RELATIONSHIP BETWEEN INTERNAL AUDIT AND CORPORATE GOVERNANCE AMONG COMMERCIAL BANKS IN ETHIOPIA

A Thesis Submitted to the Department of Accounting and Finance for Partial Fulfillment of the Requirements for the Award of Degree of Masters of Science in Accounting and Finance

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Declaration

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

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Date: ________________

Certification

This is to certify that Ato Eyasu Tilahun has carried out his research work on the topic under the title of “Relationship between Internal Audit and Corporate Governance among Commercial Banks in Ethiopia” Under my supervision. This work is original in nature and it is suitable for the award of degree of Masters of Science in Accounting and Finance.

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Abstract

This study was conducted to examine relationship between internal audit and corporate governance among commercial banks in Ethiopia. The concept of internal audit and corporate governance has not been studied in the past more so among commercial banks. Therefore this study sought to examine role of internal audit and how it relates to corporate governance among commercial banks in Ethiopia. Research design was explanatory kind of research and the research was conducted on 13 purposely selected sample commercial banks by adopting mix research data type. Data was collected using a structure questionnaire and distributed to selected sample commercial banks. It was analyzed by using descriptive statistics aided by spss data analysis tool and for each sample select commercial banks a level of internal audit independence and a level of corporate governance. Pearson Correlation *was used to analyze the relationship between internal audit and corporate governance within a test of significance of 95% confidence level. The study further found out that there was a strong linear relationship or there was positive correlation coefficient between internal audit independence and corporate governance by correlation factor of 0.676, the study also found a positive correlation between internal audit charter and corporate governance and Professional proficiency as well as Scope of internal audit work was found positive correlation of the corporate governance within commercial banks in Ethiopia. The study recommends that the elements of internal audit practices studied contribute positively to the corporate governance within commercial banks in Ethiopia. The study suggests further studies to be conducted on other elements of internal audit and their influence on good corporate governance within commercial banks in Ethiopia.*

Keywords*; Internal audit, corporate governance, commercial banks*

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Contents **Table of content** **Page No**

List of figures

List of tables

List of acronyms

IA	Internal audit
IIA	Institute of internal auditors
BOD	Board of directors
CEO	Chief executive Officers
SAS	Statement on auditing standards
IAF	Internal audit function
NBE	National bank of Ethiopia
CAF	Common Assessment Framework
OECD	Organization for economic cooperation & development
ISPPIA	International standards for the professional practice of internal auditing
ECIIA	European confederation of institute internal auditing
AC	Audit committee
CAE	Chief Audit executive
CGI	Corporate governance index
NSE	Nairobi stock exchange
SPSS	Statistical packages for the social sciences
ABC	Audit board committee
CFO	Chief Finance officer
ALCO	Asset and liabilities board committees
AIAC	Associate of the Institute of Company Accountants
CGIAR	Consultative Group on International Agricultural Research
SPPIA	Standards for professional practice of internal auditors
KPMG	klynveld peat Marwick Goerdeler
GAGAS	Generally Accepted Government Auditing Standards

CHAPTER ONE

Introduction

This chapter presents the overall introduction of the paper. The first section presents the background of the study followed by statement of the problem, objective of the study, hypothesis, significance of the study, scope of the study, limitation of the study and organization of the paper is presented.

1.1. Background of the study

Due to the importance of internal audit in internal audit effectiveness and the possible interactions organizations are setting, especially with regard to among them. Even the conceptual study conducted by organizational objective achievement, enable various recommends the empirical validation of this researchers continues show concerned over it operation. Antecedents of internal audit effectiveness .in fact, it's received much concentration than before At this junction, and recommends that and this equally makes researchers concerned over its different constructs and variables can be employ toward effectiveness, due to the fact that organization that has examining internal audit effectiveness, this leads to the effective internal audit function in place are better than absorption of these variables as antecedents toward those organization that has not such a function especially examining the internal audit effectiveness as can equally in regard to fraud detection and prevention (Badara, Saidin,2014).

Internal auditors usually assist management in ensuring that there is a proper internal control systems in place and that the operations of the company carried out efficiently, effectively and economically. External auditors on the other hand, are interested in the truth and fairness of the financial statement. In order to achieve this objective the internal auditors should perform their job independently without management influence. Internal auditors are employed by companies to do both financial and operational auditing. Their role in auditing has increased dramatically in the past two decades, primarily because of the increased size and complexity of many corporations. Internal auditing is an independent, objective assurance and activity designed what value and improves and an organizations operations. 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 in the best position to gather intelligence on inappropriate accounting practices, inadequate internal controls, and ineffective corporate governance. The presence of internal auditors will reduce any weakens in the accounting system and implementation of their recommendation will improve control and reduce the risk of fraud and errors. Corporate governance is an organizational approach which provides assurance to external stakeholders that an organization unfulfilling its responsibility to them. It is built around stewardship, leadership and control. Internal audit is a fundamental element of corporate governance structures and process with in most organizations (Guruswamy, 2012**).**

Institute of Internal Auditors (2011) defines Internal Auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization’s +-operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, controls and governance processes. Internal auditing is conducted in diverse legal and cultural environment within organization that varies in purpose, size, complexity and structure; and by persons within or outside the organization. While differences may affect the practice of internal auditing in each environment, conformance with the Institute of Internal Auditors (IIA) international standards for the professional practice of internal auditing is essential in meeting the responsibilities of internal auditors and the audit activity (Gunther, Moore, 2012).

Corporate governance as the composition of, general meeting board of directors, board meeting independency, meeting frequency election and composition of the board; The BOD is set up to monitor managers such as the CEO on behalf of the shareholders with common objectives in mind of increasing shareholder value and profitability ,zekele sited (Julia, 1998). Affirms that presence of corporate governance as a way to improve board efficiency in order to reduce

Principal-agency conflicts; While other researchers argue that it may lead to bureaucracy and increase in operational costs. Increase in agency problems may lead to poor firm performance hence decrease in firm value in the long run, gunther coted (shunk, 1998, Cadbury, 1992) describes corporate governance as the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders role in governance is to appoint the directors and auditors and to satisfy themselves that an appropriate governance structure is in place.

An internal audit function could be viewed as a first line of defense against inadequate organization governance and financial reporting. With appropriate support from the board and audit committee the internal audit is in the best position to gather intelligence on inappropriate accounting practices, inadequate internal controls and ineffective corporate governance (Zekele, 2007). It is therefore an integral and necessary part of an effective corporate governance framework. Alongside the board, executive management and external audit, internal audit is one of the cornerstones of good corporate governance.

Hermanson and Rittenberg (2003) states that the nature of internal audit activity today typically includes risk management, control governance and compliance work all of which map directly into corporate governance. Khas (1999) argues that the internal auditing functions as part of the corporate governance structure plays an increasingly important role in monitoring the internal control system of the company and its financial reporting systems. Moreover, (Kinfu, 2006) notes that one of the strongest means to monitor ethics and governance in institutions can be through an internal audit function. These statements clearly indicate the contribution that internal audit function has towards enhancing effective and good corporate governance in commercial banks in Kenya. (Chapman & Anderson, 2000) argues that the inclusion of assurance and consultancy in the definition of internal auditing results in internal auditing becoming a proactive consumer focused activity concerned with the important issues of control, risk management and governance. (Hass &Burnaby, 2006) further notes that organizations have encountered a rapid change in the economic complexity, expanded regulatory requirements and technological advancement.

These changes have given internal audit function a set of expanded opportunities to support management provide services to other organizational functions and generate direct reporting links to the audit committee. Ramamoorthi (2003) indicates that overtime there has been a massive shift in focus to one that promotes and supports effective organizational governance.(Ruud ,2003) further notes that in today's business environment the internal audit function has become a major support function for management, the audit committee, the board of directors and other stakeholders. (Morgan, 1979) consequently notes a significant opportunity for internal auditing has emerged to demonstrate its potential to add value and to break away from historical characteristic as organizational policemen and watchdog.

Under this point of view the researcher justification was Most of the studies that related to internal audit and relationship corporate governance have been carried out in developed countries, with fewer studies carried out in the context of developing countries like Tanzania and Kenya, The fact that fewer studies Were carried out in the Ethiopia context.(Ashenfi,kelifa Yodit,2013,Guruswanmy,2012,Alem,2011,Abraham,2011) and the fact that most of the studies Focused only internal audit or corporate governance rather than the relationship between them. Moreover, there is no enough study which has been carried out in Ethiopia focusing on financial institutions. This study then intended to fill this Knowledge gap.

1.2. Statement of the Problem

Corporate governance according to the Central Bank of Ethiopia involves the manner in which the business and affairs of an institution are governed by its board and senior management and provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interest of the institution and its shareholders, facilitate effective monitoring and define how an institution sets corporate objectives, runs the day to day operations of the business and protects the interests of depositors and other creditors (National Bank of Ethiopia, 2014)

Internal audit is an increasing useful and important function for every organization. External auditors can rely on the work of internal auditors in carrying out their external audit duties as both auditors are concerned that proper controls are in place. The US statement on auditing standards (SAS), the auditors, consideration of the internal audit function in an audit of financial statements, provides general guidance about: evaluating all internal auditors competence, objectivity and work performance and using an internal audit or to modify the nature, scope, and timing of audit work and to provide direct assistance on an audit. Corporate governance is an internal system encompassing polices process and people which serves the needs of shareholders and other stockholders by directing and controlling market place commitment and legislation plus a health board culture which safe guards policies and processes. Internal corporate governance also controls monitor activities and then take corrective action to accomplish organizational goals (Guruswamy, 2012)

The spotlight has only recently been placed on the independence of auditors a`nd there is little in the literature as yet to suggest how they are responding to it (Edwin, 2013) coated on (Brody and Lowe, 2000). Audit committees particularly those that include directors assist the internal auditors in this regard as their presence and involvement are seen to enhance auditor's independence and his also coated on (Spira, 2003; Vanasco, 1996; Goodwin & Yeo, 2001).In order to be in a position to be heard having an independent audit committee may help.(Bariff ,2003) underlines the way in which the internal audit function can maintain independence from management by noting the following quote from a Price water house Cooper's report which states that internal audit department needs to ensure an organizational posture which allows them to operate successfully and concentrate on strategic issues. This means both the independence and mandate to deal with significant strategic business risks and issues. If inappropriately positioned within the company, internal audit deals with tactical issues and is viewed only at that level. In appropriate positioning can also raise serious concerns about the overall independence of the internal audit function.

This study consists of international researches, because relationship between internal audit elements (internal audit independence, internal audit charter, professional proficiency and scope of internal audit work and corporate governance represents unexplored in Ethiopia context exceptions that closed to this study are: this include researches and articles.

Stewart (2010) studied internal audit independence and objectivity emerging research opportunities in Australia; the paper summarizes the existing body of knowledge relating to internal audit independence and objectivity. (Goodwin, 2007) studied the relation between external audit fees, internal audit and the audit committee in Australia. (Jevons lee & Zhcoyanggu,1998) studied low balling, legal liability and quality in America; in this study the researchers summarizes In particular, low balling serves as a substitute for legal liabilities for maintaining auditor independence. Low balling reduces the transaction costs associated with the audit engagement relative to the flat fee structure and can actually improve auditor independence. (Ghosh, Moon, 2005) studied auditor tenure and perceptions of audit quality in America; One implication of the study is that imposing mandatory limits on the duration of the auditor client relationship might impose union-tended costs on capital market participants. Keywords: auditor tenure; auditor independence; audit quality; earnings quality; man datary auditor rotation; capital market perceptions .(Bubbico & Monda ,2012) studied the impact of corporate governance on market value of financial institutions empirical evidences from Italy; the finding for this research was supports the hypothesis that governance creates value for companies and that investments to implement effective governance systems give net positive benefit and should therefore be pursued. Hence financial institutions should be encouraged to improve their corporate governance systems.

Taghavi, Moghadam(2014) studied investigating the effects of corporate governance on risk of private banks and insurance firms in Iran;). The study investigates the effects of five variables including size, CEO duality task, composition of the board of directors, ownership concentration and having an internal auditing system on risk taking of private banks and insurance firms in Iran .(Saidin ,2014) studied empirical evidence of antecedents of internal audit effectiveness from Nigerian perspective in Malaysia; Research on internal audit effectiveness is an important avenue that will improve the existing conditions of internal audit at different organization particularly at local government level and thereby assist toward objective achievement of such organization. (Harriyanto, 2012) studied relationship between internal control, internal audit, and organization commitment with good governance in Indonesia, With multiple linier regression analysis, the finding showed that internal control, internal audit, and organization commitment have positive significant relationship with the good governance. It means that when local government of Central java province implements the internal control effectively audit internal and high organization commitment, and therefore makes the good governance practices increase.

Nworji, David (2011) studied corporate governance and bank failure in Nigeria: issues, challenges and opportunities; finally the study recommends: that corporate governance should be used as a tool to help stem the tide of distress, as it entails conformity with prudential guidelines of the government. (Ramachandran Sumramanian ,2012) studied effectiveness of internal audit in Tanzanian commercial banks; Results of this study deliberate that, the risks management and corporate governance related activities of internal auditors are incorporated merely as statutory obligations and do not provide additional value to the stakeholders.(Opanga ,2011) studied the relationship between corporate governance and financial performance on insurance firms in Kenya; The study recommends that because the elements of corporate governance practices studied contribute positively to the financial performance of insurance companies, they should be embraced by all insurance firms in Kenya. The study suggests further studies to be conducted on other elements of corporate governance and their influence on financial performance.

Ashenfi, kelifa, yodit(2013) studied on corporate governance and impact on bank performance in Ethiopia: Guruswanmy(2012) studied role of internal auditing to promote good governance in the public sector in Ethiopia. (Mihret & Yismaw, 2007) studied on IA effectiveness, Value added role of IA in the Ethiopian public sector case study, factors associated with attributes of IA departments, and antecedents and organizational performance implications of IA effectiveness respectively were explored. The researchers concluded respectively that IA services is limited to regular activities, and recommended that extending the scope of services by widening the range of systems and activities audited with appropriate risk analysis would improve audit effectiveness.

Alem(2011) studied on the application of corporate governance principles in the Ethiopian private commercial banks (the case of lion international bank) the researcher focus only the application of principles and his finding out that the extent of the application of the corporate governance. These include, orienting or inducting for new board members and training for existing board members, carry out annual evaluation of the board itself, its committees and its members, have the board sufficient information and time, disclosing the activities of each of the board committees, and explain the incentive structure and remuneration practices for senior management, as well as the actual amounts paid to senior managers and to directors..

Abraham (2011**)** studied on Internal Audit Function and Corporate Governance: in Commercial Banks**:** The main findings of the study were that the rates of implementation to audit recommendation by management, attributes of IAF (or the policy for hiring and training, experience and professional certification of internal auditors), and use of IAF working papers by external auditors in the banks were low. Given the growing role of the internal audit in contemporary corporate governance, independence has gained renewed attention. The tension resulting from the pressure to provide value added services while maintaining independence prompts my research objective which is to analyze whether internal audit functions in practice are operating independently in line with theoretical best practice guidelines.

This show that there are no many studies related to the relationship between internal audit elements that means internal audit independence, internal audit charter, professional proficiency ,scope of internal audit work and corporate governance concerning in Ethiopia context that is why the researcher intent to study this topic, hence the empirical gap that the present study sought to bridge. Therefore this study thus sought to investigate to relationship between internal audit and corporate governance among commercial banks in Ethiopia.

1.3. Objectives

1.3.1. General objectives

The main objective of the study was to examine the relationship between internal audit and corporate governance among commercial banks in Ethiopia.

1.3.2. Specific objectives

- ❖ To investigate the relationship between independence of internal audit and corporate governance among commercial banks in Ethiopia
- ❖ To investigate the relationship between internal audit charter and corporate governance among commercial banks in Ethiopia
- ❖ To examine the relationship between professional proficiency and corporate governance among commercial banks in Ethiopia
- ❖ To examine the relationship between scope of internal audit work and corporate governance among commercial banks in Ethiopia

1. 4.Literature driven hypothesis

Hypotheses are tentative statements/solutions or explanations of the formulated problem

Independent variable

The independent variables of the study are internal audit independence, internal audit charter, profession proficiency and scope of internal audit work.

Internal audit 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. The chief audit executive must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The chief audit executive must confirm to the board, at least annually, the organizational independence of the internal audit activity. The internal audit activity must be free from interference in determining the scope of internal auditing, performing work and communicating results. The chief audit executive must communicate and interact directly with the board. Therefore, the following hypothesis is will be tested (Sydeny, 2010).

H0: *There is no positive and significant relationship between internal audit independence and corporate governance among commercial banks in Ethiopia.*

H1: *There is positive and significant relationship between internal audit independence and corporate governance among commercial banks in Ethiopia.*

Internal audit charter

The internal audit charter is a formal document that defines the internal audit activity's purpose, authority and responsibility. The internal audit charter establishes the internal audit activity's position within the organization, including the nature of the chief audit executive's functional reporting relationship with the board; authorizes access to records, personnel and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board. The nature of assurance services provided to the organization must be defined in the internal audit charter. If assurances are to be provided to parties outside the organization, the nature of these assurances must also be defined in the internal audit charter. The mandatory nature of the definition of internal auditing, the Code of Ethics and the Standards must be recognized in the internal audit charter. The chief audit executive should discuss the Definition of Internal Auditing, the Code of Ethics and the Standards with senior management and the board. Therefore, based on the above discussion the following hypotheses are developed (CGIAR, 2005).

H0: *There is no positive and significant relationship between internal audit charter and corporate governance among commercial banks in Ethiopia.*

H1: *There is positive and significant relationship between internal audit charter and corporate governance among commercial banks in Ethiopia*

Professional proficiency

Knowledge, skills and other competencies is a collective term that refers to the professional proficiency required of internal auditors to effectively carry out their professional responsibilities. Internal auditors are encouraged to demonstrate their proficiency by obtaining appropriate professional certifications and qualifications, such as the Certified Internal Auditor designation and other designations offered by The Institute of Internal Auditors and other appropriate professional organizations. The chief audit executive must obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement. Internal Auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organization, but are not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud. Internal auditors must have sufficient knowledge of key information technology risks and controls and available technology-based audit techniques to perform their assigned work. However, not all internal auditors are expected to have the expertise of an internal auditor whose primary responsibility is information technology auditing. The chief audit executive must decline the consulting engagement or obtain competent advice and assistance if the internal auditors lack the knowledge, skills, or other competencies needed to perform all or part of the engagement. In view of the foregoing discussion, the following hypothesis is examined **(**hj. Fadzil, 2003**).**

H0: *There is no positive and significant relationship between professional proficiency and corporate governance among commercial banks in Ethiopia.*

H1: *There is positive and significant relationship between professional proficiency and corporate governance among commercial banks in Ethiopia*

Scope of internal audit work

The profession defines internal audit's scope as including corporate governance. The scope of the internal audit should encompass the examination and evaluation of the adequacy and effectiveness of the organization's system of internal control and the quality of performance in carrying out assigned responsibilities .Internal audit to coordinate the activities of the board and communicate information among board members, external and internal auditors and management. It also may help to revisit corporate governance and its basic definition. Corporate governance is affected by a host of players within a company: its board of directors, its management and other personnel, all working to achieve number of objectives, among them transparency and reliability of public reporting and all it entails. Therefore, based on the above discussion the following hypotheses are developed (Robert Hirth, 2009).

H0: *There is no positive and significant relationship between scope of internal audit work and corporate governance among commercial banks in Ethiopia.*

H1: *There is positive and significant relationship between scope of internal audit work and corporate governance among commercial banks in Ethiopia.*

Dependent variable

Corporate governance is the set of processes, customs, policies, laws and institutions affecting the way a company is directed, administered or controlled and defines the relationships among the various stakeholders. In the real world, all enterprises, irrespective of size and ownership structure, need some principles and guide to conduct a business. However, firms of different size and ownership structures (small size firms, share companies, government owned companies, commercial banks and microfinance institutions) may require different sets of complexities of governance (Tilahun , Kibre ,2007)

1.5. Significance of the study

This study fills the research gap by examining the practices of internal audit services in the case of commercial banks in Ethiopian context. And To create awareness about the importance of the internal audit assistance and help on the key business risks and controls for to days dynamic business environment management. In addition, this study might be use to the financial institutions particularly banks to understand the services which provides and its overall roles of internal audit function in corporate governance effectiveness. Individual internal auditors of an internal audit function could compare their own contributions to the quality of their IAF to the study. The other members of corporate governance (or board of directors, audit committee and external auditors) could use these findings in to account in their interactions to better equip IAFs for their role in corporate governance effectiveness. Regard to the relationship of the corporate governance and internal audit to make corrective recommendations. For that reason, the finding that would obtain as a result of undertaking this research has certain areas of significance. The study also may serve as a reference material for other researchers who need to make a research on this area.

1.6. Scope of the study

The outputs of this research would have been greater had it included all commercial banks in Ethiopia that registered in NBE, However, the limited time and other resources do not allow doing so. But researcher covered 13 commercial banks in Ethiopia registered by the NBE and established before the fiscal year 2008/2009. It‘s included 2 government commercial banks and 11 private commercial banks specifically all head offices.

The conceptual scope of the study is therefore, to examine relationship internal audit independence, internal audit charter, professional proficiency, scope of internal audit work and corporate governance among commercial banks in Ethiopia

1.7. Limitations of the study

It is quite known that any study is not absolutely free from limitations. As a result, this study was conducted with some sort of limitations. The researcher was faced with many problems which, in fact, may affect the quality of the study. The following limitations were among others:

The purposive sampling procedure decreases the generalizability of findings and this study might not be generalizable to all areas of financial institutions (or banks). Moreover, For the reason that, the researcher was unable to access most banks IA report on account of confidentiality issues, the researcher assessed only some banks documentary sources which might affect the findings of the research.

1.8. The Conceptual framework

The conceptual framework is the schematic diagram which shows the variables included in the study. Therefore the researchers design the relationships between independent and dependent variables as follows

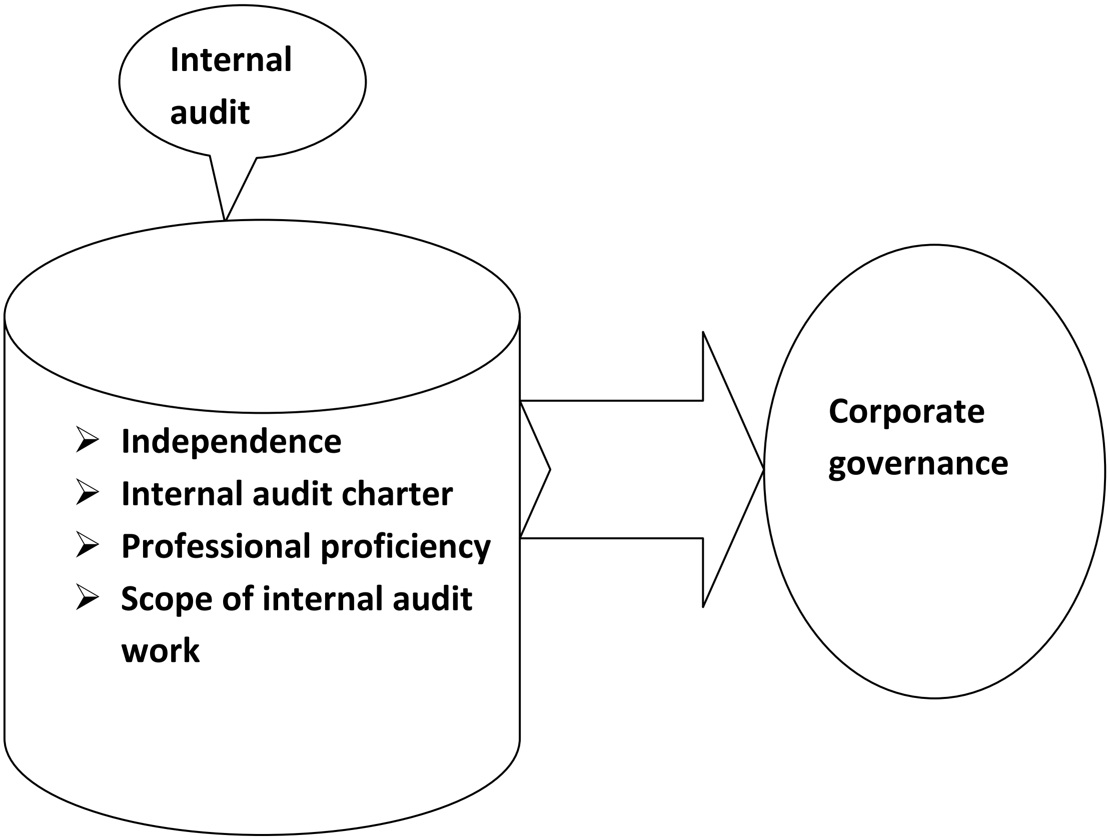


Fig 1.8.1: Conceptual framework

1.9. Organization of the paper

This research divides into five chapters. Chapter one is the introduction part which contains background of the study, statement of problem, objective of the study, research hypothesis, significance of the study, scope of the study, limitation of the study ,conceptual framework and organization of the research paper. Chapter two presents a discussion on theoretical as well as empirical literature review. Chapter three outlines the research methodology which includes research design, data type, data source and collection instruments, design of the questionnaire, sample design and data analysis techniques. Chapter four comprises the analysis of the data under descriptive statistics, Pearson correlation analysis and discussion results. In the final chapter summary of findings, conclusions, recommendations will be made and suggestions for further research will be given.

CHPTER TWO

LITERATURE REVIEW

This chapter presents the review of related literatures. The chapter is divided into two sections. The first section presents the theoretical review of literatures related topic of the study. The second section discusses the empirical literatures studied by different researchers from globally and Ethiopia point of view.

2.1. Theoretical Reviews

2.1.1. Agency Theory

Agency theory having its roots in economic theory was exposited by (Alchian & Demsetz ,1972) and further developed by (Jensen & Meckling ,1976). Conflicts arise when a firm's owners perceive that professional managers are not managing the firm in the best interests of the owners and these conflicts can spill over to other stakeholders of the same firm. According to the agency theory, superior information available to professional managers who are given full responsibility to run the firm may enable them act in a manner which will enable them gain more instead of adding value to shareholders and people are self interested rather than self sacrificing and cannot be trusted to act in the best interests of others hence they seek to maximize their own utility.

Daily (2003) argued that two factors can influence the prominence of agency theory. First, the theory is conceptually and simple that reduces the corporation to two participants of managers and shareholders. Second, agency theory suggests that employees or managers in organizations can be self seeking. The agency theory shareholders expect the agents to act and make decisions in the principal's interest contrary to this; the agent may not necessarily make decisions in the best interests of the principals (Padilla, 2000). Such a problem was first highlighted by Adam Smith in the18th century and subsequently explored by (Ross, 1973) and the first detailed description of agency theory was presented by (Jensen & Meckling ,1976). Indeed, the notion of problems arising from the separation of ownership and control in agency theory has been confirmed by (Davis, Schoorman & Donaldson, 1997). The principals have three core responsibilities in agency governance namely selecting and putting in place the governors, auditors and ensuring that there is an effective governance system in place which is adhered to by all involved parties.

Separation of ownership and control (Bhimani, 2008, Holmstrom , Milgrom ,1994) argued that instead of providing fluctuating incentive payments, the agents will only focus on projects that have a high return and have a fixed wage without any incentive component. This theory proposes that CEO and chair roles should be carried out by two distinct persons. Although this will provide a fair assessment, it does not eradicate or even minimize corporate misconduct. Here, the positivist approach is used where the agents are controlled by principal made rules, with the aim of maximizing shareholders value. Hence, a more individualistic view is applied in this theory (Clarke, 2004). Indeed, agency theory can be employed to explore the relationship between the ownership and management structure. However, where there is a separation, the agency model can be applied to align the goals of the management with that of the owners.

The model of an employee portrayed in the agency theory is more of a self interested, individualistic and are bounded rationality where rewards and punishments seem to take priority (Jensen &Meckling, 1976). This theory prescribes that people or employees are held accountable in their tasks and responsibilities. Employees must constitute a good governance structure. Therefore, the agency theory advocates that the purpose of corporate governance is to minimize the potential for managers to act in a manner contrary to the interests of shareholder. Agency theory suggests that corporate governance practices should be well implemented and monitored to facilitate more effective and control of the board as well as the CEO.

2.1.2. Stewardship Theory

The stewardship theory, also known as the stakeholder's theory, adopts a different approach from the agency theory. It starts from the proposition that organizations serve a broader social purpose than just maximizing the wealth of shareholders. This theory holds that corporations are social entities that affect the welfare of many stakeholders where stakeholders are groups or individuals that interact with a firm and that affect or are affected by the achievement of the firm's objectives (Donaldson & Preston, 1995, Freeman, 1984). Successful organizations are judged by their ability to add value for all their stakeholders.

Stewardship theory has its roots from psychology and sociology and is defined by Davis, (Schoorman& Donaldson, 1997) as "a steward protects and maximizes shareholders wealth through firm performance, because by so doing, the steward's utility functions are maximized". In this perspective, stewards are company executives and managers working for the shareholders. They protect and make profits for the shareholders. Unlike agency theory, stewardship theory stresses not on the perspective of individualism (Donaldson & Davis, 1991), but rather on the role of top management being as stewards, integrating their goals as part of the organization hence advocating for CEO duality as practices an integral part of corporate governance. The stewardship perspective suggests that stewards are satisfied and motivated when organizational success is attained. (Agyris, 1973) argues agency theory looks at an employee or people as an economic being, which overwhelms an individual's own aspirations while stewardship theory recognizes the importance of structures that empower the steward and offers maximum autonomy built on trust (Donaldson & Davis, 1991). It stresses on the position of employees or executives to act more autonomously so that the shareholders returns are maximized. Indeed, this can minimize the costs aimed at monitoring and controlling behaviors (Davis, Schoorman& Donaldson, 1997. Daily, 2003) argued that in order to protect their reputations as decision makers in organizations, executives and directors are inclined to operate the firm to maximize financial performance as well as shareholders profits. In this sense, it is believed that the farm's performance can directly impact perceptions of their individual performance.

Indeed, Fama (1980) contend that executives and directors are also managing their careers in order to be seen as effective stewards of their organization, (whilst, Shleifer &Vishny 1997) insists that managers return finance to investors to establish a good reputation so that that can re-enter the market for future finance. Moreover, stewardship theory suggests unifying the role of corporate governance so as to reduce agency costs and to have greater role of stewards in the organization and better safeguard the interest of the shareholders. Directors can be classified into four categories of insiders, business experts, support specialists and community influencers. First, the insiders are current and former executives of the firm and they provide expertise in specific areas such as finance and law on the firm itself as well as general strategy and direction.

Second, the business experts are current, former senior executives and directors of other large for-profit firms and they provide expertise on business strategy, decision making and problem solving.

2.1.3. Resource Dependency Theory

Resource dependency theory concentrates on the role of board directors in providing access to resources needed by the firm. (Hillman, Canella & Paetzold ,2000) contend that resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment and how well these resources are utilized for maximum output from the firm. Indeed, (Johnson, 1996) concurs that resource dependency theorists provide focus on the appointment of representatives of independent organizations as a means for gaining access in resources critical to firm success. It has been argued that the provision of resources enhances organizational functioning, firm's performance and its survival (Daily, 2003). In general, directors are resourceful to the firm in terms of providing resources such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy. Directors can be classified into four categories of insiders, business experts, support specialists and community influencers whom provide diversified resources for the better operation of an organization. It means that corporate governance should put mechanisms in place to ensure that resources are well utilized to get maximum output from these resources which can eventually increase firm value.

2.1.4. THE Internal Audit Framework

The internal audit department's framework provides the department with an independent structure to perform its tasks without restriction so that it can provide impartial and unbiased judgments about credit union operations. The framework establishes the line of authority for the internal auditor and dictates to whom the auditor reports. It also establishes the purpose and scope of the internal audit department.

The framework as set up by the board describes the authority that the internal auditor has to make impartial and unbiased judgments essential to internal audit activity. An internal auditor should not be in a position to make operating decisions or to instruct any credit union personnel to implement internal audit recommendations. These tasks should be the responsibility of operating management. Instead, the board of directors should empower the internal audit department to establish audit policies and programs and to review, report, and recommend changes in the credit union.

The framework should also address which credit union resources are to be available to the internal audit department. The board should make it clear that the internal audit department is granted authority to investigate any activities at the credit union and that all officers, employees, and volunteers are to cooperate with the department.

Once the board of directors has approved an internal audit department and established a framework for the department's operations, the logistics of creating the new department must be considered. The internal audit department should be located in the headquarters of the credit union and its offices should be private. Much of the information the internal audit department will deal with will be proprietary and potentially sensitive. Because of this, the department should be physically located so that sensitive material is not accessible to credit union staff. Soundproofing should be considered so that credit union employees do not overhear sensitive information. Another reason that a private office is important for the internal audit department is to ensure confidentiality of staff members who visit to discuss concerns. In particular, the credit union wants to create an environment that makes staff members feel comfortable bringing concerns to the audit department. While auditors do uncover fraud and other malfeasance, such problems are often brought to the auditors' attention by staff or management.

Adam (1994) noted that agency theory is part of the positivist group of theories which derives from the financial economics literature. It postulated that the firm consisted of a nexus of contracts between the owners of economic resources (the principals) and managers (the agents) who are charged with using and controlling those resources. According to (Bonazzi & Islam, 2006) in a corporation, the shareholders are the principals and the managers are the agents working on behalf of, and for the interests of, the principals. In agency theory, a well-developed market for corporate controls is assumed to be non-existent, thus leading to market failures, non-existence of markets, moral hazards, asymmetric information, incomplete contracts and adverse selection among others. Various governance mechanisms have been advocated which include monitoring of financial institutions, prudent market competition, and executive compensation, developing an effective board of directors, markets for corporate control, and concentrated holdings. Developing an effective board of directors remains an important and feasible option for an optimal corporate governance mechanism.

The Knowledge based theory of the firm considers knowledge as the most strategically significant resource of the firm. Employees are the custodians of knowledge within an organization. The advocates of this theory argue that because Knowledge based resources are usually difficult to imitate and socially complex, heterogeneous knowledge bases and capabilities among firms were the major determinants of success in competition and superior corporate performance. According to (Sveiby ,2001), strategy formulation should start with the competence of people. People are seen as the only true agents in business; all tangible physical products, assets as well as the intangible relations, are results of human action and depended ultimately on people for their continued existence. There has been an increasing demand for education and skill since the mid-twentieth century (Gorga&Halberstam, 2007).

For the IAF to be able to play its part in ensuring effective corporate governance, the department must have the right members of staff who are up to the task. According to IIA (2011) the chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan. Appropriate refers to the mix of knowledge, skills, and other competencies needed to perform the plan. Sufficient refers to the quantity of resources needed to accomplish the plan. Resources are effectively deployed when they are used in a way that optimizes the achievement of the approved plan. This study drew on institutional, extreme value, agency and knowledge based theories to examine the role of the internal audit function in promoting effective corporate governance within commercial banks in Ethiopia.

Changwony (2013) role of internal audit function in promoting effective corporate governance of commercial banks in Kenya and he put his study in the following conceptual frame work.

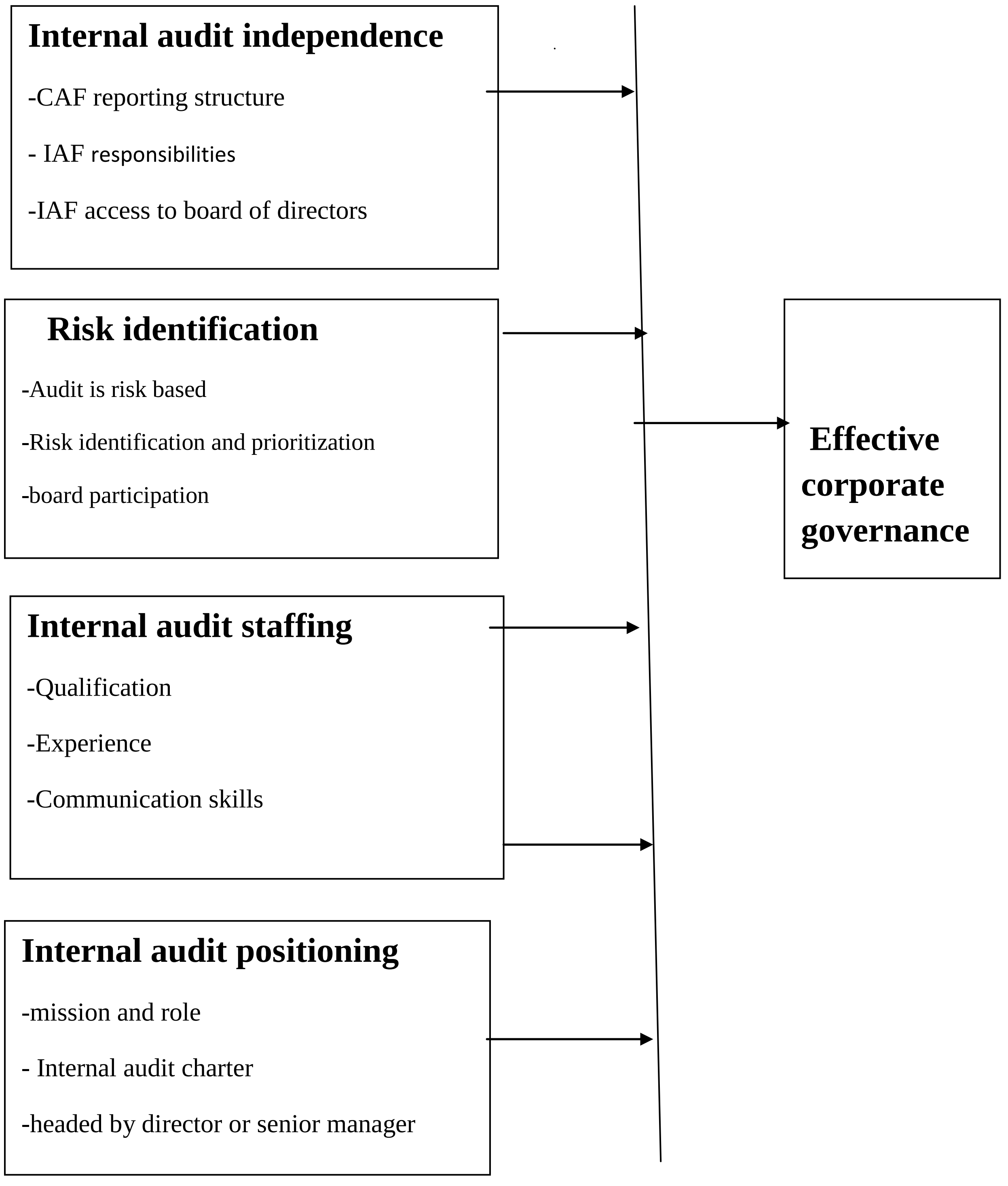


Fig. 2.1.4.1: Literature Conceptual framework

2.1.5. Effective Corporate Governance

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

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

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

- ❖ Promoting appropriate ethics and values within the organization;
- ❖ Ensuring effective organizational performance management and accountability;
- ❖ Communicating risk and control information to appropriate areas of the organization; and
- ❖ Coordinating the activities of and communicating information among the board, external and internal auditors, and management.

Regarding Ethiopia, the commercial code (1960) defined nothing in relation to corporate governance and the national bank of Ethiopia under the banking business proclamation 592 (2008) stated that the national bank may issue directives on the duties, responsibilities and good corporate governance of the board of directors. Likewise, along with National Bank of Ethiopia

(NBE) (2011) directives, sound corporate governance is vital for the health of individual banks and the banking sector as a whole to strength internal control and risk management systems of banks to prevent them from exposure to undue reputational, operational, legal and concentration risks that may result from abuse of money launderers and terrorist financiers.

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

Jesover & Kirkpatrick (2005) in their study on the perceptions of the Singaporean manager class regarding the role and effectiveness of internal audit in Singapore noted that one of the key roles of an internal auditor is the identification and evaluation of adequacy and effectiveness of the organization’s internal control system. Besides, in her empirical study on internal auditors Role and Authority in Malaysia, (Umor ,2009) point out, a key part of sound corporate governance is a strong internal control culture and IA plays an important role in evaluating the effectiveness of control systems, and contributes to an ongoing effectiveness of the organization. Moreover, Good governance principles require that audit committees or similar oversight bodies, work closely with internal auditors in fraud risk evaluation and investigations (Asare, 2009). Therefore, IAF plays a unique role in the governance process (Hermanson & Rittenberg, 2003)

2.1.6. Corporate Governance Mechanisms

Under this section, the two corporate governance mechanisms, as investigative of effective corporate governance mechanisms; i.e., board of directors (or management) and audit committee

2.1.6.1 Board of Directors

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

Directors and senior management have greater accountability for governance, risk management and control and they are relying on IA to assist in carrying out their responsibilities (Basel Committee on Banking Supervision, 2010; ECIIA, 2005; KPMG, 2003; Rossiter, 2007). Moreover, as ECIIA (2005), IAF provides advices, coaching and facilitation services to the board of directors, and IAF support management by providing assurance and consulting services on the effectiveness of risk management and internal control process, two important aspects of corporate governance (Sarens, 2009).

While an organization's policies for effective corporate governance can be delegated to appropriate levels of subordinate management, the responsibility for carrying them out remains at the top, i.e., with the board of management. This board must seek the right advice and find the right solutions for its organization's Particular circumstances and ensure that policy is implemented and the expected results are achieved. Part of that advice may come from the board's own audit committee (AC), which, in turn, could be advised by its internal auditors

(Paape, 2003). In her study of Role and Authority: an empirical study on internal auditors in Malaysia, Umor (2009) revealed that management often benefits from IA as a benchmarking source for the effectiveness and efficiency of their risk assessment and internal control practices. Also point out that internal audit may provide ways to develop and implement improvements to the existing processes; and management can use the findings to ensure conformity with established standards, contract and regulatory requirements and to achieve management goals and objectives. Hence, the presence of the IA department ensures that the organization is continually reviewed and improved for higher effectiveness and efficiency.

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

2.1.6.2. Audit Committee

The audit committee is empowered to function on behalf of the board of directors by assuming an important oversight role in the corporate governance intended to protect investors and ensure corporate accountability. In addition, the audit committee has oversight responsibility over corporate governance, the financial reporting process, internal control structure, IAFs, and external audit activities (Hermanson & Rittenberg, 2003; Rezaee, 2003) Point out that the more effective approach is the audit committee work diligently with management and auditors to identify the most complex business activities; assess their relative risks, determine their accounting treatments and obtain complete understanding of their impacts on fair presentation of financial performance and conditions. The audit committee should obtain independent advice on these business activities and related transactions, associated risks and proper accounting treatments.

Moreover, as (Okeahalam & Akinboade ,2003) Audit Committee plays a vital role in financial and operational controls in the whole system of corporate governance by making recommendations to the board concerning the appointment and remuneration of external auditors, reviewing auditors' evaluation of the system of internal control and accounting, and considering and making recommendations on the conduct of any aspect of the business of the company which should be brought to the notice of the board. By offering expanded assurance and consulting services to the organization, i.e. in particular to the audit committee of the board of directors, IAF effectively contributes to improve risk management, control and organizational governance (Hermanson & Rittenberg, 2003; Ramamoorti, 2003). Internal auditors play an intermediary role and assist in the discharge of the oversight function of audit committee (Fadzil, 2005) and it is difficult for audit committees to be effective without the support of IAF.

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

2.1.7. Internal Audit Independence and Corporate Governance

From the review of literature above we have learnt the vital role of internal audit function in any organization corporate governance. This study therefore sought to extend further to find out whether an independent internal audit function guarantees indeed good corporate governance in commercial banks in Ethiopia. Institute of Internal Auditors (2011) defines independence as the freedom from conditions that threaten the ability of the internal audit activity to carry out internal audit responsibilities in an unbiased manner. Threats to independence must be managed at the individual auditor, engagement, functional and organizational levels.

Institute of Internal Auditors (2011) for organizational independence to be effectively achieved the chief audit executive reports functionally to the board. Examples of functional reporting to the board involve the board to: approving the internal audit charter; approving risk based internal audit plan; receiving communication from the CAE on the internal audit activities performance relative to the plan; and approving decision regarding the appointment and removal of the CAE. Internal auditors must have impartial, unbiased attitude and avoid any conflict of interest. If independence or objectivity is impaired in fact or appearance the details of the impairment must be disclosed to appropriate parties. The determination of appropriate parties to which he details of an impairment to independence or objectivity must be disclosed dependent upon the expectation of the internal audit activity’s and the CAE’s responsibilities to senior management and the board’s as described in the internal audit charter (Cohen, 2002) recognizes that management has a strong influence in setting the overall tone for governance.

Claybrook (2004) argues that upper management has the broadest influence on stakeholders and that management influences operations as well as board of directors and even the audit function. (Nagy & Cenker, 2002) confirm this by noting that management and not internal auditors, ultimately determines the orientation of the internal audit functions. This is supported by (Brody & Lowe, 2002), who assert that the internal audit function sometimes is requested by management to assist it in advisory roles, such as in acquisitions, mergers and system development and implementation. (Bou-Raad ,2000) further supports this by suggesting that more can be accomplished with the internal audit function by reviewing and providing advice to management regarding business objectives. (Sarens & Debeelde, 2006) confirm that management requires the internal audit function to take on an extended role to compensate for loss of control resulting from increased organizational complexity. In addition their study results infer that internal auditors are expected to safeguard culture through personal contacts with people in the field.

Drent (2002) notes that executive and line management by utilizing the internal audit function for these various extended roles do not always appreciate the need for independence. He further argues that in the minds of many executives and managers‟ internal auditors‟ work for them and that reporting to the audit committee merely is a formality to satisfy corporate governance requirements. It is in this area that the impairment of the internal audit function’s independence poses a threat. (Van Gansberghe, 2005) suggests that this dilemma is expressed by the argument that the internal audit function must add value to management while at the same time not become its servant and faithfully report on the status to the board or some other equivalent governing body.

2.2. Review of Related Empirical Literature

2.2. 1.Empirical literature in global view

Various studies have been carried out in the past focusing on the different aspects of internal audit and corporate governance in organization and they were very critical in guiding these study, examples are.

Taghavi, Moghadam(2013**)** focused at finding out an empirical investigation to study the effects of corporate governance on risk taking of private insurance firms and banks in Iran. The proposed study of this paper considers the financial information of 13 banks and 19 private insurance firms over the period 2006-2011 in Iran. The study investigates the effects of five variables including size, CEO duality task, composition of the board of directors, ownership concentration and having an internal auditing system on risk taking of private banks and insurance firms in Iran. Using some panel data and regression analysis, the study confirms the positive effect of the ownership Concentration as well as negative impact of non-bound board members on risk taking.

Bubbico, Giorgino(2012) They set out how the quality of the corporate governance system impacts on the market value of the financial institutions listed on the Italian Stock Exchange. Implementing good corporate governance is costly, therefore verifying whether the investment is worth its cost is a relevant issue. Despite the central role that financial institutions play in the real economy, there are few studies that focus specifically on the financial industry; filling this gap in literature is especially relevant to Italy, where the enterprises are highly dependent on the banking system for their financing needs. The first step of the present study is the assessment of the corporate governance quality of the sample companies through the Corporate Governance Index (CGI). CGI is a scoring model that analyses four different macro-areas of governance: Board, Compensation, Shareholders and Stakeholders Rights, and Disclosure. A Cross-sectional data regression is then used to study the relationship between the corporate governance quality and the market value of financial institutions. The analysis, using 2010 data, proves that there is a positive and statistically significant correlation between corporate governance and performance: this finding supports the hypothesis that governance creates value for companies and that investment to implement effective governance systems give net positive benefit and should therefore be pursued. Hence financial institutions should be encouraged to improve their corporate governance systems.

Ntim. Osei(2011) they study the impact of corporate board meetings on corporate performance for a sample of 169 listed corporations from 2002 to 2007 in South Africa (SA). They findings suggest a statistically significant and positive association between the frequencies of corporate board meetings and corporate performance, implying that SA boards that meet more frequently tend to generate higher financial performance. A further investigation indicates a significant non monotonic link between the frequency of corporate board meetings and corporate performance, suggesting that either a relatively small or large number of corporate board meetings impacts positively on corporate performance. They findings are consistent across a raft of econometric models that control for different types of end of enmities and corporate performance proxies. The results provide empirical support for agency theory, which suggests that corporate boards that meet more frequently have increased capacity to effectively advise, monitor and discipline management, and thereby improving corporate financial performance.

Maigua (2013) the main objective of this study was to investigate the effect of corporate governance on financial performance of insurance companies in Kenya. Specifically, the study examined the size of board, number of board sub-committees, number of board meetings, CEO duality, and number of independent directors, number of dependent directors, age of the company and size of company in terms of asset value and how they affect the financial performance of insurance Companies in Kenya. The performance of firms was measured using Return on Assets (ROA). The study adopted descriptive research design. The population included all the insurance Companies which were operating as at December 2012. The study made use of secondary data which documentary information from Company annual accounts for the period 2007 to 2012 both years included was collected from 49 firms. Data was analyzed using a multiple linear regression model. The study found that a weak relationship exist between the Corporate Governance practices under study and the firms' financial performance. The number of Board sub-committee members, number of dependent directors and the age of the company were found to affect the financial performance of insurance companies positively.

The financial performance was however affected negatively by the Board size, number of Board meetings, number of independent directors and the asset value of the firms. Insurance firms should therefore put in place adequate board sub committees as well as ensure a higher number of dependent directors in order to enhance financial performance. Board size should also be reduced as much as possible since a larger size reduces the financial performance immensely.

Murithi (2009) set out to survey the role of internal audit in enterprise risk management for quoted companies under the industrial and allied sector listed at the NSE. The sample comprised of all 18 listed companies under the Industrial and Allied Sectors with the NSE as at 31st December 2008. The data was collected through a questionnaire to the internal audit department and where the function was outsourced it was distributed to the outsourced consultant. Data analysis was through descriptive statistics. The conclusion was that the internal auditors were well aware of their core roles in risk management but it was further discovered internal audit function were spending a lot of time in risk management beyond their mandate due to lack of a specialized risk department in the organization

Ramachandran, Subramanian (2012) the purpose of this researcher is to examine the effectiveness of internal audit function in Tanzanian commercial banks. Since this function is now a mandatory requirement as per the Banking and Financial Institutions Act 2006. Results of this study deliberate that, the risks management and corporate governance related activities of internal auditors are incorporated merely as statutory obligations and do not provide additional value to the stakeholders. They assert that that internal auditing in Tanzania commercial banks is still embracing the conservative approach which is primarily concerned with compliance and Monitoring rather than adopting value added approach. The inference of the study is more crucial to the agency theory whereby public funds are being spent on activities which do not add value to the stakeholders. This could in turn dilute the principal agent relationship, which is already a tenacious issue due to the corporate collapses witnessed over the last decade**.** The study comes as a timely contribution to practice since, Tanzanian economy is now at a growth and development stage and the Commercial Banks of Tanzania are the major contributors to the development of Tanzanian economy. The researcher suggests that it is time to change the outlook of internal audit system by Tanzanian Commercial Banks.

Edwin nejru(2013) the purpose of this researcher is to investigate relationship between internal audit and corporate governance. Internal audit is a subject that has been studied by scholars on various aspects. Some of the main areas of focus have been: the audit board committee function; risk management and internal audit; internal audit and organizational performance and the evolving trends within internal audit function. However, the concept of internal audit independence has not been reviewed in the past more so among commercial banks. This study sought to establish the independence of internal audit and how it relates to corporate governance among commercial banks in Kenya. Data was collected using a structured questionnaire distributed to all the 43 commercial banks in Kenya as at 31/12/2012. It was further analyzed by the use of descriptive statistics aided by SPSS data analysis tool and for each of the commercial bank a level of internal audit independence and a level of corporate governance were determined. A regression model was used to analyze the relationship between internal audit independence and corporate governance within a test of significance of 95% confidence level.

The study found out that there was indeed a threat to internal audit independence since the Chief Executive Officer (CEO) had powers in most banks to approve the internal audit budget, determine the compensation of the Chief Audit Executive (CAE) as well as hire and fire the CAE. The study further found out that there was a strong linear relationship between internal audit independence and corporate governance among commercial banks in Kenya. This implies that in policy and practice there are gaps in relation to internal audit independence that needs to be addressed by management.

2.2.2. Empirical Literature in Ethiopia Context

Alem(2011) This study was conducted to examine the extent to which corporate governance principles are applied in the Lion International Bank. A descriptive case study was employed to achieve the goal of this research. All of the board managers (eleven in number) and the senior manager and the board secretary which is a total of 18 participants were involved in the study. In order to get relevant data from the target population questionnaire and interviews were used. The questionnaire was administered to the board managers and the interviews were conducted with the senior manager and the board secretary. The data collected through questionnaire were Analyzed using frequency and percentage values and the qualitative data were analyzed using textual explanations. Furthermore, the qualitative data (data from interview) were analyzed together with the quantitative one to triangulate the results found from the questionnaire. The findings generally indicate that the extent of the application of the corporate governance principles in the Lion International Bank is encouraging even though the bank has still a problem with regard to enhancing the efficiency and effectiveness of the board and concerning with the transparency and disclosure of material information. As a result, the study presented some possible recommendations so as to alleviate the problems. These include, orienting or inducting for new board members and training for existing board members, carry out annual evaluation of the board itself, its committees and its members, have the board sufficient information and time, disclosing the activities of each of the board committees, and explain the incentive structure and remuneration practices for senior management, as well as the actual amounts paid to senior managers and to directors.

Ashenafi, Kelifa, Yodit(2013) the purpose of this researcher is to examining the corporate governance mechanisms and their impact on performance of commercial banks in the absence of organized stock exchange. The study assessed the relationship between selected internal and external corporate governance mechanisms, and bank performance as measured by ROE and ROA. The study used structured review of documents, and commercial banks financial data were collected covering a period 2005 to 2011. The findings indicated that board size and existence of audit committee in the board had statistically significant negative effect on bank performance; whereas bank size had statistically significant positive effect on bank performance. Similarly, capital adequacy ratio, as a measure of external corporate governance mechanism, had statistically significant positive effect on bank performance. In addition, absence of organized stock exchange; high government intervention; lack of corporate governance awareness, absence of national standards of corporate governance, as well as accounting and auditing; and weak legal framework to protect minority shareholder rights are the major factors with adverse impact on corporate governance and bank performance in Ethiopia.

Abraham (2011) this researcher had to examine the role of IAF in corporate governance effectiveness in the case of 13 purposely sampled commercial banks by adopting concurrent mixed research approach. Quantitative methods were used through survey of internal auditors, and interviews and documentary sources taken under the qualitative methods. From the total of 105 questionnaires were distributed to internal auditors, 78 had collected and 8 interviews were conducted with vice-presidents of 8 banks. The main findings of the study were that the rates of implementation to audit recommendation by management, attributes of IAF (or the policy for hiring and training, experience and professional certification of internal auditors), and use of IAF working papers by external auditors in the banks were low.

Thus, an IAF of the banks don't possess quality and its positive impact on corporate governance effectiveness is questionable, though IA practices were maintaining independence and it is value-added activity. Management of the banks need to take corrective action to audit recommendations and have to afford adequate attention to the proficiency of internal auditors to better equip an IAF quality and its role in corporate governance effectiveness. This finding indicated that extensive research should be taken in the quality of IAF and its role in corporate governance mechanisms and their interrelationships The fact that most of the studies Focused only internal audit or corporate governance rather than the relationship between them. Moreover, there is no enough study which has been carried out in Ethiopia focusing on financial institutions. This study then intended to fill this Knowledge gap.

CHAPTER THREE

RESEARCH METHODOLOGY

In this the study presents the methodology part of the research. And it is composed of the research design used in the study followed by data type and data source and collection instrument design of questionnaire, sample design, data analysis technique and procedure.

3.1. Research design

The aim of this research is to examine the relationship between internal audit and corporate governance with in commercial banks in Ethiopia. So, This Research design is explanatory kind of research. Because its explores the existing status of two or more variables at a given position in time and whether a relationship exists between them and also discovering and measuring causal relations among them, in which the principal objective is to know and understand the trait and mechanisms of the relationship and association between the independent and dependent variables; by this so the most suited for this study is explanatory.

3.2. Data type

Under this study data sources was primary data sources, because all most majority source of data collect from distribution of questionnaires, this shows that the research data type was qualitative. But**,** data analysis entails that the analyst breaks down data into constituent parts to obtain answers to research questions and to test research hypothesis. This show that research data type was not only qualitative it's also quantitative. This phenomena supported by (Anderson ,2006) by definition, when objectives must be measurable, quantitative and statistically valid and According to(Creswell ,2008) quantitative research is a means of testing objectives by examining the relationships among variables, these variables in turn can be measured, typically on instruments so that numbered data can be analyzed using statistical procedures.

Therefore in order to achieve the objective of this study the researcher used mixed research data type to examine the relationship of corporate governance and internal audit among commercial bank in Ethiopia. As to converge across qualitative and quantitative methods because the research questionnaires were had been analysis using spss analysis tools

3.3. Data source and collection instrument

Both primary and secondary data were used in this study. Primary data were collected using a questionnaire that means the researcher collected data using questionnaire method. The questionnaire was distributed physically in person to selected commercial banks and the target respondent is internal audit managers in these select commercial banks in Ethiopia. A researcher was used secondary data like review of internal audit reports, plans, and policy and procedural manuals.

3.3.1. Design of the questionnaire

All internal auditor managers of the purposely sampled 13 commercial banks were included in the survey. Questionnaires were distributed to 13 internal auditor managers of 13 purposely sampled commercial banks. Questions present in the form of affirmative statements, relating to the concepts on IA and its role in corporate governance effectiveness, in such a way as to enable measurement of the respondent’s opinions.

Most of the questions in the questionnaire were developed from the review of related literature. Therefore, the questionnaire was prepared, completed and returned to the researcher. The questionnaire had three parts. The first part was dealt with the general information of the Respondents. And the second part of the questionnaire was about questions concerning the independent variables and the third part was concern about corporate governance.

3.4 Sample Design

Sample design deals with the sample frame/ population, sample size, sampling techniques. Survey sampling is the process of choosing, from a much large population, a group about which wish to make generalized statements so that the selected part represent the total group (Leedy,, 1998). According to the NBE there are 16 private and 2 governments owned commercial banks which had been operated in the year 2014. However, to undertake this research which, the researcher purposely selected 13 commercial banks which have been operated for the last five (5) fiscal year to get enough information's, under operation before the fiscal year 2008/2009. Because of the cut year is due to the importance of experience in the banking industry. For this research the target population was all commercial banks registered by the National Bank of Ethiopia (NBE).

3.5. Data analysis techniques

The primary data were obtained from the questionnaires were coded and the questionnaire were summarized and analyzed by the use of descriptive statistics such as proportions, percentages and frequency distribution tables, and statistical package handling and analysis with the aid of the SPSS version 20 for descriptive statistics (frequencies and percentages) and inferential statistics (correlation analysis).therefore the Pearson correlation was used to analyze the relationship between internal audit and level of corporate governance within commercial banks. Hence this study test of significance of 95% confidence level was used:

CHAPTER FOUR

DATA ANALYSIS AND PRESENTATION OF FINDINGS

This chapter sets to give a detailed analysis of the data collected. Data was collected using a questionnaire and documentary sources. Data collected was further coded, validated and classified to allow for statistical package handling and analysis with the aid of the SPSS version 20 for descriptive statistics (frequencies and percentages) and inferential statistics (correlation analysis) analyzed in order for the research questions to achieve the objective of the study.

4.1 Data Analysis and Presentation of Results

4.1.1 Response Rate

In a bid to establish the actual number of responses who actively participated in the study, analysis of the response rate was conducted. Out of the 18 commercial banks in Ethiopia targeted, financial information for only 13 commercial banks was purposively selected at the time of the study and the targeted response was internal audit managers in these selected banks the response rate was 100%(that means all targeted respondents responses all questionnaires). This is in agreement with (Cooper & Schindler, 2003) who indicated that a response rate of between 30 to 80% of the total sample size can be generalized to represent the opinion of the entire population'

4.1.2. Sample Characteristic of the general information

The study also sought to determine the extent of gender representation in the position of the commercial banks in which it revealed that all of them were found to be male and the study required the respondents to state their job title within the internal audit functions. According to the findings 54% of the respondents were Director of internal audit, 23% were Head of Department or Senior Managers within the internal audit function and 23% were Chief internal auditor. The respondents were also required to indicate the number of years that they had worked within the internal audit function. From the study the period worked ranged between years. This implied that the respondents were well versed with the internal audit activities and functions. The respondents were asked to state whether it was common for internal auditors to move to other functions within the bank. It was found out that 100% of the responded indicated that this was common. This means that all of the banks surveyed move internal auditors to other functions within the bank. Further the respondents were asked if they had an internal audit charter and 100% of the respondents confirmed that they had an audit charter in place .This has been summarized in table 4.1.2.1 below.

Table 4.1.2 1: Respondents' Responses on the General Information of the Study

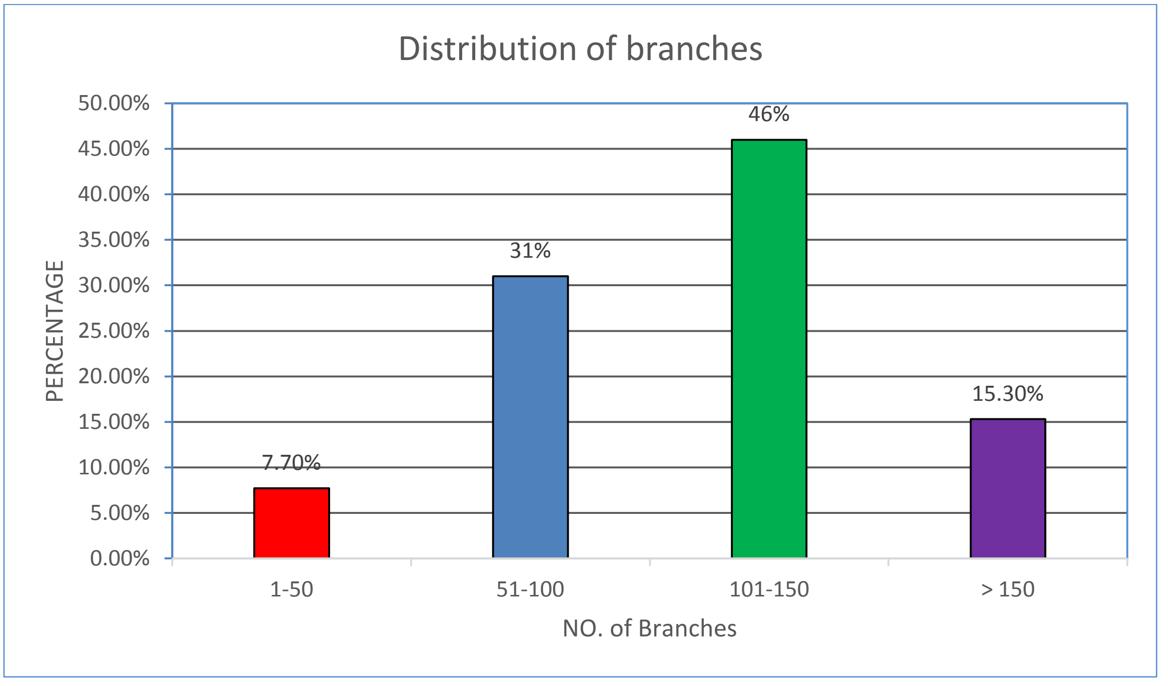
Variables	**Groups**		**Frequency**	**Percent**
Sex	Male		13	100.0
	Female		-	-
Position	Head of internal audit		3	23.0
	Director of internal audit		7	54.0
	Chief internal auditor		3	23.0
Service in years	In the Internal audit	0-5 years	3	23.0
		6-10 years	6	46.0
		Above 10 yrs	4	31.0
	In the current position	0-2 years	6	46.15
		3-5 years	5	38.47
		Above-5 yrs	2	15.38
Charter of internal auditors	Yes		13	100.0
	No		-	-
movement of internal auditors	Yes		13	100.0
	No		-	-
technical proficiency of the audit team	Yes		13	100.0
	No		-	-

Sources output spss-20

Number of branches

A good percentage of the respondents (46%) indicated that their banks had branches; slightly less than a third of them (31%) indicated that there banks had branches ranging from 51-100. This clearly shows that majority of respondents were from banks with more than 100 branches (Fig.4.1.2.2)

Figure 4.1.2.2: Distribution of the Respondents on the Number of Branches of their Banks



4.2. Relationship between internal audit independence and corporate governance within commercial banks in Ethiopia

This study was set to examine the relationship of independence of internal audit, internal audit charter, professional proficiency and scope of internal audit work within corporate governance among commercial banks in Ethiopia. To answer this objective, the respondents were asked to indicate the roles of various stakeholders in commercial banks in Ethiopia. These stakeholders included the Audit Board Committee (ABC), Chief executive Officer (CEO), Chief Finance Officer (CFO) among others (like, chief internal auditors, internal audit manager and human resources).

The respondents were asked to state where the internal audit reports functionally. The results showed that internal audit function in all the banks reported functionally to the audit committee. The result also showed that all the internal audit function reported administratively to the chief executive officer (CEO) that maintained their independence. These results suggested that opinions of internal auditors conform to the concept that IA is an independence and objective activity designed to add value and improve an organization operation (IIA, 2009).

In addition, (Mihret & Yismaw, 2007) noted that independence of individual auditors is essential to the effectiveness of IAF and when it’s effective it has positive impact on corporate governance effectiveness. It was also noted that as regards oversees of employment decisions in internal audit this was done by the CEO 28.6% of the banks; 53.8% by the Others while 15.4% of the banks this function was carried out by 2 or above authorities. The finding showed that majority of the respondents (76.9%) indicated that the CAE and human resources have the responsibility in their commercial bank to punish internal auditors when it’s get any fraud from their audit reports. On the other hand, 23.1% of the respondents indicated that this role was being done by the two or above of the bank authorities.

A good percentage of the respondents (46.2%) indicated that by ABC and the respondents 15.4% take by CEO&CAE; the remaining respondents 23.1% by two or above the bank authorities, to decision internal audit faces any intervention when performing its duties. to asses internal audit findings from their reports, Slightly more than half of the respondents (53.8%) indicated that it was the responsibility of the ABC, slightly more than a third of them (38.5%)%) indicated that it was the responsibility of the two or above of the bank authorities and the remaining 7.7% indicated that it was the responsibility of the CAE. Slightly more than half of the respondents (53.8%) indicated that it was the responsibility of the ABC to decision where internal audit acts of fraud, illegal acts, and violations of provisions of contracts or grant agreement or abuse reported to specified external parties, Slightly less than a quarter of them (23.1%) however indicated that this was the role of the two or above of the bank authorities, whereas a few of them (15.4%) indicated that this was the responsibility of the CEO and the remaining respondents 7.7% was responsible by CAE .the above discussion was summarized in the table of bellow .

Table 4.2.1: Responses of Independence items

No.	Independence items	Response									
		Audit Board Committee		*Chief Executive Officer*		*Chief Finance Officer*		**Others**		**2 or above**	
		f	%	*f*	%	*f*	%	f	%	f	%
1	To whom does the head of internal audit report functionally?	13	100	-	-	-	-	-	-	-	-
2	To whom does the head of internal audit report administrative?	1	7.7	12	92.3	-	-	-	-	-	-
3	Who oversees employment decisions in internal audit?	-	-	4	28.6	-	-	7	53.8	2	15.4
4	Who does responsible to rotate internal audit staff periodically?	1	7.7	1	7.7	-	-	10	76.9	1	7.7
5	Who do the responsible to punish internal auditor's when it Get any fraud from their audit reports?	-	-	-	-	-	-	10	76.9	3	23.1
6	Who does take the decision internal audit faces any Intervention When performing its duties?	6	46.2	2	15.4	-	-	2	15.4	3	23.1
7	Who does take the responsible to asses internal audit findings and breadth and depth of internal audit reports?	7	53.8	-	-	-	-	1	7.7	5	38.5
8	Who does the responsible to decision where internal audit acts of fraud, illegal acts, and violations of provisions of contracts or grant agreement or abuse reported to specified external parties?	7	53.8	2	15.4	-	-	1	7.7	3	23.1
9	Who does take the responsible when performance of a non audit service could impaired independence with respect to a required audit disclose the nature of the threat that could not be eliminated or reduced to an acceptable level and modifytheGAGAS statement accordingly?	5	38.5	3	23.1	-	-	1	7.7	4	30.8

10	Who does take the responsible to appraising the adequacy of the action taken by operating management to correct reported deficient conditions; accepting adequate corrective action; continuing reviews with appropriate management personnel on action considered inadequate until there has been a satisfactory resolution of the matter?	3	23.1	5	38.5	-	-	3	23.1	2	15.4

Sources output spss-20

4.3. Relationship between internal audit charter and corporate governance within commercial banks in Ethiopia

Attempts were made to measure the internal audit charter responses of respondents. Note that they were required to respond to the items saying “Audit Board Committee”, “Chief Executive Officer” , “Chief Finance Officer”, “others” or two and above bodies” of the bank authorities.

The study found out that the responsibility to approve internal audit charter lied with the audit board committee in commercial banks. Further the annual audit plan and the review of internal audit activities was the responsibility of the audit board committee. In addition the study found out that the approval of the internal audit budget was done by the CEO in 15.4% of the banks; 61.5% by audit board committee while in 15.4% of the banks it was been done by the two or above of the bank authorities . Majority of the respondents (69.2%) indicated that the ABC is the one who reviewed Responsible for the annual progress of the audit activities in relation to the plan, however, slightly more than a quarter of them (23.10%) indicated that the review annual progress of the audit activities was the role of the two or above of the bank authorities, whereas a few of them (7.7%) indicated that this was the responsibility of the CEO.

While an overwhelming majority of the respondents (84.6%) indicated that the Audit Board Committee was the ones who evaluate, approve and regularly review the risk based annual internal audit plan in the commercial banks. A few of them (15.4%) however indicated that the two or above of the bank authorities. In reply to criterion umber 7, as indicated in the below table states about developing and executing a comprehensive audit agenda for the evaluation of the management controls that majority of the respondents (76.9%) indicated that the Audit Board Committee was take the responsibility, however, slightly more than a quarter of them (23.10%) indicated that the two or above of the bank authorities. location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meetings. Shareholders should be sufficiently informed on, decisions concerning fundamental corporate changes such as amendments to the statutes, or articles of incorporation or similar governing documents of the company, the authorization of additional shares. In reply to criterion number 8 which concerns with responsible records for their adequacy to accomplish intended objectives and appraising policies and plans relating to the activity or function under audit review, majority of the respondents (69.2%) indicated that the ABC in their commercial bank records for their adequacy, On the other hand, 23.1% of the respondents indicated that this role was being done by the two or above of the bank authorities and the remaining 7.7% was CAE take the responsible. Corporations should have policies and practices that provide employees with compensation, including benefits that are appropriate given the nature of the corporation's business and employees' job responsibilities and geographic locations above discussion was summarized in the table of bellow

Table 4. 3.1: Responses of internal audit charter

No.	Items of Internal audit charter	Response									
		Audit Board Committee		*Chief Executive Officer*		*Chief Finance Officer*		**Others**		**2 or above**	
		f	%	*f*	%	*f*	%	f	%	f	%
1	Who approves the internal audit charter?	13	100	-	-	-	-	-	-	-	-
2	Who approves the internal audit budget?	8	61.5	2	15.4	-	-	-		3	23.1
3	Who approves the internal audit annual plan?	11	84.6	2	15.4	-	-	-	-	-	-
4	Who reviews the annual progress of the audit activities in relation to the plan?	9	69.2	1	7.7	-	-	-	-	3	23.1

5	Who does take the responsible to evaluate the need for internal audit where it does not exist?	4	31.1	2	15.3	2	15.3	3	23.0	2	15.3
6	Who does the responsible to evaluate, approve and regularly review the risk-based annual internal audit plan?	11	84.6	-		-	-	-	-	2	15.4
7	Who does take the responsible to developing and executing a comprehensive audit agenda for the evaluation of the management controls provided over all activities?	10	76.9	-	-	-	-			3	23.1
8	Who does take the responsible procedures and records for their adequacy to accomplish intended objectives and appraising policies and plans relating to the activity or function under audit review?	9	69.2		-	-	-	1	7.7	3	23.1
9	Who does take the responsible to authorizing the publication of reports on the results of audit Examination including recommendations for Improvement?	5	38.47	-	-	-	-	6	46.15	2	15.38

Sources output spss-20

4.4. Relationship between professional proficiency and corporate governance within commercial banks in Ethiopia

Attempts were made to measure the professional proficiency and corporate governance responses of respondents. The responses are summarized on Table 4.4.1. Note that they were required to respond to the items saying “Audit Board Committee”, “Chief Executive Officer” , “Chief Finance Officer”, “others” or two and above bodies” of the bank authorities.

When asked to indicate who determines the compensation/ salary of the head of internal audit? Majority of the respondents (92.3%) indicated this was the role of the Audit Board Committee Chief Executive Officer. There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. Bonus and incentive schemes should also be ensured that motivate employees to focus on the long term well being of the company. No director should be involved in deciding his or her own remuneration. It is the responsibility of the remuneration committee. The remuneration committee should review the compensation of members of the board, senior management and other key personnel, and should ensure that such compensation is consistent with the bank's culture, control environment, and long-term objectives and strategy to mitigate potential conflicts of interest and to provide assurance to shareholders and other stakeholders.

The study found out that on who hires and fires the head of internal audit in commercial banks in Ethiopia it was the responsibility of the audit board committee in 69.2% of the banks and in 23.1% of the banks it was done by the two or above of the bank authorities and the remaining was by HR . Thus in most of the banks the ABC can hire and fire the head of audit .Further it was found out that it was only in 7.7% of the banks where the board was conducting a board review aimed at assess skills mix, experience and other qualities. This implied that the main board skill evaluations and performance appraisal was not common in commercial banks. The respondents (53.9%) indicated that in their commercial banks, the CAE take the responsible to give advice for internal auditors when internal auditors face lack of knowledge and skills, 23% take by CEO and the remaining 7.7 % by CFO. Accordingly, the data found from this aspect as the table depicts bellow criterion number 5 discusses about responsible to monitor the quality of internal audit work, both in house and external that 53.8%, 15.4% and 30.8% of the respondents replied as ABC, CEO and CAE respectively. This criterion is therefore revealed by majority of the respondents as it has been carried out by the board, they show their agreement. Where executive directors and key personnel are eligible for performance related incentives, their compensation should be subject to relevant and objective conditions designed to enhance long term corporate value. The Board must identify key risk areas and key performance indicators of the corporation’s business such as economic value added and should constantly monitor these factors (OECD 2005). In the bellow table is criterion 7, which deals should be knowledgeable of applicable standards and competent in their application was responded by46.2%, 30.8% and 15.4% of the respondents CAE, two or above bank authorities ,audit board committee respectively and the remaining 7.7% was CEO.

A corporation should be a good citizen and contribute to the communities in which it operates by making charitable contributions and by encouraging its directors, managers and employees to form relationships with those communities. It also should be active in promoting awareness of health, safety and environmental issues, including any issues that relate to the specific types of business in which the corporation is engaged. The Basel committee for Banking Supervision (2006) recommends that having sufficient knowledge about board functions and the company is a very important element of the good corporate governance. Being knowledge full is an indicator that the board members can undertake their functions properly .These results are analyzed in table 4.4.1 below

Table 4. 4.1: Responses of professional proficiency items

No.	Items professional proficiency	Response									
		Audit Board Committee		*Chief Executive Officer*		*Chief Finance Officer*		Others		2 or above	
		f	%	*f*	%	*f*	%	f	%	f	%
1	Who determines the compensation/salary of the head of internal audit?	4	30.8	4	30.8	-		1	7.7	4	30.8
2	Who hires and fires the head of internal audit?	9	69.2	-	-	-	-	1	7.7	3	23.1
3	Who does the responsible to give Advice for internal auditors When internal auditors face lack of knowledge and skills?	1	7.7	3	23.0	1	7.7	7	53.9	1	7.7
4	Who do the responsible check job descriptions for each level of audit staff are appropriate?	-	-	2	15.4	-	-	11	84.6	-	-
5	Who does take the responsible to monitor the quality of internal audit work, both in-house and external?	7	53.8	2	15.4	-	-	2	15.4	2	15.4
6	Who does take the responsible internal auditors have sufficient knowledge of the appropriate computer-assisted audit techniques that are available to	2	15.4	2	15.4	-	-	5	38.46	4	30.76

	them to perform their work, including data analysis techniques?										
7	Who does the responsible to oversees auditors performing financial audits or attestation engagements should be knowledgeable of applicable standards and competent in their application?	2	15.4	1	7.7	-	-	6	46.2	4	30.8
8	Who does take the responsible to assign qualifications and independence of specialists and sufficient number of appropriately skilled staff and document work performed by specialists?	3	23.1	2	15.4	-		4	30.8	4	30.8

Sources output spss-20

4.5. Relationship between internal audit work and corporate governance within commercial banks in Ethiopia

Attempts were made to measure the scope of internal audit responses of respondents. The responses are summarized on Table 4.5.1. Note that they were required to respond to the items saying "Audit Board Committee", "Chief Executive Officer" , "Chief Finance Officer", "others" or two and above bodies" of the bank authorities

The finding showed that majority of the respondents (69.2%) indicated that the ABC to arrange short term training for internal auditors , slightly more than a quarter of them (23.10%) indicated that the arrange short term training for internal auditors was the role of the two or above of the bank authorities and the remaining 7.7% role by CEO. The results also showed that majority of the respondents ascertain that operating objectives and procedures are consistent with organizational goals that responsible to CAE. In reply to criterion umber 7, as indicated in the below table states about developing and assessment of the safeguarding of assets; reliability and integrity information and examination of compliance with policies, procedures, plans and legislation. According to(Melvin & Hirt ,2005), a corporation should have an effective system of internal controls providing reasonable assurance that the corporation's books and records are accurate, that its assets are safeguarded and that it complies with applicable laws. An effective internal control system contributes to safeguard the company's assets, the efficiency and effectiveness of business transactions, the reliability of financial information, the compliance with laws and regulations. The internal controls system should be periodically evaluated and updated so that it continues to be effective in a changing environment.

The audit committee is responsible to review the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board and review the performance of the external auditors. It reviews and approves the annual work plan of the external auditors; supervise its qualifications, and effectiveness. And it supervises the carrying out of the internal audit, receive and evaluate their work plan and any reports deemed relevant or significant for the Company. These results are analyzed in table 4.5.1. bellow

Table 4.5.1: Responses of Scope of Internal Audit Work Items

No.	Items scope of internal audit work	Response									
		Audit Board Committee		***Chief Executive Officer***		***Chief Finance Officer***		**Others**		**2 or above**	
		f	***%***	***f***	***%***	***f***	***%***	**f**	**%**	**f**	**%**
1	Who does take the responsible for internal auditors to get enough departments to successfully carry out its duties?	4	30.8	4	30.8	-	-	1	7.7	4	7.7
2	Who does arrange short term training for internal auditors?	9	69.2	1	7.7	-	-	-	-	3	23.1
3	Who ascertain that operating objectives are consistent with organizational goals?	2	15.4	3	23.0	-	-	7	53.87	1	7.7
4	Who ascertain that operating procedures are consistent with the organizational goals?	2	15.4			-	-	11	84.5	-	-
5	Who is the responsible to examine and evaluation of the adequacy and effectiveness of systems internal control, risk management, governance and the status of ethical behavior?	7	53.8	2	15.4	-	-	2	15.4	2	15.4

6	Who does take the responsible any special investigations?	2	15.4	2	15.4	-	-	6	46.2	3	23.0
7	Who does take the responsible to assessment of the safeguarding of assets; reliability and integrity information and examination of compliance with policies, procedures, plans and legislation?	2	15.4	1	7.7	-	-	6	46.2	4	30.8
8	Who does take the responsible to decisions that resources are acquired economically, used efficiently and adequately protected?	3	23.1	2	15.4	-	-	4	30.8	4	30.8

Sources output spss-20

4.6. Corporate Governance

Attempts were made to measure the corporate governance responses of respondents. The responses are summarized on Table 4.6.1. Note that they were required to respond to the items saying “yes” or “No”

The study found that in all the banks there was no situation where a shareholder with more than 5% shareholding was participating fully in the day to day running of the bank. It was also noted that the main board in all the banks constituted at least 5 members with all their chairpersons been non executive directors and three fifth of the members been non executive directors. Further it was noted that the board assumes office after the Central Banks of Ethiopia gives an approval acknowledging their appointments. It was also noted that the main board had put in place an audit board committee with a non executive chairman and an internal audit function in all the banks. Further the study found out that the main board meets at least four times in a financial year with every board member attending at least 75% of the scheduled meeting within a financial year. The study also revealed that in 100% of the banks the board had put in place a compliance function while in the main boards of the banks they had put in place and Asset and Liabilities board Committees (ALCO).

The study also found out that the role of approving the bank’s strategic plan was the responsibility of the main board in all commercial banks in Ethiopia. Further it was found out that it was in 100% of the banks where the board was conducting a board review aimed at assess skills mix, experience and other qualities. This implied that the main board it's qualified and performance appraisal was common in commercial banks. It was also noted that in all the banks the main board was very keen to maintain capital base in line with the Banking Act, review Central Banks Inspection reports and audit reports and provide a way forward and they are always informed on the banks performance and business condition. The study found out the main board reviewed regularly the compliance policy in an effort to assess the management of risk was in 100% of the banks in Ethiopia. On the other hand the responsibility to appoint, dismiss and define the duties of senior management rested with the mains board in 100% of the banks.

Further the board had established a credit committee to aid in review of the quality of the loan book but it was in 92.3% of the banks where the board had established a risk management board committee meant to ensure quality and integrity of risk management process. The above discussion was summarized in the table of bellow

Table 4.6.1: responses of corporate governance

No.	**Items Corporate Governance items**	**Response**			
		Yes		**No**	
		f	**%**	***f***	**%**
1	Do shareholders with more than 5% stake in the bank form part of executive directorship or senior management?	-	-	13	100.0
2	Does your board constitute at least 5 members?	10	76.9	3	23.1
3	Are the non executive directors in the board at least three- fifth of the board composition?	10	76.9	3	23.1
4	Is the chairman of the board a non executive director?	9	69.2	4	30.8
5	Do directors always assume office after central bank of Ethiopian approval is obtained?	13	100.0	-	-
6	Does the board meet at least four times in a financial year?	13	100.0	-	-
7	Do all member of the board attend at least 75% of the board meetings in a financial year?	13	100.0	-	-
8	Is the strategic plan always approved by the board?	13	100.0	-	-
9	Has the board established an audit board committee?	12	92.3	1	7.7
10	Is the chairman of the audit board committee a non executive director?	12	92.3	1	7.7
11	Has the board put in place an effective internal audit department staffed with qualified personnel?	13	100.0		

12	Has the board put in place an independent compliance function?	13	100.0	-	-
13	Does the board regularly review the bank's compliance policy to assess the extent to which it's managing compliance risk?	13	100.0	-	-
14	Does the board always maintain an adequate capital base with respect to the requirements of the banking act and business operations?	13	100.0	-	-
15	Does the board review the central bank inspection report and audit reports and advice on the way forward?	11	84.6	2	15.4
16	Is it the responsibility of the board of directors to appoint, Dismiss and define the duties of senior management?	13	100.0	-	-
17	Are the directions informed on a regular basis on the business condition of the bank?	12	92.3	1	7.7
18	Does the board regularly review its required mix of skill and experience and other qualities to assess its effectiveness?	13	100.0	-	-
19	Has the board established an Asset and liabilities committee (ALCO) to assess the mix of assets and liabilities of the bank?	13	100.0	-	-
20	Has the board established a credit committee whose main purpose is to oversee the lending policy of the bank?	12	92.3	1	7.7
21	Has the board established a Risk Management Committee to ensure quality, integrity and reliability of the bank's risk management process?	13	100.0	-	-

Sources output spss-20

4.7. Correlation analysis

Relationship between Internal Audit and Corporate Governance

The study sought to establish the relationship between internal audit and corporate Governance. The results of this analysis are as follows.

4.7.1 Pearson Correlation

Pearson Correlation/ Correlation Coefficient (*r*) measure how well the relationship truly represents the set of data. The quantity *r*, called the linear correlation coefficient, measures the strength and the direction of a linear relationship between two variables. The value of *r* is such that $-1 < r < +1$. The + and – signs are used for positive linear correlations and negative linear correlations, respectively. Positive correlation: If *x* and *y* have a strong positive linear correlation, *r* is close to +1. An *r* value of exactly +1 indicates a perfect positive fit. Positive values indicate a relationship between *x* and *y* variables such that as values for *x* increase, values for *y* also increase. Negative correlation: If *x* and *y* have a strong negative linear correlation, *r* is close to -1. An *r* value of exactly -1 indicates a perfect negative fit. Negative values indicate a relationship between *x* and *y* such that as values for *x* increase, values for *y* decrease. No correlation: If there is no linear correlation or a weak linear correlation, *r* is close to 0. A value near zero means that there is a random, nonlinear relationship between the two variables. A computation of the correlation coefficient *r* was therefore done between internal audit and corporate governance and was found to be. This meant that the relationship is positive since the value of *r* is close to +1.

The study was found out the following results: On the correlation of the study variables, the researcher conducted a Pearson Product Moment correlation. From the findings on the correlation analysis between elements of internal audit and the other study variables(that means corporate governance), the study found that there was positive correlation coefficient between internal audit independence and corporate governance by correlation factor of 0.676, the study also found a positive correlation between internal audit charter and corporate governance and Professional proficiency as well as Scope of internal audit work was found positive correlation of the corporate governance with correlation factors of 0.673, 0.563 and 0.567 respectively. These results are detailed in the table 4.7.1.1. below

Table 4.7.1.1: Inter Correlation Matrix of Study Variables (N = 13)

No.	**Independent variables**	Corporate governance	
1	Independence internal audit	Pearson Correlation	.676*
2	Internal audit charter		.673*
3	Professional proficiency		.563*
4	Scope of internal audit work		.567*

*Correlation is significant at .05 (2 –tailed)

Sources output spss-20

4.8. Testing the Hypothesis based on Correlation Analysis

Based on the research questions and problem of the study, a set of hypotheses were developed and tested to show the relationships between elements of internal audit and corporate governance within commercial banks in Ethiopia. The correlation analysis whose results is presented in table 4.8.1 bellow and provides a more comprehensive and accurate examination of the research hypothesis: Therefore, the correlation results obtained from the matrix were utilized to test these hypotheses. The hypotheses sought to test for a significant of relationship between internal audit charter, internal audit independence, Professional proficiency and scope of internal audit work and corporate governance with in commercial banks in Ethiopia.

Hypothesis 1

H0: *There is no positive and significant relationship between internal audit independence and corporate governance among commercial banks in Ethiopia.*

H1: *There is positive and significant relationship between internal audit independence and corporate governance among commercial banks in Ethiopia.*

From table 4.8.1 bellow the result showed that there is moderate relationship between internal audit independence and corporate governance. This means that H1 is accepted and H0 is rejected, Statistically significant relationship between the internal audit independence and corporate governance within commercial banks in Ethiopia: Whereas, it is consistent with the previous studies conducted by (Cohen, &Sayag, 2010; Van Peursem, 2005) they find that, the more organizational independence to the internal auditors plays the vital role in assurance of internal audit effectiveness by freely access of necessary documents, information and data about the organization for audit work, and can provide audit finding /report/ freely and directly to the responsible body, and this all supports the IA effectiveness in their sector. This may be occurred due to the organizations support to the IA effectiveness and accordingly, the Level of independence, reporting level, direct contact to the board and senior management, conflict of interest, interference, the unrestricted access to all departments and employees, appointment and removal of the head of internal audit, and performing non-audit activity may not be equally perceived. But, without the relevant senior management support simply the independence of the organization to the internal auditors may not be enough to add value and to identify the noncompliance activities performed in their office. Therefore, the existence of adequate and competent IA staff and the availability of AIAC in their office in line with the appropriate management support for internal auditor's activity are strong enough to make effective the internal audit function in the financial institution.

Hypothesis 2

H0: *There is no positive and significant relationship between internal audit charter and corporate governance among commercial banks in Ethiopia.*

H1: *There is positive and significant relationship between internal audit charter and corporate governance among commercial banks in Ethiopia*

From table 4.8.1 bellow the result showed that there is moderate relationship between internal audit charter and corporate governance, hence hypothesis (H1) is accepted and rejected H0 for this result. The availability of approved IA charter in the commercial banks in Ethiopia have positive and significant relationship on corporate governance This hypothesis which is proposed to support the effectiveness of internal audit is the existence of approved internal audit charter in the commercial banks. A well drafted IA charter is a crucial ingredient for the successful internal auditing functions. (Peursem, 2005, O'Regan, 2002) According to the authors a well drafted IA charter helps the internal audit function to perform its roles of management influence objectively and used as a way of getting access to the information (documents, records, systems, and personnel) that are necessary to perform and reach conclusions on the work. Therefore, the existence of approved internal audit charter in the financial institution the effectiveness of internal audit works by facilitating the activities of internal auditors and to make their purpose and authority in line with the standards for the professional practices formulated by the Institute of internal auditors in accordance to the rules and regulations of the organization. This strongly supports the proposed hypothesis of the positively related relationship between the Availability of internal audit charter and corporate governance.

Hypothesis 3

H0: *There is no positive and significant relationship between professional proficiency and corporate governance among commercial banks in Ethiopia.*

H1: *There is positive and significant relationship between professional proficiency and corporate governance among commercial banks in Ethiopia*

From table 4.8.1 bellow the result showed that there is moderate relationship between professional proficiency and corporate governance, hence hypothesis (H1) is accepted and H0 rejected for this result. The existence of adequate and competent internal audit staff also supposed to be the determinants of internal audit effectiveness and supports by hypothesis to know the relationship between professional proficiency and corporate governance of this research). But, this result was inconsistence with some previous auditing researches (Arena &Azzone, 2009; Cohen & Sayag, 2010) they argued that there were no correlation between professional proficiency and adequacy with the IA effectiveness. But the previous research was conducted in terms of the number of internal auditors, professional certification and level of education, whereas this research was conducted the effects of IA by considering the overall abilities of the internal auditor staffs and the availability of adequate and certified internal auditors in terms of their performance to proceed the required auditing activities by matching with the audit standards and organizational objectives by using modern technologies when compared to those previous studies. Therefore, the existence of adequate and competent IA staff in the commercial banks in Ethiopia results with positively relationship with corporate governance.

Hypothesis 4

H0: *There is no positive and significant relationship between scope of internal audit work and corporate governance among commercial banks in Ethiopia.*

H1: *There is positive and significant relationship between scope of internal audit work and corporate governance among commercial banks in Ethiopia*

From table 4.8.1 bellow the result showed that there is moderate relationship between internal audit work and corporate governance, hence hypothesis (H1) is accepted and H0 is rejected for this result. Hypothesis of this research posted that the scope of internal audit work related with corporate governance within commercial banks. The management support in terms of providing resources, giving trainings, introducing with new technologies, providing enough facilities and encourages the internal audit process with commitments to promote and communicate their added value for the effectiveness of internal audit work in their office contributes for the their companies.

TABLE 4.8.1. Summary of Hypothesis and result:

No.	**Hypothesis**	R	Discussion
1	*There is positive and significant relationship between internal audit independence and corporate governance among commercial banks in Ethiopia.*	.676*	Accepted
2	*There is positive and significant relationship between internal audit charter and corporate governance among commercial banks in Ethiopia.*	.673*	Accepted
3	*There is positive and significant relationship between professional proficiency and corporate governance among commercial banks in Ethiopia.*	.563*	Accepted
4	*There is positive and significant relationship between scope of internal audit work and corporate governance among commercial banks in Ethiopia.*	.567*	Accepted

Sources output spss-2

4.9. Document analysis

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

4.10. Discussion Results

Objective one: Relationship between Independence of Internal Audit and corporate governance

The correlation analysis reveals a significant and positive relationship between independence of internal audit and corporate governance. Then it follows that the more independent internal audit is, the higher the likelihood that risks will be effectively managed. The findings confirm the finding by (Arena, 2006) who found that companies which had their internal audit reporting to CEO and audit committees, a characteristic of independence, audit reports were being utilized helping in improvement or create good governance. Therefore organizations need to promote independence of internal audit in order for it to add value to the organization.

On the other hand (Cheung & Qiang, 1997) contend that unlimited access to all company economic activities and other resources enhance independence and effectiveness of internal audit. From the above, it can therefore be inferred that trust in internal auditors enhances independence of internal audit which in turn increases their effectiveness, and that the level of independence increases as trust increases. This independence will permit internal audit to render independent judgment and opinion the way risks are managed in an organization, leading to improvement good governance. In addition, this trust arising out of established relationships will promote unlimited accessibility to organizational resources, which is an indication of independence.

Objective two: Relationship between internal audit charter and corporate governance

The correlation analysis reveals a significant and positive relationship between internal audit charter and corporate governance within commercial banks in Ethiopia. This concurs with Part of a series of notes to help Centers review their own internal management processes from the point of view of managing risks and promoting good governance and value for money, and to identify where improvement efforts could be focused. Corporate governance best practice identifies written internal audit (IA) charters as an important element. A written charter describing the purpose, authority, and responsibility of the IA, is also required by the International Standards for the Professional Practice of Internal Auditing published by the Institute of Internal Auditors (IIA), the worldwide professional body (CGIAR, 2008).

Objective three: Relationship between professional proficiency and corporate governance

The correlation analysis reveals a significant and positive relationship between professional proficiency and corporate governance. The findings are supported by(Timberlake ,2005) who stated that internal audit enables collaboration, Commitment, information sharing and trust while enhancing genuine participation in the organization, which leads to greater success and effectiveness. It is mainly through information sharing, trust and genuine participation by staff and management that internal audit will derive its effectiveness in good governance.

Objective four: Relationship between scope of internal audit work and corporate governance

The correlation analysis reveals a significant and positive relationship between acceptances of internal audit work and corporate governance within commercial banks in Ethiopia. This shows that as long as individuals have positive receptivity of internal audit function, they will be willing to render it support in the execution of their duties. This support increases as the level of acceptance increases. This concurs with (Dittenhoffer's ,1997) assertion that if auditors gain acceptance of internal audit, they would act in cooperation with the audit staff in identifying problem areas, assist in investigatory work and develop corrective action.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter presents the summary of the research findings, conclusions, recommendations and suggestions for further study. The conclusions were drawn from the findings of the study in line with the objective of the nature of relationship between corporate governance and internal audit among commercial banks in Ethiopia.

5.1. Summary of Findings

Total of 13 questionnaires were distributed to all internal auditor managers of 13 purposely sampled commercial banks. The researcher was conducted some banks documents regarding IA report. According to document and results of questionnaires, all banks have an IA department, and the purpose and authority of IA is clearly defined in line with SPPIA. IA is value adding activity in the banks; and risk management and internal control system are done as part of IA activity in view of the fact that these are the main activities of corporate governance (Hermanson & Rittenberg, 2003).

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

The study found that the internal auditors in all the banks functionally reports to the audit board committee and administratively they report to the CEO. The study also found that the salary for the head of internal audit was been determined by both CEO and ABC in 92.4% of the banks which was treat to audit independence. The study found that the responsibility to approve the internal audit function budget rested on the ABC in 61.5% of the banks. In addition the responsibility to hire and fire the head of internal audit was done by the ABC in 69.2% of the banks. The study further found that it was common of the banks in Ethiopia for the main board to conduct a performance appraisal, skills analysis and experience checks. The study also found that the main board had put in place a compliance function of the banks and an asset and liabilities board committee in 100% of the banks.

According to the study conducted, internal audit independence, internal audit charter, professional proficiency and scope of internal audit work are independent variables while corporate governance is the dependent variable. The study was adopted in an effort to examine of each of independent variable on corporate governance within commercial banks in Ethiopia. From the analysis of the data collected it was proved that internal audit independence; internal audit charter, professional proficiency and scope of internal audit work all are positively correlated with corporate governance. A change in one unit in the internal audit independence brings the highest positive change in corporate governance 0.676 corporate governance, followed by internal audit charter which causes a change of 0.673 in corporate governance. In general the test analyzed the effect of each of the internal audit elements on corporate governance and the result was a positive output, implying that there exist positive relationship between corporate governance and internal audit within commercial banks in Ethiopia.

5.2. CONCLUSION

The study concludes that a positive and significant relationship exists between elements of internal audit corporate governance within commercial banks in Ethiopia The relationships of the internal audit elements particularly with the internal audit independence, internal audit charter, professional proficiency and scope of internal audit work contributing to the role of internal audit in effectiveness corporate governance. This study established that internal audit functions were generally independent since the Audit Board Committee approved the internal audit charter, the head of internal audit report functionally to the Audit Board Committee and that the internal audit activity is empowered to be independent by its appropriate reporting relationships to executive management and the audit committee. The findings however also established that there are some treats to internal audit activity.

The study concludes that a positive and significant relationship exist between internal audit elements effective and corporate governance of commercial banks in Ethiopia. Internal audits core competencies should directly relate to its mission, role and scope of work. The study established that internal audit function plays a positive and significant role in effective corporate governance of commercial banks in Ethiopia. This study found out that the CEO reviewed and approved the internal audit budget, hired, remunerated and fired the Chief Audit Executives.

According to the internal audit department, the study revealed that there is a significant positive relationship between the factors in the internal audit department and the objectivity of the internal auditors, and almost all banks operating in the Ethiopia have an audit manual, charter, and quality assurance department, and committed to comply with the internal audit standards of IIA. According to the audit reports the study showed the importance of having a policy of internal auditing to review audit reports with the personal responsible for the activities examined in advance of the formal release of the reports, also related to the objectivity of internal auditors the study showed that there is great effect of rotation of employees in the internal audit department on the objectivity of internal auditors,

5.3. Recommendation

This study investigated the relationship between internal audit and corporate governance in the case of 13 purposely sampled commercial banks through adopting concurrent mixed research approach to convergence across quantitative and qualitative methods (Creswell, 2003) based on the conclusions drawn, recommendations and future research areas are forwarded in this specific section of the chapter. After issuing new policies and regulations, the regulatory bodies must formulate periodic policy efficiency review plans to ensure that the policies are properly undertaken on timely basis by suitably qualified reviewers. Secondly, other financial institutions apart from commercial banks can also use the findings of this study to design and implement a tighter system covering risk management and corporate governance reporting. Internal audit staffs in commercial banks suggest that among other things, improving internal auditor's independence, timely and adequate information access, sufficient management support on education and on job training to expose internal auditors to new developments could help in improving the effectiveness of internal auditing in these banks. More specifically, this means there is a challenge on the bank management's part to ensure internal audit effectiveness.

Based on the study findings, the following are recommended:

(i) Training of internal auditors should be ensured. This will involve sending them abroad for that opportunity. In addition, a college that specializes in auditing should be established in Ethiopia. Training can be formal, such as attending courses, or informal such as attending seminars and conferences.

(ii) Independence of internal auditors should be ensured. This can be done through periodic transfer of internal auditors

(iii) There is a need for staff recruitment with the aim of ensuring that there are adequate internal auditors. This should be done hand in hand with upgrading the skills of the available internal auditors.

(iv)The working environment should be improved.

5.4. Areas for Further Studies

This study focused on examine of the relationship between internal audit and corporate governance within commercial banks in Ethiopia. There is a need to carry out a similar Study in other financial institution both public and private, in order to get further input on the topic

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Appendixes

Appendix I:

Questionnaire to be field by the internal audit managers in 13 sampled commercial banks in Ethiopia:

Dear Sir/Madam

The intent of this questionnaire is to explore information regarding relationship between internal audit and corporate governance in Ethiopia commercial banks. The questionnaire will distribute to internal audit managers of 13 purposely selected commercial banks head office. The information you provide in response to the items in the questionnaire will be used as part of the data needed for a study of relationship between internal audit and corporate governance among commercial banks in Ethiopia .the results of the study are anticipated to supply to the understanding of the role internal audit function in corporate governance effectiveness in commercial banks of Ethiopia in particular and be used to obtain insight in relation to financial institutions in general.

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

Your honest and thoughtful response is invaluable

Thank you for your participation

Kind regards,

Eyasu Tilahun Tafere, MSc student

Adama Science and Technology University

School of Business and Economics

Department of Accounting and finance

March, 2015

Research Questionnaire

Part 1: General information

1) Gender of the respondent: Male[ ] Female [ ]
2) Please indicate your position in the organization:

____

3) How many years have you served?

(A).in the internal audit function: ________________

(B).in your current position:_____________________

4) How many internal audit staff are members of the institute of internal auditors (IIA)? __________________

5) Dose your internal audit function have a charter?

Yes [ ] No [ ]

6) How many branches does your bank have? ___________________

7) Is it common for internal auditors to move to other functions within the bank? Yes [ ] No [ ]

8) Did the audit team demonstrate technical proficiency in auditing and knowledge of company policies? Yes [ ] No [ ]

Part two: Questionnaire; that related to independent variables

	Questions	Audit Board Committe e	Chief Executiv e Officer	Chief Finance Officer	Other (Specify)
I	**Independence**				
1	To whom does the head of internal audit report functionally?				
2	To whom does the head of internal audit report administrative?				
3	Who oversees employment decisions in internal audit?				
4	Who does responsible to rotate internal audit staff periodically?				
5	Who do the responsible to punish internal auditors when it's get any fraud from their audit reports?				
6	Who does take the decision internal audit faces any intervention when performing its duties?				
7	Who does take the responsible to asses internal audit findings and breadth and depth of internal audit reports?				
8	Who does the responsible to decision where internal audit acts of fraud, illegal acts, and violations of provisions of contracts or grant agreement or abuse reported to specified external parties?				
9	Who does take the responsible when performance of a non audit service could impaired independence with respect to a required audit disclose the nature of the threat that could not be eliminated or reduced to an acceptable level and modify the GAGAS statement accordingly?				

10	Who does take the responsible to appraising the adequacy of the action taken by operating management to correct reported deficient conditions; accepting adequate corrective action; continuing reviews with appropriate management personnel on action considered inadequate until there has been a satisfactory resolution of the matter?				
II	**Internal audit charter**				
1	Who approves the internal audit charter?				
2	Who approves the internal audit budget?				
3	Who approves the internal audit annual plan?				
4	Who reviews the annual progress of the audit activities in relation to the plan?				
5	Who does take the responsible to evaluate the need for internal audit where it does not exist?				
6	Who does the responsible to evaluate, approve and regularly review the risk- based annual internal audit plan?				
7	Who does take the responsible to developing and executing a comprehensive audit agenda for the evaluation of the management controls provided over all activities?				
8	Who does take the responsible procedures and records for their adequacy to accomplish intended objectives and appraising policies and plans relating to the activity or function under audit review?				

9	Who does take the responsible to authorizing the publication of reports on the results of audit examination including recommendations for improvement?				
III	**Professional proficiency**				
1	Who determines the compensation/ salary of the head of internal audit?				
2	Who hires and fires the head of internal audit?				
3	Who does the responsible to give advice for internal auditors When internal auditors face lack of knowledge and skills?				
4	Who do the responsible check job descriptions for each level of audit staff are appropriate?				
5	Who does take the responsible to monitor the quality of internal audit work, both in- house and external?				
6	Who does take the responsible internal auditors have sufficient knowledge of the appropriate computer-assisted audit techniques that are available to them to perform their work, including data analysis techniques?				
7	Who does the responsible to oversees auditors performing financial audits or attestation engagements should be knowledgeable of				

	applicable standards and competent in their application?				
8	Who does take the responsible to assign qualifications and independence of specialists and sufficient number of appropriately skilled staff and document work performed by specialists?				
IV	**Scope of internal audit work**				
1	Who does take the responsible for internal auditors to get enough departments to successfully carry out its duties?				
2	Who does arrange short term training for internal auditors?				
3	Who ascertain that operating objectives are consistent with organizational goals?				
4	Who ascertain that operating procedures are consistent with the organizational goals?				
5	Who is the responsible to examine and evaluation of the adequacy and effectiveness of systems internal control, risk management, governance and the status of ethical behavior?				
6	Who does take the responsible any special investigations?				
7	Who does take the responsible to assessment of the safeguarding of assets; reliability and integrity information and examination of compliance with policies, procedures, plans and legislation?				
8	Who does take the responsible to decisions that resources are acquired economically, used efficiently and adequately protected?				

Part three: **Corporate Governance**

	Questions ;Related to dependent variables	**responses**	
		Yes	**No**
1	Do shareholders with more than 5% stake in the bank form part of executive directorship or senior management?		
2	Does your board constitute at least 5 members?		
3	Are the non executive directors in the board at least three- fifth of the board composition?		
4	Is the chairman of the board a non executive director?		
5	Do directors always assume office after central bank of Ethiopian approval is obtained?		
6	Does the board meet at least four times in a financial year?		
7	Do all member of the board attend at least 75% of the board meetings in a financial year?		
8	Is the strategic plan always approved by the board?		
9	Has the board established an audit board committee?		
10	Is the chairman of the audit board committee a non executive director?		
11	Has the board put in place an effective internal audit department staffed with qualified personnel?		
12	Has the board put in place an independent compliance function?		
13	Does the board regularly review the bank's compliance policy to assess the extent to which it's managing compliance risk?		
14	Does the board always maintain an adequate capital base with respect to the requirements of the banking act and business operations?		
15	Does the board review the central bank inspection report and audit reports and advice on the way forward?		
16	Is it the responsibility of the board of directors to appoint, Dismiss and define the duties of senior management?		
17	Are the directions informed on a regular basis on the business condition of the bank?		
18	Does the board regularly review its required mix of skill and experience and other qualities to assess its effectiveness?		
19	Has the board established an Asset and liabilities committee (ALCO) to assess the mix of assets and liabilities of the bank?		
20	Has the board established a credit committee whose main purpose is to oversee the lending policy of the bank?		
21	Has the board established a Risk Management Committee to ensure quality, integrity and reliability of the bank's risk management process?		

Appendix 2:

Table 2.1 lists of 13 purposely sampled commercial banks in Ethiopia

Sr.n	Commercial Banks	Establishment year	Branches
	Public Bank		
1	Commercial Bank of Ethiopia	1963	909
2	Construction and Business Bank	1983	106
	Total state commercial banks		**1015**
	Private Banks		
1	Awash International Bank	1994	191
2	Abyssinia Bank	1996	111
3	Bunna International Bank	2009	72
4	Cooperative Bank of Oromia	2009	144
5	Dashen Bank	2003	146
6	Lion International Bank	2006	67
7	Nib International Bank	1999	98
8	Oromia International Bank	2008	115
9	United Bank	1998	108
10	Wegagen Bank	1997	98
11	Zemen Bank	2009	1
Total Private Banks			1151
Total commercial Banks			**2166**

Source: NBE, 2013/14 Annual Report (www.nbe.gov.et)