years' D.8-12 years' E. above 12 years

Part Two: Examining the internal audit activity performance

Direction 2: read the following questions carefully and put "X" in the table box given bellow under decreasing frequency level based on questions.

Strongly agree =5 Agree =4 Strongly disagree =3 Disagree = 2 Neutral =1

Item/Question	(5)	(4)	(3)	(2)	(1)	Remark
Do you agree that your internal audit activity comply with the Institute of Internal Auditors (IIA's) Standards?						
Is internal auditing position in your organization at a sufficiently high level and sufficiently detached from functional areas to guarantee its independence?						
Is the internal audit plan based on your organization's risk profile?						
Do managers or employees of your enterprise have proper understanding of internal auditing role in good corporate governance?						
Does internal auditing have a quality assurance program?						
Do you agree that the Internal Auditor's (IA's) of your enterprise qualification, their size and experience sufficient and appropriate?						

Is their charter or manual or any clearly state the IA's responsibility, duty, and scope of activities?						
Is their performance auditing in your enterprise?						
Is there an association between the quality of the internal audit function and the effectiveness of the audit committee?						
Do the existing reporting relationships, the management's perception and responsiveness allow the Internal Audit (IA) to contribute to good governance in the enterprises?						
Does your organization have an audit committee?						
Do you agree that functional audit report is to board/audit committee?						
Do you agree that the nature of the interaction of the internal audit function with audit committees changed?						

14. What are the results of the most recent quality assessment?

15. Is internal auditing sufficiently resourced to provide objective assurance on risk and control?

16. To what extent are internal auditors involved in auditing the effectiveness of the governance structure of the enterprise?

17. Do you think that the organization's audit department or divisions has progressed in terms of number of qualified staff?

18. What are the challenges to the internal audit function in your enterprises?

19. What role should the internal audit function play in risk management?

20. To what extent the Internal Audit practice and the scope of internal audit have escaped from the influence of the traditional auditing practices.

21. What is the contribution of the internal audit function in adding value to the management?

22. To what extent the Internal Audit Function (IAF) in your enterprise is broad?

23. What are the challenges you face from management side in your internal audit activities?

24. Are there inherent conflicts in reporting responsibilities when internal auditors report to both the audit committee and to various levels of management? If your answer is yes, what are the causes of the conflict?

Appendix B

Interviews

Dear Sir/Madam

The intent of this interview is to explore information regarding *An assessment of Internal Audit Practice of public enterprises in case of Arsi zone t*" for partial fulfillment of MSc Degree in Accounting and Finance from Jimma University.

The questionnaire will distribute to purposely selected employees of your enterprise .The information obtain in response to the items in the interview will be used as part of the data needed for a study of an assessment of internal auditing practice of public enterprises in case of Arsi zone.

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

Your honest and thoughtful response is invaluable.

Thank you for your participation

1. How the requirement of internal auditors in your enterprise is takes place?
2. Does your enterprise have an Internal Audit department, if not why?
3. Which manual your enterprise is using? Internally developed or internationally developed manual?
4. Based on your opinion the internal auditors of your enterprise have good quality to perform auditing properly? If not why?
5. What are audited in your enterprise? Is only financial performance or other things?
If there are other things, what are these things?
6. What are the challenges you faced on internal auditing process in your enterprise?
7. What are your efforts to avoid these challenges?

APENDX C

THE INSTITUTE OF INTERNAL AUDITORS

The standards consist of Attribute Standards (the 1000 Series), Performance standards (the 2000 Series), and Implementation standards (nnnn.Xn). The Attribute standards address the characteristics of organizations and individuals performing internal audit internal audit activities. The Performance standards describe the nature of internal audit activities and provide quality criteria against which the performance of these services can be measured. The Attribute and Performance Standards apply to internal audit services in general. The Implementation standards apply the Attribute and Performance standards to specific types of engagements (for example, a compliance audit, a fraud investigation, or a control self-assessment project). There is one set of Attribute and Performance Standards, however there may be multiple sets of Implementation standards: a set for each of the major types of internal audit activity. Initially, The Implementation standards are being established for assurance activities (noted by an "A" following the Standard number, e.g., 1130.A1) and consulting activities (noted by a "C" following the Standard number, e.g., nnnn.C1). The Standards are part of the Professional Practices Framework. This framework was proposed The Standards employ terms that have been given specific meanings that are included in the Glossary.

ATTRIBUTE STANDARDS

1000 – Purpose, Authority, and Responsibility

The purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the standards, and approved by the board.

1000. A1 - The nature of assurance services provided to the organization should be defined in the audit charter. If assurances are to be provided to parties outside the organization, the nature of these assurances should also be defined in the charter.

1000. C1 - The nature of consulting services should be defined in the audit charter.

1100 – Independence and Objectivity

The internal audit activity should be independent, and audit auditors should be objective in performing their work.

1110 – Organizational Independence

The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities.

1110. A1 - The internal audit activity should be free from interference in determining the scope of internal audit auditing, performing work, and communicating results.

1120 – Individual Objectivity

Internal audit auditors should have an impartial, unbiased attitude and avoid conflicts of interest.

1130 – Impairments to Independence or Objectivity

If independence or objectivity is impaired in fact or appearance, the details of the impairment should be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.

1130. A1 – internal audit auditors should refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an auditor provides assurance services for an activity for which the auditor had responsibility within the previous year.

1130. A2 – Assurance engagements for functions over which the chief audit executive has responsibility should be overseen by a party outside the internal audit activity.

1130. C1 - internal auditors may provide consulting service relating to operations for which they had previous responsibilities.

1130. C2 - If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure should be made to the engagement client prior to accepting the engagement.

1200 – Proficiency and Due Professional Care

Engagements should be performed with proficiency and due professional care.

1210 – Proficiency

Internal auditors should possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.

1210. A1 - The chief audit executive should obtain competent advice and assistance if the internal audit staff lacks the knowledge, skills, or other competencies needed to perform all or part of the engagement.

1210. A2 – The internal auditor should have sufficient knowledge to identify the indicators of fraud but is not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.

1210. C1 - The chief audit executive should decline the consulting engagement or obtain competent advice and assistance if the internal audit staff lacks the knowledge, skills, or other competencies needed to perform all or part of the engagement.

1220 - Due Professional Care

Internal auditors should apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility.

1220. A1 - The internal auditor should exercise due professional care by considering the: Extent of work needed to achieve the engagement's objectives. Relative complexity, materiality, or significance of matters to which assurance procedures are applied. Adequacy and effectiveness of risk management, control, and governance processes. Probability of significant errors, irregularities, or non-compliance. Cost of assurance in relation to potential benefits.

1220. A2 – The internal auditor should be alert to the significant risks that might affect objectives, operations, or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified.

1220. C1 - The internal auditor should exercise due professional care during a consulting engagement by considering the: Needs and expectations of clients, including the nature, timing, and communication of engagement results. Relative complexity and extent of work needed to achieve the engagement's objectives. Cost of the consulting engagement in relation to potential benefits.

1230 – Continuing Professional Development

Internal auditors should enhance their knowledge, skills, and other competencies through continuing professional development.

1300 – Quality Assurance and Improvement Program

The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. The program should be designed to help the internal auditing activity add value and improve the organization's operations and to provide assurance that the internal audit activity is in conformity with the Standards and the Code of Ethics.



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