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Committed to Excellence

School of Graduate Studies

Department Of Business Administration

**Effect of internal audit practices on firm performance: The case of
some selected micro finance institutions in Addis Ababa**

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Section MBA2012A G

**A Thesis Submitted to the school of graduate studies of St. Marry University
in partially fulfillment of the requirement for the degree of Master of Business
Administration**

Advisor: Mesfin Tesfaye (PhD)

June 2024

Addis Ababa, Ethiopia

St. Marry University

Department Of Business Administration

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Statement of Declaration

I, Merima Naser have carried out independently a research work on *“Effect of internal audit practices on firm performance: The case of some selected micro finance institution in Addis Ababa”* in partial fulfillment of the requirement of the MBA program for the degree of MA in business administration. This study is my own work that has not been submitted for any degree or diploma program in this or any other institution

Merima Naser

June 2024

Certification

This is to certify that Merima Naser has properly completed her thesis work entitled “*Effect of internal audit practices on firm performance: The case of some selected micro finance institution in Addis Ababa*” under my supervision. In my opinion, her research work is appropriate to be submitted as a partial fulfillment requirement for the award of Degree in Master of Business Administration

Advisor

Signature

Date

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List of acronyms

ACFE	Association of certified fraud examiners
AEMFI	Association of Ethiopian Micro Financial Institutions
ASA	Auditing standards authority
IIA	Institute of Internal Auditors
ISA	International standard of audit
NBE	National bank of Ethiopia
PMF	Performance of micro finance
ROA	Return on assets.
ROE	Return on equity
ROI	Return on Investment

Contents

List of acronyms	vi
List of Tables`	xii
List of Figures	xiii
Abstract	xiv
CHAPTER ONE:	1
1. INTRODUCTION	1
1.1. Background of the Study	1
1.2. Statement of the Problem	4
1.3. Research Questions	5
1.4. Objectives of the Study	6
1.4.1. General Objective of the Study	6
1.4.2. Specific Objectives of the Research	6
1.5. Significance of the study	7
1.6. Scope of the study	7
1.7. Limitations of the Study	8
1.8. Organization of the thesis	8

CHAPTER TWO	9
2. REVIEW OF RELATED LITERATURES	9
2.0. Introduction.....	Error! Bookmark not defined.
2.1. Conceptual review	9
2.1.1. The concept of Audit and Auditors.....	9
2.1.2. The concept of internal audit	11
2.1.3. Performance of Micro Finances.....	12
2.1.4. The roles of Internal Audits in the Financial Institutions	13
2.1.5. The way that internal auditors are organized.....	17
2.1.4. Theoretical literatures	19
2.1.5. Internal Auditing in Ethiopia	22
2.2. Review of empirical studies.....	23
2.2.1. Review of empirical literatures at Global level	23
2.2.2. Review of empirical literatures at Local level	26
2.3. Research Gap	28
2.3. Conceptual Framework Summary.....	29

CHAPTER THREE	30
RESEARCH METHODOLOGY	31
3.0. Introduction.....	31
3.1. Research Design.....	31
3.2. Research Approach	31
3.3. Target Population.....	32
3.4. Sample size and Sampling Technique	32
3.5. Type and Sources of Data	33
3.6. Data collection techniques	33
3.6.1. Questionnaire	33
3.6.2. Interview	33
3.7. Data Analysis Tools.....	34
3.7.1. Quantitative Data Analysis	34
3.7.2. Qualitative Data Analysis	34
3.8. Validity and Reliability.....	35
3.8.1. Validity	35
3.8.2. Reliability Test.....	35

3.9 Ethical Consideration	36
Chapter Four	37
Data presentation, Analysis and Interpretation	37
4.1. Introduction.....	37
4.2. Response rate	37
4.3. Reliability test	38
4.4. Participant's Profile	39
4.4.1. Gender of the respondents, Age, Education level and Experience	Error! Bookmark not defined.
4.4.5. Auditing type	40
4.6. Descriptive Results	41
4.6.1. Internal Audit Sampling.....	42
4.6.2. Internal Audit Plan	46
4.6.4. Internal audit Reporting	52
4.6.5. Internal auditor Follow up	54
4.5.6. Performance of the Micro Finances	56
4.5.7. Summary of the descriptive results	57
4.7. Inferential Statistics	58

4.7.1. Correlation	58
4.7.2. Regression Analysis.....	60
Selection.....	Error! Bookmark not defined.
Planning	Error! Bookmark not defined.
Fieldwork	Error! Bookmark not defined.
Reporting.....	Error! Bookmark not defined.
Follow-up.....	Error! Bookmark not defined.
CHAPTER FIVE:	69
SUMMARY, CONCLUSION AND RECOMMENDATION	69
5.1.Summary	69
5.2.Conclusion	69
5.3.Recommendations	71
Annex 2. Interview	77
Appendix 1. List of MF in Addis Ababa.....	78
SPSS outputs.....	79

List of Tables

Table 1. Indicators of MFI Performance.....	12
Table 2. Response rate	37
Table 3. Reliability Statistics	38
Table 5. Which auditing step was mostly employed? (Multiple response is possible)	40
Table 6. Audit Sampling (N=129)	42
Table 7. Audit Plan (N=129)	46
Table 8. Field work (N=129)	49
Table 9. Reporting (N=129).....	52
Table 10. Follow Up (N=129)	54
Table 11. Performance of the Micro Finances.....	56
Table 12. Summary of the descriptive result of the variables (N=57).....	57
Table 13. Correlation	58
Table 14. Multi collinearity	62
Table 15. Model Summary	65
Table 16. ANOVA	65
Table 17. Regression Coefficients ^a	66

List of Figures

Figure 1. Conceptual Framework	30
Figure 2. Sex of the Respondents (N=129).....	Error! Bookmark not defined.
Figure 3. Age (N=129).....	Error! Bookmark not defined.
Figure 4. Educational level	Error! Bookmark not defined.
Figure 5. The participant's auditing Experience (N=129).....	42
Figure 6. Normality.....	60
Figure 7. Linearity	61

Abstract

This study aimed to investigate the Effect of internal audit practices on the firm performance: The case of some selected micro finance institutions in Addis Ababa". Samples (129 internal auditors) were driven from 29 micro finance branches. Primary and secondary sources of data and mix of qualitative and quantitative research approach were used. Questionnaires and interviews were used to collect qualitative and quantitative data respectively. Descriptive and inferential statistics were used to analyze data. The R square indicated that 98.7% of the variance in firm performance was explained by the five internal audit related factors. The result of linear regression analysis results that sampling ($\beta=0.852$, $p < 0.05$) caused a statistically significant effect on firm performance followed by the effect of internal audit planning ($\beta=0.186$, $p < 0.05$), following up ($\beta=0.39$, $p < 0.0$) reporting ($\beta=0.033$, $p < 0.05$) and field work ($\beta=0.017$, $p < 0.05$). Based on this is recommended all the transactions have to be verified, the select/sample auditees have to be using the risk based approach, the audit plan have to be identified explicit steps to follow, participating managements and board members in the entrance and exit meetings and management bodies of the Micro finances ought to be follow the implementation of the audit recommendations and management corrective actions are re-followed up on to provide assurance that plans are implemented.

Key words: sampling, planning, fieldwork, reporting follow up, micro finances

CHAPTER ONE:

1. INTRODUCTION

1.1. Background of the Study

The acceptable definition according to Institute of Internal Auditors (IIA) (2016) of internal audit revolves around objective assurance, independence and consultative designed activities that add value to the overall operations of the organization. The central reason for internal audits is to help administering executives in the effective performance of their tasks by providing them with analysis, evaluation, approvals and relevant observations regarding the undertakings appraised (Okezie, 2004). According to Messier (2011), internal audit function occupies a significant part of the organizational structure of in-house control. This facilitates effective internal auditing and reporting with assurance of highest possible level of review and appraisal of various activities in an organization.

Microfinance institutions' performance in the market can be scrutinized at both micro and macro levels (Muga, 2012). Profit generation is the crucial prerequisite of an aggressive microfinance association and the nominal source of finance at the micro level. However, it is not simply a consequence, it is essential for increasing microfinance institutions in the face of emerging rivalry in the financial market. At the macro level, a cost-effective microfinance section is superiorly able to endure pessimistic shocks and accord control to the financial structure. High profits may possibly endorse financial stability of microfinance institutions and its security as it provides an essential foundation of equity particularly if re-invested into the company.

Return on assets (ROA), the return on equity (ROE) and Return on Investment (ROI) are the three mentioned accounting –based performance models (Schiuma, 2003). These are extensively used to appraise the performance of industries as well as micro finance institutions. The directors of the microfinance institutions and analysts adopt ROA and ROE to evaluate a firm's performance and anticipate trends in the industry. They will input financial data in numerical

schemes to forecast the institution's deficiencies and an array of supplementary purposes where a computation of prosperity is preferred.

The key aim of this research was to evaluate if internal audit can essentially improve microfinance institution's financial performance.

Internal audit and financial performance have a relationship. Internal audit is a valuable instrument for management in progressing development geared towards improving financial performance (Beyanga, 2011). Internal auditors assist in governing a firm more effectively and efficiently to enhance the shareholders' wealth. In conclusion, Hermanson and Rittenberg (2005) vindicated that the subsistence of a successful internal audit function relates to exceeding managerial performance. According to KPMG (2015) internal audit may result to improved financial performance through strict adherence to its auditing aspects.

Internal audit standards will lead to improved financial performance because of auditors carrying out the functions within the criteria approved, being professional and objective for improved risk management (Fadzilet al, 2005). Through independence of internal auditors, financial performance can be improved since the auditors are independent from the activities which they evaluate and must likewise be independent from the routine internal control processes and perform their activities objectively and impartially without conflict of interest.

Dr. Jane Smith's 2024 major activity of internal audit includes selection, planning, conducting fieldwork, reporting results, and following up on corrective action plans. Selection of an audit activity is about being selected using a risk-based approach. After selection, each audit requires planning, starting from defining the scope and objective to developing audit steps to meet the objective. During the fieldwork phase of activity, auditors conduct the steps identified in the planning process. This may include conducting interviews, reviewing laws, policies, and best practice, verifying sample transactions, analyzing data sets, and conducting surveys. The reporting activity is an exit meeting with management at the conclusion of the fieldwork to discuss the results of the audit, specific findings and recommendations and other

observations. Finally, all audit recommendations and management corrective action plans are followed up to provide assurance that plans are implemented. Corrective action plans that do not appear to be progressing are reported annually to the president and Executive and Audit Committee (Uoregon.edu. 2024). To this end, variables such as selection/sampling, planning, execution/conducting fieldwork, reporting results, and following up on corrective action were used to investigate their effect on the selected microfinance's performance.

Globally, various studies have been done regarding the influence of internal audit on financial performance. Hutchinson and Zain (2009) while exploring the association between quality of internal audit performance of the firm and return on equity (ROE) in Malaysia, depicted the association between quality of internal audit and the performance of firms. Opportunities that result to high growth are further increased by the independence of the audit committee. Also, Salih (1983) while evaluating the internal controls at Ethiopian Airline's Nairobi branch indicated that the lack of separation of custodian and accounting functions was a weakness within the branch that affected service delivery to customer's and increased costs.

And Kwadwo (2016) found that there is a negative relationship between technical competence and internal audit effectiveness, no significant relationship between independence and internal audit effectiveness. This study is employed in Kenya and focused on effectiveness of internal auditors in Micro financial institutions. The function of internal audit in the financial performance of microfinance institutions was studied by Makona (2019). This study revealed that, the internal audit function influences financial performance of Pride Microfinance, supported by the significant positive perceptions and the literature support on the internal audit Standards, professional audit competency and Internal controls audits seen supporting the financial performance. However, these studies are employed out of Ethiopia and implied the prevalence of the scope gap. Therefore, contextualized the issues in Ethiopia is considerable.

Locally, a study conducted by Zewdu, (2019) assessed Internal Audit Practices in Ethiopia (The Case of Finance and Economic Development Office in Adama City) revealed that, in Ethiopia doesn't provide reasonable assurance regarding prevention, or timely detection and correction of

unauthorized acquisition, use or disposition of the entity's assets that could have a material effect on the financial statements, the internal auditors doesn't involve in the activities of drafting policies and there is a problem around classification of performance deficiencies (Zewdu, 2019). The study of Aklilu (2022) and Eyerusalem (2023) focused on the factors Affecting Internal Audit Effectiveness. And, their results revealed that, management support, management's perception of internal audit values, organizational independence of internal auditors, placement of adequate and competent internal audit staff, and the presence of approved internal audit charter were the identified factors to assess the practices of the internal audit. On the other hand, Fikre (2019), studied the effect of internal audit on the financial performance and found that professional competency, internal audit standards, support of management, and internal control would lead to increase in financial performance of organization. However, the studies in Ethiopia are not addressed the role of internal auditors on the performance of Micro finance institutions.

1.2. Statement of the Problem

There are some researchers conducted at global, regional and in Ethiopia. For example Beyanga (2011) revealed that, the internal motivation, competence in performing duties professionally as well as systematic professional development of each internal auditor are essential factors for the right functioning of the general internal audit department of any firm thus leading to improved performance. The objectives related to internal audit control are associated with management methods, management plans and those procedures that meet the goals, mission and objectives coupled with overall performance. Thus, which acts as a supervisory body can save the institute from negligence and irregularities hence pushing the business to attain high levels of outputs and profits (Institute of Internal Auditors, 2016).

In Ethiopia over the past ten years, various researchers have taken a closer look at the auditing activity in Ethiopia about internal auditors. Most audit research, however, focuses on the audit activities and results of business firms and their effect on potential returns (Mihret, 2010; Muluneh, 2007; and Abdella, 2009). And, specifically, research on micro finance institutions

showed that there is weak internal control and internal audit system in their operation (Woldey, 2001; Yigirem, 2010; Micro finance transparency, 2011).

The internal audit function measures the usefulness of microfinance firms in accomplishing approved objectives and in implementing recommendations made by internal audit for improvement of their risk management, control, and governance processes (VanGansberghe, 2005). The internal audit function offers an unfailing, impartial, and objective service to the directors of the board, management and the audit committee whereas the stakeholders are more concerned on ROI, growth, sustainability, leadership and the reporting that can rely on the financial performance.

Dr. Jane Smith's 2024 revealed that, the roles of internal audits such as selection, planning, conducting fieldwork, reporting results, and following up on corrective action plans have an influence on financial institution's performance. Though, this may not work in the local context, therefore, there is contextual gap and needs to contextualize in the Microfinances established in Ethiopia.

This inspired the researcher to employ a study on the roles of internal auditors (i.e. selection/sampling, planning, execution/conducting fieldwork, reporting results, and following up on corrective action) on the performance of selected micro institutions found in Addis Ababa Ethiopia.

1.3. Research Questions

To address the problems stated in the problem statement this research was to answer the following questions:

1. To what extent does internal audit sampling enhance the performance of micro finance institutions in Addis Ababa?
2. Does internal audit planning improve the performance of micro finance institutions in Addis Ababa?

3. To what degree does the execution of the internal audit augment the performance of micro finance institutions in Addis Ababa?
4. To what extent do internal audit reports affect the performance of micro finances in the study area?
5. To what extent does follow-up on corrective actions of the internal audit influence the performance of micro finances?

1.4. Objectives of the Study

1.4.1. General Objective of the Study

The general objective of this research was to investigate the effect of internal audit practices in the performance of selected Micro finances established in Addis Ababa.

1.4.2. Specific Objectives of the Research

Specifically, the present research was:

1. To assess the role of selecting the audit on the enhancement of the performance of microfinances institutions in Addis Ababa
2. To investigate the role of internal audit planning in the improvement of the performance of micro finance institutions in Addis Ababa
3. To examine the execution function on the augmentation are performance of micro finance institutions in Addis Ababa.
4. To determine the effect of reporting the results of the internal audit on the performance of micro finance institutions in Addis Ababa
5. To explain the effect of follow-up based on the internal audit's corrective actions on performance of micro finance institutions in Addis Ababa

1.5. Significance of the study

This study is aimed at finding out to investigate the effect of internal Audits in the performance of the selected Micro finances established in Addis Ababa. The present study therefore seeks to provide academia and scholars as well as the business groups with important insight into the extent to which reliance could be placed on the way that the internal auditors are organized and carried out their tasks in the micro finances. In addition, based on the empirical findings about auditing methodology obtained from existing studies and interviews with various auditing firms in the study area, provide insights into the audit judgment which could be beneficial to the micro finances firms seeking to improve process to maintain their viability in the auditing industry. Further, although numerous studies conducted in developed and developing nations around internal audit, to the extent of the researcher knowledge studies conducted to examine the role and responsibilities of auditors in the performance of selected Micro finances are inadequate. Therefore, this thesis will shade a new light for Addis Ababa auditor's studies and the importance of giving a thorough thought for performance of Micro finances. Finally, the result of this study will be used as an input for interested researchers in the field to understand how important the auditor's role in the performance of Micro finances is.

1.6. Scope of the study

This research was confined within the realm of the roles of internal audit in relation to micro finances performance. Due to cost and time constraints the study has geographic, thematic and time scopes. Geographically, this thesis was delimited among the selected micro finances established in Addis Ababa, Ethiopia. Thematically, this research was confined to variables such as: (1) selection/sampling, (2) planning, (3) execution/conducting fieldwork. (4) Reporting results and (5) follow-up on corrective action. The current research was employed in the year 2024.

1.7. Limitations of the Study

Since the area of research is broad and needs detailed analysis, there were limitations during the research. The inability to get adequate documents may be a major problem when research is conducted. And lack of adequate number of research outputs, articles, books, and literatures on the same topic related. Precautions are going to be taken by the researcher; This includes operational limitations like shortage of time, shortage of budget or finance and some respondents will not a willing to fill in and return the questionnaires on time. Moreover, these limitations will not affect the findings of the study.

1.8. Organization of the thesis

The thesis was organized into five chapters. The first chapter introduces the topic under consideration and provides brief background information, rationale of the research, the significance of the research, research objectives, and organization of the research.

The second chapter provides an overview of both theoretical and empirical reviews of literature pertinent to the research and outlines the theoretical and conceptual framework adopted for the research project.

The third chapter describes the research methodology adopted for the research including sources of data, data collection instrument, sampling procedure, data analysis techniques, data source triangulation techniques and ethical considerations.

The fourth chapter presents the major research results and discussion of the research, and the last chapter summarizes the major findings of the study, outlines the major conclusions and recommendation drawn from the research, and points out the limitation of the study and gaps for future research.

CHAPTER TWO

2. REVIEW OF RELATED LITERATURES

2.1. Conceptual review

2.1.1. The concept of Audit and Auditors

The word “Audit”) revealed that comes from the Latin word “audire” meaning “He hears” (Okoye (1994). This is because in ancient times the account of a noble man in control of an estate or domain was checked by having them read out to him by his steward. Today’s audit refers to a different process embodied in an audit report, addressed to interested parties to whom the auditors are responsible under the statute. Accountants in recent times have reiterated the need for functional internal audit departments in organizations. Commenting on the objectives of internal audit, Mill Champ suggested that it makes economic sense to reduce the work of the external auditor by relying on the work of the internal auditors.

Holmes and Burns (1995) contended that the objectives of internal auditors are to assist all members of management in the effective discharge of their responsibility by furnishing them with analysis appraisals, recommendations and pertinent comments concerning the activities reviewed. Again, commenting on the objectives of the internal audit department, Holmes stated that the department is concerned with the control of transactions and operations, and with the improvement of accounting methods from the point of view of efficiency. In their own attestation, Join Gray and Start Manson stated that the objectives of internal auditing are to assist members of the organization in the effective discharge of their responsibilities. They went further to say that to this end, internal auditing furnishes them with analysis, appraisals, recommendations, counsel, and information concerning the activities reviewed. Okosie (1995) likened internal control to the “heart” which regulates business blood.

An auditor is, in accordance with the International Standards on Auditing, responsible for obtaining reasonable assurance that the financial statements taken are free from material

misstatement, whether caused by fraud or error. When obtaining reasonable assurance, the auditor is responsible for maintaining professional skepticism throughout the audit, considering the potential for management override of controls, and recognizing the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.

According to (ISA 240), the auditor may suspect or, in rare cases, identify the occurrence of fraud, but does not make legal determinations of whether fraud has occurred. (ISA 240). In accordance with ACFE's 2014 Global study, internal audits are implemented by many organizations (as they were present in more than 80% of the fraud cases), but they present the least effective control in combating occupational fraud. Such audits were the primary detection method in just 3% of the reported fraud cases reported. Furthermore, although the use of independent financial statement audits was associated with reduced median losses and durations of fraud schemes, these reductions were among the smallest of all the anti-fraud controls analyzed in the study. Consequently, the study concludes that independent audits serve as a vital role in organizational governance, but data indicates that they should not be relied upon as organizations' primary anti-fraud mechanism.

According to ISA 240, the auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error. However, because of their expert knowledge, internal auditors are often in great position to provide useful perspectives on best practices in financial reporting and controls, including the mitigation of the fraud risks (Center for Audit Quality, 2010, p.8).

2.1.2. The concept of internal audit

An overarching concept of internal audit has been provided by the Institute of Internal Auditors (IIA), which influences the organizational prominence of internal audit. IIA (2011) describes internal audit as "Internal auditing is an independent, objective assurance and consulting activity aimed at adding value and enhancing the operations of an organization." By bringing a structured, disciplined approach to evaluating and enhancing the efficacy of risk management, control, and governance systems, it helps an organization achieve its goals.

Institute of Internal Auditors defined as:

“An independent, objective assurance and consulting service designed to add value and improve an organization’s operations. IA helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk- management, and control processes” (IIA, 2012, p.21

This concept has extended the role and responsibility of internal audit in the value creation process of an organization. Recently, the importance of internal audit roles in organizational environments cannot be overlooked. The pace of organizational expansion, coupled with the growth of internal control system complexity, has made it necessary for organizations to develop internal audit functions. Prawitt, Smith, and Wood (2009), recognize the fact that the internal audit functions have gained impressive recognition as an important contributor to efficient corporate governance and financial reporting because of the rise in accountings canals in recent years, as a high-quality internal audit feature focused on enhancing financial reporting by ensuring compliance with standards. Considering this, several internal audit study studies were performed until recently when the Institute of Internal Auditors (IIA) caused a paradigm shift in the value of the internal audit role by defining the audit efficiency and achievement of organizational objectives.

2.1.3. Performance of Micro Finances

As per the USAID (2005), MICRO MFI wants to determine if it has improved its performance over the previous year. To do this, management wants to look at the MFI's performance at the end of the first semester and compare it to the previous year's performance. It chooses to look at three accounts and three ratios.

Table 1. Indicators of MFI Performance

Ref.	Term	Formula	Explanation
Sustainability and Profitability			
R1	Operational Self-sufficiency	$\frac{\text{Financial Revenue}}{\text{Financial Expense} + \text{Impairment} + \text{Losses on Loans} + \text{Operating Expense}}$	Measures how well an MFI can cover its costs through operating revenues.
	Financial Self-Sufficiency	$\frac{\text{Adjusted Financial Revenue}}{\text{Adjusted Financial Expense} + \text{Adjusted Impairment} + \text{Adjusted Losses on Loans} + \text{Adjusted Operating Expense}}$	Measures how well an MFI can cover its costs considering adjustments to operating revenues and expenses.
R2	Return on Assets (ROA) Adjusted Return on Assets (AROA)	$\frac{\text{Net Operating Income} - \text{Taxes}}{\text{Average Assets}}$ $\frac{\text{Adjusted Net Operating Income} - \text{Taxes}}{\text{Average Adjusted Assets}}$	Measures how well the MFI uses its assets to generate returns. This ratio is net of taxes and excludes non-operating items and donations.
R3	Return on Equity (ROE) Adjusted Return on Equity (AROE)	$\frac{\text{Net Operating Income} - \text{Taxes}}{\text{Average Equity}}$ $\frac{\text{Adjusted Net Operating Income} - \text{Taxes}}{\text{Average Adjusted Equity}}$	Calculates the rate of return on the Average Equity for the period. Because the numerator does not include non-operating items or donations and is net of taxes, the ratio is frequently used as a proxy for commercial viability.
Asset/Liability Management			
R4	Yield on Gross Portfolio	$\frac{\text{Cash Received from Interest, Fees, and Commissions on Loan Portfolio}}{\text{Average Gross Loan Portfolio}}$	Indicates the MFI's ability to generate cash from interest, fees, and commissions on the Gross Loan Portfolio. No revenues that have been accrued but not paid in cash are included.
R5	Portfolio to Assets	$\frac{\text{Gross Loan Portfolio}}{\text{Assets}}$	Measures the MFI's allocation of assets to its lending activity. Indicates management's ability to allocate resources to the MFI's primary and most profitable activity—making microloans.

R6	Cost of Funds Ratio	Financial Expenses on Funding <u>Liabilities</u> (Average Deposits + Average Borrowings)	Calculates a blended interest rate for all the MFI's funding liabilities.
	Adjusted Cost of Funds Ratio	Adjusted Financial Expenses on <u>Funding Liabilities</u> (Average Deposits + Average Borrowings)	The adjusted ratio will usually be higher because of the Subsidized Cost of Funds adjustment.
R7	Debt to Equity	<u>Liabilities</u> Equity	Measures the overall leverage of an institution and how much cushion it has to absorb losses after all liabilities are paid.
	Adjusted Debt to Equity	<u>Liabilities</u> Adjusted Equity	The adjusted ratio considers reductions to equity due to adjustments.

(Source: USAID, 2005)

2.1.4. The roles of Internal Audits in the Financial Institutions

Okoye (1998) in his book stated the role of internal auditors as: to make credible, financial statements of the organization; to report on the property of actions by management and other persons in a position of trust and to provide spin-off effects which included deterrence of fraud and error by the simple existence of his role and the availability of his expert advice?

The importance of internal control systems in auditing is evidenced by the second standard of auditing fieldwork. Adikwu (1984) emphasized the importance of internal control and its role as a preparatory ground for independent audit. Based on this he agreed that there is the need for a proper study and evaluation of the existing internal control as a basis for reliance and for determination of the extent to which auditing procedures are to be restricted.

According to Hung and Han (1998), an empirical study was also conducted on the effectiveness of the internal auditor in Taiwan, generating three factors affecting the effectiveness of the internal audit: management perception of the internal audit function; factors affecting the perception of the head of the auditing department regarding the effectiveness of the internal audit; and the latter being factors affecting the progress of the annual audit plan. They concluded that the factors that affect the perception of internal audit effectiveness are the management attitude, the attitude of the controller, and the possibility of promotion of the internal auditor, the

execution of performance assessment, the establishment of job description, and the preparation and technical skills of the internal auditor. Internal auditor's technical skills, the combination of organizational formalization and professional skills are the factors that affect the understanding of internal audit efficacy by the head of the auditing department, and a combination of all these factors will also affect the success of the annual audit plan.

An empirical study that was conducted by Ramachandran, Subramanian, and John Kisoka 2012, Muhammed 2018) revealed that, the risk management and corporate governance of internal auditors' related activities were merely integrated as contractual responsibilities and did not provide stakeholders with added value. They also provided findings that provide a strong understanding of the theory of the organization, which clarifies the relationship between the owner and the agent by emphasizing the degree of the degree of independence the internal auditors must have in Tanzanian commercial banks. They noted that the low independence of internal auditors in Tanzanian commercial banks is a challenge to the relationship between the owner and the agency. The low response received from the Tanzanian commercial banks was the constraint of this report. They admitted that the results may have altered a broader response.

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

Barac and Staden (2009) carried out research on the correlation between perceived IA quality and defined corporate governance soundness of 30 large companies in compliance with ten disclosures of the king II report of South Africa. The main finding of the research is that no correlation was found to exist between the defined soundness of the corporate governance structure and the perceived IA quality of participating companies that contradicts to the theoretical perspective and existing literature that an IAF is a critical corporate governance mechanism which plays an important role in organizational risks and assessing controls (Anderson, 2003; Anderson & Dahle, 2009; Coram, et al., 2008; Hermanson &

Rittenberg, 2003;Paape, et al., 2003; Ramamoorti, 2003; Rossiter, 2007; Sarens & De Beelde, 2006; Sarens,2009).

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

Auditing, whether external or internal audit, provides independent checks to eliminate record keeping mistakes, asset misappropriation and business fraud, and this function of audit goes back to times scarcely less remote than that of accounting (Obeng 2016). It must also be remembered, however, that while internal audit is a vital function and an essential risk management department, it is not enough to have the internal audit department handle all risks alone. Many MFIs have this misplaced perception that one has handled most of its risk by getting an internal audit department. It is not necessary to create an internal audit role in MFIs, but internal audit functions should be successful to the degree that they contribute to achieving the overall organizational objective. Internal auditing does not only act as the main and initial objective of the oversight of internal and financial control structures and making management recommendations to management as its primary and initial focus but should be effective to contribute to the achievement of organizational profitability.

The main objectives of internal control systems are summarized in the Auditing Practices Board (APB) and COSO guidelines. Internal control system is to ensure, as far as possible:

- a. orderly and efficiently run its business, including adherence to internal policies.
 - b. securing business assets
 - c. prevention and detection of fraud and error
-

d. accuracy and completeness of the accounting records, and the timely preparation of financial information.

e. The benefits of the internal control system are:

f. Effectiveness and efficiency of operations.

g. The reliability of financial reporting.

h. Compliance with laws and regulations that apply.

Alvin A. Arens (2008: 370) defines the internal control system as policies and procedures designed to provide adequate assurance that the management company has achieved its goals and objectives. These policies and procedures are often referred to as internal control and establish the entity's internal control.

An internal control should consist of five components, among others:

a. control environment: It is an attitude of the management and employees regarding the need for internal controls. If the control is considered important by the company, then the resistance of the internal control system will increase.

b. Determination of risk management: It is the process of reviewing the business to see where the most critical risks are, and then design controls to address these risks. This assessment should be done periodically, to account for any new risks that arise due to changes in the business.

c. control activity: It is the use of accounting systems, information technology, and other resources to ensure that the appropriate controls have been implemented and operate properly.

d. accounting information and communication about the information to be communicated to management control in a timely manner, so that deficiencies can be addressed. The amount of information conveyed must be in accordance with the needs of the recipient.

e. Monitoring: It is the set of processes used by management to examine and assess whether internal controls are functioning properly. Ideally, management should be able to cope with a failure to control and adjust and improve the control environment.

2.1.5. The way that internal auditors are organized.

The internal audit as a department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations. The internal audit activity helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes" (IIA, 2012).

Internal audit department performs several functions in an organization. These functions also prove to be equally valuable in a non-profit oriented organization. An internal audit function should exist separate and distinct from the work of the control group in the data processing department since the internal auditors are interested in evaluating the overall efficiency of data processing operations and the related internal control.

The internal auditor should participate in the design of the data processing system to ensure that the system (information technology) provides a proper audit trail and includes adequate controls. Among other things,

As per Okoli (2012), the internal auditors will try to determine that no changes are made in the system without proper authorization, ensure that programming personnel are functionally separate from computer operating personnel, ensure that adequate documentation is maintained, input controls are functioning effectively, and that the control groups are performing their assigned functions. The chief internal auditor must lay down rules and procedures that will guide the performance of their duties and control the department. He must provide an outline for those under him to know how they should execute their assigned functions accordingly. This outline is known as an audit plan. Audit plan may be described as a statement of objectives or targets to be attained by the department of internal audit in future, together with an outline of the steps

necessary to attain each of them. Audit plan prepared in the planning stages of the engagement, usually include such matters as the objectives of the engagement, nature of the work to be done, a time schedule for major audit work and completion of the engagements and staff requirements (Okoli, 2012).

An internal audit is an independent verification of the MFI's results. The definitions of 'independent' are very important to comprehend here. Internal audit must be a fully autonomous, operational-free feature. Freedom is assured by providing a completely independent team of workers and the department reporting directly to either the board of directors or the head of the company. It is necessary to keep the audit department autonomous for an impartial evaluation of the company. Therefore, freedom and objectivity are keys to this feature. The concept behind Internal Audit is not just to catch fraud or malpractice, but to be more proactive, i.e. by minimizing the possibilities of malpractice, to add value and effectiveness inside the company. Internal Audit is done by a specialized Internal Audit team who should be very well versed with the organization's policies and procedures (Saikou and Erina, 2022).

To predict and explain the efficacy of internal auditing, several individual theories have been developed, including communication theory, structuring theory, institutional theory, and agency theory Narkchai and Fadzil (2017). The theory of communication suggests that the efficiency of the internal audit depends primarily on the communication skills possessed by internal auditors. The theory of structuring suggests that the key structural properties required to understand the relationships between social behaviors, including accounting and auditing, are culture, power, and morality. Institutional theory assumes that internal audit practices are ultimately established by institutional standards, which, in turn, describe the institutional improvements necessary to strengthen current internal audit practices.

According to OKARO et al. (2017) which has been widely used to justify the efficacy and motivate the internal audit mechanism for an efficient risk management role . Bank collapse, for example, rose to 200 percent in the United States of America in 1980 due to fraud and mismanagement. The literature demonstrates that, according to Musah, Gapketor, and Anokye

(2019) Internal auditing was carried out in a rudimentary way in both private and state-owned institutions prior to the 1980s. As referenced in OKARO et al. (2017) It argues that internal audits have largely been focused on compliance, along with institutional financial rules, protocols and vindicating the existence of physical properties, also in private entities.

Dittenhofer (2001) and Getie Mihret, James, and Mula (2010) as cited in Coram, Ferguson, and Moroney (2008) It claimed that internal auditing in both the private and public sectors is emerging as an essential component of management and a governance mechanism. However, Mustika (2015) stated that the reliability of the internal audit function is significantly important, particularly for private organizations, as most stakeholders are the most reliable. World economic Forum (WEF) et al. (2018) and Tazilah and Hussain (2015), Internal audits of organizations are severely intertwined with the corporate leadership systems used to manage, organize and guide the institution's everyday business or relations.

The internal audit role is an autonomous, objective assurance and consultancy practice signed to add value and enhance the effectiveness and protection of the activities of an MFI (The SEEP Network 2011). The mindset of the agency being audited is closely connected to the performance or failure of the internal audit. However, very few variables had major impacts on the perception of results by the audited department manager. All businesses must also review their performance appraisal metrics, the content, and strategies of using job descriptions, and education and training (Hung and Han 1998).

2.1.4. Theoretical literatures

The principal-agent theory emerged in the 1970s. The first scholars to propose the theory may have been Stephen Ross and Barry Mitnick, who discussed the economic and institutional perspective of the theory (Mitnick, 2006). However, the most cited reference to the theory comes from Michael Jensen and William Meckling, who proposed an agency theory of the firm (Mitnick, 2006). Jensen & Meckling (1976) stated that relationships are based on the separation of ownership from control where a contract between the owner (principal) and the employee

(agent) is established. Within this relationship, the principal engages a third party(agent) to perform a service on their behalf by delegating authority to the agent (Jensen &Meckling, 1976). The contract should explain what task(s) the agent should perform on behalf of the principal who lacks the skills and abilities needed to do so himself (Fama & Jensen, 1983).

According to Eisenhardt (1989), two problems may occur in agency relationships. The first problem occurs when the desires and goals of the principal and agent differ, and the second problem occurs when the principal and agent have different risk preferences. The agent can get away with acting in its own self-interest due to information asymmetry, which arises when the agent has information superior to what the principal has (Akerlof, 1970). Information asymmetry mainly concerns the principal's lack of knowledge about the agent's work (Eisenhardt, 1989). There are two types of information asymmetry within the principal-agent relationship. The first is called ‘moral hazard’, which occurs when the agent enters a contract with bad intentions and provides misleading information (Akerlof, 1970).

The second problem is called ‘adverse selection’ and occurs when the agent has more accurate and different information than the principal. Consequently, it gives the agent an opportunity to take advantage of the situation and deviate from its duties (Akerlof, 1970).

2.1.4.2. Resolving Agency Problems

Jensen & Meckling (1976) have pointed out the generality of agency problems as they exist in all organizations and all cooperative attempts. Hence, people are generally rational and may act according to their self-interested motivations where both parties attempt to maximize their self-interests. This causes conflicts of interest (Jensen, 1994). Adams (1994) argued that agency costs rise because of the contracting process. Principal-agent problems would not arise if it were possible to write complete contracts. However, because one can never predict all future contingencies, complete contracts will never be possible (Jensen & Meckling, 1976; Fama & Jensen, 1983). On the other hand, it is possible to reduce agency problems by introducing agency costs (Roberts, 2005). Agency costs create incentives for associating self-interested opportunism

with the interest of principals and creating sanctions to limit agent opportunism (Roberts, 2005). The problem varies due to the organization's character and complexity: the bigger the problem, the more expensive it was to maintain the contractual relationship between the parties (Adams, 1994). Furthermore, several monitoring mechanism shaves been introduced to reduce agency problems (ICAEW, 2005; Roberts, 2005). Thus, principals use monitoring mechanisms as tools to verify whether the agents are carrying out their instructions properly (Fama & Jensen, 1983; ICAEW, 2005). Monitoring mechanisms can therefore help mitigate agency costs due to information asymmetry. They can consequently align the incentives between the principal and the agent (Adams, 1994).

From the above discussion, proponents of the agency theory believe that monitoring mechanisms are significant in mitigating agency problems (Fama & Jensen, 1983; Adams, 1994). Podrug (2010), on the other hand, has said that empirical research confirms show monitoring mechanisms yield stronger individualistic behaviors and reduce proactive organizational behaviors and trustworthiness; hence, they result in distrust.

2.1.4.3. The principal-Agent Theory and Internal Audit (IA)

Adams (1994) examined how agency theory can help explain the existence, roles, and responsibilities of the IA's activity. The author identified the IA's activity as having an important role in contributing toward the continual monitoring of internal controls on behalf of the board. The IA provides assurance to the board regarding the effectiveness and compliance of agency-oriented controls through the AC (Adams, 1994). In turn, the board can prevent risks before they have a significant effect on the internal control system and its financial position. The principal-agent theory emphasizes that the IA, in the same way as the EA, plays an important role in maintaining cost-effectiveness, monitoring contracts, and reducing information asymmetry (Adams, 1994). The IA has therefore become the set of functions and routines that make it possible to control both the agents' and the principals' actions and behaviors (Roberts, 2005).

2.1.5. Internal Auditing in Ethiopia

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

As to Lemma Argaw, the ministry of education, ministry of national defense and the ministry of finance were pioneers in implementing the internal audit practice in Ethiopia. He revealed this fact as follows. 'An Internal Auditing function has existed for quite a long time in Ethiopia; however, it got legal recognition in late 1980s. The internal auditing function started in the budgetary public sector as part of internal control. However, the latter part of the 1940s witnessed the establishment of Internal Audit functions in the Ministry of National Defense, Ministry of Education, and Ministry of Finance. It was also at this time that the Internal Auditing units began to sprout in non-budgetary public sector (public enterprises) like Ethiopian Highway Authority, Ethiopian Airlines, Ethiopian Telecommunications, and financial sector that formed the modern layer of the National Economy" (Lemma, 2000). Perhaps the most direct impact on the status of internal auditing in Ethiopia came from another important document issued in 1987, Proclamation No. 13 (Welde-Ruphael, 1998).

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

An Internal Auditing function has existed for quite a long time in Ethiopia. Perhaps the most direct impact on the status of internal auditing in Ethiopia came from another important

document issued in 1987. Proclamation No. 13/1987 not only reemphasized the importance of the internal audit function in government departments and public enterprises; it also empowered the Office of Auditor General in three aspects that are whether accounting records are properly maintained and reliable, whether the assets of the ministries and enterprises are adequately safeguarded and properly maintained whether policies and procedures laid down by top officials/management are complied with that implies less attention was given to operational audits a service to management.(Lemma Argaw, Dee 2000) . On July 1, 1997, the Financial Administration Regulations No. 17/1997 was issued in which the responsibility of internal aud it function was transferred from the Office of the Auditor General to the Minister of Finance to develop and maintain appropriate standards of work.

In May 2007 policy directive was issued to further strengthen the Internal Audit service function in the public bodies, however, the legal basis laid down by both in the Regulations of Council of Ministers and the Ministry of Finance Directive is applicable only to internal auditing under the helps of Public bodies and does not apply to public enterprises and the private sector, but recently Public Enterprises Supervising Authority has issued policy directive for establishment of audit committees in all public enterprises and an audit manual to maintain uniformity of audit work in all public enterprises. (Samuel Mulugeta 2009).

2.2. Review of empirical studies

2.2.1. Review of empirical literatures at Global level

Globally, (Okoli, 2012) examines the role of internal audit in financial institutions in Nigeria. In her research, she ascertained the role which internal audit plays in financial institutions and how far internal audit function has contributed to the overall performance of the organizations. Analyzing the data gathered from both primary and secondary sources, Okoli discovered that the internal audit department perform various functions which consist mainly of ensuring the production of accurate and reliable report, limitation of operational inefficiency on the part of workers and the prevention of misappropriation of funds. The researcher was also of the view

that, if internal audit is established in financial organization, it will contribute immensely towards the overall performance of these organizations through minimizing fraud and extravagant use of funds and inducing worker to give complete and accurate information.

Internal audit function and financial performance of microfinance institutions in Makindye division: a case of pride microfinance Kabalagala branch was studied by Makona (2019). The purpose of the study was to find out the effect of internal auditing on financial performance pride microfinance institutions. The study objectives were to establish the effect of internal audit Standards on the financial performance, to examine the effect of professional audit competency on financial performance and to determine the effect of internal controls audits on financial performance of Microfinance Institutions. The data was collected from 30 respondents who were employees of Pride Microfinance. The study employed a cross-section research design used on the questionnaire data that was closed ended. The findings reveal that internal audit function influences financial performance of Pride Microfinance, supported by the significant positive perceptions and the literature support on the internal audit Standards, professional audit competency and Internal controls audits seen supporting the financial performance. Based on the findings, the study concludes that internal audit Standards affect the financial performance of Pride Microfinance, the research concludes that effective audit standards implementations can derive financial performance for the organization. On the second research objective, Professional audit competency contributes to financial performance of Pride microfinance authority. Present findings on the relationship with financial performance of Pride microfinance Limited. On the third objective, Internal controls audits on financial performance Pride Microfinance through increase effectiveness in credit control, Improves marketing initiatives of the organization, enhanced control over organizational activities, mechanism for stimulating risk management, there is realization of value for money in the operations, effective internal control lead to proper credit control, auditing of financial books lead to increased profitability and proper financial management leads to effective debt collection. The research comments that Pride Microfinance should maintain the existing control environment, formation and communication, assurance services as per results of the findings which showed a positive significant effect on these

attributes to performance. On the second objective, professional audit competency can be improved through in-house audit training programs and control self-assessment questionnaires to create more awareness to staff of the roles and duties of internal auditors to enable audit services such as advisory services to run smoothly. On the third objective, the study also recommends that Management should establish and implement periodic view of internal audit performance to ensure that its performance and value to the Institution is maximized and to ensure compliance with appropriate standards and guidance.

Kwadwo (2016) employed a study on the effectiveness of Internal Audit in Micro Financial Institutions: Evidence from Selected Financial Institution in Ghana. Data was obtained from three leading MFIs in Ghana. The data was collected from 30 respondents in these MFIs using structured questionnaires and in-depth interviews with chief internal auditors of the MFIs. The result indicated a negative relationship between technical competence and internal audit effectiveness, no significant relationship between independence and internal audit effectiveness. The study recommends the upgrading of technical competence in audit staff through training programs to boost the effectiveness of the internal audit function.

The study of Mark (2018) was on internal Audit Functions and its Effect on Financial Performance. performance of Rift valley bottler's limited, Eldoret. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization meet its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. This research was guided by Agency theory. This study adopted a correlation research design, with open and closed ended questionnaire. The target population was 40 employees with a sample size of 40 people. The respondents were mainly employees from finance, human Resource, and procurement departments. The data collected was analyzed using multiple linear Regression Analysis model to show the effectiveness of internal audit functions on financial performance of the Company. The study measured the variables of internal audit functions which are risk management, internal controls, and governance in the form of financial

accountability. Findings showed that Internal auditing is an independent, objective assurance and consulting activity designed to add value, improve an organization's operations, and help an organization meet its objectives. This study recommends that organizations like Rift Valley Bottlers should always conceive and adhere to the internal audit functions in a positive way to improve its financial performance.

2.2.2. Review of empirical literatures at Local level

Aklilu (2022) studied the factors Affecting Internal Audit Effectiveness: Evidence from Microfinance Institutions Operating in Hawassa. To examine effectiveness of IA in MFIs operating in Hawassa city, the study used mixed research design with quantitative approach. Management support, independence of internal audit, having approved internal audit charter, adequate and competent internal audit staff, and quality of internal audit are used as explanatory variables while, internal audit effectiveness considered as explained variable. The population was all MFIs currently operating in Hawassa city. The targeted populations were 54 respondents and all of them were selected as Sample size based on judgmental sampling method. Both descriptive and inferential statistics were used to analyze the data. The result identified that, Management support, Independence of internal audit, having approved internal audit charter, adequate and competent internal audit staff, and quality of internal audit were contributed to internal audit effectiveness in MFIs is positively and significantly and it is making 23.9%.

The study of Zewdu (2019) assessed Internal Audit Practices in Ethiopia (The Case of Finance and Economic Development Office in Adama City). The researcher used descriptive type of research design and to achieve this objective the necessary data was collected from primary as well as secondary data sources, the primary data was collected from the target employees by using questionnaires and secondary data was obtained from manuals and related written materials and documents. Based on the findings of the study, the organization doesn't provide reasonable assurance regarding of prevention, or timely detection and correction of unauthorized acquisition, use or disposition of the entity's assets that could have a material effect on the financial statements, the company auditors doesn't involve in the activities of drafting policies

and there is a problem around classification of performance deficiencies. Based on this finding the researcher recommends that the organization should give attention regarding to these problems and try to overcome them in cooperation with the employees to perform a quality audit inspection within the organization.

Another study (Eyerusalem, 2023) revealed that, management support, management's perception of internal audit values, of internal auditors, placement of adequate and competent internal audit staff, and the presence of approved internal audit charter were the identified factors to assess the practices of the internal audit. The study adopted qualitative research methods and the internal audit staff of the Addis international bank were the primary source of data. Data was collected through questionnaires which were developed through review of the related literatures, journals, research articles, and websites used to gather data for the study. The collected data from the questionnaires were coded, they were entered into the Statistical Package for Social Sciences (SPSS) version 20 computer package for analysis. Purposive sampling technique was used to conduct the research of which the internal audit staffs were primary source of data collected. According to the research findings, the bank has strong organizational independence for internal auditors. The top management support to internal audit and management's perception of internal audit value is good that it is facilitating the practice of internal auditing. Addis international bank should provide adequate support and encouragement for training and development of the internal audit staff. Furthermore, the management should acknowledge the internal audit recommendations as a tool which contributes to the improvement of risk management, control and governance using a systematic and disciplined approach in the bank (Eyerusalem, 2023).

Fikre (2019), studied the effect of internal audit on the financial performance of Bureau of finance & Economic Development of the Oromia Regional State. In the study quantitative analysis and regression analysis were used as data analysis techniques. The studied found that a unit increase in independence of internal audit, professional competency, internal audit standards, support of management, and internal control would lead to increase a in financial

performance of organization and further unit increase in internal control would lead to increase in financial performance of organization.

2.3. Research Gap

Kwadwo (2016) found that there is a negative relationship between technical competence and internal audit effectiveness, no significant relationship between independence and internal audit effectiveness. This study is employed in Kenya and focused on effectiveness of internal auditors in Micro financial institutions. The function of internal audit in the financial performance of microfinance institutions was studied by Makona (2019). This study revealed that, the internal audit function influences financial performance of Pride Microfinance, supported by the significant positive perceptions and the literature support on the internal audit Standards, professional audit competency and Internal controls audits seen supporting the financial performance. Okoli (2012) examined the role of internal audit in financial institutions in Nigeria, and exposed that the internal audit department perform various functions which consist mainly of ensuring the production of accurate and reliable report, limitation of operational inefficiency on the part of workers and the prevention of misappropriation of funds. However, these studies are employed out of Ethiopia and implied the prevalence of the scope gap. Therefore, contextualized the issues in Ethiopia is considerable.

As per the researcher in Ethiopia organization doesn't provide reasonable assurance regarding of prevention, or timely detection and correction of unauthorized acquisition, use or disposition of the entity's assets that could have a material effect on the financial statements, the internal auditors doesn't involve in the activities of drafting policies and there is a problem around classification of performance deficiencies (Zewdu, 2019). The study of Aklilu (2022) and Eyerusalem (2023) focused on the factors Affecting Internal Audit Effectiveness. And, their results revealed that, management support, management's perception are of internal audit values, organizational independence of internal auditors, placement of adequate and competent internal audit staff, and the presence of approved internal audit charter were the identified factors to assess the practices of the internal audit. On the other hand, Fikre (2019), studied the effect of

internal audit on the financial performance and found that professional competency, internal audit standards, support of management, and internal control would lead to increase a in financial performance of organization. The research in Ethiopia is limited whether the factors affecting and their effects. Therefore, there is a knowledge gap in the roles of internal auditors in the performances of micro finances.

2.3. Conceptual Framework Summary

Dr. Jane Smith's 2024 the roles of internal audit conducts assurance audits through the following five-phase process:

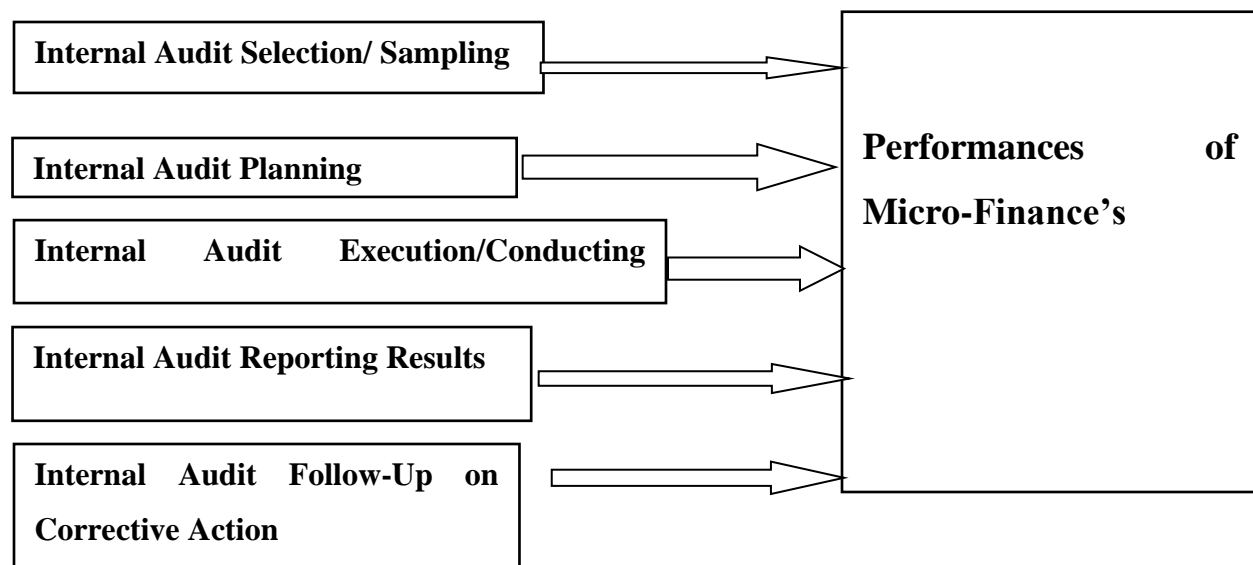
1. Selection: Audit activities are selected using a risk-based approach. Internal audit meets with leadership and management during the development of the annual audit plan to discuss risks and potential impediments to meeting objectives. This plan has been approved by the Executive and Audit Committee of the Board of Trustees. Audits can also be conducted based on concerns reported on the fraud and ethics hotline.
2. Planning: Each audit requires planning, starting from defining the scope and objective to developing audit steps to meet the objective. Internal audit conducts an entrance meeting with management to discuss the purpose of the audit, risk factors, and other logistics. Management is included in the planning phase and the details are documented in a planning and scoping memo.
3. Fieldwork: During the fieldwork phase, auditors conduct the steps identified in the planning process. Steps often include conducting interviews, reviewing laws, policies, and best practice, verifying sample transactions, analyzing data sets, and conducting surveys. Auditors meet regularly with management throughout fieldwork and discuss the status of the audit, preliminary observations, and potential recommendations.
4. Reporting: Auditors conduct an exit meeting with management at the conclusion of the fieldwork to discuss the results of the audit, specific findings and recommendations and other observations. Auditors communicate these to management through an audit observation memo and ask management to provide a response with a corrective action

plan and timeline to implement. These responses are included in the final report. Management and leadership are provided with an opportunity to review drafts and provide feedback.

5. Follow-up: All audit recommendations and management corrective action plans are followed up to provide assurance that plans are implemented. Corrective action plans that do not appear to be progressing are reported annually to the president and Executive and Audit Committee.

Based on the above, the current study follows the following conceptual framework.

Figure 1. Conceptual Framework



CHAPTRE THREE

RESEARCH METHODOLOHY

3.1 Introduction

This Chapter presents the methodological issues used in conducting this research and explains each stage taken. It involves the general research design, population of study, Sample size and sampling technique, Sources of data, research instrument and methods of data analysis and presentation.

3.2 Research Design

The current study adopted both descriptive and explanatory research design. The study described the characteristics and depth of the organizational culture on customer satisfaction and loyalty. Besides, the study provided the existing phenomena with implication on area under investigation. According to Kothari (2004) the main drive of descriptive type is to deliver explanation of the status of a given situation. Besides, descriptive research is a typical instrument to define the features of a given occurrence.

On the other hand, the nature of this research was to test the causal relationship of the dependent and independent variables. For that matter explanatory research design was also employed.

3.3 Research Approach

There are three approaches that are used in conducting given research. These are quantitative, qualitative, and mixed research approach. Quantitative research is a means for testing objective theories by examining the relationship among variables (Creswell, 2009). On the other hand, qualitative research approach is a means for exploring and understanding the meaning individuals or groups assign to a social or human problem with intent of developing a theory or pattern inductively (Creswell, 2009). Mixed approach is an approach in which the researchers

emphasize the research problem and use all approaches available to understand the problem (Creswell 2003).

Hence, based on the above discussions of the three research approaches and by considering the research problem and objective, in this study, the researcher used mixed research approach. The rationale for combining both quantitative and qualitative data is to better understand a research problem by combining both numeric values from quantitative research and the detail of qualitative research and to neutralize limitations of applying any of a single approach.

3.4 Target Population

According to the Association of Ethiopian micro finance institutions/aemfi-ethiopia.org/all/listings/ in the year of 2023, in Addis Ababa there are 30 Micro finance institutions (their list is attached in appendix 1). Therefore, the target population of the research was 30 microfinances.

3.5 Sample size and Sampling Technique

A sample design is a definite plan for obtaining a sample from a given population. It refers to the technique or the procedure that the researcher adopted in selecting items for the sample. The researcher must select or prepare a sample design which would be reliable and appropriate for this research study (Kothari, 2004).

According to the Association of Ethiopian micro finance institutions/aemfi-ethiopia.org/all/listings/ in the year of 2023 the number of the internal auditors within the 30 micro finances established in Addis Ababa were 145. Since the number of micro finances is not too large information was collected from all units in the population or a 'complete enumeration' of the population. By doing this, data for small areas may be available, assuming satisfactory response rates were achieved; data for sub-populations may be available, detailed cross-tabulations may be possible; and the estimates are not subject to sampling error. Thus, through

census all 145 internal auditors of the 30 micro finances branches were proposed to participate in this study.

3.6. Type and Sources of Data

The research used both primary and secondary sources of data. Primary data were collected through questionnaire and interview. The secondary was obtained from written documents like policies and theories on the role of internal Audits in the performance of selected Micro finances.

3.6. Data collection techniques

3.6.1. Questionnaire

Questionnaires were used for the reasons of to provide factual data from the respondents; it assured one too many communications and to incorporate many respondents; it is economic wise; and to have objective data on the area. Hence, close ended questionnaire was prepared.in the first part the questionnaire contains the demographic personal data of the respondents, the second part of the questionnaire contains the way that the internal auditors are organized and the way that the internal auditors perform their tasks. The third part of the questioner contains the: Performance of the micro finance's and the last one the questioner contains Internal auditor's effect

For the predetermined response questionnaire, a five-point Likert scale ranging from Strongly Disagree (1) to Strongly Agree (5) was used. Because a five-point Likert scale is a popular rating scale that asks respondents to indicate their level of agreement or disagreement with a series of statements or questions (Albaum, 1997).

3.6.2. Interview

Interview were provided flexibility to the interviews and helps to bring out needed information and data for the research purpose. The researcher employed five managers and internal auditor heads of five micro finances.

3.7 Data Analysis Tools

3.7.1. Quantitative Data Analysis

Simple descriptive statistics were utilized to attain a summary of the present data. Also, simple, and cross-tabulations tables were used to display the quantitative data that were collected through questionnaire.

Regarding inferential statistics correlation and multiple regressions were used to investigate the roles of internal audit in the performance of micro finances. Therefore, the following model is specified:

$$PMf = \alpha + \beta_1 S + \beta_2 P + \beta_3 E + \beta_4 R + \beta_5 F + e$$

Where: PMf= Performance of Micro finances

S= selection/sampling

P= planning

E= execution/conducting fieldwork

R= Reporting results and

F= follow-up on corrective action.

3.7.2. Qualitative Data Analysis

The research analyzed the interview through qualitative data analysis method. The reasons to use qualitative were to enrich the findings with lively and detailed information that quantitative data does not always provide; to better understand the experiences and challenges of internal audits

that can help the reader to understand the data is better. Therefore, qualitative data analysis was employed for the interview results.

The researcher follows the following steps to analysis the qualitative data: First, memos were prepared and recorded (audio and visual) carefully the data. Secondly, the recorded data were labeled and archived. It was done on paper to copy the data held. The data have the basic information like, name of interviewee, location of interview, date and time of interview and methods used. In the third place, the objectives were reviewed. Fourth, the contextual and demographic were analyzed. Fifth, it was carefully read through the data and was put into code. Sixth, the summaries of the themes were identified. Seventh, the findings were interpreted, and the contributions were assessed.

3.7. Validity and Reliability

3.8.1. Validity

To collect data through the questionnaire from the internal auditor's the researcher followed several stages from designation to collection. For the proper usage of terms, the questionnaire was commented on by auditing experts.

3.8.2. Reliability Test

To test the reliability of the measurements, a pilot test was undertaken from five respondents and a Cronbach Alpha test of reliability was calculated to measure the internal consistency of the items under the five variables. According to Funk (2007), Cronbach alpha is a measure of internal consistency and if coefficient values lie in the range of .900 to 1.00 labeled as excellent, from 0.800 to 0.899 labeled as very good and if ranges from .700 to .799 labeled as good. A Cronbach Alpha coefficient with a label of good and above good is accepted.

3.9 Ethical Considerations

When doing research, treating people unfairly and using the information acquired during the research work or allowing others to use it to harm people is unethical (Collin F., 2007). With this view, any information gathered from any individuals and the staffs during the research work treated confidentially without disclosing the respondent's identity or customer's confidential information. For this reason, the respondents were allowed to respond anonymously to the questioners.

The data was collected with the full consent of the participants. Involuntary participants were replaced by the same number of voluntary professionals or patients. The purpose of the research was clarified for increased participants on voluntary basis. According to Creswell (2003) the researcher has an obligation to respect the rights, needs, values, and desires of the informant(s), therefore the rights, needs, values, and interests of respondents should be respected. The researcher followed ethically and morally acceptable processes throughout the research process. The data was collected with the full consent of the participants.

CHAPTER FOUR

DATA PRESENTATION, ANALYSIS AND INTERPRETATION

4.1. Introduction

The main purpose of this research was to investigate the effect of internal Audits in the performance of selected Micro finances established in Addis Ababa. As a result, data were collected from 129 internal auditors of 29 response rate branches through a questionnaire. The items in the variables were measured using '5-point Likert Scale of Strongly Disagree (5) to Strongly Agree (1)'. The rule of thumb pertaining to the intervals for breaking the range in measuring variables that are captured with the five-point Likert type scale (that ranges from strongly disagree to strongly agree) is calculated by $(5-1=4)$ then divided by five as it is the greatest value of the scale ($4/5=0.8$). Afterwards, number one which is the least value in the scale is added to identify the maximum of this cell. Thus, the cut off applied in the following descriptive statics were strongly disagree if the mean is from 1 to 1.8; disagree if the mean is from 1.6 to 2.64; moderate if the mean is from 2.65 to 3.2; agree if the mean is from 3.21 to 4.2; strongly agree if the mean is from 4.21 to 5.00.

4.2. Response rate

Table 2. Response rate

Distributed questionnaire	Responded questionnaire	Response rate
145	129	88.97 %

(Source: Field Survey, 2024).

As shown in Table 2, the average response rate of the respondents computed about 88.96%. The questionnaire was distributed to 145 internal auditors of Microfinances established in Addis Ababa, 129 of them responded made the response rate 88.97%.

4.3. Reliability test

To test the internal consistency of the six variables of the questionnaire, a pilot test was employed by participating five respondents. Their responses were encoded to SPSS and the scale of the variables were computed as shown in the below Table 1.

Table 3. Reliability Statistics

Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of variables
.909	.928	6

(Source: Field Survey, 2024)

The ‘Cronbach’s Alpha’ is the widely accepted and famous instrument used to evaluate the reliability of the instruments. Cronbach’s alpha reliability coefficient normally ranges between 0 and 1. The closer the coefficient is to 1, the greater is the internal consistency of the items (variables) in scale/. The coefficient value of the Cronbach’s Alpha in the test was .928 which is labeled as excellent.

Table 4. Cronbach Alpha of the Variables

No	Variables	Number of items	Cronbach's Alpha if Item Deleted	Labeled as
1	Internal audit planning	5	.879	Very Good
2	Internal audit sampling	6	.923	Excellent
3	Internal audit field work	5	.871	Very Good
4	Internal audit reporting	5	.866	Very Good
5	Internal audits follow up	5	.911	Excellent
6	Performance of the micro-Finance	7	.903	Excellent
	Total	33		

(Source: Field Survey, 2024)

4.4. Participant's Profile

: Table 5 Socio-Demographic Data About Respondents

Variables	Description	Frequency	Percent
Gender	Female	46	35.66%
	Male	83	64.34%
Age	18-25	3	2.33%
	26-33	39	30.23%
	34-41	64	49.61%
	42-49	16	12.40%
	50-57	5	3.88%
	Above 58	2	1.55%
Education Background	Diploma	50	38.76%
	First degree	56	43.41%
	Second degree	23	17.83%
Experience of the auditors (in year)	1-4	19	14.73%
	5-8	16	12.40%
	9-12	2	1.55%
	Above 13	92	71.32%

(Source: Field Survey, 2024)

4.4.5. Auditing type

Table 5. Which auditing step was most employed? (Multiple response is possible)

		Frequency	Percent
Valid	Interview	4	3.1
	Reviewing laws, policies, and best practice	31	24.0
	Verifying sample transactions	82	63.6
	analyzing data sets	8	6.2
	Conducting surveys	4	3.1
	Total	129	100

(Source: Field Survey, 2024)

For the question i.e. which auditing step was mostly employed in the microfinance were replied as: Interview 4 (3.1%); Reviewing laws, policies, and best practice 31 (24.0%); Verifying sample transactions 82 (63.6%); analyzing data sets 8 (6.2%) and Conducting surveys 4 (3.1%). This implied that, the frequently employed auditing type in the micro finances were Verifying sample transactions with a share of 63.3%. The practices included in conducting audits are conducting interviews, reviewing laws, policies, and best practice, verifying sample transactions, analyzing data sets, and conducting surveys. The internal auditor's frequent type of auditing is verifying transactions, this type is effective for its accuracy of detecting frauds.

4.6. Descriptive Results

A descriptive result is a summary of the basic features of data in a study, providing simple summaries about the sample and the measures. Descriptive statistics are used to present quantitative descriptions in a manageable form. They help simplify large amounts of data in a sensible way. Each descriptive statistic reduces lots of data into a simpler summary.

Key Elements of Descriptive Results:

1. **Frequency Distribution:**

- Shows how often each value in a set of data occurs.

2. **Measures of Central Tendency:**

- Mean (average), median (middle value), and mode (most frequent value).

3. **Measures of Variability:**

- Range (difference between the highest and lowest values), variance, and standard deviation (how much the values deviate from the mean).

4. **Percentages and Proportions:**

- Used to express how a part of the data relates to the whole.

4.6.1. Audit Sampling

Table 6. Audit Sampling (N=129)

Descriptions		Frequency	Percent	Score mean	SD
Audit activities are selected using a risk-based approach	Strongly Disagree	3	2.3	4.06	0.97
	Disagree	3	2.3		
	Neither Agree nor Disagree	30	23.3		
	Agree	40	31.0		
	Strongly agree	53	41.1		
	Total	129	100		
Sample / plan identified explicit steps to be followed	Strongly Disagree	2	1.6	4.04	0.92
	Disagree	3	2.3		
	Neither Agree nor Disagree	31	24.0		
	Agree	44	34.2		
	Strongly agree	49	37.9		
	Total	129	100		
Internal audit meets with management during the development of the annual	Strongly Disagree	3	2.3		
	Disagree	15	11.6		
	Neither Agree nor	24	18.6		

audit plan to discuss risks and potential impediments to meeting objectives.	Disagree			3.85	1.08
	Agree	43	33.3		
	Strongly agree	44	34.2		
	Total	129	100		
The plan is approved by the Executive and Audit Committee of the Board of Trustees.	Strongly Disagree	1	0.7	3.89	0.70
	Disagree	3	2.3		
	Neither Agree nor Disagree	31	24.0		
	Agree	68	52.7		
	Strongly agree	26	20.3		
	Total	129	100		
Audits are conducted based on concerns reported on the fraud and ethics hotline.	Strongly Disagree	3	2.3	3.89	0.94
	Disagree	3	2.3		
	Neither Agree nor Disagree	38	29.5		
	Agree	47	36.4		
	Strongly agree	38	29.5		
	Total	129	100		
Grand mean				3.95	0.92

(Source: Field Survey, 2024)

The first item i.e., Audit activities are selected using a risk-based approach: The mean score of 4.06 falls within the "strongly agree" range, indicating a high level of agreement among respondents that audit activities are selected using a risk-based approach. This suggests that the

organization's current practices align well with risk management strategies, as perceived by the respondents. Additionally, with only 31% of respondents selecting "agree," and a majority falling into the "Agree" and "strongly agree" categories, the consensus is quite strong regarding the effectiveness of the risk-based approach in selecting audit activities.

The second item i.e., The audit plan identified explicit steps to be followed: With a mean score of 4.04, respondents tend to "strongly agree" that the audit plan identifies explicit steps to be followed. This indicates a high level of satisfaction with the clarity and specificity of the audit plan among the respondents. However, it's worth noting that the percentage of respondents falling into the "strongly disagree" category (1.6%) suggests that there's still a sizable portion of respondents who perceive ambiguity or inadequacy in the audit plan's explicit steps.

The third item I.e., Internal audit meets with leadership and management during the development of the annual audit plan: The mean score of 3.85 places this statement in the "agree" range, indicating a generally positive perception among respondents. However, the standard deviation of 1.08 suggests some variability in responses, indicating that while many respondents agree with this statement, there are also a significant number who disagree or have mixed views. This could imply potential inconsistencies in communication or engagement between internal audit and organizational leadership.

The fourth item i.e. The plan is approved by the Executive and Audit Committee of the Board of Trustees: With a mean score of 3.89 falling within the "agree" range, respondents generally agree that the audit plan is approved by the relevant authorities. However, the standard deviation of 0.70 suggests relatively consistent agreement among respondents, indicating a more homogeneous perception compared to the previous item. Nevertheless, the percentage of respondents in the "disagree" and "strongly disagree" categories (52.7%) underscores potential concerns regarding the adequacy or transparency of the approval process.

The fifth item i.e. Audits are conducted based on concerns reported on the fraud and ethics hotline: The mean score of 3.89 falls within the "agree" range, indicating a generally positive

perception among respondents regarding the responsiveness of audits to concerns reported on the hotline. However, the standard deviation of 0.94 suggests some variability in responses, with a percentage of respondents falling into the "strongly disagree" category. This suggests potential gaps or inconsistencies in the organization's processes for addressing concerns raised through the fraud and ethics hotline.

In summary, while the overall grand mean suggests a positive perception of the audit activities assessed, there are notable variations in respondents' perceptions across different aspects of the audit process. Addressing these variations and potential concerns can help enhance the effectiveness, transparency, and integrity of the organization's audit practices.

4.6.2. Audit Plan

Table 7. Audit Plan (N=129)

		Frequency	Percent	Score mean	SD
Each audit has an audit plan	Strongly Disagree	3	2.3	3.94	0.91
	Disagree	3	2.3		
	Neither Agree nor Disagree	31	24.1		
	Agree	53	41.1		
	Strongly agree	39	30.2		
	Total	129	100		
The audit plan defined the scope of the audit	Strongly Disagree	5	3.87	3.71	1.028
	Disagree	10	7.75		
	Neither Agree nor Disagree	32	24.81		
	Agree	52	40.31		
	Strongly agree	30	23.26		
	Total	129	100		
The audit plan defined the objectives of the audit	Strongly Disagree	6	4.6	3.90	1.12
	Disagree	9	7.0		
	Neither Agree nor Disagree	25	19.4		
	Agree	40	31.0		

	Strongly agree	49	38.0		
	Total	129	100		
The audit plan developed audit steps to meet the objective.	Strongly Disagree	3	2.33	4.06	.0.97
	Disagree	3	2.33		
	Neither Agree nor Disagree	30	23.26		
	Agree	40	31.0		
	Strongly agree	53	41.08		
	Total	129	100		
The audit plan announced by conducting an entrance meeting with management to discuss the purpose of the audit, risk factors, and other logistics.	Strongly Disagree	6	4.65	3.49	0.84
	Disagree	6	4.65		
	Neither Agree nor Disagree	41	31.8		
	Agree	70	54.25		
	Strongly agree	6	4.65		
	Total	129	100		
Management is included in the planning phase and the details are documented in a planning and scoping memo.	Strongly Disagree	2	1.55	3.6	1.069
	Disagree	20	15.50		
	Neither Agree nor Disagree	28	21.71		
	Agree	45	34.88		
	Strongly agree	34	26.36		
	Total	129	100		

Grand mean	3.78	0.99
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(Source: Field Survey, 2024)

Table 7 shows the five items of audit plan.,

The grand mean for the planning was 3.78 pointed out that, the audit planning is properly exercised in Micro Finances established in Addis Ababa.

On the first item of audit plan, *each audit has an audit plan* (score mean= 3.94-), revealed that the respondents agreed with the items. As shown in the audit sampling the audits are selected, here each audit has its own plan.

On the second item i.e. *The audit plan defined the scope of the audit* (score mean= 3.71) revealed that, the participants agreed with the item. Thus, the audit plans made in micro finances defined the scope of the audits.

The third item reads as *the audit plan defined the objectives of the audit accounted a score mean of 3.90* implied that the auditing plan has defined the objectives of the audit.

On the fourth item (*the audit plan developed audit steps to meet the objective*) (score mean= 4.06) pointed out that the participants agreed with the item. In the above step the audit defined the objectives, and here specific steps to meet each objective.

The fifth item, i.e. *the audit plan announced by conducting an entrance meeting with management to discuss the purpose of the audit, risk factors, and other logistics* computed a score mean of 3.49. This shows that, opening meetings are carried out to announce the audit plan and to discuss the needed resources and cooperation from the bodies in the managerial positions.

The sixth item reads as *management is included in the planning phase and the details are documented in a planning and scoping memo* (score mean=3.6). The final step in the audit plan phase is documentation. In the study area all the planning issues are documented. This is vital for the remaining follow-up and reporting phases because the fieldwork must be as per the documented audit plans.

4.6.3. Internal audit Field work

Table 8. Field work (N=129)

		Frequency	Percent	Score mean	SD
Auditors are conduct the steps identified in the planning process	Strongly Disagree	5	3.87	3.97	1.06
	Disagree	4	3.1		
	Neither Agree nor Disagree	30	23.25		
	Agree	40	31.0		
	Strongly agree	50	38.75		
	Total	129	100		
Auditors meet regularly with management throughout fieldwork	Strongly Disagree	46	3	2.13	1.09
	Disagree	41	15		
	Neither Agree nor Disagree	24	24		
	Agree	15	41		
	Strongly agree	3	46		
	Total	129	100		
Auditors meet regularly discuss the status of the audit	Strongly Disagree	3	2.32	3.87	1.09
	Disagree	15	11.62		
	Neither Agree nor Disagree	24	18.60		
	Agree	41	31.78		

	Strongly agree	46	35.66		
	Total	129	100		
Auditors meet regularly discuss preliminary observations	Strongly Disagree	3	2.32	3.8	0.86
	Disagree	3	2.32		
	Neither Agree nor Disagree	31	24.03		
	Agree	64	49.61		
	Strongly agree	28	21.70		
	Total	129	100		
Auditors meet regularly discuss potential recommendations.	Strongly Disagree	4	3.1	3.72	1.02
	Disagree	10	7.75		
	Neither Agree nor Disagree	32	24.81		
	Agree	51	39.53		
	Strongly agree	35	24.81		
	Total	129	100		
Auditors conducted an exit meeting with management at the conclusion of the fieldwork to discuss the results of the audit	Strongly Disagree	10	7.75	2.86	0.90
	Disagree	32	24.81		
	Neither Agree nor Disagree	52	40.31		
	Agree	35	27.13		
	Strongly agree	0	0		
	Total	129	100		

Grand mean	3.39	1.00
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(Source: Field Survey, 2024)

Table 8 shows the five items of audit field work. The grand mean 3.39 revealed that, the fieldwork was exercised in a good manner. While implementing the audit, the auditors identified and made consensus on the planning process and consecutively they made interim periodic meetings about the progress, concerning the preliminary observations and discussed on the recommendations.

On the first item such as *auditors are conduct the steps identified in the planning process the participants* were agreed with a score mean of 3.97 From this it can be inferred that, in the research auditors are conducting the steps identified in the planning process the participants.

On item two our *Auditors meet regularly with management throughout fieldwork* (score mean= 2.13) revealed that there were periodic meetings among the auditors and the managers of the microfinances while the audit plan was implemented.

The score mean of the third item that was *Auditors meet regularly discuss the status of the audit* (score mean= 3.87). There was also periodic discussion about the progress of auditing in the field.

On item four i.e. *Auditors meet regularly to discuss preliminary observations* (score mean= 3.8). The opening observations in the field work have been also discussed among the auditors.

On item five i.e. *Auditors meet regularly to discuss potential recommendations* (score mean= 3.72). it was also responded that the auditors were made meeting to discuss on the finding-based recommendations. Considering reporting, the item reads as “*Auditors conducted an exit meeting with management at the conclusion of the fieldwork to discuss the results of the audit*” computed a mean score value of 2.86 and SD of 0.90

4.6.4. Internal audit Reporting

Table 9. Reporting (N=129)

		Frequ ency	Percent	Score mean	SD
Auditors communicate the results of the audit to management through an audit observation memo	Strongly Disagree	3	2.32	3.87	1.09
	Disagree	15	11.62		
	neither Agree nor Disagree	24	18.62		
	Agree	41	31.78		
	Strongly agree	46	35.66		
	Total	129	100		
Auditors ask management to provide a response with a corrective action plan and timeline to implement.	Strongly Disagree	4	3.11	3.13	0.88
	Disagree	30	23.25		
	Neither Agree nor Disagree	40	31.01		
	Agree	55	42.63		
	Strongly agree	0	0		
	Total	129	100		
These responses of the management are included in the final report.	Strongly Disagree	6	4.65	2.75	0.86
	Disagree	42	32.56		
	Neither Agree nor Disagree	67	51.94		

	Agree	6	4.65		
	Strongly agree	8	6.2		
	Total	129	100		
Management and leadership are provided an opportunity to review drafts and provide feedback.	Strongly Disagree	20	15.50	2.82	1.14
	Disagree	30	23.25		
	Neither Agree nor Disagree	38	29.46		
	Agree	34	26.35		
	Strongly agree	7	5.4		
	Total	129	100		
All audit recommendations and management corrective actions are planned.	Strongly Disagree	9	6.98	3.10	1.01
	Disagree	20	15.50		
	Neither Agree nor Disagree	62	48.06		
	Agree	25	19.38		
	Strongly agree	13	10.07		
	Total	129	100		
Grand Mean				2.76	0.99

(Source: Field Survey, 2024)

The first item of reporting “Auditors communicate the results of the audit to management through an audit observation memo” was also agreed by the respondents (mean=3.87).

A score mean of 3.13 (agree) was computed for the second item i.e. “Auditors ask management to provide a response with a corrective action plan and timeline to implement”.

The third item i.e. “These responses of the management are included in the final report” calculated a mean and SD values of 2.75,

The mean value for (Management and leadership are provided an opportunity to review drafts and provide feedback) was 2.81 (laid in the agree cut off).

The fifth item reads as *all audit recommendations and management corrective actions are planned* moderately agreed by a value of 3.10.

The grand mean (2.76) for the reporting process shown that the reporting process was good.

4.6.5. Internal auditor Follow up

Table 10. Follow Up (N=129)

		Frequency	Percent	Score mean	SD
The audit recommendations and management corrective actions are re followed up on to provide assurance that plans are implemented.	Strongly Disagree	12	9.3	3.17	1.07
	Disagree	15	11.63		
	Neither Agree nor Disagree	55	42.63		
	Agree	33	25.58		
	Strongly agree	14	10.85		
	Total	129	100		
Corrective action plans that do not appear to be progressing are reported periodically to the management	Strongly Disagree	9	6.9	3.04	0.97
	Disagree	19	14.73		
	Neither Agree nor Disagree	67	51.93		
	Agree	25	19.38		
	Strongly agree	9	6.98		
	Total	129	100		
Actions are corrected as per the	Strongly	17	13.18		

audit recommendations and management corrective action plan	Disagree			3.02	1.08
	Disagree	15	11.63		
	Neither Agree nor Disagree	54	41.86		
	Agree	34	26.36		
	Strongly agree	9	6.98		
	Total	129	100		
The management followed up either the audit recommendations were important to the performance of Micro finance institute	Strongly Disagree	51	39.53	2.32	1.23
	Disagree	16	12.40		
	Neither Agree nor Disagree	34	26.36		
	Agree	25	19.38		
	Strongly agree	3	2.32		
	Total	129	100		
The management followed up either the audit recommendations were important to the performance of Micro finance institute	Strongly Disagree	71	55.04	1.90	1.19
	Disagree	24	18.60		
	Neither Agree nor Disagree	12	9.30		
	Agree	19	14.73		
	Strongly agree	3	2.32		
Grand Mean				2.69	1.08

(Source: Own Survey, 2024)

The grand mean 2.69 revealed that, the follow-up was exercised in a moderate manner. While implementing the audit, the auditors identified and made consensus on the reporting process and consecutively they made interim periodic meetings about the progress, concerning the preliminary observations and discussed the recommendations.

The respondents moderately agreed with the follow-up items: (1) the audit recommendations and management corrective actions are re-followed up to provide assurance that plans are implemented. (Score mean=3.17; and SD=1.07); (2) Corrective action plans that do not appear to be progressing are reported periodically to the management (score mean 3.04); (3) Actions are corrected as per the audit recommendations and management corrective action plan (score mean= 3.02 and SD=1.08. In the other hand, they were disagreed (4) the management followed up either the audit recommendations were important to the performance of Micro finance institute (score mean=2.32 and SD=1.23) and (5) The management followed up the audit recommendations were important to the performance of Micro finance institute (mean= 1.90; SD=1.19).

4.5.6. Performance of the Micro Finance institutions

Table 11. Performance of the Micro Finances

	Min	Max	Mean	SD
Operational Self-sufficiency of the financial institution is high	2	5	4.43	.827
Financial Self-Sufficiency of the financial institution is high	1	5	3.11	1.251
Return on Assets (ROA) of the financial institution is high	1	5	2.28	1.395
Return on Equity (ROE) of the financial institution is high	1	5	3.28	1.165
Adjusted Return on Equity (AROE) of the financial institution is high	2	4	3.05	.439
The financial institution's potential to debt is high	1	5	3.14	1.118
Valid N (listwise)				

(Source: Own Survey, 2024)

Table 12 revealed that, the participants strongly agreed (with a score mean value of above 4.2) on the operational Self-sufficiency of the financial institution. In the study area, the internal

auditors participated in this study moderately agreed (3.11) with the financial Self-Sufficiency of the financial institution. However, they disagreed (2.28) on the Return on Assets (ROA) of the financial institution. And the Adjusted Return on Equity (AROE) of the financial institution was perceived as moderate with a score mean value of 3.05. The return on Equity (ROE) of the financial institution was also moderate with a score mean value of 3.28. The potentiality of the studied financial institution's potential to debt was moderate (score mean=3.14 and SD=1.118).

4.5.7. Summary of the descriptive results

Table 12. Summary of the descriptive result of the variables (N=33)

Type of the Variable	Variable names	Mean	SD
Dependent variable	Performance of the Micro Finances	3.84	0.58
Independent Variables	Plan	3.78	0.99
	Sampling	3.95	0.92
	Field work	3.39	1.00
	Reporting	3.13	0.99
	Follow up	2.69	1.08

(Source: Own Survey, 2024)³¹=*

The score means values shown that the highest was 3.95 (sampling) followed by 3.78 (plan), reporting (2.760). The variables such as Field work (score mean=3.9 and SD= 1) and follow up (score mean=2.69 and SD=1.0) implied that, in average the respondents disagreed and moderately agreed with the items.

4.7. Inferential Statistics

This part is composed of correlations, regression analysis and regression coefficients.

4.7.1. Correlation

Table 13. Correlation

		PMF	Planning	Sampling	Field work	Reporting	Follow up
PMF	Pearson Correlation	1	.940**	.985**	.047	.120	.199
	Sig. (2-tailed)		.000	.000	.682	.294	.078
	N	79	79	79	79	79	79
Plan	Pearson Correlation	.940**	1	.899**	-.088	.071	.182
	Sig. (2-tailed)	.000		.000	.440	.535	.109
	N	79	79	79	79	79	79
Sampling	Pearson Correlation	.985**	.899**	1	.035	.094	.171
	Sig. (2-tailed)	.000	.000		.757	.410	.132
	N	79	79	79	79	79	79
Field work	Pearson Correlation	.047	.088	-.035	1	.065	.403**
	Sig. (2-tailed)	.682	.440	.757		.569	.000
	N	79	79	79	79	79	79
Reporting	Pearson Correlation	.120	.071	.094	.065	1	.116
	Sig. (2-tailed)	.294	.535	.410	.569		.310

	tailed)						
	N	79	79	79	79	79	79
Follow up	Pearson Correlation	.199	.182	.171	.403**	.116	1
	Sig. (2-tailed)	.078	.109	.132	.000	.310	
	N	79	79	79	79	79	79
**. Correlation is significant at the 0.01 level (2-tailed).							

(Source: Field Survey, 2024)

The table presents Pearson correlation coefficients depicting the relationships between Performance of the Micro Finances (PMF) and various audit activities, including Plan, Sampling, Field Work, Reporting, and Follow Up. Notably, PMF exhibits remarkably strong positive correlations with both Plan ($r = 0.940$, $p < 0.01$) and Sampling ($r = 0.985$, $p < 0.01$), indicating that a well-defined plan and effective sampling techniques are closely tied to better microfinance performance. Conversely, correlations between PMF and other audit activities such as Field Work, Reporting, and Follow Up are weaker, suggesting less direct influence on microfinance performance.

Moreover, correlations among audit activities themselves unveil interconnectedness within the audit process. For instance, Plan and Sampling demonstrate a strong positive correlation ($r = 0.899$, $p < 0.01$), indicating their often-concurrent implementation. Similarly, there are positive correlations between Sampling and both Field Work ($r = 0.094$) and Follow Up ($r = 0.171$), as well as a notably stronger correlation between Field Work and Follow Up ($r = 0.403$, $p < 0.01$), suggesting a sequential relationship in their execution.

While some audit activities show weaker correlations with PMF, such as Reporting and Field Work, they still exhibit positive associations, albeit less direct. It implies that while these activities may not directly impact microfinance performance to the same extent as Plan and

Sampling, they still contribute to the overall audit process. However, further exploration may be warranted to elucidate the exact nature of their influence and potential areas for improvement.

Overall, the analysis underscores the critical role of a well-defined plan and effective sampling techniques in driving superior microfinance performance. Additionally, it highlights the interconnectedness of various audit activities and their collective contribution to the audit process, emphasizing the importance of a holistic approach to enhancing microfinance performance and operational efficiency

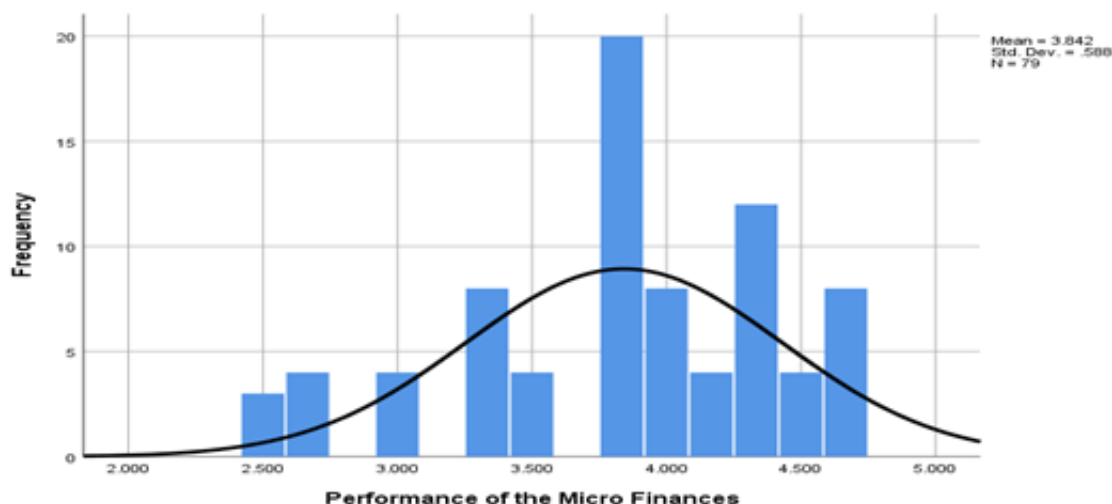
4.7.2. Regression Analysis

4.7.2.1. Regression Assumption Test Variables

Multiple linear regression analysis makes several key assumptions: the five main assumptions of linear regression are absences of multi-collinearity, kurtosis and skewness, normality and linearity depicted as follows.

1- Normality test

Figure 2. Normality

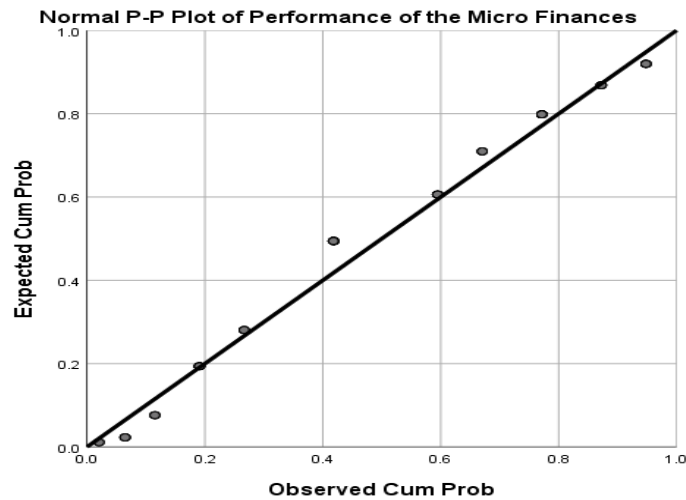


The above figures show normality. Multiple linear regressions require there must be a linear relationship between the outcome variable and the independent variables. On the figure above,

there is normality relationship between independent variables and dependent variable. Thus, in this study the assumption of linearity is satisfied.

2- Linearity test

Figure 3. Linearity



The above figures show linearity. Multiple linear regressions require there must be a linear relationship between the outcome variable and the independent variables. On the figure above, there is linear relationship between independent variables and dependent variable. Thus, in this study the assumption of linearity is satisfied.

3- Multicollinearity test

Table 14. Multi collinearity

Variables	Tolerance	Variance Inflation factors (VIF)
(Constant)		
Planning	.188	5.330
Sampling	.188	5.328
Field work	.815	1.228
Reporting	.966	1.035
Follow up	.797	1.255

(Source: Own Survey, 2024)

A regression assumes that there is little or no multi-co linearity in the data. Multi-co linearity occurs when the independent variables are not independent from each other. A second important independence assumption is that the error of the mean must be independent from the independent variables. Thus, it is tested using the following criteria.

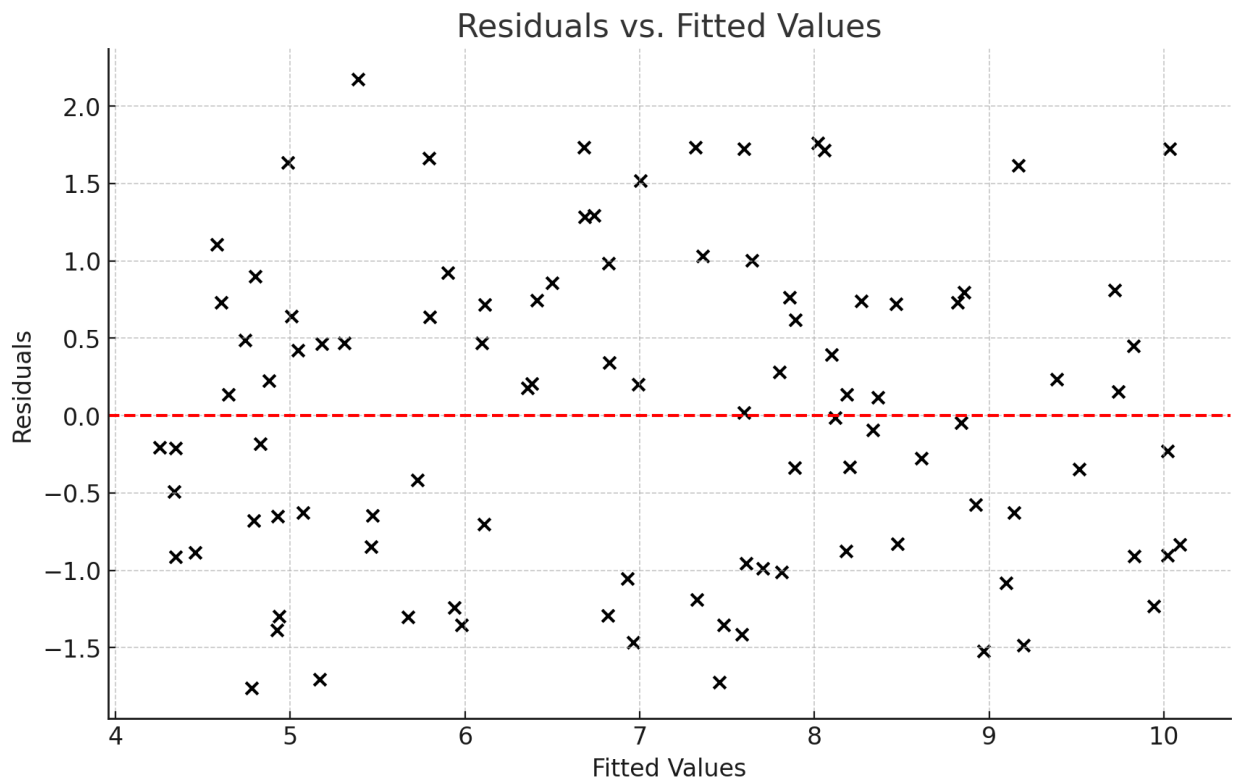
(a) **Correlation matrix** – when computing the matrix of Pearson's Bivariate Correlation among all independent variables the correlation coefficients need to be smaller than 1. Thus, from this research finding correlation table indicates that all independent variables have correlation coefficient less than one and there is no strong correlation between the independent variables. As shown in Table 13 of the Pearson correlation among the independent variables is less than 1.

(b) **Tolerance** – the tolerance measures the influence of one independent variable on all other independent variables; the tolerance is calculated with an initial linear regression analysis. Tolerance is defined as $T = 1 - R^2$ for these first step regression analysis. Thus, from the finding in coefficient table above all Tolerance values of the three models were less than one.

(c) **Variance Inflation Factor (VIF)** – the variance inflation factor of the linear regression is defined as $VIF = 1/T$. Similarly, with $VIF > 10$ there is an indication for multi-collinearity to be present; with $VIF > 100$ there is certainly multi-collinearity in the sample. Thus, from the coefficient table above all VIF values are less than 10. These figures confirm to us there are no violations of little or no multi-collinearity between independent variables. Thus, it can be concluded that all the variables in the study have low correlation power as a result there is no multi-co linearity problem.

4- Homoscedasticity scatter plot

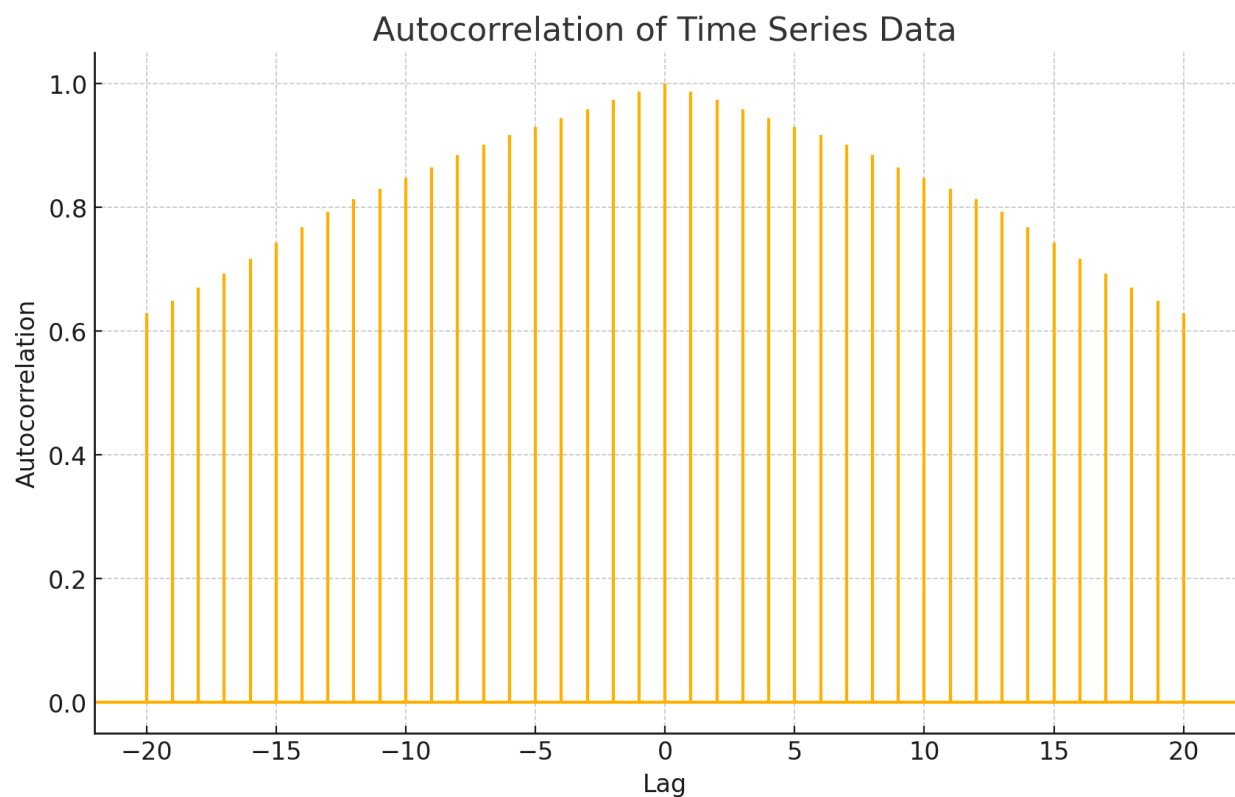
Figure 8 homoscedasticity



The above scatter plot assesses homoscedasticity by plotting the residuals against the fitted values. The plot should show no clear pattern, and the spread of residuals should be constant across all levels of the fitted values. This is an indication of homoscedasticity, where the variance of the residuals is consistent across the range of the fitted values.

5- Autocorrelation Using DW Statistics

Figure 9 Autocorrelation



The above autocorrelation plot of the time series data. The Durbin-Watson statistic for the given time series data is approximately 0.0180.0180.018. This low value suggests the presence of positive autocorrelation in the residuals of the time series data.

4.7.2.2. ANOVA and Regression Coefficients

Table 15. Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.902 ^a	.814	.806	.282
a. Predictors: (Constant), follow up, Reporting, plan, Field work, Sampling				

(Source: Own Survey, 2024)

As per Table 15, in the mode, the three important elements i.e. R, R² and the adjusted R² accounted .902, .814 and .806 respectively. This implied that, with a value of .8147/81.4% of the variance in the model can be predicted using the independent variables. In other words, 81.4% of PMF is explained by the five variables.

Table 16. ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	42.691	5	8.538	107.678	.000 ^b
	Residual	9.753	123	.079		
	Total	52.444	128			
a. Dependent Variable: Performance of the Micro Finances						
b. Predictors: (Constant), Follow up, Reporting, Sampling, Field work, plan						

(Source: Own Survey, 2024)

The ANOVA table results indicate that the regression model, which includes the predictors Follow up, Reporting, Sampling, Field work, and Plan, significantly explains the performance of microfinances. The regression model's sum of squares (42.691) is much larger than the residual sum of squares (9.753), showing that the model explains a substantial portion of the total variance in microfinance performance. The degrees of freedom for the regression (5) and

residual (123) indicate that the analysis is based on 128 observations. The mean square values for regression (8.538) and residual (0.079) are used to calculate the F-statistic (107.678), which is very high, suggesting a strong model fit. The p-value is less than 0.001, demonstrating that the model is statistically significant and that the likelihood of the F-statistic occurring by chance is very low. Overall, these results imply that the predictors significantly impact the performance of microfinances, validating the effectiveness of the regression model.

Table 17. Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.138	.323		.428	.000
	Plan	.186	.078	.200	2.396	.001
	Sampling	.852	.100	.737	8.508	.000
	Field work	.017	.068	.012	.253	.001
	Reporting	.033	.042	.031	.774	.002
	Follow up	.039	.065	.035	.599	.004
a. Dependent Variable: Performance of the Micro Finances						

(Source: Own Survey, 2024)

The provided regression analysis offers valuable insights into the factors influencing the performance of microfinance institutions, with the dependent variable being the Performance of the Micro Finances. The model encompasses several independent variables: Plan, Sampling, Field Work, Reporting, and Follow Up.

The analysis indicates that the intercept term, representing the expected performance when all independent variables are zero, is statistically significant ($p = 0.000$), suggesting its relevance in explaining performance variations.

Among the independent variables, Plan, Sampling, Field Work, Reporting, and Follow Up all exhibit significant impacts on microfinance performance. For every one-unit increase in the Plan variable, a 0.186-unit increase in microfinance performance is expected, which is statistically significant ($p = 0.001$). Similarly, the coefficient for Sampling suggests that for every one-unit increase in this variable, microfinance performance is expected to increase by 0.852 units, also highly statistically significant ($p = 0.000$).

Moreover, Field Work, Reporting, and Follow Up also demonstrate significant impacts on microfinance performance, with coefficients of 0.017, 0.033, and 0.039, respectively. These results suggest that even seemingly minor aspects such as field work, reporting, and follow-up procedures can contribute to enhancing microfinance performance.

Examining the standardized coefficients (Beta) reveals further insights into the relative importance of each independent variable. Among them, Sampling emerges as the most influential factor, with a standardized coefficient (Beta) of 0.737, indicating its critical role in predicting microfinance performance compared to the other variables considered.

In conclusion, this analysis underscores the importance of strategic planning, effective sampling methodologies, and meticulous attention to field work, reporting, and follow-up procedures in enhancing the performance of microfinance institutions. These findings offer actionable insights for stakeholders seeking to optimize the performance of microfinance operations.

4.8 Interview

Based on the interviews, most institutions have a robust internal audit function, conducting regular audits across all departments to ensure compliance, identify risks, and recommend improvements covering financial, operational, and compliance areas. The audit planning process involves a risk-based approach, focusing on high-risk areas first, and is developed collaboratively between the internal audit team and senior management. Auditees are selected based on risk assessment, with the audit scope and objectives determined by the audit committee in consultation with the internal audit team. Detailed audit steps are developed and approved before implementation.

Auditors use a combination of interviews, document reviews, and data analysis, utilizing standardized tools and methodologies to maintain consistency and reliability. Objectivity and independence are upheld by adhering to professional standards and ethics. Audit findings are documented in detailed reports, reviewed by the audit committee, and shared with relevant department heads and senior management. Debrief sessions are conducted to discuss key findings and recommendations.

Management follows up on audit recommendations through a structured process, assigning each recommendation to a responsible person and regularly monitoring progress. The audit committee reviews the implementation status in subsequent meetings.

Challenges include keeping up with regulatory changes and ensuring employee training. The internal audit significantly contributes to governance and risk management by providing independent assurance on the effectiveness of controls.

CHAPTER FIVE:

SUMMARY, CONCLUSION AND RECOMMENDATION

5.1. Summary

In the study, 79.9% of participants were male, with most respondents aged 34-41 (51.9%). The educational background showed 43% with a first degree, and 65.8% had over 13 years of experience. The most employed auditing step was verifying sample transactions (63.3%). The audit activities were largely selected using a risk-based approach, and audit plans were well-defined, involving management in the planning phase. During fieldwork, auditors frequently met with management to discuss progress and observations. Reporting practices included exit meetings and management feedback. Follow-up on audit recommendations was moderately agreed upon, though less so regarding management's view on their importance. Regression analysis highlighted that all dependent variables (Plan, Sampling, Field Work, Reporting, and follow up) significantly impacted microfinance performance, with sampling being the most influential. These findings suggest that strategic planning, effective sampling, and thorough audit procedures are crucial for enhancing microfinance performance.

5.2. Conclusion

The analysis of audit sampling practices reveals mixed perceptions among respondents. While there is strong alignment with risk management strategies, significant disagreement indicates gaps in understanding or implementing the risk-based approach effectively. Similar inconsistencies are seen in the perceived clarity and execution of audit plans, communication with leadership, approval processes, and handling hotline reports. Overall, positive perceptions exist, but notable variations need attention to enhance effectiveness.

Audit planning in microfinance institutions shows generally positive perceptions but significant concerns about clarity and implementation. While most audits have a plan, issues with defining

audit scope and objectives, developing steps to meet objectives, conducting entrance meetings, and including management in planning suggest room for improvement.

Fieldwork practices are generally well regarded but show significant issues in execution and communication. While steps identified in the planning process are usually conducted, regular meetings, discussions of audit status, preliminary observations, potential recommendations, and exit meetings exhibit high variability and substantial disagreement, indicating areas for improvement.

The reporting process is moderately effective but faces substantial concerns regarding clarity, inclusion, and implementation of recommendations. While there is agreement on the practice of communicating audit results and requesting management responses, there is significant disagreement on the inclusion of management responses, review of drafts, and planning of corrective actions.

Follow-up practices in microfinance institutions are perceived less favorably, indicating a need for stronger practices and better communication. There are inconsistencies in following up on audit recommendations, reporting non-progressing corrective actions, and implementing corrections. There is also a significant perceived lack of importance or follow-up on recommendations.

The performance of microfinance institutions is perceived variably. Operational self-sufficiency is viewed positively, but other financial performance metrics, such as financial self-sufficiency, return on assets, and return on equity, suggest moderate satisfaction and areas needing improvement.

5.3. Recommendations

Based on the findings of study the Recommendation is given below

The First key finding of the study, audit sampling practices reveals mixed perceptions among respondents. While there is strong alignment with risk management strategies, significant disagreement indicates the gaps in understanding or implementing the risk-based approach effectively,

For the first key findings it is advisable for micro finances and other financial institutions to select/sample auditees using the risk-based approach. And the auditing type employed have not to be solely verifying sample transactions. It is advisable if all the transactions are verified.

The second key finding of the study on audit planning in microfinance institutions shows generally positive perceptions but significant concerns about clarity and implementation.

It is advisable for the second findings the audit plan identified with explicit steps to follow, the audit plans recommended be defined the scope of the audit, the objectives of the audit, The audit plan must be developed audit steps to meet the objective. Auditing recommended be as per the steps identified in the planning process

The third key finding of the study on Fieldwork practices are generally well regarded but show significant issues in execution and communication, the recommendation for this Auditors has regular meetings with management throughout fieldwork.

The fourth key finding of the study on Follow-up practices in microfinance institutions are perceived less favorably, indicating a need for stronger practices and better communication. There are inconsistencies in following up on for this,

It is advisable for the management bodies of Micro finances ought to be follow the implementation of the audit recommendations and management corrective actions are re-

followed up on to provide assurance that plans are implemented And It is recommended to attend management and board members in the entrance and exit meetings

Annex 1. Questionnaire



FACULTY OF BUSINESS ADMINISTRATION

DEPARTMENT OF MASTER OF BUSINESS ADMINISTRATION

QUESTIONNAIRES TO BE FILLED BY AUDITORS

Dear respondents, I am Merima Nasir candidate of Master s Degree in Business Administration. The main objective of my thesis is to investigate *“The Role of internal audit on the performance of Micro finance institution: The case of some selected institution* ‘The only purpose of this study is academic i.e., for the fulfilment of master’s degree. Your responses will be kept confidential. Therefore, your genuine and timely responses are the main determinants of the success of this study. So, I kindly request your co-operation in filling in the questionnaire honestly.

Thank you, Dear Respondent,

Part 1: General questions

1. Sex Male ☐ Female ☐
2. Age: 18 to 26 ☐ 27 to 33 ☐ 34 to 41 ☐ 42 to 49 ☐ 50 and above ☐
2. Marital Status: Unmarried ☐ married ☐ Divorced ☐
3. Education level: Diploma ☐ Degree ☐ MA/MS ☐ Others ☐
4. Experience in Auditing (in Year)?
Less than 3 years ☐ 4 to 7 years ☐ 8 to 11 years ☐ 12 and above ☐
5. You are:
Internal auditor ☐ external auditor ☐
6. Which auditing step was employed? (Multiple response is possible)
Interviews ☐ Reviewing laws, policies, and best practice ☐
Verifying sample transactions ☐ analyzing data sets ☐
Conducting surveys ☐ If other, Specify.....

Part II. Role of internal Audits

Respond by putting “X” Mark to the only number that best fits your opinion and feelings.

NB: 5=strongly Agree, 4=Agree, 3=neither Agree nor Disagree, 2=Disagree, and 1 represents strongly Disagree with the respective statements stated below.

S. No.	Descriptions	1	2	3	4	5
1	Planning					
1.1	Audit activities are selected using a risk-based approach					
1.2.	The audit plan identified explicit steps to be followed					
1.3.	Internal audit meets with leadership and management during					

	the development of the annual audit plan to discuss risks and potential impediments to meeting objectives.					
1.4.	The plan is approved by the Executive and Audit Committee of the Board of Trustees.					
1.5.	Audits are conducted based on concerns reported on the fraud and ethics hotline.					
2.	Selection/Sampling					
2.1.	Each audit has an audit plan					
2.2.	The audit plan defined the scope of the audit					
2.3.	The audit plan defined the objectives of the audit					
2.4.	The audit plan developed audit steps to meet the objective.					
2.5	The audit plan was announced by conducting an entrance meeting with management to discuss the purpose of the audit, risk factors, and other logistics.					
2.6	Management is included in the planning phase and the details are documented in a planning and scoping memo.					
3	Fieldwork					
3.1.	Auditors are conduct the steps identified in the planning process					
3.2.	Auditors meet regularly with management throughout fieldwork					
3.3.	Auditors meet regularly discuss the status of the audit					
3.4.	Auditors meet regularly discuss preliminary observations					
3.5.	Auditors meet regularly discuss potential recommendations.					
4	Reporting					
4.1.	Auditors conducted an exit meeting with management at the conclusion of the fieldwork to discuss the results of the audit					
4.2.	Auditors communicate the results of the audit to management through an audit observation memo					
4.3.	Auditors ask management to provide a response with a corrective action plan and timeline to implement.					
4.4.	These responses of the management are included in the final report.					
4.5.	Management and leadership are provided an opportunity to review drafts and provide feedback.					
5	Follow Up					

5.1.	All audit recommendations and management corrective actions are planned.					
5.2.	The audit recommendations and management corrective actions are re-followed up on to provide assurance that plans are implemented.					
5.3.	Corrective action plans that do not appear to be progressing are reported periodically to the management					
5.4	Actions are corrected as per the audit recommendations and management corrective action plan					
5.5.	The management followed up either the audit recommendations were important to the performance of Micro finance institute					
6	Performance of Micro finance institute					
6.1.	Operational Self-sufficiency of the financial institution is high					
6.2.	Financial Self-Sufficiency of the financial institution is high					
6.3.	Return on Assets (ROA) of the financial institution is high					
6.4.	Return on Equity (ROE) of the financial institution is high					
6.5.	Adjusted Return on Equity (AROE) of the financial institution is high					
6.6.	The financial institution's potential to debt is high					
6.7.	The is regular and efficient follow up mechanisms					

Annex 2. Interview

1. Your position
2. Experience in micro finances?
3. To what extent the micro finance implemented internal audit?
4. How is the audit planned?
5. Who and who select the auditee, its scope, objectives, steps to be followed developed?
6. How are the auditors conducting the audit?
7. What are the audit reporting mechanisms employed?
8. How does the management follow up the audit recommendations and management corrective actions?
9. How do you rate the performance of micro finance institute in terms of its operational and financial self-sufficiency? Based on its return on Assets and return on Equity and Adjusted Return on Equity? Profitability?

Appendix 1. List of MF in Addis Ababa

1. Addis and Credit saving institution.
2. Africa village financial services
3. Agar MF
4. Bussaa Gonofaa MF
5. Debo MF
6. Digaf MF
7. Dynamic MF
8. Elsabi MF
9. Eshet MF
10. Gasha MF
11. Grand MF
12. Harbu MF
13. Kaafi MF
14. Kershi MF
15. Lefayeda MF
16. Liyu mf institutions S.C
17. Meklit MF
18. Metemamen MF
19. Neo MF
20. Nisir MF
21. One microfinance
22. Poverty eradication community
23. Rays MF
24. Sheger MF
25. Tesfa MF
26. Vision fund mf institution
27. Wallet microfinance

28. Wasassa MF
29. Yegna microfinance
30. Yemisrach microfinance

(sourceaemfi-ethiopia.org/all/listings): Association of Ethiopian micro finance institutions

SPSS outputs

Item-Total Statistics					
	Scale Mean if Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Squared Multiple Correlation	Cronbach's Alpha if Item Deleted
Performance of the Micro Finances	17.22	2.322	.798	.987	.381
Plan	17.15	2.097	.685	.912	.405
Sampling	17.25	2.378	.778	.978	.395
Field work	18.24	3.866	.063	.193	.661
Reporting	17.37	3.572	.076	.085	.689
Follow up	18.10	4.121	-.132	.235	.729

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