



**ST. MARY'S UNIVERSITY
SCHOOL OF GRADUATE STUDIES**

**THE EFFECT OF INTERNAL AUDIT ON FIRM PERFORMANCE; IN
THE CASE OF PHARMACEUTICALS FUND AND SUPPLY AGENCY**

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**A THESIS SUBMITTED TO ST. MARY'S UNIVERSITY SCHOLL OF
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DECLARATION

I, the undersigned, declare that this thesis is my original work, prepared under the guidance of **Dr. Arega Seyoum**. All sources of materials used for the thesis have been duly acknowledged. I further confirm that the thesis has not been submitted in part or in full to any other higher learning institution for the purpose of earning any degree.

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June, 2016

ENDORSEMENT LETTER

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

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ABSTRACT

This study a descriptive type which attempts to investigate the effect the internal audit on firm performance. The study was carried out in Federal Democratic Republic of Ethiopia pharmaceuticals fund and supply agency and its 14 selected branches. 40 internal auditors were used as data source which were selected using the stratified sampling techniques. To obtain the required information close-ended questionnaires were used as data gathering tools. Qualitative and quantitative (Mixed) approaches were employed to analyze and interpret the filled in data.

The findings of the study showed that inefficient internal control, inefficient internal audit, lack of internal audit independence and lack of developmental programs for internal auditors and other organizational factors were critical factors influencing the effect of internal audit on the firm performance.

To alleviate those problems, it is recommended that the management and the audit department of the organization at head office and branches has to work jointly to improve the performance of the internal audit department and helps the organization to achieve its goals and objectives.

Key Words: *Firm performance; internal audit; internal audit effect; PFSA;*

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Daniel Girmay

June, 2016

Addis Ababa, Ethiopia

Contents

CHAPTER ONE.....	13
1 INTRODUCTION.....	13
1.1 Background of the Study.....	13
1.2 Background of the Organization	15
1.3 Statement of the Problem	16
1.4 Research Question.....	18
1.5 Objectives of the Study	18
1.5.1 General Objective.....	18
1.5.2 Specific Objectives.....	18
1.6 Significance of the Study	19
1.7 Scope of the Study.....	19
1.8 Organization of the Study	19
CHAPTER TWO.....	21
2 REVIEW OF RELATED LITERATURE	21
2.1 Introduction.....	21
2.2 THEORETICAL REVIEW.....	21

2.2.1	Definition of Internal Audit.....	21
2.2.2	Auditing Through World History	23
2.2.3	Internal Auditing in Ethiopia.....	24
2.2.4	Role and Mandate of Internal Audit	25
2.2.5	Scope and Priorities of Internal Audit	26
2.2.6	The Importance of Auditing	29
2.2.7	Characteristics of Internal Auditing	30
2.2.8	Audit and Internal Control in the Organization.....	32
2.2.9	Link, between Organization’s Goals and Internal Audit	33
2.2.10	Charter of Internal Audit	33
2.2.11	Internal auditing and Firm performance.....	33
2.2.12	The effect of internal audit	34
CHAPTER THREE.....		35
3 RESEARCH DESIGN AND METHODOLOGY.....		35
3.1	Introduction	35
3.2	Study Area.....	35
3.3	Research Design.....	35

3.4	Study population and Sampling	36
3.5	Data Collection Instruments.....	36
3.6	Reliability of Test.....	39
3.7	Validity of Test.....	39
3.8	Statistical Treatment of the Data and Analysis Technique	39
3.9	Limitations of the Study	40
CHAPTER FOUR		41
4 RESEARCH FINDINGS: ANALYSIS AND DISCUSSION		41
4.1	INTRODUCTION.....	41
4.2	Discussion	41
5 SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION.....		49
5.1	INTRODUCTION.....	49
5.2	SUMMARY OF FINDINGS	49
5.3	Conclusions	53
5.4	Recommendations	55
Bibliography.....		58
Appendix A: Questionnaires		62

LIST OF TABLES

<u>Tables</u>	<u>Page</u>
Table 4.1. Questionnaire distribution and response	41
Table 4.2. Respondents field of study.....	42
Table 4.3. Respondents level of study.....	43
Table 4.4. Internal audit impact on the organization	44
Table 4.5. Relationship between achieving goals & IA in the organization.....	44
Table 4.6. Factors militated against audit report.....	45
Table 4.7. Factors affect internal audit reports in the organization.....	46
Table 4.8 Independence of auditors in their work.....	47
Table 4.9. Present valuation of internal audit.....	48

ACRONYMS

IA – internal auditing

IIA – Institute of Internal Auditors

CG – Corporate governance

CIA – Certified Internal Auditor

CIIA – Chartered Institute of Internal Auditors

MoFED – Ministry of Finance and Economic Development

WLA – World Lottery Association

FP – Firm Performance

PFSA – Pharmaceuticals Fund and Supply Agency

CHAPTER ONE

1 INTRODUCTION

This chapter introduces the research agenda of this study. This chapter outlines the background of the study and the organization, statement of the problem, research objectives (purpose), research questions, research significance, methodology, scope and organization of the remaining chapters.

1.1 Background of the Study

Today, several forces have led to a quiet revolution in internal audit. Democracy requires government to be accountable in its use of public money and in providing effective, efficient and economical service delivery. Ever larger and more complex systems require greater competencies, thus internal audit has had to become ever more professional (Van Gansberghe, 2003).

Internal audit can play an important assurance role in an organization's governance processes, particularly in the area of risk management and control. In many organizations, the expectations placed upon internal audit have increased and the function is being relied on to make a significant contribution (The Institute of Chartered Accountants in England and Wales, March 2004; The Internal Audit function).

Organization performance can also be "the ability of an organization to identify and implement appropriate strategies within the framework of the aims it pursues" (Bouquin, 1997). The objectives of the organizations may vary, but once the organization's purpose has been defined, then, success depends on the ability to

define appropriate strategies and to implement them. Organizational arrangements must ensure the level of effectiveness in both economically and strategically and the combination of these two, we call it internal control. It is also necessary to test the effectiveness and suitability of a particular aspect of internal control. As Internal audit has becoming an important and integral function of organizations in achieving their objectives and protecting their assets.

The IA department is very important inside a firm that the IA regarded as the key element in the application of accounting systems which in turn, helps in evaluating the work of the department. The efficiency of IA helps develop the work of the company because the financial reports reflect the IA department's quality. Moreover, an internal audit is a significant part of the CG structure in an organization and CG encompasses oversight activities taken by the board of directors and audit committees to make sure that the financial reporting process is credible (Public Oversight Board, 1994).

The IA department provides a reliable, objective, and neutral service to the management, board of directors, and audit committee; while stakeholders are interested in return on investments, sustainable growth, strong leadership, and reliable reporting on the financial performance and business practices of a company (Ljubisavljevic & Jovanovi, 2011).

Internal auditing is performed by professionals with an in-depth understanding of the business culture, systems, and processes, the internal audit activity provides assurance that internal control in place are adequate to mitigate the risks, governances processes are effective and efficient, and organizational goals and objectives are met.

The paper seeks to empirically and statistically ascertain the impact of the internal audit in the organization's success in the federal democratic republic of Ethiopia PFSA.

1.2 Background of the Organization

The Pharmaceuticals Fund and Supply Agency or the then Pharmaceuticals and Medical Supplies Corporation (PHARMECOR) were first established in 1970 E.C.

And, the internal audit service was first established as of Megabit 1, 1971 E.C. to help the organization achieve its goals in an economic and efficient manner by assessing the risk areas in the organization and giving advice to the management having three auditors and the department head. Because, the expectations of the management placed upon internal audit have increased and the function is being relied on to make a significant contribution.

According to Proclamation number 553/1999, the Federal Democratic Republic of Ethiopia Pharmaceuticals Fund and Supply Agency was reestablished having the following objectives to;

- ❖ Secure proper life and productivity of the people and pharmaceuticals share a vital role in the health service;
- ❖ To supply quality assured essential pharmaceuticals at affordable price in a sustainable manner to the public; by mobilizing funds from different sources to ensure uninterrupted and sustainable supply of pharmaceuticals to all public health facilities and thereby serve the public in an equitable manner.

While the agency stands to achieve these missions, it is believed that internal audit can play an important assurance role in an organization's governance processes, particularly in the area of risk management and control; and in general in its performance. The department is also very important inside a firm that the internal audit is regarded as the key element in the application of accounting systems which in turn, helps in evaluating the work of the department. The internal audit is considered as the backbone of the business accounting as it is the section that records all businesses related to the company. The efficiency of internal audit helps develop the work of the company because the financial reports of the organization reflect the internal audit department's quality.

Currently, the organization have 17 branches in all regions and administrative cities with the annual growing budget of around 13 Billion ETB and the internal audit service grows to a directorate level and has a total staff number of 12 auditors which among having the Directorate Director, two auditors are senior and coordinators, eight Senior auditors and Two Junior Auditors at the head office level and two Auditors (Senior and Junior Auditor) at each branch throughout the country.

1.3 Statement of the Problem

Internal audit is an evaluation function available to an organization to examine and appreciate the proper functioning, consistency and effectiveness of its internal control (IFACI, 1998). To this end, internal auditors should review the various activities of the organization, measure the risks and the arrangements put in place to control them, ensure performance in carrying out assigned responsibilities and make recommendations to improve its security and increase efficiency. It is one

of the essential mechanisms of the internal control system. No company can disregard it, even partially, without losing at the same time control of a key to its survival. A vital member of company management, the internal auditor is a party to an audit charter defining his/her independence. When the internal audit department does not meet the expectations of senior management, it should take adequate steps to upgrade it (IFACI, 1998) and play its role in helping the organization to achieve its objectives.

The internal audit in Ethiopia is facing problems that hinders it to help the organization in meeting its corporate goals such as, lack of mechanisms in place to follow up the implementation of internal audit recommendations; absence of strategic plan and consistent documentation styles for audit work, lack of resources, poor leadership for internal audit function (IAF), (Mihret and Yismaw, 2007), shortage of trained and skilled manpower, Lack of independence, negative management perception towards the internal audit functions, and inadequate organizational status.

Having these problems in mind, this motivates the researcher to study the effect of internal audit on firm performance of Pharmaceuticals Fund and Supply Agency (PFSA).

The researcher believes that, this little contribution would show whether the problems stated in previous studies are solved or still remain unchanged. It could also help specially the management of the agency at what position is its internal audit department regarding helping the agency to achieve its corporate goals in an effective and economical way, and knowing the status of the IA for the management of the organization helps to take corrective measures in strengthening the department.

1.4 Research Question

For the purpose dealing with the above problem, the study was focused to answer the following broad research question:

- ❖ How is the internal audit functions contribute to organizational performance?
- ❖ What is the relationship between the internal audit and organization performance?
- ❖ Is internal audit a mechanism to achieve organizational goals?

1.5 Objectives of the Study

1.5.1 General Objective

The general objective of the study is to examine the effect of internal audit function on organizational performance and come up with recommendations of feasible solutions for the problems identified.

1.5.2 Specific Objectives

Specifically, the study assumes the following objectives:

- To determine if internal audit ascertain the correctness of financial records.
- To find out if internal audit inspect and verifies organizational assets and auditing.
- To know the factors hammering pa ring audit procedures in the organization.

1.6 Significance of the Study

The study is expected to provide some conclusions and recommendations regarding the effect of internal audit on the firm's effectiveness and also it lays a ground for further studies on similar or related topics. In practice, it will also help workers in the internal audit department in the agency to focus on the features of quality of internal audit function.

Some of the contributions of this study are;

- ❖ It can help the management to show on how to use the internal audit department most effectively and efficiently.
- ❖ Helps to fill the gap of shortage of studies regarding the effect of internal audit on firm performance and provide a way for future in-depth research.
- ❖ This study can help the management to identify the problems with the internal audit based on the research findings and take corrective measures.

1.7 Scope of the Study

The study focused on the effect of the internal audit on the firm performance of the Pharmaceuticals fund and supply agency /PFSA/ at home office and the selected branches.

1.8 Organization of the Study

The research report has five Chapters. The first chapter deals with introduction, background of the study, statement of the problem, basic research question,

general and specific objectives of the study, significance of the study, and scope and limitation of the study as well.

The second chapter also deals with literature review which includes both theoretical and empirical evidences related to the research problem as well as previous related studies with the title the researcher work to assess.

The third chapter deals with methodology of the study. It details the research design, participants of the study, sources of data; data collection tools and the instruments employed, and also discuss the methods of data analysis used.

The fourth part deals with data presentations and analysis of research findings, and finally, the last but not least part, chapter five also give conclusions and recommendations were discussed followed by the references and appendixes.

CHAPTER TWO

2 REVIEW OF RELATED LITERATURE

2.1 Introduction

This chapter will provide the readers an imminent into prior studies that have been conducted on the internal audit contributions. It will provide the reader the important concepts related to the study and will also make the backbone for the research analysis. The aim behind this study is to increase the understandability of the basic concept related to the internal audit effect and other concepts.

2.2 THEORETICAL REVIEW

2.2.1 Definition of Internal Audit

The Institute of Internal Auditors (IIA, 2011) defines Internal Audit 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, control and governance processes. Its objective is to assist members of the organization in the effective discharge of their responsibilities. To this end, internal audit furnishes them with analysis, appraisals, recommendations, counsel and information concerning the activities reviewed. The audit objective includes promoting effective control at reasonable cost.”

The above definitions of internal audit call for internal audit, to be an independent function within an organization placing greater emphasis on its objectivity. Thus,

internal auditing primarily provides an independent objective opinion to the management of the organization.

The findings of an independent focused internal audit function also brings to the fore its findings and recommendations which act as a tool to officers in a organization to take suitable corrective action and help in plugging the loopholes which would otherwise go undetected for a considerable period of time.

The definitions stress on two aspects of internal audit assurance and consultancy. It is important that in fulfilling both these roles, internal audit remains independent of the project.

It is the management's responsibility primarily to manage the project and they should therefore make the decisions, but internal audit could act as a facilitator within this process.

The Ministry of Finance and Economic Development (MoFED) internal audit manual defines internal audit as “a systematic, independent appraisal of all operations including administrative activities for the purpose of advising on management practices and controls.” The responsibilities of internal auditors according to the manual are to:

- Conduct internal audits at specific time intervals to ascertain that public money and property are used for intended purposes;
- Develop audit programs and audit procedures which are specifically designed to meet the requirements of the public body;
- Develop a monitoring system which will at regular intervals test and report to management on the public body's compliance with applicable internal and external directives and procedures;

- Advise management at regular intervals on its internal practices and controls and on whether they are efficient, effective and economical;
- Submit audit reports to the head of the public body.

The internal audit entity shall be independent and the internal auditors should be unbiased in performing the internal audit. To ensure independence of internal audit the internal audit department shall be directly subordinated to the head of the organization. And the internal auditor should have possibility of open professional communication with the head of the organization and inspect where she/he regards that there is the risk of errors.

2.2.2 Auditing Through World History

Auditing predates the Christian era. Anthropologists have found records of auditing activity dating back to early Babylonian times (around 3000 BC). There was also auditing activity in ancient China, Greece and Rome. The Latin meaning of the word “auditor” was a “hearer or listener” because in Rome auditors heard taxpayers, such as farmers, give their public statements regarding the results of their business and the tax duty due (Principles of auditing; Rick Hayes, Roger Dassen, Arnold Schilder and Philip Wallage, 2005).

Auditors (Rick Hayes et al; 2005) existed in ancient China and Egypt. They were supervisors of the accounts of the Chinese Emperor and the Egyptian Pharaoh. The government accounting system of the Zhao dynasty in China included an elaborate budgetary process and audits of all government departments. From the dawn of the dynastic era in Egypt (3000 BC) the scribes (accountants) were among the most esteemed in society and the scribal occupation was one of the most prestigious occupations.

Egyptian Pharaohs were very severe with their auditors. Each royal storehouse used two auditors. One counted the goods when they came in the door and the second counted the goods after they were stored. The supervisor looked at both accounts. If there was a difference, the auditors were both killed.

Eze (2005) stated that the term audit was derived from the Latin verb “audire” which means “to hear”. Organizations need to have internal auditing as it helps them being a cornerstone of strong governance, internal auditing fill the gap between management and the board, assesses the ethical climate and the effectiveness and efficiency of operations, and serves as an organization’s safety for compliance with rules, regulations, and overall best business practices.

2.2.3 Internal Auditing in Ethiopia

According to the Internal audit manual of the then Ministry of Finance and Economic Development (MoFED), The history of the development of internal auditing in Ethiopia dates back to about the middle of the 1940s just about the time when internal audit was evolving as an organized profession in the United States. Internal audit in Ethiopia, had its early legislative root in the Constitution of 1923 which authorized the establishment of an “Audit Commission” (Article 34); and the Audit Commission itself was established much later by Proclamation 69/1944 to audit the accounts of the Ministry of Finance.

The same Proclamation mandated the then Ministry of Finance to audit other budgetary institutions as a measure of internal control over the financial operations of the budgetary institutions. It appears that this early practice of internal auditing as per Proclamation 69/1944 was, in fact, to be the root of what

the Inspection Department of the Ministry of Finance and Economic Development (MoFED) continued to perform to this day, until the recent reorganization.

The latter part of the 1940s witnessed the establishment of internal audit functions in key public sector institutions such as the national defense, education, road construction, and other non-budgetary public sectors, which included the Ethiopian Airlines, Telecommunication and the financial sector consisting of the modern layer of the Ethiopian economy. These institutions in one way or the other had external links or financing operations, which created awareness of the need for internal controls to sectarian appropriate financial management and to safeguard organizational assets.

The period of the early 1950s, marked the introduction of a budgetary system in government. The commencement of an annual public budget in 1955 for the first time in the history of the country ushered in a system of financial administration based on the annual budget with all its attendant requirements for strengthened internal control in the budgetary agencies. This entailed the formation of internal audit as an integral part of the budgetary internal control system.

2.2.4 Role and Mandate of Internal Audit

According to the Chartered Institute of Internal Auditors, the role of internal audit is described as follows;

1. The primary role of internal audit should be to help the board and executive management to protect the assets, reputation and sustainability of the organization.

It does this by assessing whether all significant risks are identified and appropriately reported by management and the risk function to the board

and executive management; assessing whether they are adequately controlled; and by challenging executive management to improve the effectiveness of governance, risk management and internal controls. The role of internal audit should be articulated in an internal audit charter, which should be publicly available.

2. The board, its committees and executive management should set the right “tone at the top” to ensure support for, and acceptance of, internal audit at all levels of the organization.

2.2.5 Scope and Priorities of Internal Audit

Internal audit’s scope should be unrestricted there should be no aspect of the organization which internal audit should be restricted from looking at as it delivers on its mandate. Whilst it is not the role of internal audit to second guess the decisions made by the board, its scope should include information presented to the board as discussed below.

- Internal audit should include within its scope the design and operating effectiveness of the internal governance structures and processes of the organization.
- The information presented to the board and executive management for strategic and operational decision making,
- Internal audit should include within its scope the processes and controls supporting strategic and operational decision making. It should assess whether the information presented to the board and executive management fairly represents the benefits, risks and assumptions associated with the strategy and corresponding business model.

- The setting of, and adherence to, risk appetite
 - Internal audit is not responsible for setting the risk appetite but should assess whether the risk appetite has been established and reviewed through the active involvement of the board and executive management. It should assess whether risk appetite is embedded within the activities, limits and reporting of the organization.
- The risk and control culture of the organization
 - Internal audit should include within its scope the risk and control culture of the organization. This should include assessing whether the processes (e.g. appraisal and remuneration), actions (e.g. decision making) and “tone at the top” are in line with the values, ethics, risk appetite and policies of the organization.
 - Internal audit should consider the attitude and assess the approach taken by all levels of management to risk management and internal control. This should include management’s actions in addressing known control deficiencies as well as management’s regular assessment of controls.
- Risks of poor customer treatment, giving rise to conduct or reputational risk
 - Internal audit should evaluate whether the organization is acting with integrity in its dealings with customers and in its interaction with relevant markets.
 - Internal audit should evaluate whether business and risk management are adequately designing and controlling products, services and supporting processes in line with customer interests and conduct regulation.

- Capital and liquidity risks
 - Internal audit should include within its scope the management of the organization's capital and liquidity risks.

- Key corporate events
 - Examples of key corporate events could include significant business process changes, introduction of new products and services, outsourcing decisions and acquisitions/divestments. Internal audit should decide if these events are sufficiently high risk to warrant involvement on a real time basis. In doing so, Internal audit will evaluate whether the key risks are being adequately addressed (including by other forms of assurance, e.g. third party due diligence) and reported. Internal audit should also assess whether the information being used in such key decision making is fair, balanced and reasonable, and whether the related procedures and controls have been followed.

- Outcomes of processes
 - Internal audit should evaluate the design and operating effectiveness of the organization's policies and processes.
 - As part of this evaluation, internal audit should consider whether the outcomes achieved by the implementation of these policies and processes are in line with the objectives, risk appetite and values of the organization.

2.2.6 The Importance of Auditing

Auditing involves investigating information prepared by someone else to decide whether the information is fairly stated. All people audit to some extent in their personal lives.

It can be said that the function of auditing is to lend credibility to the financial statements. The financial statements are the responsibility of management and the auditor's responsibility is to lend them credibility. By the audit process, the auditor enhances the usefulness and the value of the financial statements, but he also increases the credibility of other non-audited information released by management.

Auditing is the process of investigating information prepared by someone else in order to determine whether the information is fairly stated. If you're a business owner, you're responsible for the information being audited, which you present in your financial records. If you're the auditor, you investigate the assertions made on the financial statements to make sure you agree with what the company is saying about itself.

The importance of auditing can also be described by its functions in the organization. Al-Shammari (2010) mentioned many factors of internal audit functions as follows:

- The internal control systems and arithmetic evaluations in an attempt to; ensure that the accounting system and internal controls systems are appropriate; ensure that the systems are suitable for the facility and propose system enhancements.
- Assessing plans and procedures to determine weaknesses or defects in the systems and procedures used by the company and to propose

modifications and enhancements needed, and to provide authority to the internal auditor for the examination of the aspects of establishment activity.

- Taking into consideration the staff commitment to the company policies and procedures and therefore, internal auditor has to monitor these policies and procedures' implementation and to clarify them to the employees.
- Safeguarding established funds as the development and implementation of systems is an attempt to make sure that the facility safeguards assets and funds against manipulation and fraud, to detect fraud and minimize losses stemming from neglect/abuse (e.g. loss of proper storage).

2.2.7 Characteristics of Internal Auditing

From the definition of internal audit, we can find that a good internal audit function Iheke Patricia (2009), has stated the following characteristics.

- a) Independence; the following conditions can assist the status of the internal auditor
- He should be free to arrange and pursue his duties by himself
 - He should not have any restrictions to the records of the enterprise.
 - He should be free to report to a high level of management than his immediate superior.
 - He should be objective
 - He should have no conflicting interest within the enterprise and no restriction upon the extent of his work by management

- He should be consulted on new or revised systems
- He should not hold non-auditing functions.

b) Staffing and Training

- The internal audit unit should be staffed by qualified, trained, efficient, effective and experienced workers and who should be too busy to look into every part of the auditing function. Training should be a planned and continuing process at all levels.

c) Due care

- An internal auditor must at all times exercise care, skill and judgment. He should be knowledgeable in terms of the enterprise he works for, his environment and the technicalities of his offices, He should be honest and of high integrity. He should be professionally qualified.

d) Relationship

- Internal Auditors should have a good working relationship, maintain mutual understanding with management, external auditors, review agencies etc.

e) Audit planning stages

The internal auditor must be able to approach his duties as follows.

- Identification of organizational goals
- Following up relevant changes in status rules and procedures.
- Definition of internal audit objectives
- Identification and evaluation of risks to which organization is exposed
- Following up strengths and major weakness in internal controls of the organization
- Identification of major audit areas.
- Following up external and plans and other review panels.

- f) Evaluation of internal control system
 - The internal auditor's uses the same approach as external auditors to verify the system and this involves:
 - Investigation
 - Recording
 - Identification of controls and
 - Compliance test of controls.
- g) Evidence
 - In the same way as the external auditor, the internal auditor will evaluate audit evidence to ensure sufficiency, relevance and reliability.
- h) Reporting and follow up
 - The internal auditor must produce timely, accurate and complete reports to management as regularly as laid down.
 - The importance of internal audit department in an organization
 - From the foregoing characteristics of good internal auditing, the researcher was able to observe that any unit of an organization that has the elements mentioned above is of paramount importance to the organization.

2.2.8 Audit and Internal Control in the Organization

Every organization has the need to establish internal audit for the purpose of internal control. Internal control is the whole system, finance or otherwise established by the organization in an orderly manner, ensure adherence to the

existing role, and safeguard the assets of the organization in order to accomplish a task.

2.2.9 Link, between Organization's Goals and Internal Audit

Shah Saud & Nathalie Marchand (2012) stated that internal audit play the role of assisting the firm's management in achieving objectives. The institute of internal auditors stated about internal audit that it, "helps the organization accomplishes its objectives" (IIA, 2004).

2.2.10 Charter of Internal Audit

Charter of internal audit department is the official document stating purpose of internal audit activities, as well as authorities and responsibilities. Internal audit charter specifies the place of internal audit entity, as integral part of the organizational structure, availability of tangible and intangible assets, as well as entitlement to the staff information and various assets, as required for fulfillment of the internal audit function. Internal audit charter states also the scopes of internal audit. Head of the internal audit entity should periodically review the internal audit charter to ensure its compliance with the modern internal audit concept, code of ethics of internal auditors and internal audit standards.

2.2.11 Internal auditing and Firm performance

The internal audit ensures that the internal control systems are adhered to and strictly carried out. The aim and objective of the organization is to serve the

public. If the merits and rationale for internal audit are harness performance and in the organization be stimulate and enhanced, hence improvement in sustainability.

2.2.12 The effect of internal audit

In responses to the accounting scandals that occur in 2001, congress passed the Sarbanes – Oxley Act of 2002 (SOX) to help instill confidences in the financial statement of companies. It required management to disclose significant deficiencies in the internal controls when they certify quarterly or annual financial statements. The Act also requires all firms to assert as the effectiveness of internal controls around the financial reporting process and requires an accounting firm to express an opinion on the effectiveness of internal control over financial reporting.

These standards include the process that companies and accounting firms are required to follow to determine the effectiveness of firm's controls.

Securities Exchange Commission (SEC) Release, No .33-8124 (August 29, 2009) required management to disclose significant deficiencies in internal control, when they certify quarterly or annual financial statements. The Act required all firms to assert as to the effectiveness of the internal control around their financial reporting process and to have accounting firms express an opinion on the appropriateness of management's assertion.

CHAPTER THREE

3 RESEARCH DESIGN AND METHODOLOGY

3.1 Introduction

In this chapter, the researcher stated the methods which he adopted in carrying out the research work. The methodology encapsulates such as research design, population of the sample size and sampling techniques, instrumental for data collection, testing techniques, inferences and conclusion. The content of this chapter will not only make it simpler for the reader to understand the analysis done in this study, but will clarify the procedure adopted.

3.2 Study Area

The study was held on the federal democratic republic of Ethiopia pharmaceuticals fund and supply agency (PFSA) here in Addis Ababa mainly at the head office level and its 14 branches.

3.3 Research Design

The prerequisite for choosing the sources of information is based on the selection decision of the nature of the information to be searched. When using qualitative research, it has an advantage for the possibility of acquiring current and up-to-date information about the study. Most of the time, quantitative research is believed to offer the researcher with rigorous, reliable, verifiable data which helps to test a hypothesis; and qualitative research tries to explain a phenomenon that occurs in natural setting through the eyes and views of the participants.

In this case, to obtain complete detail information; the researcher used descriptive research design by using both qualitative and quantitative (Mixed) approach using close ended questions because this method helps to generate and analyzes data.

3.4 Study population and Sampling

The population of this study includes 40 staff of the internal audit department of the PFSA home office (director, coordinators, senior and junior auditors) and in the selected branch audit staff (senior and junior auditor). The stratified sampling technique was used in distributing the questionnaire.

3.5 Data Collection Instruments

The research is more qualitative research based. Hence, in order to carry out this, the researcher employs the following data collection instruments. Data collection includes primary and secondary data. Secondary data were collected from different sources like annual reports of the agency, internal audit reports, relevant scientific articles, research books; and from websites and other secondary sources. Primary data were collected from target respondents through questionnaire.

Standard close-ended questionnaires with some modification (Iheke, 2009) for the respondents were used. The questionnaires were administered personally to the concerned staff at the home office level and distributed by email to the respondents at branch. Observation was made on the actual principles, practice of auditing. Audited books and procedures were personally scrutinized for the information purpose of the research. Telephone calls were made whenever it was expedient.

The questionnaire contains different parts and types of questions. The first part intends to obtain general information, about the respondents including gender, field of study, level of study and work experience etc., the second part intends to obtain specific information regarding the specific questions.

Using Taro Yamani Formula to get sample size.

$$n = \frac{N}{1+N(e)^2}$$

When; n = sample size

E = error of margin

N= population

I = Constant

Therefore, the sample size becomes;

$$n = \frac{40}{1+40 (0.05)^2}$$

$$\frac{40}{1+40 (0.0025)}$$

$$\frac{40}{1.1}=36$$

In line with the above computation, a total of 36 copies of questionnaires measuring the work of PFSA were distributed. The Bowely stratified sampling techniques is used in distributing the questionnaire.

$$NX = \frac{n(Nr)}{N}$$

N

Where N = population

n = samples size

Nr = population in each level

In line with this research work, n=36, N=40

Number of percentage of questionnaire distributed.

Internal Auditor	Number Distributed	Number Returned	%
Department Head (HO)	1	1	2.5
Coordinators (HO)	2	2	5
Senior Auditor (HO)	7	7	17.5
Senior Auditor (BO)	14	13	35
Junior Auditor (HO)	2	2	5
Junior Auditor (BO)	14	11	35
Total	40	36	100

3.6 Reliability of Test

This is a test or measure of the extent to which a research instrument will yield the same result under the same conditions that is the consistency of the work.

For the reliability of the instrument a pilot survey was carried out to test the questionnaire that was distributed on a similar sample from the criteria for the selection of subject met by the subject.

3.7 Validity of Test

According to Anyanwu (2000), validity refers to the degree to which a measuring instrument measures what is designed to measure.

The face validity was carried out by delivering the standard questionnaires to advisor who went through the questions and made appropriate suggestions and corrections that helped meet the validity.

3.8 Statistical Treatment of the Data and Analysis Technique

Data treatment is an activity which involves edition, coding and classifying data to make it suitable for further analysis. In preserving the process, data for this research, Chi-square method is used.

3.9 Limitations of the Study

Because of time factor and financial problem the study limited only to pharmaceuticals fund and supply agency at home office and its purposely selected branches.

CHAPTER FOUR

4 RESEARCH FINDINGS: ANALYSIS AND DISCUSSION

4.1 INTRODUCTION

The purpose of the analysis of data is to dig out information useful in decision making. Data appear in a variety of forms and the measured. After data collected, data must be processed, analyzed and interpreted in order to present the study findings.

4.2 Discussion

Table 4.1 Questionnaire distribution and response

Internal Auditor	Number Distributed	Number Returned	Number not Returned	%
Department Head (HO)	1	1	-	2.5
Coordinators (HO)	2	2	-	5
Senior Auditor (HO)	7	7	-	17.5
Senior Auditor (BO)	14	13	1	35
Junior Auditor (HO)	2	2	-	5
Junior Auditor (BO)	14	11	3	35
Total	40	36	4	100

The table 4.1 shows that out of 40 questionnaires distributed of which 36 out of 40 questionnaire were completed and returned and this representing 100, of the total questionnaires administered. However, 4 were not returned and this represents 10%.

QUESTION 1.

WHAT IS YOUR FIELD OF STUDY?

Table 4.2 Respondents field of study

Field of study	Number	%	Computation
Accounting	35	87.5	35/40X100
Management	5	12.5	5/40X100
Economics	-	-	-
Other Specify	-	-	-
Total	40	100	

In the case of the field of study the respondents were composed of from Accounting graduates (35, 87.5%) and Management graduates are (5, 12.5) and no other fields for the internal auditors. From the above table, we can also conclude that the internal auditors in the organization have relevant profession to what they are expected to do in their office (i.e. the audit).

QUESTION 2.

WHAT IS YOUR LEVEL OF STUDY?

Table 4.3 Respondents level of study

Level of study	Number	%	Computation
Diploma	-	-	-
BA Degree	37	92.5	37/40X100
Masters Degree	3	7.5	3/40X100
Others Specify	-	-	-
Total	40	100	

Table 4.3 above shows that out of the 40 respondents, only 2 hold a masters' degree in Accounting given 7.5%, and the rest 92.5% holds BA Degree in their profession. From this, it can be conclude that there majority of the internal auditors have a professional qualification to do the audit in the organization. This can help the organization to deliver its services with good quality.

QUESTION 3

TO WHAT EXTENT HAS INTERNAL AUDIT IMPACTED ON THE ORGANIZATION?

Table 4.4 Internal audit impact on the organization

Response	Number of respondents	%
Not Significant	7	19.4
Significantly	22	61.2
Undecided	7	19.4
Total	36	100

The table 4.4 above shows, 19.4% or 7 respondents affirmed that the internal auditor has not significantly affected public sector performance, while 61.2% or 22 respondents disagreed. Also 19.4% responsibly were undecided.

QUESTION 4

WHAT RELATIONSHIP EXISTS BETWEEN ACHIEVING CORPORATE GOALS AND EFFICIENT INTERNAL AUDITING IN THE ORGANIZATION?

Table 4.5 Relationship between achieving goals & IA in the organization

Response	Number of respondents	%
Positive Relationship	30	83.33
No Relationship	1	2.77
Undecided	5	13.8
Total	36	100

The above table shows that 83.33% or 30 respondents affirmed that there is a positive relationship that exists between the achievement of corporate goals and objectives, and efficient conduct of internal audit in the organization at the home office and its branches. However, 2.77% or 1 respondent disagrees that there is no relationship between achieving of corporate goals and efficient internal audit while 13.88 or 5 respondents were undecided.

QUESTION 5

WHAT FACTORS HAS MILITATED AGAINST AUDIT REPORTS IN THE ORGANIZATION?

Table 4.6 Factors militated against audit report in the organization

Response	Number of respondents	%
Inefficient internal control system	6	16.7
Inefficient internal audit	-	-
Lack of internal audit independence	5	13.9
All of the above	25	69.4
None of the above	-	-
Total	36	100

From the 4.6 above 69.4% or 25 respondents associated inefficient internal control system, inefficient internal audit and lack of internal audit independence. Neglect of internal auditors by management and lack of internal control auditor's independence as factors militating against audit reports of the organization. However, 16.7% or 6 respondents have an opinion that, the inefficient internal control system is the problem and 13.9% or 5 respondents respond the main factor

militating in the organization their audit reports is lack of internal audit independence.

QUESTION 6

WHAT FACTORS AFFECTING THE EFFECT OF THE AUDIT REPORTS IN THE ORGANIZATION?

Table 4.7 Factors affect internal audit reports in the organization

Response	Number of respondents	%
Lack of qualified staff	12	33.3
Lack of facilities	23	63.9
Restriction of auditors from certain files	1	2.8
Undecided	-	-
Total	36	100

The table 4.7 above, shows that the opinion of respondents 33.30% or 12 respondents said that lack of qualified staff effective auditing in the organization, while 63.90% or 23 are of the opinion that lack of facilities effective auditing in the organization and 2.80% or 1 respondent holds that the restriction of certain files adversely affect effective auditing in the organization at head office and its branches.

QUESTION 7

WOULD YOU SAY THAT AUDITORS ENJOY ENOUGH INDEPENDENCE IN THE PERFORMANCE OF THEIR WORK?

Table 4.8 Independence of auditors in their work

Category	Number	%
Yes	9	25
No	27	75
Total	36	100

Table 4.8 above shows that 9 respondents or 25% are of the opinion that auditors enjoy enough independence in the performance of their duties in the organization, while 27 or 75% respondents are of the opinion that do not enjoy independence. From this information, it is observed that the independence of the auditors, which is fundamental right of the auditors, is not fully guaranteed in the organization and its branches.

QUESTION 8

WHAT IS THE PRESENT VALUATION OF AUDITING SYSTEM IN THE ORGANIZATION?

Table 4.9 Present valuation of internal audit

Options	Response	%
Very Effective	7	19.4
Effective but not efficient	9	25
Average Effective	7	19.4
Poor	13	36.1
Total	36	100

The opinion of respondents in the above table 4.9 shows that 7 or 19.4% of them said the present valuation of the auditing system in the organization is Very effective. 9 or 25% of the respondents said it is effective but not efficient and 19.4% or 9 respondents respond saying the valuation of the present auditing system is Average effective while 36.1% or 13 respondents respond that it is poor.

CHAPTER FIVE

5 SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

5.1 INTRODUCTION

This is the conclusion chapter of this study. The finding and the result of the findings will be presented in this chapter and a general conclusion in respect of the outcomes of the study and recommendation for further research will be outlined.

5.2 SUMMARY OF FINDINGS

Internal auditing is very important in every organization. The internal audit is explained above; though effective, still have problems which have constituted to unsatisfactory performance as expected of a standard internal audit.

The problem range from; inadequate staff, lack of independence of internal auditors, lack of properly qualified staff with cognate experience, management neglect the internal auditors.

I have got an idea of who an auditor is, it becomes necessary for us then to know who are the non-auditing officers and their hindrances to internal audit efficiency. The way I understood “an officer” is anybody who has been entrusted with the authority to command, direct or to possess certain vital information. The non-

auditing officer was those within the establishment other than the auditor (internal and external who possess the authority to command, direct influenced the auditor's opinion through the information they possess.

In other words, the non auditing officers are those persons within the system under who are not involved directly in the audit but hold or possess certain information whose provision influence the audit opinion or that person whose performance are under auditors examination.

THE ROLE OF NON- AUDITING THAT AFFECT AUDIT WORK

The responsibility to examine the financial records falls on the auditors and so they are accountable for the assignment. Their work cannot be efficiently done. (i.e they cannot express a reliable opinion of the non auditing officers refuse to discharge their moral and legal obligations as required. The roles of non-auditing officers with respect to audit work may not be their primary roles but the same they are vital to audit work.

Some of roles are:

- a) Making available books, accounts and other records as may be required.
- b) (CAMA) 1990 gave them auditors the right to have access at all times to the company's books accounts and vouchers. It is from these books that auditors may obtain reasonable evidence that financial statement were prepared as reflections of what transpired during the period under reporting. It is therefore the duties of non-auditing officers to ensure the

existence of these books of account and vouchers, ensure that they are well kept and made available to the auditors without procrastinations.

- c) Provision of any other information as may be required
- d) To assist auditors in obtaining information as explanation from third parties where necessary. At times the auditor may need certain and vital information within the establishment. It becomes necessary to make contacts with third parties outside the establishment to obtain or confirm such information. It becomes necessary that non auditing officers concerned be ready and co-operating in enabling the auditors to obtain the information.

I. Deliberate refusal to supply vital information on the pretence of unavailability or confidentially

These non auditing officers are often found of withholding information that know would be useful for the audit and even where the auditors made requests they would still deny having such information. By this, the auditor or may be forced to device further methods or techniques to obtain the required information which may be more expensive and time consuming.

II. Non Recognition of internal audit department

A way to frustrate a unit is to give little or no recognition to the importance of that unit; this will definitely lead to poor funding and staffing of that unit. This has been the case for many internal audit departments that are given due recognition and so they are poorly funded and staffed by the non-auditing officer who are in position of authority.

III. Creating opportunities to influence auditors opinion through threats and gifts:

Many non auditing officers and usually those whose performances are under examination often resort to threats and the giving gifts as the case maybe in order to dissuade the auditors from giving opinion expected of persons independent in mind and attitude. Threat come in the area of employments and promotion and mostly associated to internal audits while gifts often used to dissuade the external auditors, though the external auditors can be threaded with non auditors fees and remuneration and that of non reappointment, their interest are legacy secured.

WHY BEHAVE IN SUCH WAYS AS THEY DO?

There is a common saying “there is no fire without smoke” so I do believe that every behavior must have at least a cause. The following are some of the cause of the attitude of these non auditing officers in their attempt to hinder the auditors work.

- *Ignorance of objects of audit:* Most of the non auditing officers have not appreciated the necessities of the auditors and most importantly, the internal auditor. Some believe that the private sector created internal department in its industries and establishments to provide jobs for people. It is even seen by some that is a way to promote and maintain the continuity of redtops usually associated with government functionaries. Many have called for its abolitions; many have seen it as an enemy a watch dog for the owners and therefore, need to be treated as enemy. So it is not too surprising to see these non auditing officers putting up various kinds of behavior to fight the unit.

- *Ignorance of responsibility of the auditor:* The refusals of some non auditing officers to co-operate has been claims to be due to the fact that they hold certain confidential information on trust, but are ignorant of the fact that the law empowers the auditor to get whatever information he requires.
- *An attempt to cover up fraud and internal errors:* Some non auditing officers are aware of these objects of audit and their responsibilities to auditors but they still put up their un co-operation attitude just to cover up the fraud and intentional errors they have committed or they collaborated to commit.

5.3 Conclusions

From this study it could be observed that the internal auditor occupies such a paramount position that his/her importance cannot be emphasized. She/he ensures people good and effective internal control system.

Specifically as a watch dog for the management, the internal auditor forms a connecting link between the various segments of management. She/he ensures that accounting and the management controls are implemented. However, in this part of the world the importance and functions of internal auditor are to a great extent overlooked.

Most of the governmental organizations create internal audit department in their offices, but they fail to take the advice of internal auditors. The implication of refusal to take advice of internal audit department in their offices, and this is why in daily news like huge sums of money have been misappropriated or mismanaged

in one way or the other. The implication of refusal to take advice will not be for better management and up keep of financial records while probing the management when required thus they do these by not implementing the reports of the internal auditors.

It is common knowledge that most organization chief executives do not have time to go through the internal auditors report. And as such they do not know when the corrective measures applied by the internal auditor could be introduced in order to check or control excesses. These are the reason why in some areas, the internal auditors are being described as toothless-bull-day.

Also from the foregoing, it can be seen that the purpose of internal auditing is not to detect fraud as some people think. A properly conducted internal audit may reveal discrepancies, mistakes loopholes in the system and sometimes fraudulent, manipulations as a by-product of the work.

Finally, looking through this research generally and thoroughly, it is observed that internal audit department should not be overlooked in any establishment. For instance, most understandable managers and top personnel offices avert fraud (taking something of value from someone also through direct) of some sort for fear of being detected, harassed and penalized by the auditors, and as such other crimes such as theft of cash, theft of materials and supplies. This paper has therefore established how internal audit could be a tool for management control.

5.4 Recommendations

Based on the problems identified above, and having examined the effect of non auditing officers, the ways they had been performing these roles and why they are behaving the way they do, the task would be incomplete if I do not suggest ways of ensuring that the best is to obtain by the auditors from the non auditing officers. The researcher therefore wishes to put forward the suggestions and recommendations which if implemented will augur well for the establishment and improve the internal auditing process generally. The internal audit department is ill staff to be compared with the magnitude of work they carry out before the department to function effectively; more staff should be engaged. This will facilitate the audit work of the establishment. Assuming that there are enough staff in the unit the staff could be distributed to various departments to check the activities of the workers and report their finding to the management.

- 1) *Evaluate the non auditing officers on the advantages to the management:* it is a tool for ensuring effective implementation of the internal control system and in fact it allows such internal system to be reviewed. With internal management policies are seen to be complied with and adequate information is made available to management for review and decision making. If non auditing officers are given proper education/training they would see reasons to co-operate with the auditors since the exercise will benefit them and this would enable them to give more attention to the internal audit reports.

The internal auditor should be given a higher status in the establishments. In most establishments I understand, there were strong feelings and expressions about the low status of internal auditor's hierarchy of organization. In the head office the

internal auditors, I observed that they are pushed away from the main building and are provided accommodations near a pharmaceuticals warehouse in underground, narrow and very cold offices. It is strongly recommended that internal audit should be considered for higher status comparable to those of their counter parts who perform management duties. This will make it possible for them contribute to the growth of the organization.

- 2) *Mobility*: There is an urgent need for transportation to be readily available to staff of this office mainly at the head office as they have a duty to visit branches. It is very important that internal audit staff should be provided with vehicles. The nature of their work warrants that allocation is made to the department to enable them carry out audit work at the branches or perform other field assignments. Sometimes, management required internal auditor to conduct investigation on certain issues and the information needed may be obtained far from their office. In such circumstances use of vehicle is inevitable. In the head office which I observe during this research work, there was a general complaint that internal audit requires vehicle to enhance their productivity.
- 3) *Establishment of audit committee*: Section 359 (3) of companies and allied matters decree 1990, (CAMA) made it mandatory for all public companies to have audit committees. Much good would be done to internal audit. If every organization has an audit committee and if the internal auditors can be appointed by this audit committee and made to report to them so as to prevent the unnecessary and direct or indirect intervention of the management in the internal audit.
- 4) *Appointment and qualification of internal auditors*: The caliber of people to occupy the position of internal auditor should be such as to make them

comparable in status and responsibility with that of other management staff. This would enable the management to accord much to the internal audit.

- 5) *Management should react promptly to audit reports:* Whenever anomalies should be corrected immediately and adherence to lay down polices by the staff concerned should be monitored where possible reassignment of incorrigible staff should be strongly recommend. During my study I found that the chief executive of the organization asking for an audit report which he already has it more than two months ago. So, the management of the organization should react promptly to audit reports and corrective measures.

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Appendix A: Questionnaires



St. Mary's University

School of Graduate Studies

Dear PFSA employee;

I am MBA in Accounting and Finance student at St. Mary's University. As part of my study; I am carrying out a research on the effect of internal audit on firm performance in Pharmaceuticals Fund and Supply Agency (PFSA).

Objective of the study; to examine the effect of Internal Audit in the Firm performance

You have been selected to participate in this survey, and I would appreciate you for answering all the questions. Please answer the following questions as candidly as you can! Please be assured that the responses you give are for academic purposes only and don't put your name on the questionnaire. No individual answers will be analyzed. Rather, only composite information will be used.

Thank you for your assistance in providing this valuable information.

Daniel Girmay

dgirmay79@gmail.com

QUESTIONNAIRE

PERSONAL PROFILES

SECTION A:

General Instruction: Kindly indicate your response to each of the question below by ticking (√) in the box where appropriate and comment where necessary.

1. Gender: Male Female
2. How long did you work in the office?
1 - 5 , 5 - 10 , 10 - 15 15 – above
3. Field of study: Accounting , Management , Economics
Other specify _____
4. Level of education: Diploma , BA Degree , Masters Degree ,
Others specify _____
5. What is the present evaluation of auditing system in the organization?
Very effective , Effective but not efficient , Averagely effective ,
Poor

SECTION B:

1. DID YOU HAVE ANY STAFF STRENGTH OR CLASSIFICATION?

(a) Yes (b) No

2. WOULD YOU SAY THAT THE STRENGTH IS ADEQUATE FOR YOU?

(a) Yes (b) No

3. IS THE OFFICE OF THE INTERNAL AUDIT DEPARTMENT HEAD CONCERNED WITH WHAT HE DOES?

a) Yes (b) No

4. HAS THE INTERNAL AUDIT DEPARTMENT HEAD CARRIED OUT HIS DUTIES EFFECTIVELY?

(a) Yes (b) No

5. ARE THERE HINDRANCES IN THE PERFORMANCES OF THE AUDITOR'S JOB?

(a) Yes (b) No

6. DOES THE INTERNAL AUDITOR HAVE SECURED THEIR INDEPENDENCE IN THEIR JOB?

(a) Yes (b) No

7. IS THE WORD AUDIT EFFECT TAKEN SERIOUSLY IN THE ORGANIZATION?

(a) Yes (b) No

8. ARE THERE INTERNAL CONTROL SYSTEMS IN THE GOVERNMENT ACCOUNTING SYSTEM?

(a) Yes (b) No

9. ARE THERE ADEQUATE FACILITIES FOR THE AUDITOR'S JOBS?

a) Yes (b) No

10. DOES THE OFFICES OF THE INTERNAL AUDIT DEPARTMENT HAVE ADEQUATE AND qualification staff?

a) Yes (b) No

11. ARE THE FINANCIAL STATEMENTS OF THE FINANCE DEPARTMENT PREPARED TIMELY FOR audit?

a) Yes (b) No

12. ARE AUDIT REPORTS ADEQUATELY RESPONDING TO BY THOSE CONCERNED?

a) Yes (b) No

SECTION C:

1. TO WHAT EXTENT HAS INTERNAL AUDIT IMPACTED ON THE ORGANIZATION?

- A. Not Significant B. Significantly C. Undecided

2. *WHAT RELATIONSHIP EXISTS BETWEEN ACHIEVING CORPORATE GOALS AND EFFICIENT INTERNAL AUDITING IN THE ORGANIZATION?*

- A. Positive relationship B. No relationship C. Undecided

3. *WHAT FACTORS HAS MILITATED AGAINST AUDIT REPORTS IN THE ORGANIZATION?*

- A. Inefficient internal control system
B. Inefficient internal audit
C. Lack of internal audit independence
D. All of the above
E. None of the above

4. *WHAT FACTORS AFFECTING THE EFFECT OF THE AUDIT REPORTS IN THE ORGANIZATION?*

- A. Lack of qualified staff
B. Lack of facilities
C. Restriction of auditors from certain files
D. Undecided

5. *WOULD YOU SAY THAT AUDITORS ENJOY ENOUGH INDEPENDENCE IN THE PERFORMANCE OF THEIR WORK?*

- A. Yes B. No

6. *WHAT IS THE PRESENT VALUATION OF AUDITING SYSTEM IN THE ORGANIZATION?*

- A. Very Effective
- B. Effective but not efficient
- C. Average Effective
- D. Poor

Thank you!
Daniel Girmay