

MONETARY POLICY AND ITS IMPLICATION FOR BALANCE OF PAYMENT STABILITY IN NIGERIA BETWEEN 1986-2015



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ABSTRACT

Keywords

Internal auditing
Independence
Objectivity and integrity
Audit committee
Internal audit charter
Corporate governance
Risk management
Effective audit.

The effectiveness of the internal audit units in the public sector in promoting good corporate governance and risk management depends on several factors including the level of organizational independence they enjoy. This study therefore, sought to investigate the organizational independence of the internal auditors in the local government sector in Ghana. Descriptive research method was employed. The study deployed multistage sampling method to select internal auditors and purposive sampling for external auditors from Ghana Audit Service. In all, a total of 120 questionnaires were administered to them, out of which only 90 questionnaires were completed and returned. The main finding of the study include among others: inadequate budget allocation, internal audit units are given low status, management determine the scope of internal audit work due to absence of internal audit charter. The most serious threats to internal auditors' independence include intimidation and familiarity threats. The study concludes that, the organizational independence of the internal auditors in the local government sector is in danger. It recommends that every assembly should establish an effective and quality Audit Review Implementation Committee (ARIC) that would give necessary support to both internal auditors and external auditors. Each assembly should have its own Internal Audit Charter. The internal audit units also need to be supported with necessary logistics.

Contribution/ Originality: This study is considered to be the first in Ghana and one of very few studies in the world discussing the organizational independence of internal auditors in the public sector. It brings to light the factors that impair the organizational independence of internal auditors in the public sector.

1. INTRODUCTION

Due to the complexity and dynamic nature of the business environment, it has become necessary to establish internal audit units to ensure good corporate governance in both private and public sector organizations. In 1941, Arthur E. Hald who was one of the founders of the Institute of Internal Auditors (IIA), stated the need to create internal audit function in every organization and make it an integral part of corporate governance system. All businesses especially those with large environment should have internal audit departments if they want to survive. The recent corporate failures have increased the prominence of internal auditing. Regarding this issue, [Schneider \(2003\)](#) argued that the bankruptcies, financial irregularities and fraudulent activities that occurred in Enron, WorldCom and other firms have increased the need for corporate monitoring. The study concluded that external audit failures related to these events increase the role of internal auditing in corporate monitoring.

Internal audit is regarded as the key component of corporate governance system. Recently, internal audit is described as adding value to the organization. Adding value is described by the [The Institute of Internal Auditors \(IIA\) \(2006\)](#) as organization existing to create value or benefits to their owners, other stakeholders, customers and clients. This concept provides the purpose for their existence. [IIA \(1999\)](#) defined internal audit as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization to accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. This definition signifies that internal audit has undergone a paradigm shift from emphasis on accountability about the past to improving future outcomes to help auditees operate more effectively and efficiently ([Nagy and Cenker, 2002](#); [Goodwin, 2004](#)). [Adams \(1994\)](#) used agency theory to explain that it is in the interest of management to maintain a strong internal audit department. The main emphasis of this definition is an independent and objective provision of internal audit services. Independence and objectivity are some of the core values of internal audit and these are enshrined in the code of ethics issued by [IIA \(2006\)](#).

The level of contribution that internal auditors can make in improving risk management and organizational performance depends on its status in the organization. The internal audit function of an organization should be given a sufficiently high status in the organizational structure to enable better communication with top management and to ensure independence of internal auditor from auditees ([Mihret and Yismaw, 2007](#)). This argument is in line with the assertion of [Belay \(2007\)](#) who argued that organizational independence allows the internal audit unit to conduct work without interference by the entity under audit. The internal audit unit should have sufficient independence from those it is required to audit so that it can both conduct its work without interference and be seen to be able to do so.

[IIA \(2009\)](#) emphasis that, the internal audit activity must be independent and that the internal auditors must be objective in performing their work. [IIA \(2009\)](#) defined organizational independence as the freedom from conditions that threaten the ability of the internal audit activity or chief audit executive to carry out internal audit responsibilities in unbiased manner. The internal auditors in practical manner cannot be independent from management but the

independency has to do with the mental attitude and objectivity of the auditors. Independence is paramount value in providing effective internal audit service to the management, for it affords an atmosphere of objective and uninhibited appraisal and reporting of findings without influence from the units being audited. Internal auditors should be free from any factors that pose threats to its independence and objectivity. The organizational status of internal auditors should provide job security for internal auditors so that they cannot be dismissed for the sake of producing objective findings (Van Gansberghe, 2005). In institutions, the organizational structure of internal auditors represent variations that highlight two outstanding issues regarding objectivity; statutory independence and budgetary independence. Management who are involved in corrupt practices often become eager to intervene in the audit reviews, scope of work, and the results. To avoid such attempts, the Head of Internal Audit Unit should hold an adequately powerful position to be isolated from such influences.

The level of independence of internal auditors also depends on the budgetary status of the units and it is important for the internal audit unit to have adequate resources at their disposal. The efficiency and effectiveness of internal audit units depends on the availability of resources. Inadequate resources will limit the scope of audit work (Belay, 2007). IIA (2009) stated that the Chief Internal Auditor must ensure that internal audit resources are appropriate, sufficient and effectively deployed to achieve the approved plan. The required resources needed by the internal audit unit are normally determined at the early stage of audit plan so that it can be incorporated into the master budget of the organization. Modern auditing demands the use of appropriate technology and auditing the technology itself as audit area, developing staffs through several cost effective means like training. The internal auditors reporting relationship in any institutions and organisations should enhance their organizational independence. Organizational independence is also facilitated when the Chief Internal Auditor reports functionally to the board and administratively to the organization's CEO (The Institute of Internal Auditors Research Foundation (IIARF), 2014).

As part of corporate governance structure, audit committee is one of the key players in ensuring that, resources are safeguarded and utilized efficiently and effectively in achieving the objectives of the organizational. An audit committee is an independent body which comprises experts from various fields in the organisation. It plays significant role in promoting good corporate governance. The presence of audit committee in an organization protects the independence of internal auditors which is one of the qualities of auditors (Zain *et al.*, 2004). Bishop *et al.* (2000) argue that, cooperation between internal auditors and audit committee is an important element of sound corporate governance. According to Yan *et al.* (2007) a relation exists between audit committee quality, auditor independence, and internal control weaknesses. They posit that a quality audit committee can ensure that the internal control systems are strong and effective and also protect the organizational independence of auditors.

The relationship between the audit committee and internal auditors is an important one, with both a reciprocal strengthening of each other's function (Goodwin and Yeo, 2001). This means that audit committee can strengthen the internal audit function by protecting their independence and ensure that audit recommendations are implemented by management. Internal auditors on

the other hand, can be important resources to the audit committee as it strives to fulfil its responsibilities (Turley and Zaman, 2004). The assertion of Turley and Zaman (2004) is in line with Bishop *et al.* (2000) who posit that, internal audit is a valuable resource that can provide information needed for audit committee to meet their governance mandate.

To reduce the incidence of impairment of independence of internal auditors, the corporate governance board which includes audit committee, should set out internal audit charter. According to IIA (2006) the internal auditors should draw their powers, authorities, and responsibilities from the internal charter instead of taking instructions from management. Section 1000.A1 of the IIA (2009) provides that, the nature of assurance service provided to the organization must be defined in the internal audit charter. The mandatory nature of the definition of internal auditing, the code of ethics, and the standards must be recognized in the charter.

A concrete audit charter to bind all parties strictly is considered the most effective way to reduce outer influence. Audit should be conducted with complete and unrestricted access to all forms of audit evidence like employees, property, policies and procedures of internal control systems, key information necessary for audit work (Belay, 2007). The IIA (2009) states that, the internal auditors must be allowed total access to assets, employees, records and all forms of audit evidence necessary for their work. The authority of the internal auditors to have total access to audit should be stated in the internal audit charter of the organization. Angus and Mohammed (2011) recommend that internal auditors should have sufficient freedom to accomplish their task efficiently. The internal audit charter would give the internal auditors the freedom to perform their task more effectively and efficiently.

In order to attract and retain competent internal auditors, their condition of service should be good. The internal auditors are likely to be influenced by management and other officers with gifts and assistance if their condition of service is poor. They may also prefer to move to different position within the same organization in order to enhance their personal development. As Goodwin and Yeo (2001) put it, the internal audit is used as a training ground. The studies of Sarens and De Beelde (2006a); Stewart and Subramaniam (2010) also affirmed this assertion. They posit that senior management expect internal audit to be a training ground for future managers. This implies that, people are not willing to stay longer in the internal audit position, probably due to lack of recognition and poor working conditions and the overall effect of this is that, the independence of the internal auditors will be in danger.

The internal auditors provide assurance services to management who employ them and this puts them in a difficult situation to provide objective and independent report on the activities of the organization especially when corrupt management interferes with their work and show disrespect for them (Guruswamy, 2012). The internal auditors would not be effective if they lack organizational independence (Belay, 2007). Unlike external auditors who are appointed by members at annual general meeting on temporary basis, internal auditors are appointed by management on permanent basis and are supposed to audit the same management. The question that remains to be answered is, can internal auditors be independent from management? This study, therefore, seeks to find out the level of organizational independence of internal auditors at the local government sector in Ghana. It specifically seeks to achieve the following objectives:

- i. To examine the factors that impair the independence of internal auditors in the public sector.
- ii. To examine threats to independence of internal auditors
- iii. To determine the roles of audit review implementation committees in protecting the independence of internal auditors.

2. METHODOLOGY

The purpose of the study was to investigate the organizational independence of the internal auditors in the public sector in Ghana. This involved examining the organizational status of the internal auditors, approved mandate and internal audit charter, the reporting relationship, the condition of service and the presence of the audit committee in the public sector institutions. This study was, therefore, structured within the framework of a descriptive research approach. Descriptive research studies are designed to obtain information, which concerns the current status of phenomenon (Saunders *et al.*, 2007).

The population of the study comprised all the internal auditors at the local government level and officials from Ghana Audit Service. The study employed multistage sampling method to select internal auditors. Three regions (Northern, Central and Upper East) were randomly selected out of the ten regions and proportionate simple random sampling was then deployed to select the assemblies excluding those which were newly created in 2012 from the three regions. Due to the small size of the internal auditors in the selected assemblies, all the internal auditors were included in the sample. In all, a total of 100 internal auditors participated in the study and 20 external auditors from Ghana Audit Service in the three regions were purposively selected. The total sample size was 120. However, the response rate was 75% % as the researchers were unable to retrieve 26 and 4 questionnaires from the internal auditors and external auditors respectively. In the opinion of the researchers, this response rate was good enough for the study.

In this study, self-administered questionnaires were used to explore the organizational independence of the internal auditors. The questionnaires were designed based on standards covering organizational independence of internal auditors provided by the IIA (2009). Two different sets of questionnaires were constructed to collect data from internal auditors and external auditors. The questionnaires were made up of closed-ended items (where respondents were offered options from which they were to select those items that they deemed appropriate) and open-ended questions (those that participants provided their own responses). The data collected was analysed using summary statistics, frequency distribution tables and graphs.

3. RESULTS AND DISCUSSION

3.1. Factors That Impair Organisational Independence of Internal Auditors

This section examined the status of the internal audit units in the assemblies, policies and procedures of the assemblies concerning internal audit units, budgetary allocation, access to audit evidence and reporting relationship. These factors determine the level of independence of internal auditors in both private and public sector institutions. The factors were presented in the form of likert-type of scale (5-1) from strongly agree to strongly disagree and the internal auditors were

required to express the extent to which they agree or disagree with them. The findings are presented in Table 1.

Table-1. Descriptive statistics of factors that may impair organizational independence of internal auditors

| Factors | Observ. | Mean | Std. Deviation |
|--|---------|--------|----------------|
| 1. Internal audit department is given low status in management Structure | 74 | 3.5541 | 1.24022 |
| 2. Inadequate budget allocation for the department | 74 | 4.6892 | .46598 |
| 3. Policies and procedures are not clearly defined for the internal audit unit | 74 | 4.4595 | .50176 |
| 4. Management have wrong perception about internal auditors as fault finders rather than adding value to the organisation | 74 | 3.4324 | 1.43423 |
| 5. No opportunity to seek the assistance of experts during audit especially when assessing value of a contract or property | 74 | 3.4324 | 1.09895 |
| 6. Internal auditors are not given a representation in Board meeting | 74 | 3.1486 | .35817 |
| 7. The unit is not allowed to carry out pre-transaction audit | 74 | 3.2568 | .43983 |
| 8. The unit is not allowed to choose any transaction or area of interest for audit | 74 | 3.5405 | .50176 |
| 9. Management interferes with the work of internal auditors | 74 | 4.5676 | .49880 |
| 10. Sectional heads are not cooperating with the internal audit departments | 74 | 4.6757 | .47132 |

Source: Field Survey data, (2014)

Scale: mean of 5 - 4.6 is Strongly agreed, 4.5 - 3.5 is Agreed, .34 - 2.5 is Neutral, 2.4 to 1.5 is Disagreed and mean below 1.5 is Strongly disagreed

The descriptive statistics from Table 1 revealed that, the respondents unanimously strongly agree that internal audit units have inadequate budget allocation with a mean response of 4.6892. This runs contrary to the requirement of IIA (2009) which states that the Chief Internal Auditor must ensure that internal audit resources are appropriate, sufficient and effectively deployed to achieve the approved plan. They also strongly agree with a mean response of (4.6757) that, the sectional heads are not cooperating with them. We argue that non-cooperation of sectional heads with the internal audit units makes the work of the units very difficult as they need the cooperation and assistance of every individual in the evidence search. It was also observed that, they were no clear policies and procedures for internal audit units (4.4595). This could lead to role conflict.

On the issue of management perception of internal auditors as fault-finders rather than adding value to promote good corporate governance, they respondents were neutral (3.4324). The organizational independence of internal auditors would be weak when management have wrong perception about them as fault-finders. With regard to board representation, the respondents were also neutral (3.1486). However, it is evident that, the internal audit departments are given low status in the assemblies within the management structure (3.5541).

The respondents were of the view that, management sometimes interferes with their work (4.5676). The respondents expressed mix views on issue of the opportunity to seek the assistance of experts during audit process especially when assessing value of a contract, property etc. In this

view, evidence search is a difficult task for internal auditors in the various assemblies. Audit is about obtaining sufficient and appropriating audit evidence in order to form an opinion as whether the financial statements and books of accounts show true and fair view about the state of the affairs of the organization.

The internal auditors report direct to the coordinating director who is the administrative head of all the government departments and agencies in the assembly. This goes contrary to the position of IARF (2014). This reporting relationship does not enhance the independence of the internal auditors since the coordinating director is an auditee.

3.2. Threats to Organizational Independence of Internal Auditors

The study also examined the threats that internal auditors experienced in the various assemblies. The threats were presented in the form of likert-type of scale (5-1) from strongly agree to strongly disagree and the internal auditors were required to express the extent to which they agree or disagree with them. The evidence is depicted in table 2 below.

Table-2. Threats to independence of internal auditors

| Threats | Oberv. | Min. | Max | Mean | Std. Deviation |
|-------------------------|--------|------|------|--------|----------------|
| 1. Self-review threat | 74 | 1.00 | 5.00 | 2.5676 | 1.43423 |
| 2. Self-interest threat | 74 | 2.00 | 5.00 | 3.0405 | .95715 |
| 3. Intimidation threat | 74 | 3.00 | 5.00 | 3.9189 | .73572 |
| 4. Advocacy threat | 74 | 1.00 | 4.00 | 2.6351 | .93008 |
| 5. Familiarity threat | 74 | 4.00 | 5.00 | 4.6486 | .48065 |

Source: Field Survey data, (2014)

Scale: mean of 5 - 4.6 is Strongly agreed, 4.5 - 3.5 is Agreed, 3.4 - 2.5 is Neutral, 2.4 to 1.5 is Disagreed and mean below 1.5 is Strongly disagreed

Table 2 showed that, the most serious threats to organizational independence of internal auditors are familiarity threat with a mean response of (4.6486) and intimidation threat with a mean response of (3.9189). This suggests that, the ability of the internal auditors to press for sufficient and appropriate audit evidence is weak. This may affect the quality of internal audit work. The respondents were neutral with regard to self-interest threat (3.0405), self-review threat (2.5676) and advocacy threat (2.6351). To enhance the independence of the internal auditors, they have to avoid engaging themselves in other activities that would create conflict of interest. To this end, the researchers wanted to find out whether the internal auditors are given other non-related audit roles. It was observed that 20 of the internal auditors representing 27% do other work such as preparation of budget while 54 of them representing 73% do not engage in other roles. On the basis of this, they experienced low self-review threat. The internal auditors cannot audit any transaction that they were previously involved because there will be conflict of interest. Therefore, internal auditors can engage in area such as budget preparation and planning stage of the activities of the assemblies but not implementation stage.

3.3. Conditions of Service

The study also assessed the conditions of service of the internal auditors since this has a bearing on their organizational independence. The evidence is depicted in Table 3

Table-3. Descriptive statistics of conditions of service of internal auditors

| Scale | Frequency | Percentage (%) |
|--------------|-----------|----------------|
| Very Good | 9 | 12.2 |
| Good | 13 | 17.6 |
| Somehow good | 44 | 59.5 |
| Bad | 5 | 6.8 |
| Very bad | 3 | 4.0 |
| Total | 74 | 100 |

Source: Field Survey data, (2014)

From Table 3, majority (44) representing 59.5% of the respondents indicated that their conditions of service is somehow good, 12.2% of them expressed that their conditions of service is very good while 4% indicated that it is very bad. However, 87.8% of the respondents revealed that, they have future plan to take any position higher than their current job within the assemblies or elsewhere. This study confirmed the work of [Goodwin and Yeo \(2001\)](#) who argued that internal audit is used as a training ground. With this future interest in mind, their focus will be to win the favour of management rather than their professional work and this will eventually impair their independence as they would not want to go against them if even management are doing things wrong.

3.4. Internal Audit Charter

The Mandate, responsibilities and powers of the internal auditors should be defined in the internal auditor charter in order to enhance their independency. This allows them to have unrestricted access to all forms of audit evidences. The study sought to find out from the internal auditors whether their assemblies have their own internal audit charter or not. The result is depicted in Table 4

Table-4. Internal audit charter

| Response | Frequency | Percentage |
|----------|-----------|------------|
| Yes | 14 | 18.9 |
| No | 60 | 81.1 |
| Total | 74 | 100 |

Source: Field Survey data, (2014)

From Table 4, majority (60) representing 81% of the internal auditors indicated that they did not have internal audit charter and management determine their scope of work. The study went further to find out whether the internal auditors are fully allowed access to audit evidence or not. The result is shown in Table 5.

Table-5. Access to audit evidence

| Response | Response | Response |
|-------------------|----------|----------|
| Fully allowed | 23 | 31.1 |
| Partially allowed | 51 | 68.9 |
| Not allowed | 0 | 0.0 |
| Total | 74 | 100 |

Source: Field Survey data, (2014)

The descriptive statistics from Table 5 revealed that, Majority (51) representing 68.9% of respondents asserted that they are partially allowed access to audit evidence as a result of management interference. While 31.1% of them indicated that they have full access to all audit evidence but quick to point out that, it is difficult sometimes. This evidence corroborate the findings of Belay (2007) who discovered that the internal audit units in the public sector in Ethiopia were partially allowed access to records. Full access to all audit evidence helps internal auditors to provide complete and reliable audit reports.

The internal audit charter binds management to allow internal auditors to execute their work without any restrictions and implement internal audit recommendations. The internal auditors cannot operate efficiently and effectively without formal mandate (internal audit charter). The absence of the internal audit charter allows management to define the scope of internal audit work. In the views of the researchers, this has great potential of reducing the quality of internal audit work because of scope limitation and difficulties in obtaining sufficient and appropriate audit evidence.

Figure 1 sought to determine whether the MMDAs have audit review implementation committees.

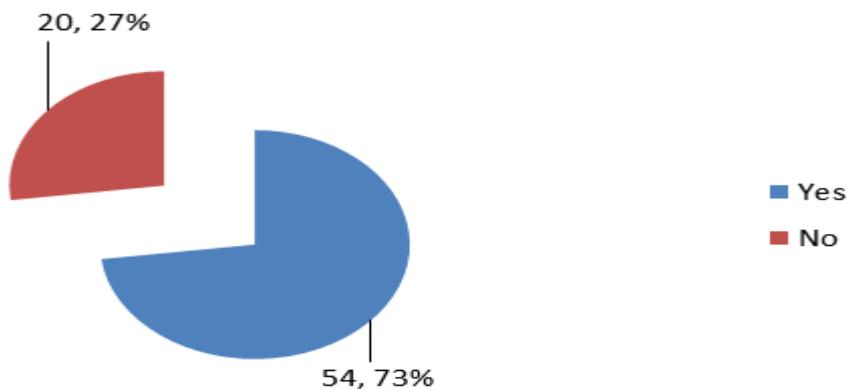


Figure-1. Presence of Audit Review Implementation Committee

Source: Constructed from field data,(2014)

The results from Figure 1 indicated that, majority (54) representing 73% of the respondents indicated that the MMDAs have audit committees. However, it was observed that the committees are not functioning well. The respondents believe that it is necessary to have effective audit committees so that the independence of the internal audit departments could be enhanced. It was also observed that the audit committees can provide support such as defending the budgetary status of internal audit departments, ensuring access to all forms of audit evidence, defining the scope of internal audit work and ensuring timely implementation of audit recommendations.

In relation to implementation of audit recommendations, the respondents, both internal and external auditors stated that management is not committed in implementing audit recommendations as it is evident in Figure 2.

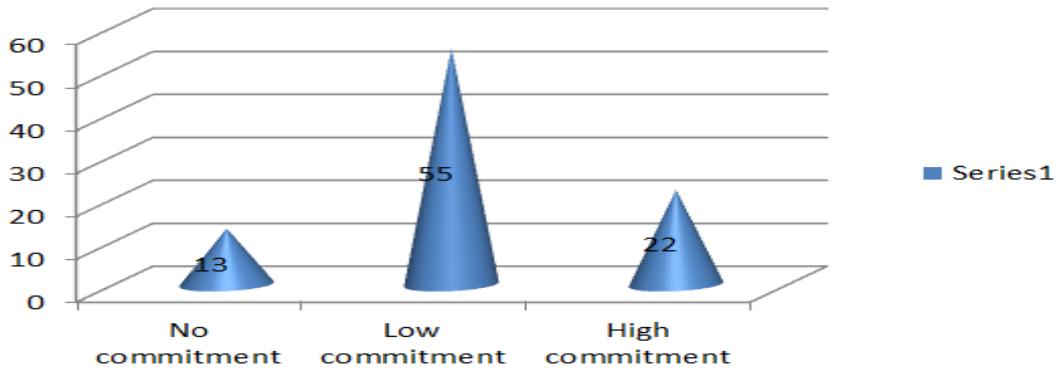


Figure-2. Commitment of Management in Audit implementation

Constructed from field survey data, (2014)

It can be deduced from Figure 2 that, majority (55) representing 61.1% of the respondents were of the view that management is showing low commitment in implementing audit recommendations while 22 (24.4%) believed that management shows high commitment. However, 13 representing 14.4% of the respondents did not think that management is showing any commitment as regards implementation of audit recommendations. It was also observed that the ineffectiveness of the audit committees allows management to decide what to do with the audit recommendations and even dictate the work of internal auditors. This suggests that the audit review implementation committees in the assemblies are not playing their roles in protecting the independence of the internal auditors.

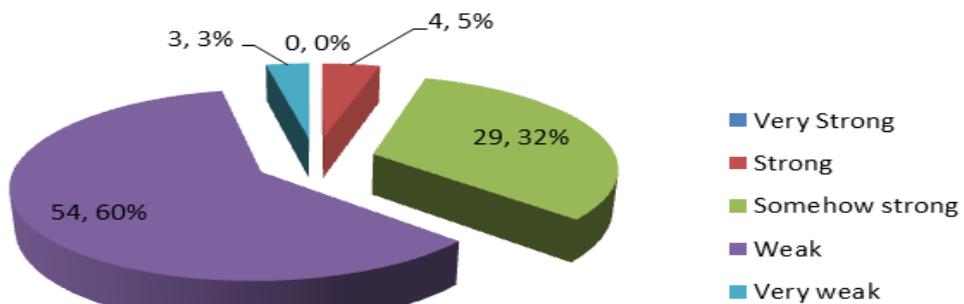


Figure-3. Rating of independence of internal auditors from management

Constructed from field survey data, (2014)

3.5. Reliance on Internal Auditors by External Auditors

One of the factors that external auditors consider before relying on internal auditors' work is the organizational independence of internal auditors. Therefore, the study sought to find out from the respondents how they rate the independence of internal auditors from management. The result is presented Figure 3

It is evident that, majority (54) representing 60% of the respondents rated the independence of the internal auditors from management to be weak. As a result of this, 87.5% of external auditors asserted that they rarely rely on the work of internal auditors. The reasons they expressed were scope limitation, poor quality work, inexperience of the internal auditors and management interference with the work of internal auditors.

4. CONCLUSIONS AND RECOMMENDATIONS

4.1. Conclusions

The evidence from the study indicates that the organizational independence of the internal auditors is in danger. The internal audit units are not adequately resourced to independently carry out their duties without unduly depending on management. The evidence search is a difficult task for internal auditors in the various assemblies as they experienced high intimidation and familiarity threats. The reporting relationship in the assemblies impairs the organizational independence of the internal auditor. They report functionally to coordinating directors and this is not the best reporting line. The best way is to report administratively to coordinating directors and functionally to audit committees.

Management interferes with the work of internal auditors due to absence of internal audit charter in most of the assemblies and the ineffectiveness of the audit review implementation committees. From this evidence, it could be argued that, the scope of the internal audit activities is limited. Management is not committed to implementing audit recommendation. The status of the internal auditors in the various assemblies does not enhance their independence as they receive low recognition and low representation on board meetings.

4.2. Recommendations

On the basis of the conclusion, the following recommendations are proposed for the consideration of Internal Audit Agency, management of the assemblies and the internal auditors.

1. Every assembly should establish an audit committee. The audit committee should be made up of experts from different field that are independent from the management of the assemblies. The audit committee should be effective. The existence of audit committee enhances the independences of the internal audit unit because they have no clearly defined relationship with the internal audit staffs and less frequent meetings are held with them as a follow up and control the effectiveness of the internal audit units from the perspective of strengthening governance structure. The current reporting relationship of internal auditors to coordinating directors does not make internal auditors to enjoy some level of independence. For the purpose of enhancing the independence of the internal auditors, they should rather report to audit committee.
2. Each assembly should have its own internal audit charter. The management should involve the internal audit staffs and the audit committee in developing the charter. This would bind management and the internal auditors in executing their respective duties.
3. The internal audit units need to be adequately resourced including the use of appropriate technology. The availability of resources would enable the internal auditors to do quality work within the timeframe.
5. The internal auditors should be given high status in the assemblies so that they cannot be manipulated by management. The Chief Internal Auditors should be placed at a level that is recognized in the assemblies, preferable the level with the finance officers and other key influential persons in the assemblies.
6. The internal audit agency should monitor the internal audit units on regularly basis. This would help the agency to know whether the internal audit units are achieving the desired results

or not. Monitoring includes addressing internal audit findings and recommendations and ensures that the management of the assemblies take corrective actions

7. It is also recommended that the internal auditors should not stay in a particular assembly for more than three years because of familiarity and intimidation threats. This is also necessary to enhance their independence.

8. The work of the internal audit units should not be decided by the Coordinating Directors. The unit should be autonomous to decide what auditing activities to carry out. When Coordinating Directors define the work of internal audit, the scope of the unit would be limited and the independence of the auditors would be at risk.

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