

ST.MARY'S UNIVERSITY
BUSINESS FACULTY
DEPARTMENT OF MANAGEMENT

INTERNAL AUDITING PRACTICE

(IN THE CASE OF COMMERCIAL BANK OF ETHIOPIA FINFINE BRANCH)

BY

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JUNE 2014

ADDIS ABABA

INTERNAL AUDITING PRACTICE

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CHAPTER-ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Today, several forces have led to a quite resolution in internal audit. Documentarily requires government to be accountable in its uses of public money and in providing effective, efficient, and economical service delivery. Every large and more complex systems require greater competencies, thus internal audit has had to become ever more professional. (Cecilia Nordin Van Gansberghe, 2003)

Reporting relationships of internal auditing has changed and developed together with the progress of internal auditing. At the beginning reporting lines of internal auditors went to the accounting level and external auditors, who saw internal auditors mainly as assistant in financial audits.

Accordingly as functions and role of internal auditing expanded, changed and shifted more to management oriented matters than accounting matters, reporting lines have also been transformed and currently in many countries internal audit reporting have also been transformed.

Internal audit reporting lines ideally classified in to administrative and functional, the chief audit executive should report functionally to the board or audit committee and administratively to the chief executive officer of the organization. (Rolandas Rupsys,2005)

The internal auditing staff in Commercial Bank of Ethiopia Finfine branch often reports the audit committee of board directors and also to president or another high executive. This strategic placement high in the organizational structure helps to ensure that the internal auditors will have ready access to all unit of the organization, and that their recommendation will be given prompt attention by department head and other line executive whose work they review. Thus, it would be generally not be desirable for the internal auditing staff to be under the authority of chief accountant regardless of their reporting level.

However the internal auditors are not independent in the same sense as the independent auditors. The internal auditors are employees of the organization in which they work, subject to restraints inherent in the employer-employees relationship.

A large part of the work in internal auditors consists of operational audits; in addition, they may conduct numerous compliance audits. The number and kind of investigative project vary from year to year. Unlike CPA's who are committed to verify each significant item in the annual financial statements, the internal auditors are not obligated to repeat the audits on annual basis.

1.2 STATEMENT OF THE PROBLEM

The objective of internal auditing is to assist members of the organization in the effective discharge of their responsibilities. The internal auditing function includes verification, evaluation and compliance of operation. The end product of any audit work culminates in writing of an audit report, but unlike the external auditor's report, the internal audit is not standardized short-form in its content. Consequently, the audit report of internal auditor requires a lot of imagination and creativity with communicative ability in its writing.

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

As per our research we found some problems in commercial bank of Ethiopia finfine branch and we classified in to two categories with some overlapping. First, the competence of internal auditor that leads to trivial audit finding, lack of professional development, respective audit work, and non-value added internal audit report.

Second, structural problem(reporting relationship) in the form of assigned task that impair the auditor independency, and fear of losing promotion, job security, and wrong perception about internal auditors as faultfinders and their task as policing rather than auditing.

Above all, vague reporting relation-ship brings:

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

1.3 REASEARCH QUESTIONS

- Rate the internal auditors' activities independent from other operational activities of the organizational?
- To what extent the internal auditors are skilled in dealing with people communicating information effectively?
- Does the organization manager give appropriate response for internal auditor's reports and recommendation?
- The internal auditors planning, examining and evaluating audit information, communicating results and following up on timely basis?
- To what extent internal auditors are independent from top management influence?

1.4 OBJECTIVE OF THE STUDY

1.4.1 General Objectives

The study tries to analyze the reporting line of internal auditing and investigate its relationship with internal audit scope, independence, good governance and audit committee, Furthermore conduct a case study on Commercial Bank of Ethiopia Finfine Branch

1.4.2 Specific Objectives of the Study Area

- To investigate the reporting line of internal audit unit in Commercial Bank of Ethiopia Finfine Branch and its actual or potential effect on internal auditor's independency.
- To assess the quality of internal audit unit of Commercial Bank of Ethiopia Finfine branch.
- To examine whether managers or employees of Commercial Bank of Ethiopia Finfine branch have proper understanding and knowledge of internal audit role in good governance.
- To assess the performance of internal auditors
- To conform that, internal auditors review the reliability of financial and operating information.
- To assess internal auditors, are they review the means of safe guarding assets and as appropriate, verifying existence of such asset?

1.5 SIGNIFICANCE OF THE STUDY

The researchers believe that the result of this research paper will have the following significances.

- ✓ This research paper will be used as an initiation for those who are interested to conduct a detailed and comprehensive study regarding the internal audit in Commercial Bank of Ethiopia Finfine Branch
- ✓ It will enable the governing body, specifically the managements, the higher responsible body, and audit committee of selected public enterprise, to be aware of the importance use of internal audit, and give insight how they use internal audit service most efficiency.
- ✓ Various problems that related to internal auditing will be investigated and presented to the organization for the purpose of solving it in the near future.
- ✓ It will suggest the possible solution of internal auditing related problems that leads proper internal auditing principle.
- ✓ It will help to improve internal control standard of the organization.
- ✓ It will also motivate the internal auditors to prepare strong internal auditing report.

1.6 SCOPE AND LIMITATION OF THE STUDY

The scope of this paper covers internal auditing practice of Commercial Bank of Ethiopia Finefine branch. It deals with the quality and application of internal auditing and the division of the internal audit department.

The researchers believe that the findings of this study would have been more productive if it would be conducted an all government non-government organizations in Ethiopia.

1.7 METHODOLOGY OF THE RESEARCH

1.7.1 Research Method

Descriptive method is used in the study. According to Creswell (1994) it can help in order to show the different facts that are connected with the nature of the status of the current problem or condition as it happens at the time of the study. This is the reason why, it is considered as one of the most applied methodology in most studies. Furthermore, it will also be helpful in order to offer logical use in the studies which focus on dissemination of information, at the same time, it can help in order to investigate based on normative standards. It will be helpful in order to focus on the practices which exist, beliefs and processes that are currently going on and the effects that are being felt and experienced, together with the trends that are currently developing (Best, 1907).

1.7.2 Population & Sampling Technique

Department	Total No _o f employees In the Department	Number ofemployees Selected from the department
Manager	1	1
CRO(Customer Relation Officers)	6	2
Accountant	1	1
Maker/Tellers	40	3
Checkers	4	1
Marketing officers	2	1
Auditors/Branch controls	6	6
Total	62	15

The target population for the research is employee of commercial bank of Ethiopia finfine branch.

The total population size of clerical employees are 62.it is not appropriate and cost

Efficient to take all of the employees in conducting this research, and thus a sample of 15 employees were selected from the total population that comprises as follows;

In selecting the sample for this research, the total population was grouped in to 7 departmental strata and the sample will be selected through simple random sampling technique from each strata.

1.7.3 Types of Data to be Collected and Used

In organizing the paper and arriving at the specified objectives both primary and secondary sources of data were used.

This research is made based on primary and secondary data as an input:

Primary data

The sources of these data are employees of Commercial Bank Of Ethiopia Finfine Branch. But due to time and financial constraint,

Secondary data

The main source of secondary data that is serve as an input for the research is information from books, bank internal auditing policy and procedure manual, internet and related literature to internal auditing practices.

1.7.4 Methods of Data Collection

Questionnaire is used in order to gather primary data from the respondents. Where in the respondents is asked to rate the level of their agreements towards the statements given. This is also be advantageous because it is make filling up questionnaire a lot easier and faster and also assure the quality of data.

1.7.5 Data analysis Method

The data that is collected from the questionnaires with the appropriate response, appropriate data analysis techniques is used in order to bring the best result. These data analysis techniques are tabulation and more over qualitative data analysis techniques.

1.8 Operational Definitions

Auditing: Auditing is rather a generic term meaning examination which involves report of attestation attending is an objective examination performed by a professionally qualified person

Internal Auditing: internal auditing is a management control activity performed within an organization as a service to management by an employee of the organization. It involves a review of operations through the measurement and evaluation of other control mechanisms, and assessment of the extent of their compliance. In order to maintain independence they present their reports directly to the board of directors or the top management.

External Auditors(Independent Auditors): external auditors are independent staff assigned by an auditing firm to asses and evaluate financial statement of their clients or to perform agreed up on evaluations and is engaged as an independent contractor external to the organization to render an independent opinion.

Audit Committee: audit committee is another mechanism designed to monitor and improve effectiveness of organization's function.

Compliance Audit: compliance audit is carried out to determine if entities are complying with applicable laws, regulation, policies and procedures.

Finance Audit: financial audits review accounting and financial transactions to determine if commitments, authorizations, receipts and disbursements are properly and accurately recorded and reported.

Operational Audit: operational audit examines the use of resources with a view to determine whether resources are being used in the most effective and efficient manner.

CHAPTER-TWO

LITERATURE REVIEW

2.1 INTERNAL AUDIT HISTORICAL BACKGROUNDS

2.1.1 Evolution of auditing

The history of auditing started as man's awareness of the need to safeguard state and personal property that has been inferred from the records of Mesopotamian civilization going back as early as 3500 BC. These records, involving financial transactions displayed various markings, which may be construed as a system of verification, internal controls and separation of duties, (Cecilia Nordin Van Gansberghe, 2003). Ancient Rome employed the "hearing of accounts", where one official would compare his records with those of another, entails an application of both separation of duties and verification practice, hearing of accounts, which gave rise to the term "audit", from the Latin "Audire", to listen.

An auditor's an evaluation should relate to the existing system of internal control, not to controls no longer applied or those contemplated for the future. Occasionally, employees may by pass controls they believe are time-consuming or unnecessary.

In addition, some control may have been redesigned, but not yet implemented, an auditor must be of control by pass and redesigned control in order to assure studying and evaluating control which actually exist.

In the medieval period, industrial Revolution in Europe changed the role of auditing that went beyond hearing of accounts to include verification of accounting records and associated supporting documentation. An independent appraisal function established within an organization. Internal auditing is control function that exists by examining and evaluating the adequacy and effectiveness of other control. The institution of internal auditor (IIA) defines the internal auditing as an independent appraisal activity established within an organization to examine and evaluate its activities as service to the organization. This definition explains that internal auditors (profession of internal auditing) has being done the extent and nature of assignment performed and the action taken by the managements as result internal audit report. This is the activities

Within the organization and internal auditors must have in departmental in mental attitude to world the appraisal of internal auditor.

Since Second World War internal audit, has evolved rapidly from the primary function, which is concerned with financial and accounting, matters to the one that addresses the entire range of operation activities. Internal audit profession has advanced primarily as a consequence, of the increase in size and decentralization of organization, the greater complexity of their operations, and the resulting need for means of monitoring their numerous activities, various government organizations are expected to have an internal auditing function and an audit committee composed of non management directors, (Irvin Gliem, 2000).

2.1.2 The Development of internal audit in Ethiopia

An internal auditing function has existed for quite a long time in Ethiopia; however, it got legal recognition in late 1980s. The internal auditing function started in the budgetary public sector as part of internal control. However the later part of the 1940s witnessed the establishment of internal Audit function in the Ministry of nation defense, Ministry of education, and Ministry of finance. It was also at this time that the internal auditing units began to sprout in non – budgetary Public sector (public enterprise) like Ethiopian Airlines, Ethiopian Telecommunication and financial sector that formed the modern layer of the national Economy (Lema argaw, Dec2000).

Internal auditing in Ethiopia obtained legal recognition for the first time in 1987 through proclamation No. 13/1987. This proclamation empowered Office of Auditor General (O.A.G) to direct the internal auditors of Government office and public enterprise in three aspects that are whether accounting records are properly maintained and reliable, whether the assets of the ministries and enterprises are adequately safeguarded and properly maintained; and whether policies and procedures laid down by top officials/management are complied with that implies less attention was given to operational audit as a service to management. (Lemma Argaw, Dec 2000).

In 1994 the civil service reform program organized a task team that was formed by prime minister to assess and review the performance of civil service and come with the following findings; absence of internal Audit function in some the ministries and public enterprises, internal auditors devoted most of their times and efforts on pre-audit, internal auditors neither have the skills needed now working manuals.

On July 1,1997 the financial administration regulations no. 17/1997 was issued in which the responsibility of internal audit function was transferred from the office of the auditor general to the

ministry of regulation set out the responsibilities of the minister of finance to develop and maintain appropriate standards of work and conduct for application throughout all the public bodies internal audit function and after this financial regulations almost all public bodies established internal audit services, almost all public bodies discontinued pre-audit or pre-checking. (wolderuphael W.Giorgis)

In 1998 the ministry of finance issued an operational audit manual to strength the audit function in the public bodies. According to this manual internal audit services are made to report to the top persons of the organizations.

In may 2007 policy directive was issued to further strengthen the internal audit service function in the public bodies, however, the legal basis laid down by both in the regulations of council of ministers and the ministry of finance directive is applicable only to internal auditing under the auspices of public bodies and does not apply to public enterprises and the private sector, but recently public enterprises supervising authority has issued policy directive for establishment of Audit committees in all public enterprise and an audit manual to maintain uniformity of audit work in all public enterprise.

Generally, the history of internal auditing in Ethiopia dated back to the 1940s just about the time the profession was also evolving in Europe and in the United States. Although, the prologue of internal auditing in our country counts half a century and all the above endeavors has made to the development of internal audit in Ethiopia there are challenges that hinders or slows the speedy growth of internal audit. (Lemma Argaw, Dec 2000).

In this chapter we try to analysis the reporting structure of internal audit, looking in to the relationship between reporting relationship and internal audit scope explain how independency could be impeded by reporting relationship, elucidate the relationship between corporate governance and reporting relationship, and finally discuss internal audit relationship with audit committee.

2.2 REPORTING RELATIONSHIP AND INTERNAL AUDIT SCOPE

Reporting relationships of internal auditing has changed and developed together with the progress of internal audit discipline. At the beginning (when internal auditors mostly were dealing with accounting and financial issues) reporting lines of internal auditors went to the accounting level and external auditors, who saw internal auditors mainly as assistant in financial audits. Accordingly as functions and roes of internal auditing expanded, changed and shifted more to management oriented matters that accounting matters, reporting lines have also been transformed. Moreover, if at the

beginning reporting lines of internal auditing were generally simple and straightforward; together with changed functions of internal audit they have made a shift to more complex and difficult relationships. (Rolands Rupsys, 2005).

The change in internal auditing scope is best seen in the definition of internal auditing adopted by the institute of internal auditors.

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. (Irvin Gliem, 2000)

This definition recognizes two major pillars of internal audit that are the scope of internal auditors and constituencies or customers of internal auditors. The scope of internal auditors is to provide independent, objective assurance and consulting activity, so that to add value to the organizations in the course of evaluate and improve the effectiveness of risk management, control, and governance processes. At the same time, it recognizes that there are many different constituencies for internal audit services that are; senior management, who are interested on the accomplishment of the objective of the organizations, operational management they focuses on the value added services of internal auditors for the improvement of organization's operations, and audit committees and the board of directors their center of attention are the effectiveness of risk management, control, and governance processes.(IIA Research Department, 2003).

The question that should be raised at this juncture is how internal audit serve these different constituents? And how should be the reporting relationship with those constituents? Because there will be potential conflicts and demands from the various customers, for instance audit committees are primarily interested in assurance series regarding ask and control, operational management is primarily concerned with consultative help regarding the efficiency of operations and adequacy of control mechanisms, senior management is concerned with both consultative advice and assurances regarding risk and control. However, there may be overlap (i.e operational management may desire assurance about the effectiveness of control that has implemented to control the operations for which it is responsible. Audit committees may want consultation regarding risk assessment and control processes.), According to A.A.A (American Accounting Association) analyses on independency and objectivity framework for internal auditors, the above mentioned expansion of internal audit scope and constituents is correlated with the organizational status of the internal audit unit. When there is

high level reporting, the scope of potential engagements is less limiting; when there is lower level reporting, the reporting universe (i.e the population of users who could benefit from the audit/reports) becomes more limited. Ten years ago, internal audit might have been seen as an adjunct of external audit, or as a box ticking, fault-finding function that provided nothing much in the way of constructive value. But attitudes have changed, people have changed their minds about what internal audit can deliver and a lot of internal audit's customers are educated about internal audit profession role and scope (Richmond, Dec 2006)

Many articles have been written about the change in internal audit scope; the article by Prof. Yohannes Kinfu on the title "The Upstream and downstream of internal Audit" explains internal audit has been evolving from downstream of internal audit that focuses on the origins of transaction recording and balancing into the upper management task and becoming tool of management for planning, organizing and control (upward stream of internal audit.) and this evolution demands the interlocking capacities in order to effectively perform its role, which are: advisory capacity, implemented capacity, Reporting capacity, and routine testing responsibility and the article concludes that these capacities and responsibilities definitely enlarge the internal audit role and functions ever wider, demanding more extensive knowledge and not specialization in traditional fields. (Prof. Johannes Kinfu, 2000).

Rolandas Rupsys put in plain words about internal audit activity in the organization and broad range of internal audit functions, which are assessment of internal controls, operational audits, compliance audits, fraud investigations, partial or full participation in financial audits, providing an independent assessment on risk management, control, and governance processes of the organization. (Rolandas Rupsys, 2005).

Moreover, new companies place greater emphasis on non-financial reporting, and internal auditors should be well placed in the organization to make sure the businesses get the most from this change of emphasis positioned to help businesses manage the risks and take advantage of business opportunities. Internal audit, with its traditional focus on financial data and reporting systems, may be wary of addressing this new area, so the internal auditors should step out of their comfort zone to satisfy this demand of the organization. (Richard Porter and Jon Hauck, March 2007), so the scope of internal audit is not only narrow – focusing on financial compliance and internal.

Generally, in the past, internal auditors were taken as fault finders and intruders and their contributions were measured the number of frauds they detect in the course of their audits. They were

also seen as specialists in negative reporting, forecasting on what is wrong within an organization and discovering other's mistakes. The passage of time has shown some dramatic changes on the image of internal auditing. Gradually internal auditing has changed from a "watch dog" to a "help dog". In other words, the image of internal auditors has changed from feared policeman more and more as internal consultants and as valued employees who understand the problems of management and are capable of providing the needed controls and problem solving skills (Wolderuphael W. Giorgis 2000).

However, the question from our country prospective is that, is the scope of internal auditor changed from the protective function, such as audit balance sheet accounts, the routine verification of the financial transactions, accuracy of calculations, and adequacy of physical custody into evaluating and improving the effectiveness of the risk management processes and governance processes?

Above all, the competency of auditor determines the scope and the quality of audit work performed in the organization. Competency is measured in terms of academic level, experience, skill and the effort of staff to continue professional development. Competency determines the efficiency of the auditor setting a systematic and disciplinary approach to evaluate and improve the effectiveness of the risk management, control and governance process and add value to the organization. In addition the audit activity must have sufficient funding relative to the size of its audit scope because budget impacts the audit activities' to carry out its duties (Zelege Belay, 2005).

In conclusion, the reporting relationship, audit scope, competency of the internal auditor, and sufficient budget for internal audit are interrelated factors that positively or negatively affect the efficiency and effectiveness of internal audit function.

2.3 REPORTING RELATIONSHIP AND INDEPENDENCY

Independence and objectivity are often treated synonymously; however, according to Webster's dictionary defines independence as the quality or state of being independent. Independent in turn is defined as being not dependent, not subject to the control of others, not subordinate, and not requiring or relying on something or someone else also, to be independent is defined as not looking to others for one's opinions or for the guidance of conduct and not being biased by others. Objectivity, on the other hand, is defined as an existing independence of mind, relating an object, as it is itself, and also as expressing or involving the use of facts without distortions by personal feeling or prejudice. In comparing the two concepts, it becomes clear that even if one is lacking independence. (I.e dependent subject to the control of others, subordinate, and requiring or relying on someone else), it is still

possible for one to be objective in the sense of relating to An object as it is itself or expressing or involving the use of facts without distortion by personal feeling or prejudices. (IIARF, 2001).

The organizational structure of the internal audit unit poses a practical constraint or a limit on the independency and/ or objectivity of internal auditor. For example, if the internal audit unit is situated in the finance's department with the director of internal auditing reporting directly to the CFO, it is difficult, if not impossible, for internal auditor to objectively evaluate the performance of peer offices under the controller, in general the higher the reporting level, greeter the independency and or objectivity of internal auditors, (IIARF, 2001).

Obviously, in today's modernized system of audit and control the auditor frequently plays an important advisory role which may jeopardize his or her independence, auditors may fine themselves too involved in consultancy. For example in the united Kingdome internal audit units play an important role in supporting the accounting officer, however, if the internal auditors are too involved in developing the internal control system it may become more difficult to maintain independence when auditing these systems. Additionally, some internal audit units do not have a direct reporting line to the head of the department or agency which may compromise their independence. (Miekatrien Streck and Greert Bouckaert, 2006).

So far we can see that reporting relationship is one of the factors, which affect the independence of internal audit, however, what are the key measures that will ensure that the reporting lines support and enable the effectiveness and independence of internal audit function. Institute of internal auditors suggests the following main measures regardless of the reporting relationship the organization choose (IIA, practical advisory, 2002).

The measures are summarized of as follows:-

- The head of internal audit should meet privately with the board /audit committee without the presences of management. This will reinforce the independence and direct nature of the reporting relationship.
- The board/ audit committee should have the final authority to review and approval the annual audit plan and all major change to the plan.
- The board / audit committee should review the performance of the head of internal audit and the overall internal audit function at least once a year, as well as approved the compensation level for the head of internal audit.

- The charter for the internal audit function should clearly articulate both the functional and administrative reporting lines for the function as well as its principal activities.
- The reporting line should be to someone with sufficient authority to provide internal audit with sufficient support to accomplish its day – to day activities.
- The reporting line should facilitate open and direct communication with the CEO, the senior executive group and line management.
- The reporting line should enable adequate and timely information flow, so that internal audit receives adequate communication and information concerning the activities, plans and business initiatives of the organization.
- Budgetary control and consideration imposed by the administrative reporting line should not impede internal audit in the process of auditing.

2.4 REPORTING RELATIONSHIP WITH AUDIT COMMITTEE

In relation to the emergence of the concept corporate governance a marked increase in audit committee activity is occurring around the world, primarily driven by rules and recommendations issued in response to local corporate crises. Audit committees' involvement in overseeing internal auditing, risk management activities and effectiveness of internal control is clearly expected and explicitly stated in many countries rules. We are going to review the experience of twelve countries that are:- Australia, Canada, China, Germany, Hong Kong, Mexico, Netherlands, Russia, United Kingdom, South Africa, and Ethiopia respectively (Curtis C. Verschoor, 2001).

In Australia Corporate Governance Council of the Australian Stock Exchange (ASX) issued ("Principles of Good Corporate Governance and Best Practice Recommendation") in 2003. This document recommends that audit committees be composed of non executive directors accountable to the board, a majority of whom are independent, and that the audit committee's role include, among other things, assessing the performance and objectivity of the internal audit function; reviewing results of risk management and internal compliance and control systems; and assessing whether external reporting is consistent with audit committee members' information and knowledge and adequate for shareholder needs.

Canadian Securities Administrators issued rules to improve investor confidence in early 2004. The rules mandate independent to communicate directly with internal auditing and accountable to the board.

The China securities regulatory commission requires at least one third of board members to be independent directors, and its rules provide for the optional appointment of an audit committee. If an audit committee is established, a majority of its members must be independent and at least one independent director must be an accounting expert. The committee's principal responsibilities should include supervision of the internal audit function.

In Germany the Transparency and Disclosure Act was passed in July 2002 requiring companies by law to publish an annual statement of compliance of compliance or non compliance with the code's recommendation. The code recommends the establishment of audit committees that would be accountable to the board to deal with issues of accounting, auditing, and risk management.

The rules governing the listing of securities on the stock exchange of Hong Kong limited and the rules governing the listing of securities on the growth enterprise market of the stock exchange of Hong Kong limited require listed companies to establish an audit committee composed of non executive directors, a majority of whom are independent. The audit committee should have clear terms of reference, including oversight of the financial reporting system and internal control procedures.

The Mexican Securities and Banking commission recommend that all public companies adopt its code of best practices, which recommends the size, role and responsibilities of the audit committee. Among those responsibilities are assisting the board in reviewing financial information of external reporting and helping to oversee internal control systems and to evaluate their effectiveness.

In Netherlands the Dutch Corporate Governance Code, issued in 2003, recommends practices for the supervisory board and the audit committee. The supervisory board should supervise the operation of the internal risk management and control system. The corporate governance code recommends that audit committees be established and fulfill an oversight role with regard to the responsibilities and functioning of internal auditing and the organization's compliance with recommendations and observations.

In Russia corporate behavior code was developed in April 2002 recommended the establishment of an audit committee for purposes of implementing and monitoring controls over an organization's financial and business activities. The code also recommends that the audit committee consists solely of independent directors.

In United Kingdom combined code on corporate governance, issued in 2003 advise audit committees to monitor and review the effectiveness of the internal audit function including reviewing internal auditing remit, appointing or terminating the head of internal auditing, and meeting privately with the head of internal auditing at least annually.

In South Africa a report on Corporate Governance, issued in 2002, focuses on board and audit committee practices and the conduct to improve governance. The role function and reporting requirements of internal auditing are specifically covered. Audit committees are required to concur in the appointment and dismissal of the internal audit head and accountable to the board. And, the report recommends that internal audit plans be based on risk assessment as well as on issues highlighted by the audit committee and senior management.

In Ethiopia public enterprises supervising authority issued directive no 002/97 for the establishment audit committee that explains the accountability, responsibility and authority of audit committee, which are resolving conflicts between auditors (internal or external) with the management concerning that audit report; evaluate the objectivity and the independency of internal and/or auditors when they execute their duty; the audit committee is accountable to public enterprise supervisory authority. (E.P.E.S.A audit committee directive, 2003).

To summarize two main points are mentioned in all countries practice that are the composition of audit committee and the role of audit committee. First, almost all countries have the same approach that the audit committee should be non executive independent directors, and some deemed one of the independent directors must be an accounting expert. The roles of audit committee are assessing the performance and objectivity of the IAF, reviewing results of risk management and internal compliance and control systems, assessing whether external reporting is consistent with audit committee members' information and knowledge and is adequate for shareholders needs, oversight of the financial reporting system and internal control procedures, assisting the board in reviewing financial information for external reporting and helping to oversee internal control systems and to evaluate their effectiveness, oversight the organization's Compliance with recommendations and observation, monitor and review the effectiveness of the internal audit function including reviewing internal auditing remit, appointing or terminating the head of internal auditing, and meeting privately with the head of internal audit department, audit report, evaluate the objectivity and the independency of internal and/ or external auditors when they execute their duty.

Our main concern is that internal auditors are functionally report to audit committee, who has the above mentioned role, so how internal auditors should work with audit committee. A research conducted by Catherine L. Bromilows, Barbara L. Berlin, and Richard J. Anderson that included face to face interviews with more than 50 prominent audit committee chares, corporate governance though leaders, and C.A.E from around the world, as well as surveys of audit committee chairs and C.A.E in the United States. The final report identifies four key activities C.A.E. can undertake to strengthen internal audit and audit committee relationships.

First, pursue ongoing communication with the audit committee chair, 59% of the C.A.E responding to the survey indicates the communication and interaction with the audit committee increased significantly. Additionally, as indicated by audit committee chairs and C.A.E interviewed recognize that audit committees function best when they have open, candid and frequent communication with internal auditors.

Second, build audit committee awareness of risks and business issues, as revealed through interviews with audit committee chairs, risk awareness ensuring a thorough understanding of the complete set of key risks that the company faces is a growing priority of many committees.

Third, expand or formalize audit committee training according to many of the audit committee chair interviewed, they formalize training plans at the beginning of their annual planning cycle identifying the continuing education topics they wish to cover during they are and how they will obtain such knowledge. Audit committee's looks to formal conferences, in house board room education and allocating specific sessions at audit committee meetings to provide training needs.

Finally, facilitate greater interaction with the audit committee, interviews conducted with audit committee chairs indicate savvy chief audit executives are taking steps to provide audit committee member with broader exposure to internal audit manager and staff.

2.5 CORPORATE GOVERNANCE AND REPORTING RELATIONSHIP

Recent events have highlighted the critical role of board of directors in promoting good governance. In particular, boards are being charged with ultimate responsibility for the effectiveness of their organization's internal control systems, and internal audit function play a key role in assisting the board to discharge its governing responsibility. (KPMG, 2003).

The key role of internal audit is to assist the board and /or its audit committee in discharging their governance responsibility by delivering an objective evaluation of the existing risk and internal

control framework, systematic analysis of business process and associated controls, reviews of existence and value of assets, a source of information on major frauds and irregularities, ad hoc review of other areas of concern, including unacceptable levels of risk, review of the compliance framework and specific compliance issues, review of operational and financial performance, recommendations for more effective and efficient use of resource, assessment of the accomplishment of corporate goals and objectives, feedback on adherence to the organization's value and code of conduct code of ethics.

However, in attempting to adequately discharge their responsibilities, internal auditors often find themselves in an anomalous position. They report to senior management within the organization, yet are expected to objectively review management's conduct and effectiveness. The only satisfactory solution to this problem is for internal audit to report primarily and directly to the board and / or its audit committee rather than to senior management.

CHAPTER THREE

DATA ANALYSIS AND INTERPRETAION

3.1 OVERVIEW OF THE RESPONDENT PERSON

This chapter present the data collected through questioner.

During the data collection, the researchers focused on the internal audit practice of Commercial Bank of Ethiopia Finfine Branch. Since the Commercial Bank of Ethiopia, Finfine branch has only six internal auditors/controls the target group to collect the data is only fifteen peoples classified under their respective question so as to prepare it for further analysis and interpretation.

3.2 CHARACTERISTICS OF THE STUDY POPULATION

The questioners were dispatched to various departments such as Audit/Control department, Managers, Accountants and other operational departments

Table 1 characteristics of the study population

No	Description	Item	Figure	Percentage (%)
1	Age	<20	-	-
		21-35	11	74
		36-50	2	13
		>50	2	13
		Total	15	100
2	Sex	Male	10	67
		Female	5	33
		Total	15	100
3	Year of service	<3	6	40
		3 – 6	4	27
		>6	5	33
		Total	15	100
4	Educational Level	Diploma	3	20
		First Degree	10	67
		Masters	2	13
		Other	-	-
		Total	15	100

(Source: primary data)

Table 1 describes that firstly 74% of the respondents are between the age of 21-35 and 13% are between the age of 36-50 and above 50 respectively therefore more employee of commercial bank of

Ethiopia finfine branch are young, secondly 67% of the respondent are male and 33% female this implies that more of the respondent are male with that of female respondents but we cannot say the paper is gender biased because more of the employees to respond our questions in the given places are male, thirdly 40% of the respondents have 1-3 years of service, 27% are within 3-6 years and 33% fallen in more than 6 year of services, in connection of this more of our respondents are auditors/controls and they are between the range of 27% and 33% so they have sufficient working experience in the given place. Finally 20% of the respondents are diploma holder, 67% are degree holders and the remaining 13% have masters so this implies that more of the respondents are degree holders.

3.3 ANALYSIS OF THE FINDINGS OF STUDY

Table 2 Internal auditing function exists in the organization

Description	response	Respondent	
		No.	Percentage
Why the internal auditing function exists in your organization?	Add value of the organization	15	100
	Imposed by the government		
	Others		
	Total	15	100

(Source, Primary data)

Table 2 describe that 100% of response of the existence of auditing in the organization is to add value of the organization So, it indicates that the existence of auditing in commercial bank of Ethiopia finfine branch increase the value of the organization in various dimensions.

Table 3 Adequate planning and supervision in the organization

Description	response	Respondent	
		No.	Percentage (%)
Is there adequate planning and supervision of activities in the organization?	Yes	14	94
	No	1	6
	Total	15	100

(Source, Primary data)

The above table describes that 96% of the respondent agree that there is adequate planning and supervision on their organization. This implies that the organization had proper and strong planning and supervision but 6% of the respondents did not agree with this.

Table 4 Internal auditors' level of knowledge

Description	response	Respondent	
		No.	Percentage (%)
Do you believe that internal auditors/branch controls / of CBE has enough level of knowledge, skill and practical experiences?	Yes	9	60
	No	6	40
Total		15	100

(Source, Primary data)

The responses on table 4 are 60% of the respondents agree that auditors/branch controls/ of commercial bank of Ethiopia Finfine branch had enough level of knowledge, skill and practical experiences but 40% of the respondent do not agree with 60% of the respondents. What so ever, the positive answer lead the percentage there is equivalent negative responses regarding with this so, still there is a doubt on the level of knowledge of internal auditors/branch controls/ between staffs this is due to some of the staff in internal control have insufficient knowledge that might be less experience for the position or dissatisfaction on the job.

Table 5 Employees sufficient understanding of internal control structure of the organization

Description	response	Respondent	
		No.	Percentage (%)
Do employees have sufficient understanding of internal control structure of the organization?	Yes	8	53
	No	7	47
Total		15	100

(Source, Primary data)

Table 5 states that 53% of the respondents believe that employees have sufficient understanding of internal control structure of the organization beside this 47% of competitive respondents' replies that employees have no sufficient understanding of internal control structure of the organization this implies the employees are partially informed or partially aware about the company's internal control structure .

Table 6 Continuous training on internal auditing

Description	response	Respondent	
		No.	Percentage (%)
Do the internal auditors/branch controls/ get continuous training on internal auditing?	Yes	13	87
	No	2	13
Total		15	100

(Source, Primary data)

On table 6 most of the respondent i.e. 87% replies that auditors/branch controls/ get continuous training on internal auditing and 13% of respondent does not agree with this. Therefore almost more than half of the respondent agrees that there is strong and continuous training on internal auditing.

Moreover, most respondents which answer “yes” is put what kind of training is given by the bank which is Bank procedure and audit process and procedure.

3.3.1 Reporting relationship

Table 7 Reporting relationship

Description of the question	No. of respondent on each type of response					Total respondent
	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	
The current reporting line of internal audit functions in your organization promotes internal to discharge its role in good governance.	4	6	1	4		15
Did you agree that the current reporting relationship create conflict of interest with the management?	4	1	7	3		15
The internal audit staff checks the accuracy and completeness of reports submitted to NBE and other outside parties.	3	5	4	3		15
Total percentage	74%	79%	80%	67%	0%	

(Source, Primary data)

As per the table 7 presentation some percentage analysis needs to more clarification of the table

Therefore the respondent answers are 27% strongly agree, 40% agree, 6% neutral 27% disagree for the description 1 also 27% answers strongly agree, 6% agree, 47% neutral 20% disagree for description 2 and 20% respondents answer strongly agree, 33% agree, 27% be neutral, and 20% disagree of discription3 .

Moreover on the multi dimensional views the total respondents for all of the three descriptions are 74% strongly agree, 79% agree, 80% neutral, 67% disagree and no one of the respondent strongly disagree.

3.3.2 Scope

Table 8 Scope

Description of the question	No. of respondent on each type of response					Total respondent
	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	
Internal audit is playing sufficient enough to address the very purpose for which it is established	6	4	3	2		15
Increase or decrease in internal audit scope brings an increase or decrease in level of reporting status respectively.	4	6	2	3		15

(Source, Primary data)

The scope of the organization in terms of addressing its purpose for which it is established 40% of the respondent strongly agree, 27% agree, 20% are neutral and 13% disagree and also the respondent in terms of increasing or increasing in internal audit scope brings an increase or decrease in level of reporting status responded as 27% strongly agree, 40% agree, 13% neutral and 20% of the respondent is not agree but in both cases no one of the respondent is strongly disagree.

In our assumption it implies that internal audit playing sufficient enough to address for each it address and increase or decrease in level of reporting status is good and it is supported strongly agree and agree by the respondent widely

3.3.3 Independency

Table 9 independency

Description of the question	No. of respondent on each type of response					Total respondent
	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	
Do you agree that the environmental in which the internal audit operates in conducive to promote independence in your organization?	4	8	2	1		15
While the audit function performs its duty do you agree that it is free to any transaction or area of interest for audit?	3	9	1	1		15

(Source, Primary data)

Many authors mentions that independence means avoiding relationship that may impair the auditor's objectivities.

Beside this on table 9 the respondents make their own judgment regarding with "internal auditing operation promotes independence within the organization?" and "while audit function performs its duty did you agree it is free from any transaction or area of interest?" so, for the first quoted issue 27% respondents are strongly agree, 53% agree, 13% respondents are neutral and 7% disagree moreover for secondly quoted issue 20% strongly agree, 60% agree, 7% are choose to be neutral and 13% disagree beside this no one of the staff is strongly disagree so on both quoted question more respondents are agree there for it implies that internal audit promote independence and free from any area of transaction in commercial bank of Ethiopia finfine branch.

3.3.4 Effect of reporting

Table 10 Effect of reporting

Description of the question	No. of respondent on each type of response					Total respondent
	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	
The board members curious to strengthen and support the internal audit function.	6	5	2	2		15
The management and other organs of the system support understand and appreciate the role of internal audit function.	6	4	3	2		15

(Source, Primary data)

Report is the major channel of communication between the auditor and the user of financial statements in connection with the respondents make their judgments based on the presented questions which is about the board members in supporting the internal audit function so 40% of the respondent strongly agree, 34% agree, 13% responded as neutral and disagree respectively.

Also for the question of does the management and other organs support, understand and appreciate the role of internal auditors based on this some percentage justification made that is 40% strongly agree, 27% agree, 20% neutral and 13% of the respondent disagree.

3.3.5 Accuracy of records and completeness of records, prevention, detection and correction of fraud and errors

Table 11 Accuracy, completeness and fraud detection

Description of the question	No. of respondent on each type of response					Total respondent
	Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	
The internal audit staffs verify the mathematical accuracy of the general ledger position.	8	5	-	2		15
The internal audit staff examine the proper maintenance of records on all financial transaction	7	5	2	1		15
The internal audit staff audit the accuracy of calculations on all incomes of both domestic and foreign banking transaction	6	4	3	2		15
The internal audit staff examine, verify accuracy of transaction	7	5	1	2		15
The internal audit staff test that all transaction are authorized.	9	4	-	2		15

(Source, Primary data)

As per the table 11 presentation some percentage analysis needs to more clarification of the table

Therefore the respondent answers are 53% strongly agree, 33% agree, 13% disagree for the description 1 also 47% answers strongly agree, 33% agree 13% neutral 7% disagree for description 2

additionally 40% respondents answer strongly agree, 27% agree, 20% be neutral, and 13% disagree of discription3 and 47% answers strongly agree, 33% agree 7% neutral 13% disagree on description 4 finally 60% answers strongly agree, 27% agree, 13%disagree.

This table as per percentage presentation implies that more of the respondents strongly agree on more operational questions so commercial bank of Ethiopian finfine branch had proper maintenance of records, accuracy of calculation, accuracy of transaction and authorization of transaction.

CHAPTER FOUR

SUMMARY, CONCLUSION AND RECOMMENDATIONS

4.1 Summary of findings

The be the most effective, preferable and profitable in a banking there must be effective internal auditing system, updated technology, and so many thing that might help the bank but all those mentioned thing without proper follow up and supervision is nothing they are like seeding wheat's in sand so there should be strong and competitive internal auditing practice.

The following findings are stated under the summary

- ✓ Adequate planning and supervision had been observed in commercial bank of Ethiopia finfine branch
- ✓ Commercial bank of Ethiopia finfine branch internal controls had get continuous training
- ✓ Internal auditors/controls are very alert in fault findings which occurred in mathematical accuracy and general ledger position
- ✓ The staff of commercial bank of Ethiopia finfine branch believed that the existence of internal auditing add value for the organization.
- ✓ Some of the internal audit staff have less adequate knowledge
- ✓ The board management and other top managements support the internal audit section function.
- ✓ Employees have sufficient understanding of internal control structure of the organization.

4.2. Conclusion

The researchers after making of deep analysis and findings we made a conclusion on the following.

1. Commercial bank of Ethiopian finfine branch has adequate planning and supervision of activities.
2. Internal auditors/controls have independency on their operations.
3. The board members and other top management staffs support the internal audit functions and it is model for other banking firm managements.
4. Commercial bank of Ethiopia has positive trend in connection with conducting various training in various categories in definite period of time.
5. On overall the researched organization have good modern technology acceptance.
6. Some staffs especially internal auditors who have less knowledge should be helped by the seniors.

5.3. Recommendations

The researchers after making of deep analysis and findings we made a recommendation on the following.

1. Internal auditors/controls of commercial bank of Ethiopia finfine branch have not sufficient understanding of internal control structure of the organization. So we recommend that the internal auditors of Commercial Bank of Ethiopia Finfine branch would try to have sufficient knowledge by reading some relevant procedures and manuals of the organizations even the management conduct a training based on internal control structure.
2. Some internal auditors/branch control/ of commercial bank of Ethiopia finfine branch has no enough level of knowledge, skill and practical experience only they are guided by the computer.

There would be strict guideline during an internal/external vacancy announcement and also some times the departments made experience sharing training occasionally and also senior staffs must share their trends for those who have not sufficient knowledge.

3. Lastly Policy, procedures and internal memos are not properly implemented by the employees of the commercial bank of Ethiopia Finfine branch.

To minimize these default internal auditors/controls operational auditor would like to be very sensitive to ensure that all policies and procedures are respected and implemented by employees.

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APPENDIX

St.Mary's University
Faculty of business
Department of Accounting

**Questionnaires to be filled by the employees of Commercial Bank
Of Ethiopia (CBE) Finfine Branch**

Objective: The purpose of this questionnaire is used to support a research paper on the topic of **“Internal Auditing Practice: The case of Commercial Bank Of Ethiopia Finfine Branch”** to serve as a partial fulfillment of the Bachelor of Arts Degree in Accounting.

The answer given by a respondent and the identification of the respondent will not be disclosed to any party shall be used solely for an academic purpose.

Note:

- You are not supposed to write your name.
- Put an “X” mark in the box of your choice.

PART I: Background information

1 Age <20 21-35 36-50 >50

2 Gender: Male Female

3 work experience-----

4 Educational levels: Diploma First Degree
Masters Other-----

5 Years of Services: 1-3 yrs 3-6yrs >6yrs

6 Your position in the organization-----

PART II: Introduction

7 why the internal auditing function exists in your organization?

Add value to the organization

Imposed by the government

Other, please specify-----

DECLARATION

We the undersigned declare that this senior essay paper is our original work, prepared under the guidance our advisor Ato Fitsum Habte. All sources of materials used for the manuscript have been duly acknowledged

Name: Netsanet Wondossen

Name :Tesfahunegn Wogi

Signature_____

Signature_____

Date_____

Date_____

Name:Tewahdo Henok

Signature_____

Date_____

ADVISOR APPROVAL

This paper has been submitted for examiner with my approval as the university advisor

Name_____

Signature_____

Date of submission_____

