

**The Internal Audit Function as a Corporate Governance Mechanism
in a Developing Economy: An Empirical Study of the Nigerian
Financial Sector**

By

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Abstract

This study investigates the contributory power of the Internal Audit Function (IAF) as one of the four mechanisms of Corporate Governance. The primary aim of the research is to examine the capacity of the IAF to fulfil its contributory role as one of the four cornerstones of CG particularly in the financial sector (FS) of a developing country- Nigeria. Four research questions were put forward. First, what is the level of independence of the IAFs in the Nigerian financial sector (NFS), Second, To what extent are the IAFs in the NFS performing their roles in conformity with the Institute of Internal Auditors (IIA)'s standards?, Third, how objective are the internal auditors in the Nigeria Financial Sector (NFS)?, and finally, to what extent are internal auditors in the NFS competent in fulfilling their expected roles? To provide some answers to the research questions, the study made use of triangulation of both quantitative and qualitative primary data gathered from both questionnaire survey on 88 respondents (internal auditors) from firms in the NFS, through purposive sampling method. Four hypotheses formulated for the study were tested using both binary logistic regression analysis (BLRA) and thematic analysis on the collected data, with the aid of a conflation of 3 theories (Agency, Transaction Cost Economy and Institutional theory- 'ATI').

Overall, the study provided strong evidence to indicate that the IAFs of the NFS cannot be said to be totally independent of management. The study also established that the auditing methodology of the IAFs of the NFS is not in tune with the new order of internal audit practice (i.e. IIA's standards). Likewise, the internal auditors in the NFS were not found to objective and proficient. Areas requiring improvement include the manner of appointment and dismissal of CAEs, irregularity of audit committee meeting attendance by the CAEs, insufficiency of training for the IAs as well as their low membership with the Institute of Internal Auditors (IIA). The originality of the study and its key contribution to the body of knowledge reside in the evolution of the expansive theoretical framework ('ATI'), and the development of four different models applied to investigate the IAF's contributory power in CG.

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List of Acronyms and Abbreviations

ACAEBIN	Association of Chief Audit Executives of Banks in Nigeria
ACCA	Association of Chartered Certified Accountants
ACCs	Audit Committee's Chairpersons
ACIN	Audit Committee Institute Nigeria
AGMs	Annual General Meetings
ASX	Australian Stock Exchange
ATI	Agency, Transaction Cost Economy and Institutional theories
BCCI	Bank of Credit and Commerce International
BLRA	Binary Logistic Regression Analysis
BoDs	Board of Directors
CAE	Chief Audit Executive
CBN	Central Bank of Nigeria
CBOK	Common Body of Knowledge
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CIA	Certified Internal Auditor
CIAs	Chief Internal Auditors
COOs	Chief Operating Officers
CPA	Certified Public Accountants
CPE	Continuing Professional Education
CSA	Control Self-Assessment
ERM	Enterprise Risk Management
EU	European Union
FCA	Fellow of the ICAN
FRCN	Financial Reporting Council of Nigeria
GAAP	Generally Accepted Accounting Principles
IAA	Internal Audit Activity
IAC	Internal Audit Charter
IAES	Internal Audit's Efficiency Scores

IAF	Internal Audit Function
ICAEW	Institute of Chartered Accountants of England and Wales
ICAN	Institute of Chartered Accountants of Nigeria
IIA	Institute of Internal Auditors
IIARF	Institute of Internal Auditors Research Foundation
IoD	Institute of Directors
ISPPA	International Standards for the Professional Practice of Internal Auditing
LIRS	Lagos State Internal Revenue Services
MMR	Mixed Methods Research
MTG	Management Training Ground
NAICOM	National Insurance Commission
NDIC	Nigeria Deposit Insurance Corporation
NFS	Nigeria Financial Sector
NSE	Nigeria Stock Exchange
OECD	Organisation for Economic Co-operation and Development
OLS	Ordinary Least Square
PCAOB	Public Company Accounting Oversight Board
PWC	Pricewaterhouse Coopers
QAIP	Quality Assurance and Improvement Program
RBAP	Risk Based Audit Plan
SAS	Statement of Auditing Standards
SEC	Securities and Exchange Commission
SOX	Sarbanes-Oxley Act
SPEs	Special Purpose Entities
TCE	Transaction Cost Economics
UK	United Kingdom
USA	United States of America
VIF	Variance inflating factor

Chapter 1: Introduction

1.0 Chapter Overview

The main aim of this chapter is to construct a broad background for the study. Examination of the capability of the Internal Audit Function (IAF) to fulfill its contributory role as one of the four cornerstones of Corporate Governance particularly in the financial sector of a developing country is the focus of this thesis. The rising cases of corporate scandals worldwide in the recent time have resulted into many negative impacts on the investing public and other stakeholders (see Porter, 2009; Malin, 2010; Adeyemi & Adenugba, 2011; Otusanya & Lauwo, 2010). Unceasingly, issue relating to corporate governance has always been visited in finding solutions to these un-ending concerns.

While other three key mechanisms of Corporate governance, as indicated by Gramling, *et al.* (2004) i.e. External auditing, Audit committee, and Management have been under intense criticism due to their seeming failures in addressing the negative incidences and ensuring good Corporate governance in corporate entities, much attention however seems to have been shifted to Internal auditing as corporate stakeholders seek solutions to the perceived breakdown in the systems of business reporting, internal control and ethical behavior apparent in some of these scandals (Boyle, Wilkins & Hermanson, 2012; Adeyemi & Adenugba, 2011; Hass, Abdolmohammadi & Burnaby, 2006; Sarens & Abdolmohammadi, 2011).

This study starts with an acknowledgment of the perspective of four cornerstones of corporate governance representing the primary representatives of organisation's stakeholders (i.e. Management, audit committee, external auditor and IAF (see Gramling *et al.*,2004). Also, the many contentions about the relevance of internal auditing in maintaining corporate order are also acknowledged and brought to fore.

The continuous push for appreciation of IAF as one of the key mechanisms of sound corporate governance, in spite of the many unresolved controversies surrounding its relevance and value addition to corporate governance in the literature, suggests the need

for an empirical verification of the ability of the IAF for its assumed role of strengthening corporate governance, and therefore, the crux of this study.

The chapter is organized as follows. While the next section discusses the motivation and scope of the study, sections 1.2 and 1.3 center on the study's problem definition and the research objectives respectively. Section 1.4 itemizes the study's research questions, and section 1.5 gives an overview of the research methods. Section 1.6 highlights the significance of the study, and finally, Section 1.7 gives a snapshot of the contents of the rest of the chapters covered in the thesis.

1.1 The Motivation and Scope of the study

The thrust for this research stems from the scant studies and limited literature on the issue of IAF's enhanced roles in corporate governance's domain. While studies on the internal auditing's theoretical framework, IAF's changing roles, improved status, and how it can be strengthened in response to its rising and challenging roles within the corporate governance's ambit are numerous and multidimensional (Harmanson, 2002; Adams, 1994; Dominic & Nonna, 2011; Boyle, Wilkins, & Harmanson, 2012; Pape, 2007; Swinkels, 2012), little has, however, been reported on variables that are associated with IAF's ability to play active role in promoting corporate governance (Sarens, Abdolmohammadi & Lenz, 2012; Abiola, 2012).

Whereas, IAF has been argued to be one of the cornerstones of corporate governance, startlingly, none of the extant studies on corporate governance, within the knowledge of the researcher has specifically attempted to establish empirically, how capable the IAF is as a cornerstone of corporate governance in financial sectors, and particularly in developing economies. Incidentally, the Nigerian financial sector (NFS), particularly its banking industry, is overwhelmed with issues of poor corporate governance, bothering on corporate accountability, risk management, and governance process. Going by Gramling *et.al* (2004)'s position on IAF and their perspective of same as resource to each of the other three cornerstones (i.e. external auditor, audit committee and management), and the advocacy on the enhanced roles of IAF by the Institute of

Internal Auditor (IIA), one may want to say that the respite is here at last. However, the un-abated cases of corporate governance's failure worldwide is a big challenge and open up an area of curiosity into capability of the function (IAF) for its enhanced roles in ensuring sound corporate governance.

Aside from the limitation of studies on IAF's capability to deliver enhanced roles in corporate governance's domain, most especially in developing economies, and its changing roles within corporate governance's domain, no study, at least within the knowledge of the researcher has specific sectorial focus either from developing or developed countries. Likewise, an ideal theoretical paradigm appears yet to be agreed despite the numerous studies on IAF's theorisation specifically devoted to internal auditing (see Paape, 2007, 238; Swinkels, 2012; Boyle, 1993; Gendron and Bedard, 2006). Therefore, efforts geared towards broadening the horizon of theoretical lenses currently employed in internal auditing's research are considered worthwhile. Therefore, a thorough reflection on the scant theoretical lenses of internal auditing forms part of this research's outlines.

Of the extant scant studies on internal auditing, and corporate governance, such as Paape, Scheffe, & Snoep (2003); Gramling *et al.* (2004); Munro, & Stewart (2011); Burnaby & Hass (2011), Adel, & Maissa (2013); Karagiorgos, *et al.*(2010), Saren, Beedle & Everaert (2009); Sarens, Abdolmohammadi & Lenz (2012); Ebaid (2011); Paape (2007); and Swinkels (2012); only Karagiorgos, *et al.*(2010); Paape, Scheffe, & Snoep (2003); Ebaid (2011); Cohen & Sayag (2010) and Sarens, Abdolmohammadi & Lenz (2012) studies seem similar to this research based on their focus on IAF and corporate governance, and thus provided useful guidance and direction particularly in the area of conceptual framework. The other referenced studies appear fragmented in approach. For instance, instead of looking at IAF's role in corporate governance through a wider perspective of its interactions with the other three key cornerstones, as argued by Gramling *et al.* (2004), most of the studies applied one to one relationship, thus producing mixed and divergent results.

Of the ones considered similar to this study based on the contextual focus (Karagiorgos, Drogalas, Gotzamanis & Tampakoudis, 2010; Paape, Scheffe, & Snoep, 2003; Ebaid, 2011; Cohen & Sayag, 2010; and Sarens, Abdolmohammadi & Lenz, 2012), none is found to have a specific sectorial focus, therefore, creating a gap which this study aims at filling, by focusing an important sector as financial, whose beneficial roles in any economy cannot be overemphasized. The recent corporate challenges that ravaged economies worldwide further amplify the relevance of this sector across climes (Gras-Gil, Marin-Hernandez, & Garcial-Perez de Lema, 2012). The significance of financial sector in any economy cannot be overemphasized. The sector is known to serve as the lubricant which facilitates the smooth running of any economy (Yaqub & Omobitan, 2012).

Whereas, the linkage between financial sector and economic growth has been a subject of discussion over time (Garba, 2014), it is however established that the sector is expected to galvanize economies by mobilizing funds from surplus to deficit ends, manage the payment systems and facilitate the effectiveness of monetary policies (Yaqub & Omobitan, 2012). Ndebbio (2004) relying on his findings from a study focusing sub-Saharan African countries establishes that a developed financial sector triggers sustainable economic growth. Hicks (1969) using England economy also affirms that a well-developed financial sector engenders sustainable economic growth. The referenced study emphasizes the interrelationship of nations' financial sector with economic growth by maintaining that the industrialization of England (United kingdom) was facilitated by the nation's developed financial sector which among other roles makes funds available to people and government. Thereby, facilitating production, trade and capital formation that resulted in sustainable job creation, and economic development in England. The argument is that well-developed financial sector provokes sustainable economic growth (Bensivenga, 1995). Other studies that corroborate this position include Amara & Quintin (2007), Thornton (1995), Rousseau & Sylla (2001), Calderon & Lieu (2002) and Agarwal (2001).

The massive bail-out that followed the 1999 global financial meltdown across countries is a confirmation of the acknowledgment of the importance of financial sector in any economy. Garba (2014) disclosed that the belief of the affected countries is that once the financial sector is revived the whole economy shall be revitalized.

The Nigerian financial sector no doubt presents an ideal model of financial sector of a developing economy. This is so given that the country's financial sector like any other developing economy's financial sector has a less-developed capital market which indicates the nation's inability to tap fully into the huge opportunities of capital accretion internally, and huge potentials of foreign direct investments that a developed capital market offers. The limitation of most developing economies in this regards is mainly responsible for their low capital formation, unemployment, poor Gross domestic product, low per capital income, and ultimately poor standard of living generally. Studies focusing on factors that could further strengthen financial sectors of these climes will expectedly provide insights on what to do to address some of the economic plagues confronting these economies, and therefore a worthwhile endeavour.

While Karagiorgos, *et al.* (2010) focuses no specific organization, industry, sector, or country, (in addition to the fact that it offers no empirical evidence on the impact of IAF on corporate governance), Paape, Scheffe, & Snoep (2003) focus only top listed companies in 15 European union (EU) member countries, with no particular sector or industry in focus. Ebaid (2011) no doubt offers a divergent platform on IAF and corporate governance studies by focusing an emerging market (Egypt). The study however fails to be specific on a particular sector or industry but rather on the countries' listed firms with deliberate exclusion of banks and other financial institutions. The author adduces the reason of peculiarity of financial sector's regulatory framework in terms of effectiveness of internal control and compliance with regulations capable of ensuring good corporate governance practices. This further indicates continuous neglect of this very important sector in academic research on IAF and corporate governance, and consequently calls for attention that this study avails. The study's overall

conclusion of doubts about the significance of the IAF as a corporate governance's mechanism in Egyptian firms also stimulates the current study from a similar domain.

In the case of Cohen & Sayag (2010), the focus is on both private and public organizations in Israel. Differences in the objectives of private and public organizations however may not allow any meaningful inference to be drawn from such study. While private organization is profit oriented, public organization is usually service inclined. The study of Sarens, Abdolmohammadi & Lenz (2012), no doubts provides very useful empirical insights into the subject of the research. The study nonetheless makes professional internal auditors of the status of Chief Audit Executive (CAE), and who are members of the Institute of Internal Auditors (IIA), its focus. This is a sharp departure from the other studies earlier mentioned. As much as the study has its own rationale for this, and makes the ampleness of large membership of the IIA in United States of America (due to its pioneering status in the field of internal auditing) a justification, the referenced research may be said to be ingrained with limitation of generalization of result, more so that there is no industry or sectorial focus. In addition, the results may have limitation of professional bias as inclusion of only professional internal auditors suggests abinitio that an informed and patterned result may emerge, as opinion of other practicing internal auditors, who are not members of the IIA, is not incorporated. This study consequently aims at improving on this weakness by incorporating all internal auditors (whether or not members of the IIA) in the NFS.

The gaps identified above provide the first motivation for the research. Incidentally, the relationship between IAF and corporate governance issues in developing countries attracts little attention and focus in academic literatures (Abiola, 2012). To the best of the researcher's knowledge, the few studies identified in this regards are Barac and Van Staden (2009), Akinteye, York and Qudrat-Ullah (2015) and Abiola (2012). However, the various gaps identified in these studies further motivate this research.

For instance, Abiola (2012), a study of corporate governance in the Nigerian banking sector and relevance of internal auditors aside from focusing only the Nigerian banking

industry, relies on feedbacks (through semi-structured interview) from 23 internal auditors. The significance of sample size in generalization of research findings certainly cannot be overemphasized. Wider coverage could have been achieved if the study's focus is extended to cover all firms in a particular sector (for instance, financial sector) in the country. In addition, a mixed method approach capable of generating corroborative evidences would have yielded a stronger and more reliable result. Sparse feedback based on a limited scope on a crucial matter like corporate governance might be refuted easily. This study therefore aims at more robust sample size and mixed methods (involving both qualitative and quantitative data).

For Akinteye *et.al* (2015), a study that investigates IAF's quality in Nigerian listed firms, though found evidence that the IAF of Nigerian listed firms is fully integrated into the business and as such puts the IAF in good position to function as an effective corporate governance's mechanism, however also fails to concentrate on a particular sector of the listed companies. In addition, the study also does not explore the corroborative advantage associated with mixed method in behavioural research. Only qualitative research approach (interview method) involving descriptive statistical analysis was employed. Furthermore, only 8 heads of IAFs were involved in the study's interview. Generalising results emanating from interactions with only 8 heads of IAFs for Nigerian listed companies appears too wishful and such outcome is vulnerable to criticism particularly that there are more than 8 sectors on the Nigerian Stock Exchange (NSE) listing.

Lastly, the finding of Barac and Van Staden (2009) that no correlation was established between the defined soundness of the corporate governance's structures and the perceived internal audit quality of participating 30 large companies in South Africa is puzzling and further gives credence to the rationale of the current study. A study from developing nation (such as South Africa), indicating no correlation between IAF and corporate governance contradicts the general position in the literature and certainly is expected to trigger further research in this direction particularly from another major developing nation in sub-saharan Africa .

Worth of note is the concern on the issue of corporate governance in the NFS. Poor corporate governance has become a common lexicon in the NFS (Adegbite, 2012; Babalola & Adesoji; 2011; Aileman & Ojeka, 2013). Aileman and Ojeka (2013) further maintain that boards and management of some major banks in Nigeria were not equipped to run their institutions. Internal auditing is a dynamic and evolving profession and no longer a branch of accounting profession or a branch of information technology (Bou-Raad; 2000). Whereas with a view to promoting the significance of IAF in corporate accountability and governance, the IIA was established over seventy years ago in the USA, the internal audit profession in Nigeria is however still seeking identity, following the full institute status of the IIA Nigeria chapter in 2013. In the same vein, it was discovered that most of the internal audit practitioners in the country currently do not associate with the IIA, whose core objective is capacity building through knowledge sharing. This type of environment no doubt, presents another divergent platform for a study on IAF and corporate governance.

Finally, the position of Nigeria in the Sub Saharan Africa in terms of her population and Gross domestic product justifies the focus on the country's financial sector among the other developing economies in the continent. Nigeria is the largest economy in Africa (Suberu, *et al.*; 2015).

1.2 Problem Definition

The aim of this study is to assess the effectiveness of IAF as a mechanism of corporate governance in a developing country, Nigeria, plagued with corporate governance issues such as falsification of companies' financial statements, executive recklessness, and abuse of corporate office (Otusanya & Lauwo, 2010), and with budding internal auditing profession.

The argument of this study is that if indeed IAF is a key mechanism of corporate governance (Gramling *et al.*; 2004), and a resource to the remaining three key components of corporate governance – management, audit committee, and external audit, in line with its enhanced role post Sarbanes-Oxley Act (SOX) of 2002, how far

has it impacted corporate governance and helped in restoration of public trust particularly in the NFS?. Going by the position of the IIA, an IAF that will add value is however expected to be the one that is independent, conduct its activities in conformity with established standards, and the one comprising of a team of objective internal auditors with high level of proficiency.

1.3 Research Objectives

The study's specific objectives which the researcher planned to accomplish were to:

- i. investigate the level of independence of the IAF from management in the Nigerian financial sector.
- ii. establish the level of adoption of the IIA's international standards by the IAFs for its engagements in the Nigerian financial sector
- iii. establish the level of objectivity of the individual internal auditors in the Nigerian financial sector.
- iv. establish if the internal auditors in the Nigerian financial sector possess the required level of proficiency to fulfill their expected roles.

The above objectives were converted into research questions (shown in section 1.4 below). As indicated in chapter 4 of the thesis, 4 different testable hypotheses, and 15 propositions were formulated to provide empirical answers to the research questions.

1.4 Research Questions

The following research questions were formulated from the above listed objectives:

- (i) What is the level of independence of the internal audit functions in the Nigerian financial sector?.
- (ii) To what extent are the internal audit functions in the Nigerian Financial sector performing their roles in conformity with the Institute of internal auditors' standards?
- (iii) How objective are the internal auditors in the Nigerian financial sector?.
- (iv) To what extent are internal auditors in the Nigerian financial sector competent in fulfilling their expected roles?.

1.5 Overview of Research Method

This study adopted triangulation of theories and data with an overall pragmatic philosophy, a conflation of both positivism and constructivism philosophical paradigms. In line with previous studies in this area of research, primary data (comprising both quantitative and qualitative) were applied for this study through a questionnaire survey and semi-structured face-to-face interviews. While Binary logistic regression analysis (BLRA) was performed on the quantitative data for the test of the hypotheses, thematic analysis was performed on the qualitative data. The results of the thematic analysis were then applied for necessary corroborations of the findings from the BLRA. In all, 4 hypotheses were tested.

1.6 Significance of the Study

First, this study has reasonably demonstrated the inadequacy of a singular theoretical lens to evaluate the relevance of IAF in the corporate governance's mosaic, and its capability to function as a mechanism of corporate governance. This study forges ahead the use of a conflation of three different theories (namely Agency, Transaction Cost Economy, and Institutional theory ('ATI')) in the study of IAF's contributory roles to corporate governance. The tripodal theoretical model ('ATI') evolving from the study has provided a paradigm through which some of the gaps identified in the extant studies (reviewed in chapter 4) associated with limitation of theoretical openness, can be appropriately addressed. The development of the tripod theoretical model (ATI) espoused in the study is a new approach in internal auditing research. This is expected to provoke further research endeavours, and broaden the frontier of knowledge accordingly.

Second, this research work is the first study to concentrate exclusively only on the financial sector which hitherto suffered neglects from researchers in the field of internal auditing and corporate governance. Whereas, the study's outcome could presently be limited in generalization to only developing economies, it is however capable of stimulating interests of researchers in the financial sectors of developed nations. This is

considered a way of gaining insights about the characteristics of IAF in the sector that is being shielded from the prevalent scrutiny the IAFs of other sectors face at the moment.

Finally, the four models that evolved conceptually under the study, aside from being a modest response to passionate calls for paradigm shifts in internal auditing and corporate governance's studies (Sarens,2009), and applied to test the study's hypotheses empirically, open a new path for future studies in internal auditing.

1.7 Thesis Organisation

Following the Introduction of the study covered in this chapter, the rest of the thesis is organized as follows. Chapter 2 provides the background of the study environment and sheds light on the status of corporate governance and internal auditing in Nigeria. The next two chapters (Chapter 3 and 4) of the thesis deal with the review of literature establishing the study's theoretical underpinnings and empirical review of extant studies on internal auditing and corporate governance. The study's propositions and hypotheses are consequently synthesized in chapter 4.

Chapter 5 presents the research design. This gives an account of the research methodology adopted for the study, while analyses of the research data are presented in both chapters 6 and 7. The summary of the findings of the study, their discussions, conclusion, limitations and potential future research opportunities uncovered in the course of the study and the study's major contributions to the body of knowledge are presented in Chapter 8 of the thesis.

Chapter 2 : Internal auditing and Corporate governance

2.0 Chapter Overview

The objective of this chapter is to discuss the concept of corporate governance generally, establish the key mechanisms of corporate governance in organisations and at the end, expatiating internal auditing as one of the key mechanisms of corporate governance particularly as suggested by existing studies. In doing this, some seminal and contemporary studies on corporate governance generally are reviewed, establishing there from, some concerns on corporate governance from both developed and developing economies. Thereby, identifying the major unresolved issues regarding corporate governance particularly from sub-saharan Africa.

In addition, the history of evolution of internal auditing as a component of accounting function is traced, and developments that made it a profession distinct from accounting practice are also brought to fore. Also, the nexus between internal auditing and corporate governance is discussed and the study's conceptual framework is consequently espoused. Finally, an overview of the Nigerian financial sector and recent developments therein (making it a focus of this study) are discussed.

Overall, this chapter is structured into four main sections. The first section focuses discussions on corporate governance generally, highlighting the many unresolved issues regarding corporate governance as espoused in extant studies, focusing particularly developments on corporate governance in developing economies.

The second section focuses discussions on auditing generally, concerns about audit crunch and efforts made to sustain the relevance of auditing globally, while establishing various developments that have led to emergence of internal auditing as a profession globally. The third section is on discussion of the relationship between internal auditing and corporate governance, and consequently establishes the study's conceptual framework. An overview of the Nigerian financial sector and various recent developments in the sector are discussed in the last section.

2.1.0 Corporate Governance

Businesses around the world need to be able to attract funding from investors in order to expand and grow (Mallin, 2010). Investors however require certain level of assurances on the safety of their funds as well as on the expected returns thereon. These assurances are usually and traditionally derived from disclosures made about business status in companies' annual financial statements, duly attested by an independent person (auditor). Surprises of the recent years in form of sudden business collapses without any premonition particularly as could be gleaned from various disclosures in audited financial statements suggest the limitation of audited financial statements in terms of completely meeting investors' information requirements. Therefore, it has become evident that additional non-financial information (about operation and management of business organizations) are also vital to enable investors have detailed and full knowledge about how well their investments are being managed by managers of these corporate entities.

Whereas annual reports may give a reasonably accurate picture of business activities, information on many other critical areas of business are not included in companies' annual reports (Mallin, 2010). These critical areas relate to how businesses are being run by the management, the processes and structures designed by organizations towards achieving its objectives, the manner of business decisions that are taken in running corporate entities, the soundness of business decisions taken by those in charge, adequacy of various structures put in place by business to carry out their day to day activities, the effectiveness of board supervision of the management towards achievement of business objectives etc. All these details are woven around governance of business organization.

It is reasoned that further assurances can be provided when investors are abreast of governance issues relating to their business. The need for sound corporate practices in managing firms' affairs cannot be overemphasized particularly in retaining the confidence and continuous supports of various concerned parties of corporate entities (such as investors, shareholders, creditors, suppliers of inputs, employees, governments,

host communities etc). Continuous business catastrophes worldwide in recent times and the need to put these unpleasant events in control to avoid uncontrolled business tragedies globally are the main thrusts for the heightened interests and discussions of corporate governance worldwide. Mallin (2010) identifies the phenomenal collapse of Enron in 2001 and the subsequent financial quagmires that consumed other numerous and big companies in various countries as other landmark disasters that led to the increased attention in corporate governance particularly over the last couple of decades.

Whereas there are varying and very wide viewpoints on the term “Corporate governance”, the term is however generally construed to mean practices, mechanisms, structures, rules or processes put in place for administration of corporate entities with an overarching motives of ensuring and maintaining fairness to all stakeholders while pursuing their objectives. Different legal, economic, political, historical and cultural environments across countries however have impacts on the level of good corporate practices across nations (Aguilera & Jackson, 2003).

Unlike developed countries with sophisticated capital markets, sound legal framework and low level of corrupt practices, developing countries (such as Nigeria) are endemic with high-level of corruption, weak legal and regulatory frameworks, and the consequential underdeveloped capital market. These factors hinder ability to attract foreign investments that are capable of stimulating rapid economic developments in these environments. Therefore, studies that could contribute meaningfully to enhancement of corporate governance in these domains are expected to serve as eye-openers and consequently help in advocacy for best corporate practices. The impacts of foreign investments in developing countries cannot be overemphasized, and foreign investors continuously look for an environment where good corporate practices exist before their commitments.

2.2.0 Evolution and transition of internal auditing

Society facilitates initiation and growth of economic entities by providing them with resources, and put their control and management in the hands of some “agents” known as “the management”. As their command over resources increases, these entities gain

significant economic, social and political power and thus accountability is demanded of their managers to forestall possible abuse of this power (Porter, 2009). Millichamp & Taylor (2008) maintain that the evolution of corporate entities with limited liabilities (limited liability company) in 1856, following the liberalization of incorporation of companies (with limited liability, through the enactment of the Companies Act of 1856), was the greatest gain of industrial revolution.

This development is however not without some challenges associated with the split between ownership and control and the associated contracting costs. One of such major issues is the likelihood of opportunistic or selfishness tendencies on the part of the management at the expense of the owners. Millichamp & Taylor (2008), while quoting the Institute of Chartered Accountants of England and Wales (ICAEW, 2006), also amplify this fear by stating that “no agents are trustworthy, and that if the management can make themselves richer at the expense of the principal, of course they will”. Porter (2009) re-emphasises that managers are perceived to be in a position to use corporate resources for their own, rather than for the shareholders’ benefit. Also, human frailties are such that when the manager is reporting about his stewardship, he may conceal some vital facts which are necessary to determine the true state of affairs of the business (Olusanya, 2008). Aside from covering up their misdeeds, Sikka, Filling, & Liew (2009) add that directors can maximize their personal welfare (such as end of year bonus) at the expense of shareholders by presenting optimistic or even misleading financial statements.

In a bid to thwart these noted tendencies, Olusanya (2008) and Power (1999) in Otusanya and Lauwo (2010) explains that auditing and auditors are promoted as trust engendering mechanism and watchdog with the capacity to promote a particular kind of social order. An auditor is an independent person, whose duties, among others, include investigating and examining the business transactions with a view to reporting whether the financial statements prepared by the business managers (agents) to indicate periodic performances represent a “true and fair view” of the state of affairs of the business.

Auditing thus lends credibility to financial statements of companies (Hayes *et al.* 2005; Carpenter *et al.* 2004).

Adeniyi (2010) hinted that roles analogous to audit dates back to many hundreds of years. This he elucidates, began in the ancient Egypt and Rome, where people were employed to assess endeavours of tax collectors and estate managers, with a view to ascertaining whether returns made by them are accurate and devoid of irregularities. Audit profession however can be said to commence in the 20th century, following the enactment of the Companies Act 1900, which specifically made it obligatory for directors of companies to produce annual accounts (Millichamp & Taylor 2008).

The owners of business (hereafter referred to as “shareholders”), who had vested their power of oversight on managers of their investments in the hands of few among them (the board of directors-“BoDs”), need to be assured that their business is being well managed and will continue to be profitable (Mallin, 2010), after all, it is generally assumed that shareholders have resolved to delegate wealth to directors to have their (shareholders’) wealth maximized (Sikka, Filling & Liew, 2009). The annual reports (ARs) or accounts presented to them in annual general meetings (AGMs) serve this assurance purpose. This assurance is however further enhanced when it is reported upon by an independent person (also engaged by the shareholders), that such is in accordance with accepted accounting standards and gives a “true and fair view” of the business activities (i.e assurances of full disclosure and conformity to generally accepted accounting principles (GAAP)). What connotes “true and fair” view in financial statement’s audit though contentious and debatable, is however not the focus of this study.

Today, a much wider range of people are interested in the annual reports and accounts of companies. Millichamp & Taylor (2008) indicate that aside from the owners of the business, other group of people that may be interested in this assurance include:

- i. employees of the company,
- ii. customers,

- iii. lenders,
- iv. creditors,
- v. suppliers,
- vi. government,
- vii. the public, including those who are interested in issues such as consumer protection, environmental protection, and political, as well as other pressure groups,
- viii. the government, including tax authorities and regulatory agencies, and
- ix. people who act in the advisory capacity to all the parties aforementioned. These include accountants, stockbrokers, credit rating agencies, financial journalists, and financial analysts.

From the above, it may therefore be contested that the society in general wants to be assured that companies' annual reports (also called financial statements) can be relied upon. This position aligns with Porter (2009)'s argument that managers of large public companies today are considered to be accountable to society as a whole for a wide range of corporate activities.

Reflecting on the above exposition therefore, it can be seen that auditing of financial reports of companies, prepared by the management adds assurances of full and accurate disclosures, conformity to GAAPs, or applicable financial reporting framework, before users of such reports, particularly the owners. These assurances are however, given after a systematic process of objectively obtaining and evaluating evidences regarding management's assertions about economic activities of an entity. The degree of alignment between the various assertions and established criteria (such as control systems, the GAAPs, financial reporting framework) are then ascertained and communicated to the interested users, by an independent person, called auditor. It is the process of arriving at such opinion that is referred to as "auditing".

2.2.1 Internal and External Audit

Given that the company's directors are saddled with the responsibility of producing "true and fair" accounts (Millichamp & Taylor, 2008), they are therefore expected to

maintain all reasonable level of controls in the business that will ensure correctness, and completeness of recording of all financial transactions in the business, It will be depressing for the directors of organisations , while carrying out their stewardship role to rely on the external auditor for the effectiveness of their organisation’s internal control system as the external auditor is considered not privy to the contract of agency that exists between the owners and them. The external auditors only concern themselves with testing of the efficiency and reliability of the internal control systems put in place by the directors, with a view to gauging the degree of the risk involved in case of failure of such, and also to know the highest risk area where greater audit effort should be directed (Millichamp & Taylor, 2008).

It is with the intention of ensuring effectiveness of an organisation’s internal control systems that directors initiate an “internal watchdog”. Who is expected to keep an eye over the various control systems initiated by the management to ensure that their instructions and guidelines are adhered to in the course of running the organisation’s affairs on behalf of their principals, the shareholders. This management’s internal mechanism is referred to both in literature and practice as “internal audit”. In practice however, it is allowed and equally found that the roles of this internal mechanism are handled by external auditor, acting however as subcontractors (Millichamp & Taylor, 2008). This audit exercise whether provided by an in-house staff or outsourced, the concern is “independence”. The rising controversy over “make or buy” decision of IAF is examined in details in chapter 4, 7 and 8 of the thesis. In summary, the concept of auditing is better appreciated when it is looked at being classified into two (internal and external audit). Omotoso (2006) reaffirms that audit can be categorised into external and internal, according to the primary beneficiaries. The major differences between the two functions are as shown below:

	Internal audit	External audit
Objectives	evaluation of organisation's risk management processes and systems control and to make recommendations for the achievements of organisational objectives	expression of an opinion on whether the financial statements show a true and fair view, and whether proper accounting records have been maintained
Scope	all aspects of the organisation's activities, including operational considerations and compliance issues	financial records and processes, risk management processes
Responsibility	Management	Shareholders
Approach	<ul style="list-style-type: none"> i. risk based ii. evaluation of internal control systems iii. testing of systems iv. evaluation of operational efficiencies 	<ul style="list-style-type: none"> i. risk based ii. testing of basis on which financial accounts are produced and reliability of systems iii. verification of assets and liabilities.

Table 2.1: Differences between Internal and External Audit

2.2.2 Auditor's Esteem

The privilege hitherto enjoyed by external auditor is utterly disappearing due to numerous cases of audit failure. Reliance on corporate auditing and auditor's claims of being able to objectively ascertain the state of the financial affairs of business entities are routinely weakened and being challenged by unexpected corporate collapses, frauds, financial scandals and general crisis of capitalism (Sikka, Filling, & Liew, 2009). Incidences of audit failure associated with falsification of annual reports is nauseatingly

becoming more and more rampant across economies – US: Enron, Worldcom, Global Crossing, Cendant, Sunbeam and Waste Management; UK: BCCI, Independent Insurance, Equitable Life, Maxwell and Polly Peck; Germany: Metallgesellschaft among others (Okaro and Okafor, 2009).

While in Nigeria, external auditors of companies such as Lever Brothers (now Unilever Nigeria Plc), African Petroleum Plc (now Forte Oil Plc), and Cadbury Nigeria Plc had been fingered for cases of audit failures (see Okaro and Okafor, 2009; Uadiale, 2010; Otusanya and Lauwo, 2010; Adeyemi and Fagbemi, 2011), unfortunately, financial institutions are not left out of this window dressing and audit failure issue. The Central Bank of Nigeria (CBN)'s directive in 1999 to banks to restate their financial statements to fully recognize huge stock of “toxic assets” warehoused in billions of Naira further attests this allegation. Restatement of corporate accounts at least may be taking as an evidence of account falsification.

The resulting effect of the scandals on the investing public (Porter, 2009) were the main reason for drawing attention towards the quality of financial statements and invariably questioning the relevance of external auditors as trust engendering mechanism and watchdog, in ensuring that “true and fair” financial statements are produced at least (Otusanya and Lauwo, 2010). External auditors are no doubts in a unique position in monitoring the fairness of financial statements and other information produced by corporate managers (porter, 2009). They alone have the statutory rights and privileges to request for organisations' records in search of the required evidences on management's assertions on economic activities of entity under their care, as indicated by Porter (2009).

However, business failures characterised by deficient financial reporting and fraudulent corporate disclosures have figured prominently, and indeed no longer a new phenomenon both in developed and developing economies (Adeyemi & Fagbemi, 2011). For over three decades or so, the extent and brutality of the impact of unexpected corporate failures and revelations of cases of transgression and reckless

management by senior company officials have demonstrated that the two fold approach (management on one side, and external auditor on the other side) to securing corporate accountability and ensuring social order may have become inadequate (Porter, 2009, Otusanya & Lauwo, 2010, Sikka, Filling, & Liew 2009). This has had a negative and cumulative impact on the way informed opinion views financial reporting and the auditing profession in particular (Adeyemi & Fagbemi, 2011; Porter, 2009, Otusanya & Lauwo, 2010; Sikka, Filling, & Liew 2009).

The auditor's connection with failing or distressed companies has created a firestorm of controversy (Carpenter *et al.* 2004), thus smearing the esteem of external auditors. In the last decade, studies have shown that the auditing profession has had to deal with a lot of challenges than it has done in its lengthy history which spans over one hundred years (Mactosh, Francis, & Ongoch, 2010; in Adeyemi & Fagbemi, 2011).

While there has been serious defence made to exonerate accountants and of course auditing professionals by some scholars such as Defond, Francis, and Carcelo (2005), accounting and auditing profession continues to receive blows due to the alleged and established cases of their professionals' involvement in some of the scandals. These professions are being questioned about the ethical standards of their members that were said to be involved. Members of the society do expect these watch dogs to at least sound early warning signals whenever fraud and other irregularities are observed (Otusanya, & Lauwo, 2010). An emerging body of literature however argues that accounting professionals have increasingly applied their expertise to facilitate, conceal and promote anti-social practices (Sikka, 2008a; Us Senate Permanent Sub-committee on Investigations, 2005; Bakre 2007; in Otusanya, and Lauwo, 2010). Bakre (2007) while looking at the unethical practices of accountants and auditors and the compromising stance of professional bodies in the corporate world, cited Nigeria (a developing country) to affirm that accountants and auditors were partly responsible for cases of distress and closure of companies and banking institutions in Nigeria.

Adeyemi (2004), while lending his voice on this great concern, states that there is a general opinion that modern day Nigerian accountants are mere tools in the hands of

perpetrators of fraud. If external auditors are being alleged of collaborating with company's management to perpetrate their con, the question therefore is how independent of the management are the external auditors, and how reliable are the audited financial statements?. Is this suggestive of non-sufficiency of principal's monitoring cost?.

The involvement and culpability of accountants and auditors in unethical practices and conflicts of interest have long been documented by critical accounting scholars in developed and developing countries (Garcia-Benau and Humphrey, 1992; Sikka and Willmot, 1995; Cousins *et al.*, 2000; Bakre, 2007; Sikka, 2008; Sikka *et al.* 2009; Gue'nin-Paracini and Gendron, 2010). The major reference point in the annals of auditor's misdeeds is the case of Enron, the Texas (USA)-based energy trading company which shook up the auditing profession worldwide due to the case of fraud facilitation and unethical behaviour of the company's auditor – Messrs Arthur Andersen. Enron debacle caused a crisis in respect of the confidence placed on auditors and raised questions on the reliability (and relevance) of financial reporting (Otusanya, and Lauwo, 2010).

Arthur Anderson was accused of issue of conflict of interest which led to it (Arthur Anderson) being accused of professional misconduct and other unethical accounting practices (Michell and Sikka, 2002).

As indicated by Otusanya and Lauwo (2010), the quality of the audit and the independence of the auditors were questionable because Arthur Andersen was also rendering non-audit professional services for Enron and earned substantially high fees in respect of same. For instance, the audit firm earned \$55million for regular exchanges of employees within Enron from Arthur Andersen, causing conflict of interest and thereby affecting the auditor's independence (Otusanya and Lauwo, 2010). Auditors cannot give unbiased opinions unless they are independent of all parties involved (Millichamp & Taylor, 2008). The lack of independence on the part of the external auditors may be considered to be the source of the malaise that is plaguing the corporate world across the globe.

The unceasing criticism of the auditing profession essentially boils down to issues of audit quality (Defond, Francis, and Carcelo, 2005), associated with enfeebled auditor's independence. While Defond, Francis, and Carcelo, (2005) do not seem to appreciate the familiarity threat associated with Arthur Andersen's earning of about same amount from non-audit services as from audit services in the referenced case, they however hint that the issue of objectivity and independence are part of the thrusts for SOX 2002.

“The engagement characteristic addressed in SOX that garnered the most attention is the auditor's provision of non-audit services and the potential for these services to compromise the auditor's objectivity and independence”

Auditors are not only required to be independent in fact and in attitude of mind, but must be seen to be so (Millichamp & Taylor, 2008). If Arthur Andersen is seen to have compromised its independence in the referenced case, then of what substance is the acclaimed independence?. Similarly, the investigations into the collapse of Bank of Credit and Commerce International (BCCI), one of the largest bank failures that have taken place worldwide, implicated the external auditor, Pricewaterhouse Coopers (PWC), who acted as both private consultant and tax advisor to the bank's management in order to enhance its own private profits (Arnold and Sikka, 2001, Mitchell et al, 2001). A case of compromised independence was proven against the external auditor who was said to have accepted loans and financial benefits from the BCCI's management (Arnold and Sikka, 2001).

The issue of due diligence expected of auditors is another matter that came up in Arthur Andersen and WorldCom Saga, where the audit firm was found to have failed to take proper steps to detect accounting irregularities (Wong, 2004 in Otusanya and Lauwo, 2010). The Enron case earlier mentioned also highlights the overriding need for the external auditor to be able to ask searching questions without holding back for fear of offending a lucrative client (Mallin, 2010). One therefore wonders if an external auditor whose hand is already soiled can have enough courage to question a company's

management team when it matters. Does this suggest vote of no confidence on external auditor?

Going by the saying, “he who pays the piper dictates the tune”; one can also predict the likely impact of the persistent flaw in the manner of engagement and retention of external auditor on their independence. This phenomenon, according to Ronen & Cherny (2003) implicitly makes the auditor beholden to his client and its management. While conventional wisdom, according to the writers sees nothing wrong in the situation, it may however make the auditor to end up seeing things through the eyes of management without even realising it.

Looking at the issue of diminishing esteem accorded the external audit, and what could have triggered it aside from auditor’s alleged unethical roles in corporate collapse, Okike (2004); DeFond, Francis & Carcello (2005); Sikka (2009); and Ronen & Cherny (2003); in their different studies identify: *developments within information technology, ever dynamic business world with its various challenges, relaxed legal framework, anachronistic audit standards, non-suitability of the extant curriculum and professional accounting education to produce the required skill set for modern day auditors faced with the issue of assurance in this modern business time*. These changes and challenges have had (and will continue to have) significant impact on the auditing profession (Okike, 2004).

It is beyond dispute that the movement from an industrial economy to an information economy has wrought massive changes on the nature of business, accounting and auditing (Ronen & Cherny, 2003). During the era of industrial economy, client’s books and records were maintained manually for all intents and purposes, and there were major gaps in data. The auditor’s primary focus then was validation of data. Auditors thus expended major efforts to verify records through such activities as extensive counting of inventory and confirming accounts receivables and payables with external parties. Other than long term assets and debt, by the time the auditor’s field work was completed, the rest of the balance sheet had usually completed its cycle, with most of

the inventory turned over, most of the receivables collected, and most of the payables settled. This thus enabled the auditor to look back and further validate his assessment of the data and valuations as at the statement date. Stressing the above point further, Ronen & Cherny (2003) indicate that long term projects were accounted for on a percentage-of-completion basis, but auditors had methods and techniques such that they were confident in the carrying of the projects.

With the advent of information technology (IT), and the continuous eruption in IT world however, business data are produced electronically with ease, and in volumes thus posing the challenge of data overload, and putting the auditor at the mercy of the data processing systems: the “black box syndrome” (Ronen & Cherny 2003). Closely related to this challenge is the impact on auditing profession, of the very dynamic business environment with bouquet of “financial derivatives”, the movement from tangible to intangible assets with very long lives, and from liabilities whose principle and terms are known and specified to liabilities whose principle and terms are legally related to and dependent on other factors. Evidently, even Nobel prize winners in economics had difficulty in gauging market turbulence and arrive at an objective valuation of complex financial instruments (Sikka, Filling, and Liew, 2009). It is therefore doubtful if auditors are more knowledgeable, or can make better assessment of market volatility to verify valuation of complex financial instruments (Sikka, Filling, and Liew,2009). Sikka, Ronen & Cherny (2003) note that the above scenario thus puts the auditor at the mercy of the client, and that auditors are therefore naturally tempted to adopt the client’s position. These concerns on inadequacy of external auditors’ competence in the modern day business world further raise the pessimism on the relevance of external auditors and reliability of audited accounts carrying their attestation.

One point that is clear from the above exposition is that the relevance of audited financial statements is continually becoming doubtful, as the various accounting scandals in the corporate world have called into question the value of the financial statements audit, and increases the societal awareness on corporate accountability. Incidentally, external auditors, being the easiest target, according to Ronen & Cherny

(2003) are always singled out as the culprits. Issues bothering on auditor's independence, competence and due diligence usually characterise the basis of public aspersion on external auditors.

While the concerned professionals and some accounting scholars may not subscribe to the notion that audit cord is broken, with a view to minimising societal fury against the auditing profession, ensuring sanctity of financial reporting, and promoting good corporate accountability probably, some measures identified by accounting scholars who are also worried about the rising negative public view on auditing as a tool of corporate accountability include:

- i. modification of the anachronistic audit standards (Ronen & Cherny, 2003;).
- ii. adoption of audit trinity approach, encompassing external audit, internal audit and audit committee (Porter, 2009), this recommendation may not be unconnected with Sikka, Filling and Liew (2009)'s contention that the current audit model is flawed and cannot be rectified.
- iii. fortification of the legal framework as it relates to auditors' ingenious caveat on liability on failed audit (Sikka, Filling and Liew, 2009).
- iv. adoption of financial statement insurance (FSI), that will involve an intermediary, an insurance company (as recommended by the proponent) between company's management and auditors. The FSI (as recommended by Ronen & Cherny, 2003;), will play the role of an underwriter of audit service, and will thus be the one that will be in charge of appointment and dismissal of external auditors and will also take all liability arising from the audit services. This according to them will engender external auditors' independence, and further shield them from the public continuous disparagement.

2.2.3 Stature of Internal Auditing

Historically, internal audit has been considered as a monitoring function, the "organizational policeman and watchdog", tolerated as a necessary component of

organizational control but deemed subservient to the achievement of major corporate objectives (Karagiorgos *et al.*, 2010). However, internal audit has evolved considerably since the IIA was established in the United States in 1941 (Bota-Avram, 2011). The institute is dedicated to the furtherance of the state of the arts (both in philosophy and practice) of internal auditing (Dittenhofer, 2001). Dittenhofer (2001) and Swinkels (2012) further emphasize that since its inception that spanned over seventy (70) years, the institute has pre-occupied itself with the practice of quality internal audit, its edicts, its statements of responsibilities and body of ethics. The growing stature of internal auditing across climes might not be unconnected with the increasing “vote of no confidence” on external audit as a means of fortifying corporate accountability, arising from their smeared image in connection with various corporate scandals, and the need to retain public confidence in corporate sustainability (Sarens *et al.*, 2011). Burnaby & Hass (2011), and Sarens *et al.* (2011) disclose that the significance of the internal auditing profession has grown dramatically over the last decade as the numerous frauds and whimsical practices of financial management has escalated.

Traditionally, the internal audit focus is on company’s internal control. Putting this succinctly, Ebaid (2011) indicates that it is designed to safeguard firm’s assets, and assist in the production of reliable accounting information for decision making purposes. If truly the IAF is meant to assist in the production of reliable accounting information, then one wonders the level of interaction between this mechanism and external audit in pursuance of their role of attestation on management’s assertions on financial transactions.

Moreover, according to Martin & Lavine (2000), understanding of both the financial and operational aspects of the firm is one of the core competencies of internal auditors. Accordingly, if this competency can be leveraged for increased external audit’s efficiency and effectiveness, significant overall cost savings is anticipated (Gras-Gil, Marin-Hernandez, & Perez de Lema, 2012). One therefore expects high level of collaboration between the external auditor and internal auditor in improving the quality of external audit. The question is whether the need for this level of relationship is appreciated by the concerned. The findings of Gras-Gil, Marin-Hernandez, & Perez de

Lema (2012) which indicates that greater collaboration of external auditor with internal auditor promotes quality financial reporting in Spanish banks provides an head start in this direction.

While external auditor's reliance on the work of internal audit has been researched for almost three decades (Clark *et al.*, 1980; Margheim, 1986; Schneider, 1985; Whittington & Margheim, 1993), the focus of many studies has been on the objectivity, work performance and competence of the internal auditors (Brown, 1983; Messier & Schneider, 1988; Schneider, 1985). Considering the fact that there is now a closer alignment between external audit role and internal audit focus in this changed audit environment, triggered by the eruption in business world, further examination of this relationship (i.e. between internal and external audit) is thus warranted (Munro & Stewart, 2011).

Going by the definition of the IIA (IIA, 1999, 2004), internal audit is defined as "an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organization accomplish its objective by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process".

Internal audit is conceptualized in theory as both an assurance and consulting activity concerned with evaluating and improving the effectiveness of risk management, control and governance process (Munro and Stewart, 2011). Obviously, this is an expanded vista over the initial restrictive focus of keeping an eye over the various control systems initiated by the director to ensure that their instructions and guidelines are adhered to in the course of running the organisation's affairs on behalf of their principals, the shareholders. This new definition shifts the focus of the IAF from one of assurance to that of value added through consulting (Nagy, & Cenker 2002; Porter, 2009; Karagiorgos, *et al.*, 2010; Ebaid, 2011; Burnaby, & Hass, 2011). The objectives of internal audit are therefore generally more inclusive. Its scope may include operational audits, reviews of projects and programs, management audits, and other related

assignments (Buenger, & zamir, 1991). As a matter of fact, some voices were suggesting that the 21st century internal auditor must be prepared to audit virtually everything.

The increased roles assumed by the IAF has no doubt, necessitated an expansion of the skill set and attributes that internal auditors need to perform their work as efficiently as possible (Bota-Avram, 2011). Martin (2013) argues that transforming the IAF requires sufficient resource, expertise and capabilities. Capabilities around industry specific knowledge, insight skills to address financial reporting, information technology security, data analysis, understanding of operational challenges, compliance requirement, business analysis, critical thinking, communication science, Enterprise Risk Management (ERM), risk valuation, etc.,. Appreciating the need for a wide departure in auditors approach, and the need for up to date and multifarious skills, Allison (1994) argues that an internal auditor who operates by yesterday's rules, and approaches the future by looking in the rear view mirror runs the risk of failing to do his job properly. Quoting an excerpt of the PricewaterhouseCoopers (PWC), on its findings on 2014 state of the internal audit profession study in May 2014,

“ this year’s research once again confirms that today’s increasingly complex and risky business landscape has resulted in many internal audit functions struggling to be viewed as valuable. Further, internal audit’s ability to build the right capabilities and deliver on expectations continues to be challenged”.

It is with this great challenge that the IIA while bracing up for the enhanced role makes the issue of capacity building through collegiality a priority. In this modern and rapidly changing business world, characterized by continuous revolution in information technology and very stiff business competition, it is nevertheless, doubtful if the recommended skill sets are available in most IAFs, particularly in a developing economy, such as Nigeria, where internal auditing profession is just evolving with scant membership (currently around four hundred). Thus, the researcher’s keenness in establishing if the internal auditors in the NFS possess adequate level of competence to

fulfill their enhanced roles, as included in the research objectives. Outcome of this exploration will assist to address the issue of ‘‘make or buy decision’’ of IAF.

Reflecting once again on the IIA definition, it can be seen that internal audit is not only characterized as an independent, but also as an objective activity (Swinkels, 2012). The issue of independence and objectivity affects both the external audit and internal audit. This according to Power (2003), affirms that all audits irrespective of categorization possess the same general characteristics. Interestingly, the IIA standards require internal audit to assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement (Schneider, 2009). How objective the internal auditors are and to what extent are all these standards being adopted in IAF’s activities, also form areas of concern under this study, and are thus included in the study’s objectives.

The emergence of audit committee of the board in the domain of corporate accountability is with a view to ensuring the independence of the auditor. Literature suggests that a valuable audit committee should play an important role in strengthening the financial controls of a business entity. A number of studies have found that companies with an audit committee, particularly when that committee is active and independent are less likely to experience fraud (Beasley, *et al.*, 2000; Abbott, *et al.*, 2000; McMullen, 1996) and other reporting irregularities (McMullen, 1996; McMullen & Raghunandan, 1996). Independence and objectivity appear the watchword in promoting the effectiveness of the trinity audit function of external auditor, internal auditor and even audit committee. Of interest therefore is examination of the level of interaction that exists between IAF and audit committee. According to Raghunandan, Read, & Rama (2001), empirical research related to audit committee’s processes such as the interaction between audit committees and internal auditors is in development stage, previous researchers such as McMullen (1996), and Scarbrough *et al* (1998) contend that further studies are needed to provide increased understanding of audit committee’s processes and activities.

The internal auditor by virtue of his engagement as an employee of an organization has his reporting line directed to the management, and by virtue of his assurance and consulting roles is a powerful tool not only on the issue of internal control effectiveness but also in the area of calibrating business risks, and recommending appropriate mitigants for their management.

In the course of discharging his responsibilities to both the management and audit committee, the internal auditor faces a lot of dilemma, arising from the divergence of goals between the two masters. For example, while the audit committee sees the IAF as capable of giving them the necessary hints on effectiveness and adequacy of firm's internal control, management may not see the value-added aspect of controls-related activities and divert IAF's focus away from such activities and more towards activities that produce immediate, contemporaneous cost savings (Gray, 2004; Anderson, 2003). This is so, given management's perception of IAF as a powerful business tool that can enhance the firm's economic performance (Abbot, Parkers, & Peters, 2010). This challenge of serving two masters underlies inclusion of the relationship of the IAF with both the management and the audit committee under the study's focus.

2.2.4 Reflections on Internal auditing profession and its legitimisation

Whereas, internal auditing as a profession can be said to have benefitted greatly from the unparalleled and concerted efforts of the IIA (Arena and Jeppesen, 2010; Bota-Avram and Popa, 2011; Gacon, 2013), which is acknowledged as a reputable, global professional body driving the practice of, and laundering the image of internal auditing across climes (O'Regan, 2001, Bota-Avram and Popa, 2011), yet the issue of legitimization of the internal auditing profession can be said to remain contentious (Gacon, 2013). The major contention on the legitimization of the internal auditing profession is the lack of exclusivity of the profession on matters of IAF (O'Regan, 2001; Gacon, 2013).

Clarity of mapping of jurisdiction of activities places value of elitism and prestige on profession (Gacon, 2013). Of concern therefore, is the fact that other non-internal

auditing professionals also fight fiercely to encroach the territory ordinarily expected to be within the exclusive jurisdiction of internal audit professionals. This is being made possible through outsourcing of IAF in organisations (discussed fully in chapter 4).

Since the mid-1990s, internal audit has increasingly been outsourced to public accounting firms, and this trend has led to a competitive relation between the internal and external auditors (Arena and Jeppesen, 2010). The issue of outsourcing of IAF has become a serious matter of competition between internal auditor and external auditors (Rittenberg and Covaleski, 2001). Gacon (2013) maintains that the “big four” audit firms are in a superior position in this competition due to the fact that businesses often desire to outsource their IAF to them given their extensive knowledge and experience (considered appropriate for internal audit activity) acquired through auditing financial reports and consulting projects. Thus motivating what Abbot (1988) refers to as intellectual jurisdiction. Intellectual jurisdiction, according to Abbot (1988) refers to a situation where the superior profession controls the knowledge base, but allows other occupations to practice more or less unrestricted.

Contrary to their claim of expertise, the members of external audit profession appear very skeptical about internal auditor’s competence. A study carried out by Arena and Jeppesen (2010) to analyse the process of professionalisation of internal auditing in Denmark, applying Abbot (1988)’s perception, indicates that external auditor ordinarily desires to keep internal auditors in a subordinate position (Arena and Jeppesen, 2010). The author went further by stating that internal auditors in Denmark actually derive their legitimacy mainly from the public perception of them as assistants to the external auditors, their legitimacy is derived from the society’s perception of them as the “right-hand men” of the external auditors.

While discussing the need for further legitimization of the profession, O’Regan (2001, p.217) in his article titled “Genesis of a profession: towards professional status for internal auditing”, synthesized the definition of a profession as:

*“an occupation based on advanced, complex, or esoteric knowledge,
backed by a social legitimacy deriving from both an institutional*

framework and a credible ethical basis (however disputed the latter may be)’’

The above definition of a profession, the author indicates is inspired by reflections on both the functionalist and interactionist’s perspectives of profession as captured in sociological literature. Whereas the functionalist perspective according to the author sees ethical legitimacy as crucial to the definition of a profession, the interactionist’s paradigm is a complete shift from this mindset, seeing emergence of a profession as expressions of institutional self-interest. Rather than altruistic groups of citizens serving society, professionals are perceived by the interactionists as greedy and suspicious groups of men and women craving economic advantage and social prestige in a ruthless manner.

Macdonald (1995, p. xii), while describing this paradigm shift between the functionalists and interactionists, states as follows: ‘‘The sociological question change from what part do professions play in the established order of society’’, to ‘‘How do such occupations manage to persuade society to grant them a privileged position’’?. Chambers and Odar (2015) also agree with this paradigm by maintaining that ‘‘society cedes professional status to an occupational group when it is in society’s best interest to do so’’.

While analysing the internal auditing as a profession along his conceptualized definition of profession, O’Regan (2001), concurred that the IIA has truly created the trappings of a formal proto-professional framework, with a defined body of knowledge, and an institutional framework that delivers certifications (Bota-Avram and Popa, 2011), a sophisticated literature (including serials), research activities, written standards and a public service ethos embodied in a code of ethics. Going by this submission, and complemented by endorsements of internal auditing evidenced by its increased visibility in the corporate governance landscape, one may want to say that internal auditing profession has achieved remarkable level of legitimization (Bota-Avram and Popa, 2011).

Questions are however being raised about the legitimization of internal auditing as a profession (see O'Regan, 2001; Gacon, 2013; and Chambers & Odar, 2015) . For instance, O'Regan (2001) raises doubts about the full legitimization of the profession by raising the following critical issues against the profession:

- i. ill-defined symbolism and mythology,
- ii. short term tenor of internal audit professionals in organisations
- iii. increased doubts and concern over an appropriate professional title for the internal auditing professionals
- iv. ethical compromise; and
- v. absence of monopolistic privilege or clearly defined jurisdiction of internal audit activity.

Ruminating on the above, Gacon (2013) and Chambers and Odar (2015) support O'Regan (2001)'s position by maintaining that presently, internal auditing cannot be regarded as an independent profession. Putting this mildly, Lenz and Sarens (2011) indicates that internal auditing has not generally been seen as part of the solution to the recent global financial turmoil.

On the issue of symbolism or mythology, Gacon (2013) hints that observation of traditional professions, such as doctors, lawyers and architects reveals certain characteristics that distinguish these professions from other occupations. On the part of internal auditing as a profession however, there is no obvious image that identifies the internal auditor as a professional, no symbolic image in internal auditing to compare with, to give one example, the social significance of the barrister's wig (O'Regan, 2001 p. 221). Reflecting on these revelations, it truly seems that more needs to be done towards creating a uniform means of professional identity for the internal auditing professionals.

Another issue considered to be affecting internal auditing as a profession is the practice of perceiving and using internal audit departments in organisations as a training ground, and mere stepping stone to other function in the organization (O'Regan,2001'). The feeling that internal audit staff needs to interact with all departments in an organization

and, the feeling that internal auditors have deep knowledge of an organization business, makes management to always see the IAF in most organization as an appropriate training grounds. After one or two years in internal audit, the candidate is expected to move on to other, and presumably greater function. The impact of this practice is the creation of an impression of ‘‘non-professional’’ function of the IAF. O’Regan, (2001) hints that such practice may erode the professional status of internal auditing, by downgrading the intrinsic value of the discipline as a rewarding and credible career. This contentious issue of using IAF as management’s training ground is extensively discussed in chapter 4.

Also, of severe impact on the professionalization of internal auditing is the fact that current internal audit activities (i.e. assurance and consulting) necessitate a blend of employees with diverse backgrounds and trainings. Thus raising questions on identification of internal auditors as true professionals. Though internal audit professionals till date are still referred to as ‘‘Internal auditors’’, concerns are continuously being raised on appropriateness of this professional title in these days of enhanced roles of the function. The general argument is whether professionals in the field still need to be addressed as ‘‘Internal auditors’’, firstly given the enhanced focus of the IAF to include both assurance and consulting instead of the antiquated and narrow focus of compliance only.

The internal auditing literature includes considerable debate over the appropriate title for the internal auditor (O’Regan, 2001). Suggested titles to replace the existing one include ‘‘performance evaluator (Sawyer, 1998), ‘‘control assurance consultant’’, ‘‘business process consultant’’ and corporate governance officer (Ennis, 1998). To be addressed as ‘‘internal auditor’’ truly may look less rewarding, and inappropriate particularly when looking at the practice of outsourcing IAF to external audit firm. So where is the ‘‘internal’’ in IAF outsourced?, one may want to ask. Driving this name change agenda, Sawyer (1998, 9.112), the so-called ‘‘father of modern internal auditing’’ (Bota-Avram and Popa 2011) insists:

‘‘changing our name will have the salutary effect of boosting the

profession from the common place aspect of mathematical verification to the managerial concept of organization-wide evaluations. To declare that one is an evaluator rather than an auditor might be uplifting''

While the agenda of the anticipated name change is clear, the position of O'Regan (1998) appealing to the IIA to retain the existing appellation is considered appropriate firstly on the basis of consistency and also to avoid unnecessary confusion before the public. Possibly, retention of the existing professional designation may likely garner overwhelming support from the internal auditing practitioners if such is to be put to vote or opinion survey. The new role of consulting assigned internal auditors, in a way portrays the function as a partner to the management, such that any decisions reached by management in the course of their pursuance of the organisation objectives may also be perceived as having substantial input of the internal auditors. Therefore, on the issue of ethical concern, a reminiscence of various catastrophic incidences that ravaged the corporate landscapes across globe recently may portend an unfavourable outlook for internal auditors playing a partner of the management through its expanded role of consulting. The fact that internal auditors are usually seen as proponents of the need for economy, efficiency and effectiveness in relation to organisationals' affairs may be a potential source of concern when it comes to the way the public generally perceive internal auditors (O'Regan, 2010). Putting this concern succinctly, O'Regan (2010) alerts that:

''The use of internal auditing in the late twentieth century to support The ruthless cost cutting measures associated with the so-called new public management (NPM) paradigms (Power, 1997) could be a potential weakness in the discipline's ethical standing.

On the various efforts made by the IIA towards professionalization of the internal auditing profession, O'Regan (2010), Bota-Avram and Popa (2011), and Arena and Jeppesen (2010) admitted that the following initiatives of the global professional body

have really gone a long way in pursuing the legitimization of the internal auditing profession:

- i. formation of the IIA in 1941 with the main aim of pursuing legitimization of the internal auditing as a profession,
- ii. the formation of auditing standards (popularly known as Standards for the Professional Practice of Internal Auditing, first version of which was issued in 1978 (Gacon, 2013, Chambers and Odar, 2015)
- iii. establishment of the institute's (IIA) Research foundation in 1968, which finances scientific research in the field of internal auditing,
- iv. establishment of a professional magazine "Internal auditor", which constitutes a medium of knowledge sharing in the field of internal auditing,
- v. development of the Code of ethics of internal auditors in 1968 (Gacon, 2013);
- vi. IIA's certification through professional examinations

As skeptical as Gacon (2013) is about the professional status of internal auditing, the author in unison with O'Regan (2010), Bota-Avram and Popa (2011), and Arena and Jeppesen (2010) also acknowledges all the above initiatives of the IIA towards ensuring that internal auditing is positioned as a legitimate profession before the public. This notwithstanding, the concerns raised on the internal auditing's ill-defined symbolism and mythology, short term tenor tendency of the internal auditors in organisations, contentions on the appropriate professional title for the internal auditing practitioners, concern on the ethical compromise of the internal auditors, and most significantly, the obvious unclear mapping of jurisdiction and the seeming encroachment of the internal auditing's domain by external audit firm (using the "outsourcing" leniency), suggest that the issue of legitimization of internal auditing as a profession is yet to be resolved.

It is as a result of the concern above that the following have been put forward as necessary steps to actualize the dream of making a profession of internal auditing:

- i. pursuance of a clearly defined scope of activities and expertise of internal auditing, distinguishing internal auditing from other professions

(Gacon, 2013). To professionalise, internal auditing will need to demonstrate that it is different from external auditing (Arena and Jeppesen, 2010,p. 126).

- ii. determining the necessary qualifications for performing the work of an internal auditor and collaboration with universities in order to develop educational programs exclusively meant for breeding internal auditing professionals (Gacon, 2013; Richard and Kimberly, 2000). Improving the relationship between the internal auditing professionals and the academia is considered a good step, given that each has a great deal to offer the other, and working together, Richard and Kimberly (2000) maintain they can open yet another door of opportunity for today's students and tomorrow's professionals.
- iii. seeking "regulative bargain" with state with a view to obtaining a jurisdiction within which it can set its terms of reference (O'Regan, 2001).
- iv. creation of a professional image of internal auditing among both internal and external clients (Gacon', 2013).

Development of internal auditing profession is certainly evolving and the effort of the IIA on the evolution across nations cannot be overemphasised.

2.2.5 Internal Auditing Profession in Nigeria

Seventy seven (77) years after the official establishment of the IIA in the United States of America (USA), internal auditing as a profession is just evolving in Nigeria. It is doubtful if any notable line of separation exists between the auditing and accounting professions in Nigeria. This is so given that auditing is perceived as an adjunct of accounting. Accounting profession in Nigeria is currently regulated by two professional accounting bodies- the Institute of Chartered Accountants of Nigeria (ICAN) and the Association of National Accountants of Nigeria (ANAN).

While the ICAN focuses professionalism of private sector's accountants, ANAN regulates the practice of public sector's accountants. However, the profession of internal auditing which has gained remarkable advocacy in most developed countries particularly in USA and united kingdom, just started to be seen as a full fledged profession quite distinct from external audit in Nigeria. The IIA Nigeria was established in 2002 as an affiliate of the IIA Global and became a full chapter of the global body (the IIA) in 2013. Following its full institute status in 2013, the IIA Nigeria has become a very fast growing body of risk, governance and control professionals in Nigeria. Even with the existence of two notable professional bodies that regulate the practice of accountancy in the country, external and IAFs of both the private and public sectors are still subsumed under the accounting profession.

With the advent of the Nigeria chapter of the IIA however and following its full chapter status in 2013, the internal auditing profession in Nigeria is gradually gaining publicity through knowledge sharing focus of the institute via conferences, and seminars. According to the Secretariat of the local chapter of the institute, current membership is around four hundred. This confirms the infancy status of the IIA in the country. Sarens and Abdolmohammadi (2010) confirm that there is a great variability in the maturity of the internal auditing profession when comparing countries worldwide. They maintain that variability at country level can partially be explained by cultural differences. Nigerian case however, is perceived as a combination of culture and orientation. The implication of the level of maturity of the internal auditing profession in the country on the overall performance of IAFs generally, and specifically in the country's financial sector is expected to be established at the end of this research effort.

2.3.0 Internal auditing as a mechanism of Corporate governance

Generally, it is established that developed countries remain in the forefront of agitation for good corporate governances and had consequently codified good corporate practices. With a view to imitating these good corporate practices, developing countries replicate corporate governance codes from developed economies by domesticating the

established best practices for their corporate entities. These codes first establish mechanisms of instituting good corporate governance practices, and second, put in place necessary framework for monitoring adherence to the espoused good practices. In literature, the various mechanisms are classified as either internal or external. For instance, Munisi and Randoy (2013) identify internal mechanisms as comprising Boards of directors, debt financing, ownership concentration, executive compensation, and executive director shareholdings; and external mechanisms as including market for corporate control, product market competition, and the executive labour market.

In most internal auditing literature however, key corporate governance mechanisms are identified and discussed as the Board of directors, Management, Internal auditing and external auditing (see Gramling *et.al*, 2004). Since the redefinition of internal auditing by the IIA in 2009, particularly indicating internal auditing as an enabler of corporate governance, studies investigating how the aforementioned mechanisms interplay and the relationship between their connections and corporate governance continue to gain prominence.

While studies investigating the relationship of these various mechanisms on the soundness of corporate governance are diverse and tenuous, a recent dimension introduced into the discussion of the significance of corporate governance practices in firms particularly within the Accounting and Internal auditing community relates to the relationship between internal auditing and corporate governance. The intensified academic interests in this area is borne out of the increased advocacy for internal auditing mostly by the global regulatory body of internal auditing (the IIA), and the internal auditing professionals' desire to push for their relevance and therefore promote internal auditing as a pillar of corporate governance. The intense interests in this area by internal auditing scholars perhaps, can be argued to be triggered by the IIA's self-acclaimed remit as "governance process" accompaniment (see IIA (1999)), and the uncertainties surrounding the value addition of internal auditing in firms (see Chambers, 2014).

In assessing the capability and relevance of internal auditing as one of the cornerstones of corporate governance (Gramling *et al.*, 2004; Gras-Gil *et al.*, 2012), the contributions

made to corporate governance by the IAF usually come to mind. Whereas, it has been established that quality IAF influences corporate governance positively (see D' Silva and Ridley, 2007), it has however become a big challenge for the IAF and internal auditors to show their value addition both inside and outside an organization (Sarens, 2009; Lenz and Sarens, 2011; Chambers, 2014) in assessable forms. Possibly, one conceivable way to prove the relevance of the IAF to corporate governance is to find evidence to demonstrate that IAF, as one of the building blocks of corporate governance has positive impact on the quality of corporate governance.

Proving the value addition of internal audit however seems a daunting task (Lenz and Sarens, 2011). This is so given that evaluation of such values could be subjective particularly in the absence of generally adopted metrics or parameters. Nevertheless, it is considered insufficient to be emphasizing the value-addition of the internal auditing without tracking and measuring such values. Chambers (2014, p.64) contends that once an IAF is no longer adding value, it has on itself become a cost centre and a drain on company's resources.

Given that IAF's impact cannot easily be traced and mapped against the organisational bottom line, it therefore becomes crucial that the value addition of the IAF is established. *"...it is important for internal auditors to be able to clearly articulate to management and other stakeholders how the internal audit function adds value (Reding et al. 2013, p. 2-5). 'An examination of the pressures on internal audit in recent years reveals the struggle to demonstrate that the function can add value'" (Spira and Page, 2003, p. 653).* Lenz and Hann (2015) insist that proving the value addition of IAF remains the only way internal auditing generally can be seen as a legitimate function before its major stakeholders.

Internal auditing's major or primary stakeholders according to Chambers (2014) include the following:

- i. organisation's audit committee;
- ii. the Chief Executive Officer (CEO) or overall head of enterprise;

- iii. the Chief financial officer (CFO) or the individual to whom the CAE reports administratively;
- iv. the other chief officers of the enterprise (in some cases).

Business-unit executives, usually called “auditees” are classified as secondary stakeholders. The same author classifies organisation’s employees, investments analysts, shareholders, external auditors and regulators and the general public as tertiary stakeholders (see Chambers, 2014, p. 50).

IAF that contributes to corporate governance is ordinarily said to be effective (Gras-Gil *et al.*,2012). For an IAF to be referred as effective however, such function must have possessed some qualities. Incidentally, Internal audit quality is an issue of great concern to both the internal and external audit profession (Gramling and Vandervelde,2006). According to Sarens (2009), effectiveness of IAF is discussed in terms of the positive impact it has on corporate governance. This position therefore might be interpreted to mean that an IAF that desires to be effective will be the one that has positive impacts on corporate governance. Only effective IAF can perform its tasks properly (Savc’kuk, 2007). Whereas, the internal auditing literature has established that an effective IAF is critical to the success of a company (Carcello *et al.*, 2005; Savc’kuk, 2007; Barac *et al.*,2009; Gras-Gil *et al.*,2012); little empirical evidence on the correlates of IAF’s effectiveness is however found in literature (Lenz and Sarens,2011, Arena and Azzone,2009). Expressing this succinctly, Soh and Martinov-Bennie (2011) maintain that performance evaluation mechanisms of internal auditing have not evolved contemporaneously. This further affirms the need for acceptable metric of assessing IAF’s effectiveness.

Sarens (2009) nevertheless maintains that only IAF that has positive impact on the quality of corporate governance can be said to be effective. For Ernst and Young (2007) as reported in Soh and Martinov-Bennie (2011) the top two metrics used in the measurement of IAF’s effectiveness are:

- (i) completion of audits in comparison to an IAF plan, and
- (ii) the length of time for issuing IAF’s reports.

How these two yardsticks translate to values of internal auditing in firms is however unclear particularly relying on Ernst and Young (2007)'s earlier counsel that cost savings or revenue enhancement should be the benchmark of IAF's value assessment.

The referenced survey indicates that in order to demonstrate the value and relevance of the IAF to business, value tracking (in terms of cost savings and/or revenue enhancements) should be used as a mechanism (Soh and Martinov-Bennie, 2011). Surprisingly however, the same survey showed that 51% of the respondents do not conduct any value tracking of the IAF, while only 13% assess the contribution of the function from actual cost savings perspectives. The study further amplifies the complications surrounding the perspectives on assessment of IAF's effectiveness. Yet studies continue to postulate that an IAF by being identified as a constituent part of the corporate governance can add value (Gramling *et al.*, 2004; D'Silva and Ridley, 2007). It has also been particularly argued by studies such as Sav'cuk (2007, p. 277), a study that attempts to design appropriate principles for evaluating internal audit's evaluation, that IAF as a corporate governance mechanisms can add value to an organisation once it is effective. Stakeholders of IAF however, seem not convinced with this value addition claims (such as number of reports issued, number of individuals auditors with relevant certifications, number of recommendations in audit reports, etc.) of internal auditors (Chambers, 2104). Failure to design an appropriate way of justifying the value addition of IAF indicates knowledge gap on acceptable metrics of value addition of IAF (i.e. IAF's effectiveness) and therefore indicates the need for a model to be conceptualized. This is a very important additional motivation for this research endeavor. Evolution of an acceptable framework or indicators of a value-laden IAF will certainly help in addressing this quagmire the internal auditing profession currently faces and expectedly help in shaping the direction of studies relating to the relevance of internal auditing, while also broadening the burgeoning academic endeavours in the field.

Coram *et al.*, (2008) acknowledge that there have been limited studies on the effectiveness of IAFs. Worried by the scant studies on appropriate benchmarks to be adopted for assessing internal auditing effectiveness, Arena and Azone (2009) while

identifying organisational drivers of internal audit effectiveness on the basis of questionnaire data from 153 CAEs from Italian companies summarized the three approaches of measuring IAF's effectiveness as found in extant literature as: process measures, output measures, and outcome measures. These are as clarified below:

- i. Process measure, i.e. evaluating IAF compliance with Statements for the Professional Practice of Internal Auditing –SPPIA (see Al-Twajjry et al. 2003);
- ii. Output measures: i.e. focus on auditee and their feedback on IAF (Arena and Azzone, 2009); and
- iii. Outcome measures: i.e. level of implementation of internal audit recommendations (see Mihret and Woldeyohannis, 2008; Arena and Azzone, 2009).

Mihret *et al.*(2010) while rationalizing the first approach as the most appropriate, observe (through an explorative study on antecedents and organisational performance implications of internal audit effectiveness) that non-implementation of internal audit's recommendations arising from prior internal audit on the part of management may not necessarily suggest an ineffective IAF as it could be that some of the recommendations are unpopular, costly or impracticable to implement and thus jettisoned. This argument can therefore be leveraged to question the acceptability of using the level of implementation of recommendations of internal audit in measuring IAF's effectiveness.

Likewise, using feedback from internal audit's customers for measuring effectiveness of IAF is also criticized by the same authors based on challenges of operationalization associated. The authors argued that varied backgrounds and experiences of the internal audit's customers become a concern in this regard. Each internal audit's customers certainly have their own peculiar and divergent expectations. Each of these customers will ultimately define the value of its IAF based on how well their specific expectations are met (Chambers, 2014, pg 68). To further strengthen this line of argument, Lenz and Sarens (2011) indicate that issues around who the internal audit's customer (s) is (or are) has been a subject of debate for some time, maintaining that customers of internal audit seem numerous. "internal audit currently has multiple of customers to serve". For

Chambers (2014, p.50), internal audit's customers (stakeholders), and their expectations can vary dramatically from one organisation to the next.

Arguing along these lines of opinion therefore, one might be wondering whether there can be congruence of performance indicators of internal auditing by these multiple customers and indeed if there can be any point of convergence in assessing internal audit's effectiveness along this paradigm. Precisely expressed, Chambers (2014, p. 51) indicates that internal auditors will from time to time encounter conflicts between the expectations of different stakeholders. Thus, indicating that leaving evaluation of IAF's effectiveness to its multiple customers with diverse expectations might be challenging and perhaps disputable.

To balance his argument, Mihret *et al.* (2010) indicates that application of compliance with the International Standards for the Professional Practice of Internal Auditing (ISPPIA) presents a multi-dimensional approach in evaluating internal audit's effectiveness and as such is viewed the best approach. Corroborating this stance, the position paper of IIA-UK and Ireland (2002) clearly indicates that the IIA's International standards are the benchmarks against which effective internal audit activities can be measured. Apparently, this standpoint might attract less criticism due to the anticipated universality of adoption of the ISPPIA. The IIA mandates compliance with the standards for every individual who provides internal audit services (Burnaby, *et al.*, 2009). Aside offering a multi-dimensional approach as hinted by Mihret *et al.* (2010), the ISPPIA offers a general platform on which the practice of internal auditing is expected to operate globally and therefore signals a model for development of any meaningful approach for assessment of internal audit's value.

While discussing the purpose of the ISPPIA, Reding *et al.* (2013) further argue that the standards, in addition to offering a framework for performing and promoting a broad range of value-added internal audit, also establish the basis for the evaluation of IAF's performance. The standards are '*principles-focused, mandatory requirements consisting of statements of basic requirements for the professional practice of internal*

auditing and for evaluating the effectiveness of performance, which are internationally applicable at organisational and individual levels... (Reding, et al. 2013, p.2-9-2-10)''. Burnaby *et al.* (2009) identify the adoption of the IIA standards for evaluation of internal audit's performance, as one of its three cores. Studies that relates to evaluation of IAF or the value-addition of IAF usually leverage on this direction (see for instance Barac and van Standen, 2009; Barac et al., 2009).

Adopted from Savc'kuk (2007), table 2.2 below details out the relevant sections of the IIA standards that are considered relevant to the effectiveness of the IAF.

S/n	Standards	Focus	Details
1	1000	Purpose, Authority, and Responsibility	Internal Audit charter approved by the board is obligatory. Charter must include the purpose, authority, and responsibility of the internal audit.
2	1100	Independence and objectivity	The internal audit activity must be independent, and internal auditors must be objective to perform their work. The function must be subordinated to the appropriate management to ensure independence of the function and objectivity of the internal auditors
3	1200	Proficiency and Due professional care	Engagements must be performed with proficiency and due professional care. Continuous professional development must be present to ensure efficiency.
4	1300	Quality Assurance and Improvement Program (QAIP)	It is obligatory for the CAE to develop and maintain a QAIP that covers all aspects of the internal audit activity and continuously monitors its effectiveness. This program includes periodic internal and external quality assessments and ongoing internal monitoring. <i>The standards however do not provide efficiency estimation factors.</i>
5	2000	Managing the IA activity	The CAE should effectively manage the internal audit activity to ensure it adds value to the organizations.
6	2100	Nature of work	The internal audit activity must evaluate and contribute to the improvement of governance, risk management, and control processes using a systematic and disciplined approach.
7	2200	Engagement planning	Internal auditors must develop and document a plan for each engagement, including the engagement's objectives scope, timing, and resource allocation.
8	2300	Performing the Engagement	Internal auditors must identify, analyze, evaluate, and document sufficient information to achieve the engagement's objectives.
9	2400	Communicating Results	Internal auditors must communicate the results of the engagements.
10	2500	Monitoring Progress	It is obligatory for the CAE to establish and maintain a system to monitor the disposition of results communicated to management

Table 2.2: IIA standards on IAF effectiveness (adapted from Savc'kuk, 2007).

Savc'kuk (2007) based on the above as a guide, identifies four (4) different platforms or metrics that can be adopted for assessing IAF's effectiveness. These are:

- i) internal audit level of subordination,
- ii) internal auditors' qualifications,
- iii) internal audit's strategy; and
- iv) internal audit's efficiency estimation.

The referenced study adopts the metrics and creates internal audit's efficiency scores (IAES) to aid its analysis. This is seen as a head-starter in evolution of ideal framework for measuring the value addition of any IAF.

For Arena and Azzone (2009), IAF's effectiveness is linkable to the resources and competencies of the internal audit team, activities and processes performed, as well as the function's organisational role. The approach adopted by Barac *et al.* (2009) in their study of perceptions of the value added by South African IAFs mirrors Arena and Azzone (2009). Specifically, organisational status, staffing and work environment, implementation of IAF's recommendations, IAF's involvement in risk, services rendered by the function, and performance measure are the metrics adopted in Barac *et al.* (2009). This is also seen as a further push on Savc'kuk (2007), and Arena and Azzone (2009).

Gramling and Vandervelde (2006), while contributing to the debate surrounding the need for a universally-accepted metrics for evaluating IAF's effectiveness, provide useful hints on how IAF's quality can be assessed. According to the authors, IAF's quality can be assessed using current guidance on IAF's quality as inspired by both the professional internal and external auditing standards. This position is not quite different from Mihret *et al.* (2010)'s submission on ideal metric for IAF's effectiveness.

For instance, Statement of Auditing Standards (SAS) 65 describes the internal audit's quality characteristics as consisting:

- i. Competence (e.g. educational level and professional experience, professional certification and continuing education, Audit policies, programs and procedures, practices regarding assignment of internal

auditors, supervision and review of internal auditors' activities, quality of working paper documentation, reports, and recommendations, evaluation of internal auditors' performance).

- ii. Objectivity (e.g. Organisational status of the function, reporting relationship, party responsible for internal audit engagement decision); and
- iii. Quality of work performance (e.g. adequacy of audit programs, scope of work performed).

In the same vein, the IIA standards (ISPPA) focus the following characteristics of IAF's quality:

- i. Independence,
- ii. Objectivity,
- iii. Proficiency, and
- iv. Due care

Addressing the same concern of how best to assess IAF's quality, perhaps following the lines of argument of Gramling and Vandervelde (2006), Sarens (2009) indicates that effectiveness of IAF can be assessed along the line of IAF's quality, the quality of the individual internal auditors in the IAF, and the quality of the two important aspects of corporate governance-internal control and risk management. This view (which is in tandem with Mihret *et al.*; 2010) implies that to have an adequate understanding of IAF's quality, one needs to understand the factors determining IAF's capacity to monitor and improve internal control and risk management process. The line of argument advocated by Sarens (2009) definitely can be accommodated within the focus of the IIA's redefinition of internal auditing (i.e. IIA,1999), *"...it helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes"*

2.3.1 Internal Audit and Corporate Governance Literature

In internal audit literature, the central themes of discussions in recent time, specifically since the re-definition of internal auditing in 1999, had been on the contributory roles of internal audit in the improvement of the effectiveness of risk management, control and governance process; and how the internal auditing assurance and consulting activities do contribute to organisations' ability to accomplish their set objectives. The discussions along this area usually focus Governance, control and risk management (GCR).

While internal control and risk management appear two different concepts, internal control has been argued to be a subset and an integral part of risk management (see Spira and Page, 2003; Reding *et al.* 2013). To drive down this argument, Reding *et al.* (2013, p. 3-2 to 3-3) maintain that internal control is part of risk treatments designed to execute the risk management strategies.

For the IIA, Governance is seen as “*the combination of processes and structures implemented by the board to inform, direct, manage, and monitor the activities of the organization towards achievement of its objectives*”.

Given that the shareholders are represented by the board, the responsibilities of setting organisational objectives, and pursuance of same is that of the board and the management. The board sets the objectives of organizations on behalf of the shareholders, communicates the set objectives to the management to develop appropriate strategies of achieving the set objectives under their oversight. In pursuing the objectives, the management ordinarily is faced with series of risks capable of preventing accomplishment of such objectives. Risk management according to Bahrman (2011, p. 23) is “*the set of processes through which management identifies, analyses, and responds appropriately to risks that might adversely affect achieving the organisation's objectives*”

To demonstrate the significance of IAF in corporate governance, Paape, Scheffe and Snoep (2003) maintain that company's BoD has significant oversight to play most especially in the area of ensuring implementation of appropriate policies by the

management. *“This board must seek the right advice and find the right solutions for its organisation’s particular circumstances and ensure that policy is implemented and the expected result achieved. Part of that advice may come from the board’s own Audit Committee which in turn could be advised by its internal auditors”* (Paape *et al.*, 2003, p. 251).

In responding to risk, it is argued that management can avoid, accept, share or transfer the risks to the third party (see Redding *et al.*, 2013). Internal control is however seen as activities employed by the management to manage the risks retained in the organization. Sarens (2009)’s inkling about the significance of internal control and risk management in assessing IAF’s quality is derived from the IIA’s new orientation of internal auditing on control, risk management and governance.

Bearing the IIA standards in mind, Sarens (2009) while presenting an Editorial for International Journal of Auditing on *“Internal Auditing Research: Where are we going?”*, focuses the IAF’s characteristics and the characteristics of the individual internal auditors which are within the professional standards of both the internal and external auditing, and which enhance the capability of the function (IAF) to achieve its expected roles of monitoring and improving internal control and risk management in organisation. These two studies (i.e. Gramling and Vandervelde , 2006; and Sarens, 2009) though seem different in their approach, can be argued to have same ultimate focus on IAF’s characteristics and the characteristics of the individuals engaged in the function within the framework provided by standards guiding both external audit, and the internal audit professional standards (i.e. ISPPIA). Consequently, with a view to having a coordinated approach for the review of related literature that are diverse in focus and orientation, the guidelines offered by the referenced studies are adopted as a guide for this study, and therefore also applied to shape the focus of the study’s empirical literature review.

Special consideration is however given to the insights drawn from Sarens (2009) as all factors adopted in the previous and numerous studies on IAF’s effectiveness can be subsumed in the general perspective advocated by the author. From all the referenced studies (such as Barac *et al.*, 2009; Arena and Azzone, 2009; Gramling and

Vandervelde, 2006; Sav'cuk,2007; Mihret and Woldeyohannis, 2008), the central focus remains the IIA standards. The IIA standards and the definitional focus of internal auditing by the IIA (2009) remain the basis of Sarens (2009). The linkage of internal auditing's new focus specifically to enhancement of corporate governance further lends weight to Sarens (2009)'s exposition and thus considered an endearing schema for the literature review focus in chapter 4 of the thesis.

To begin with, Sarens (2009) indicates that only IAF that adds value to an organisation can be said to be effective. Leveraging on Gramling (2004) to answer himself on the question, "when can we talk about an effective IAF"?, the author indicates that only when an IAF's quality impacts positively the quality of corporate governance. According to Sarens (2009), the characteristics of the IAF itself, and the characteristics of the individual auditors constituting the function (i.e. IAF's characteristics and internal auditors' characteristics) are the two main factors that determine the IAF's capacity to monitor and improve risk management and internal control (the two main focus of corporate governance). The need for identifying a focus-driven and established approach for the review here is borne out of the fact that no studies has ever attempted to integrate the various concepts this study attempts to explore (i.e. IAF's independence, conformity of IAF's engagements with the relevant IIA's standards, internal auditors' objectivity and competence). Sarens (2009) incidentally stands out from those various extant studies that have linkages with the study's broad themes due to its comprehensiveness in terms of various perspectives on effectiveness of IAF.

2.3.2 Internal audit function's quality

IAF's quality is an extensively studied area of the internal audit literature (Gramling *et al.*, 2004). The rationale for researchers' interests in this area can be argued to be inspired by the continuous enhanced roles of strengthening corporate governance in companies expected from the function (IAF). IAF as one of the acclaimed cornerstones of corporate governance (Gramling *et al.*, 2004) is seen theoretically to occupy a vital position in the mechanisms required to ensure corporate social order (Gras-Gil,*et al.*,2012; Cohen, *et al.*,2011; Schneider,2009; Savc'uk,2007). Each of the remaining parties saddled with corporate governance responsibility in firm (i.e. External auditor,

Audit committee and Management) perceive internal audit as a valuable partner. Given this beneficial relationship, Gramling *et al.* (2004) argue that each of the parties accountable for firm's corporate governance therefore has some responsibilities for ensuring or at least evaluating the quality of the IAF.

For instance, board and management of corporation who are desirous of confirming that their firm's internal controls are effective and reliable, ordinarily may want to be concerned with the effectiveness of their firm's IAF (Gramling and Vandervelde,2006; Omoteso and Obalola,2014). The external auditor who is also desirous of leveraging on the deep knowledge of the IAF about the firm's business and environment may ordinarily have the tendency to rely substantially on the work already performed by internal auditors for the essence of timely and quality audit. Omoteso and Obalola (2014, p. 138) agree that adequate knowledge of the firm's business is required for effective auditing of an entity, and they concur that external auditor has limited knowledge of the organisation and its staff. For the external auditor to leverage maximally on the internal auditor's deep familiarity with the firm in this regard, and in line with the guidance from auditing standards (see SAS 65) the external auditor would be interested in ascertaining the quality of such IAF. As a matter of fact, the external auditor in accordance with the referenced standard is required to make inquiries about appropriateness and management of internal audit personnel on matters such as:

- i. organizational status within the entity
- ii. application of professional standards (particularly as it relates to objectivity and competence of the internal audit's personnel)
- iii. audit plan, including the nature, timing , and extent of audit work
- iv. access to records and whether there are limitations on the scope of their activities.

Paragraph 24 of SAS 65 specifically advises the external auditor to perform procedures to evaluate the quality and effectiveness of the internal auditor's work. Apart from making use of the internal auditor's work in performing his assignment (i.e. annual external audit), the external auditor may also require direct assistance of the internal

auditor in performing some aspects of his work. In doing this, objectivity and competence of the internal auditor shall be subjected to thorough assessment.

‘‘when direct assistance is provided, the auditor should assess the internal auditors’ competence and objectivity...’’ (SAS 65, para 27).

In the same vein, the audit committee who is saddled with the responsibility of ensuring quality financial reporting, effective internal control and risk management, also ordinarily would be interested in monitoring and ensuring quality IAF so as to assure itself of the reliability of assurances it obtains from such function. A close working relationship between the audit committee and internal audit is anticipated, as such is recognized a fundamental principle of corporate governance (Munro and Stewart, 2011:467; Chambers, 2008). Turley and Zaman (2007) argue that audit committee sets the appropriate tone that allows the IAF have a certain degree of influence in the organization. Thus it can be argued that IAF derives its status, independence and relevance from the manner of its coordination with the audit committee.

The more highly competent and objective staffs of an IAF is, and the more detailed their testing, the more likely the external auditor would want to make use of their work. PCAOB (2004) contends that companies should ordinarily be motivated to develop high-quality IAFs given the considerable flexibility that external auditors have in making use of the work of IAF. Whereas it is expected that external auditor would ordinarily want to leverage on IAF of an organisation to avoid duplication of efforts and repetition of work, the independent auditor (external auditor) is however at liberty to determine the extent of such reliance he is willing to put on IAF’s services. Avoidance of duplication of efforts and work on the part of the external auditor connotes some cost saving benefits in times of cost of audit, timely execution of annual audit and reliability of same to organisation. In determining the appropriateness and extent of such reliance however, Reinstein, Lander and Gavin (1994:30) recommend that at a minimum, the external auditor should:

- i. consider the results of prior years’ audit

- ii. review how internal auditors allocate their audit resource in response to their risk assessment procedures (e.g. between operating and financial activities)
- iii. review their internal audit reports to ascertain their scope of work

Appropriateness of using the IAF to complement their own efforts relates to relevance, reliability and potential cost saving benefits of the function to the external auditor and ultimately to the organisation as well. Reinstein *et al.*(1994) affirm that once it is ascertained that IAF fails any of these tests of appropriateness (i.e. relevance, reliability, and cost saving potential), the external auditor would not make use of the function, except as a supporting staff on the audit. This aligns with the findings of the Ernst and Young (2007), that upholds the significance of cost benefits (in terms of cost savings and/or revenue enhancements) when it comes to reckoning with the value and relevance of the IAF.

An external auditor desirous of relying on internal auditors activities focuses on the IAF's independence, internal auditors' level of objectivity and competence. To determine competence, it is argued by Reinstein *et al.*(1994) that *“the external auditor needs to know the internal auditor's educational level and professional experience, their professional certification and continuing education, the audit policies, programmes and procedures they operate under; how they are assigned and how they are supervised and reviewed. They should assess the quality of internal auditors' audit programmes, working paper documentation, reports and recommendations”*.

The authors also go on by saying that *“to determine objectivity, the external auditor needs to know the organisational status of the officer to whom the internal auditors report; if the internal auditors have access to audit committee or its equivalent; who hires and fires the auditors; if policies prevent auditors from auditing areas where relatives are employed or where they may themselves be assigned”*.

In addition, Gramling *et al.*(2004) indicate that the IIA standards require the IAF's head (i.e. the CAE) to develop and maintain a QAIP that includes periodic internal quality assessments of the IAF and ongoing internal monitoring. Attributes standard 1310 of the IIA standards specifically requires IAF to put in place:

quality assurance and improvement program capable of both internal and external assessment of the function. The standards require that IAF must maintain a program that will enable it carry out on-going monitoring of the performance of the internal audit activity, and periodic self- assessments or assessments by other persons within the organization with sufficient knowledge of internal audit practices.

According to the standard (IIA 2009), external assessment of the function is also required to be carried out once every five years by a qualified, independent assessor or assessment team from outside the organization.

From the above discussion on the roles played by the IAF to the three other corporate governance mechanisms, one may want to argue that IAF is a resource center and a valuable nexus to the remaining cornerstones. Gramling *et al.*(2004) however contend that for the function to be deemed as a valuable resource, it must be seen as having an appropriate level of quality, and that the level of such quality determines the level of coordination IAF will have with the other three mechanisms, and consequently predicts the quality of corporate governance.

The above clue notwithstanding, little attention is paid to evaluation of the value-addition of IAF (Soh and Martinov-Bennie, 2011). Academic research also seems not to be highly disposed to this. *“Despite increasing attention to the IAF’s role within corporate governance, only limited research has examined the effectiveness of its function”* (Soh and Martinov-Bennie, 2011, p.608). This concern further validates the focus of this study.

2.3.3 IAF's Independence and internal auditors' Objectivity

“Independence” can be said to be the foundation upon which internal audit rests. Mousa (2013) indicates that the importance of the attribute is apparent in the definition of internal auditing provided by the IIA (1999).

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

While Stewart and Subramaniam (2010) observe that independence and objectivity are closely related, authors such as Paape (2007) and Mutchler (2003) maintain the two concepts are not well distinguishably defined. According to the IIA standards, independence is defined as “*the freedom from conditions that threaten the ability of the internal audit activity (or function) to carry out internal audit responsibilities in an unbiased manner*”. In order to create a more comprehensive meaning, Mutchler (2003) defines independence as “*a desired characteristics of the environment in which the assurance services are performed by the individual or team*”.

The Glossary to the IIA standards however presents a distinguishing distinction between the two concepts in the following way:

- **Independence** – the freedom from conditions that threaten objectivity or the appearance of objectivity. Such threats to objectivity must be managed at the individual auditor, engagement, functional and organizational levels.
- **Objectivity** – An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made. Objectivity requires internal auditors not to subordinate their judgment on audit matters to that of others.

Stewart and Subramanian (2010) reflecting on the above definitions further contends that independence can be seen as a ‘‘state of affairs’’ while objectivity can be perceived as ‘‘state of mind’’. While this position is adopted to direct the literature review made in this study, a more definite and exact description of the two connected concepts is anticipated as it is argued in literature that the line of distinction between the two key concepts is obscured (see Mutchler, 2003; Stewart and Subramanian, 2010).

The issue of independence of IAF has been a long-standing challenge to internal auditors and the internal auditing profession (Ahmad and Taylor, 2009) particularly within the expanded framework of IAF’s roles to organisations. Aside the issue of organisational positioning of the IAF, the challenge of conflict of interest, the dual and seeming incompatible roles (‘‘assurance’’ and ‘‘consulting’’) of internal auditing under the enhanced corporate governance framework is posing, same is also inspiring more and more attention on the IAF’s independence (see Sarens, 2009; Lenz and Sarens, 2011; Chambers and Odah, 2015). The traditional role of internal audit is expanding from a watchdog of controls to a value-added business advisor (Ahlawat and Lowe; 2004; Savc’uk, 2007). Providing a guide for research agenda on the issue, areas considered germane by Mutchler (2003) include:

- i. understanding the relation between the organizational positioning of the IAF and the overall independence and effectiveness of the organizational governance system
- ii. knowing the appropriate control (firewalls) for those internal audit units that provide both consulting and assurance services;
- iii. assessing the relation between the organizational positioning of the internal audit unit and the occurrence and detection of fraudulent company’s activities;
- iv. evaluating how external auditors make assessment of the work of internal auditors.

Drexler (2003) argues that corporate governance can be impaired by a lack of IAF’s independence.

Another dimension to the evaluation of independence of IAF is by investigating the source of the IAF, whether in house or outsourced, i.e. whether maintained as a department in the organisation or farmed out. James (2003) contends that IAF's sourcing arrangement is another key factor that distinguishes IAFs. Whereas the issue of outsourcing of internal auditor continues to attract intense criticism by the internal audit profession and practitioners, it is argued that contention for exclusivity of jurisdiction might not be a sound basis for internal audit profession to cast aspersion on outsourcing of the function. TCE theory (extensively discussed in chapter 3 and reflected upon in chapters 6 and 8 of the thesis) may be adopted as a guide to direct decision on internal audit sourcing. Cost benefit analysis is the key tenets of the theory. However, studies have shown that external auditor usually tend to place stronger reliance on the work of IAF when such function is outsourced on the ground that they believe the management may not be able to easily sway the function to their side, and thus an indication of guaranteed independence (Stewart and Subramaniam, 2010).

Another relevant issue on IAF's independence that has been contentiously discussed in literature is the use of IAF as a training ground in organizations (see Messier *et.al*, 2011; Christopher *et.al*, 2008; and Godwin, 2004). However most internal auditing literatures do use this as one of the indicators of internal auditors' objectivity. The manner most authors do anchor discussions on IAF's independence and internal auditors' objectivity as a singular concept is responsible for this interwovenness and seeming haphazard manner of discussing indicators of IAF independence and internal auditors' objectivity.

2.3.4 IAF's Characteristics

The ISPPIA or "Standards" clearly set out the various characteristics expected of an effective IAF. The standards provide a framework for performing and promoting a broad range of value-added internal audit. The standards are grouped into two- "Attribute" and "Performance" standards. While the attribute standards address the features of organisations and individuals performing internal audit, the performance standards describe the nature of internal audit and provide quality criteria against which the performance of IAF can be measured (the IIA, 2012). The standards thus apply to both the IAF and individual internal auditors. Specifically, the IAF is expected to ensure

independent organisations to which the function is made, and the individual auditors are expected to conform to the standards related to *individual objectivity, proficiency and due professional care*.

In addition to the requirement of *independence* on the part of IAF is the issue of adopting *appropriate auditing technology or techniques* capable of delivering internal audit services that adds value to the organization. IAF adds value to the organisation (and its stakeholders) when it provides objective and relevant assurance, and contributes to the effectiveness and efficiency of governance, risk management and control processes (IIA, 2012).

Concerning the characteristics of individual internal auditors that make up the IAF, Sarens (2009), complimentary to the usual focus of extant studies (such as Ahlawat and Lowe, 2004; Brody and Lowe, 2000; Scheneider,2003) mainly on internal auditors' objectivity, argues that other attributes of the internal auditors such as the following also contribute to the internal auditors' capacity to monitor and improve risk management and internal control:

- a. educational background,
- b. previous work experience,
- c. professional certification (s),
- d. training and development programme,
- e. behavioural skills,
- f. technical skills; and
- g. competencies

Whereas all the above attributes are perceived by auditors as representing different traits, the IIA standards 1200 (Proficiency and due professional care) recognize them as competencies and are classified under the interpretation of the standard as '*proficiency*'. Specifically, standard 1200 of ISPPIA requires that "*internal auditors must possess the knowledge, skills, and other competencies needed to perform their individual responsibilities ...*". So, as suggested in the referenced study, the above

presents a platform to assess the adequacy of the individual internal auditors' characteristics.

On the issue of internal control and ERM's quality, Sarens (2009) indicates that as established in previous studies, "internal control deficiency disclosures" can be used to assess the quality of organisations' internal control. The author however expresses his uncertainty on the operationalisation of risk management's quality, maintaining that no clear definition of risk management's quality is provided in literature. Nevertheless, the referenced study suggests that the eight interrelated components of ERM framework as indicated by COSO (2004) can be adopted in the alternative. According to the author, these are (i) internal environment, (ii) objective setting, (iii) event identification, (iv) risk assessment, (v) risk response, (vi) control activities, (vii) information and communication; and (viii) monitoring.

In extant literature, independence of IAF is studied from the perspective of the organizational position of IAF. This is dominantly studied in terms of the IAF's reporting relationship. Areas extensively considered here include the recommended dual reporting lines of IAF i.e. functional reporting relationship with the BoD or Audit committee and administrative reporting relationship with the management (Sarens, 2009) and the agitations thereon (see Chambers and Odar, 2015; and Lenz and Sarens, 2011).

Whereas a strand of studies focuses how such recommended dual reporting relationship can be further optimized, others are looking at strategic adjustment of the reporting relationship in favour of the board or its audit committee, perceived as the key stakeholder of internal audit (Chambers and Odar, 2015; and Lenz and Sarens, 2011). For instance, Sarens (2009), and Lenz and Sarens (2011) though believe the dual reporting relationship of internal audit and the Board, and internal audit and management, seems problematic, are of the view that such can be enhanced for full potentials of IAF to firms. Contrarily, Paape *et al.* (2003), and Chambers and Odar (2015) bluntly indicate that the dual reporting model of internal audit is defective and advised that internal audit needs to cut the umbilical cord that joins it with management. Both strands of perspectives are discussed in details in chapter 4. Charting a new

research focus around this contentious area however, Sarens (2009) incites further research on the intensity of functional and administrative relationship maintained by the IAF with the BoD or Audit committee on one hand and with the senior management on the other hand.

Areas such as what proportion of meeting time, of Audit committee or BoD, spent on internal audit topics, to what extent do the BoD, the audit committee and senior management provide input for the internal audit's planning?, how intensively do they (BoD, Audit committee, and Senior management) follow up on internal audit's findings and recommendations?, according to the author need to be looked into critically. Extant studies (Christopher, Sarens and Leung, 2008) in this area though scant (Stewart and Subramaniam, 2010) seem to be adopting this focal direction. In recognition of the above clues, this study attempts to investigate among others, areas such as the level of relationship between IAF and management, and between IAF and audit committee in the NFS.

The indicated focus is with the aim of establishing the level of independence enjoyed by the IAFs in the NFS, and shall be done by examining the organizational status of IAF in the NFS through investigation of the manner of reporting relationships maintained by IAF in the country's financial sector. Establishing this will expectedly reveal the level of IAF's quality in the sector and consequently inform of its capability as a cornerstone of corporate governance in the NFS. The curiosity that prompted this investigation cannot be timelier given continuous neglect of financial sector in most studies that bother on internal auditing and corporate governance, obviously due to the peculiarity of the sector in form of regulatory framework. Incidentally, the recent global financial turmoil has reemphasized the significance of this sector and calls for serious attention on matters that relate to IAF and corporate governance in the sector (Gras-Gil *et al.*, 2012).

In line with the IIA's guidance on IAF's independence and internal auditors' objectivity, Ebaid (2011) argues that IAF should be given the appropriate status in the organization so as to enable the function to exercise organizational independence. In order to have a clearer appreciation of "organisational independence" of the function,

Chapman (2001) provides a guidance by defining it as ‘‘the placement of the IAF in the reporting structure that will make it free to determine the audit scope and perform audit work without interference’’.

IAF’s organizational status is therefore epitomized through the manner of relationship maintained by the function with corporate governance’s other internal mechanisms (particularly both Management and Audit committee).

Whilst the IAF is expected to maintain healthy relationships with the two named internal mechanisms, such level of relationship existing between the function and the duo, is a strong determinant of how independent the function is, and will also be perceived to be. In order to strengthen the function’s independence, the IIA standards (Attribute Standard 1110 of the *International Standards for the Professional Practice of Internal Auditing*-IIA, 2004) prescribes for IAF, a reporting line capable of making the function accomplish its activities (Christopher *et al.*, 2009).

IAF’s ability to accomplish its activities of value addition to the organization through its dual roles of assurance and consulting, while also remaining independent is seen as a dilemma (See Lenz Sarens, 2011; Chamber and Odar, 2015), and an area of serious threat to IAF’s independence. This dilemma and the arguments thereon are not unconnected with the uncertainties associated with the dual roles of the IAF as both an assurer and a consultant to the organization. While audit committee relies heavily on the assurance role of the IAF, management also relies extensively on the extended role of consulting from the function. Thus IAF is conducting assessments of the management (for its assurance) as well as assessments for them in the capacity of consultant (Peurseem, 2005).

Whereas Omoteso and Obalola (2014.p. 144) further assert the significance of the supporting role IAF plays for management particularly in terms of preventing and curbing corporate fraud (among others) through establishment and operation of physical security and monitoring processes, fraud reporting hotlines (including whistle blowing activities, training and education for staff member), Drent (2002) indicates that management ordinarily in utilizing the IAF for the extended (dual) roles do not always

appreciate the need for IAF's independence and objectivity of the individual internal auditors.

The issue of the optimal level of relationship between IAF and the audit committee, and management has been of controversy particularly going by the argument of Christopher *et al.* (2009), that too much involvement of, for example senior management in the internal audit's planning could have a negative impact on the IAF's independence. So one can then argue that too little a level of coordination between management and IAF is as undesirable as may be too much a level of coordination between them.

The second issue to be looked into in the area of IAF's characteristics is the appropriateness of the auditing technology and techniques used by IAF. Albeit, the IIA standards on best practice for internal audit, in line with the revised focus of internal auditing globally on internal control, risk management and governance make case for risk-based audit approach, studies on compliance with the standards are however scant (Sarens, 2009), and therefore warrant attention. Accordingly, the author suggests the following areas for such academic endeavours:

- i. existence of internal audit operating manual,
- ii. whether IAF uses a Risk-based audit plan (RBAP),
- iii. how frequently does the IAF update the internal audit planning?,
- iv. whether IAF facilitate risk and control self-assessment (CSA),
- v. whether IAF conducts auditee satisfaction surveys,
- vi. whether IAF uses computer-assisted audit technique,
- vii. whether IAF is familiar and does comply with the IIA ISPPA,
- viii. whether IAF have a quality assessment and improvement program (QAIP) in place, and
- ix. whether IAF uses external quality assessment

Till date, the provisions laid down in the IIA standards remain the best guidelines for conduct of internal audit engagements and any IAF that would add value to organisations is expected to conduct its engagements in full compliance with the standards.

The IIA standards and the various inputs from extant studies such as above shall be applied in addressing the second research question – “To what extent are IAFs in the NFS performing their roles in conformity with the IIA standards?”. The research questions shall be explored specifically by looking at the conformity of the IAF’s activities with the IIA’s standards.

2.3.5 Internal auditors’ Characteristics

Mousa (2013) maintains that whereas appropriate organizational status ensures IAF’s independence, the level of objectivity of each internal auditor is the basis of evaluating independence of IAF. Sarens (2009), though agreed with Mousa (2013)’s position, however suggested that other numerous personal attributes such as educational background or qualification of internal auditors, work experience, professional certification, behavioural skills etc, are areas that can also be looked into when exploring internal auditors’ characteristics. The issue of multidiscipline skills required for the enhanced roles of IAF, and the challenges associated with finding internal auditors with the required skill sets has being identified as a very crucial issue when it comes to IAF responding to its ever dynamic roles particularly within the concern of enhanced corporate governance domain. Sarens (2009) argues that the capacity of IAF to monitor and improve risk management and internal control processes is determined by an internal auditor’s personal characteristics relating to possession of appropriate level of competence.

Discussions of internal auditor’s competence, and the study’s research question on internal auditor’s characteristics (i.e. whether internal auditors in the NFS have adequate level of competence to fulfill their expected roles) is informed by the above arguments. This is thoroughly addressed within the domain of the literature review in chapter 4 of the thesis. For the purpose of exactness and defined focus, the empirical literature review in chapter 4 of the thesis shall be shaped within the perspectives explained above, and consequently, the conceptual framework of the study is synthesized as illustrated below.

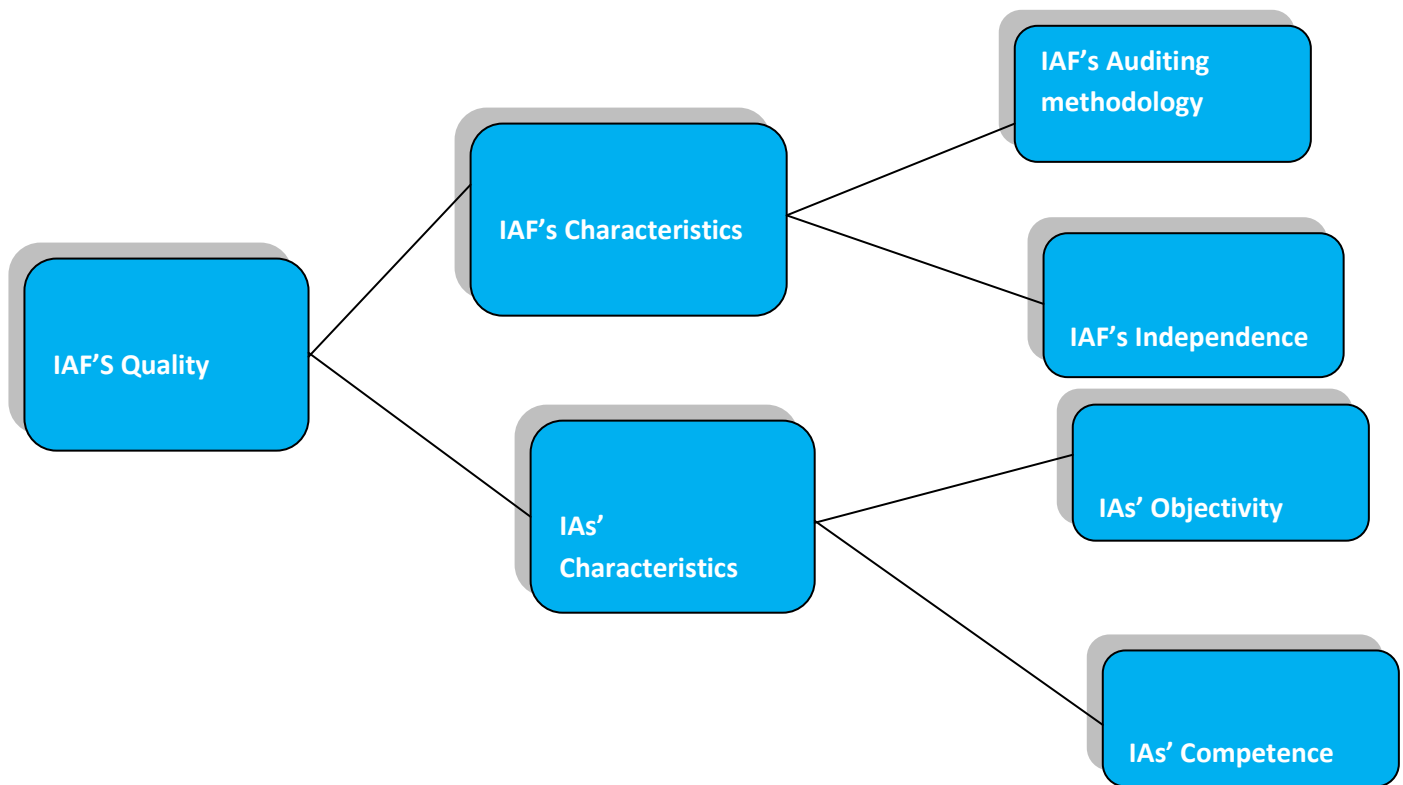


Figure 2.1: Study's Conceptual framework

2.4.0 Structure of the Nigerian financial sector

Nigeria, officially known as the Federal republic of Nigeria is a multi-ethnic and culturally diverse country located on the Western coast of Africa covering a total surface area of 923,768square kilometers, with an estimated population of about 197million (Nigerian Bureau of Statistics). Nigeria gained her independence from the United Kingdom on October 1, 1960 and is presently divided into 36 federating units known as States, and its Federal capital territory known as Abuja. The country, usually referred to as the ‘giant of Africa’ is widely known for her monolithic economy. Nigeria is the largest oil producing and exporting country in Africa (Suberu *et.al*; 2015). Petroleum accounts for about 95% of the country’s foreign exchange income and 70% of government revenue.

Nigerian financial sector is generally classified into formal and informal groups. The formal group of the Nigerian financial sector comprises bank and non-bank financial

institutions. The banks, based on the different functions they are meant to perform, are classified into different categories. These include Deposit money banks (DMBs) also known as commercial banks, Development banks (such as Bank of Agriculture, Development bank of Nigeria, Bank of industry, The infrastructure bank, Nigerian Export-Import bank (NEXIM), Mortgage banks, and Micro-finance banks. The non-bank financial institutions include insurance companies, finance houses, discount houses, Bureau De change, Pension fund administrators, pension fund custodians, insurance brokers, issuing houses, stock broking firms, registrars. Both the bank and non-banking financial institutions are regarded as the formal financial sector.

Whereas the DMBs (popularly referred to as commercial banks), which constitute about 80% of the Nigerian financial sector are primarily involved in deposit mobilisation from the surplus units, and granting of such as credit facilities to the deficit ends, development banks (such as Bank of agriculture, bank of industry etc) are specifically set up to cater for specific sectors of the country's economy. This is with a view to stimulating economic development across the country. It is generally agreed that financial sector plays a catalytic role in the process of economic development (Onwe, 2013).

The informal financial sector in Nigeria includes local money lenders, money changers, pawn brokers and thrifts and savings associations. Whereas, the formal sector has defined operating structure with specific regulatory framework, the informal sector operates outside the regulatory purview of the government. The informal sector engages in activities which are not easily measured and it cuts across a wide range of areas of informality (such as environmental, spatial, economic, and social), covering business activities, employment, markets, settlements, and neighbourhoods.

The regulatory bodies of Nigeria formal financial sector include the Federal ministry of finance (FMoF), Central Bank of Nigeria (CBN), Nigeria Deposit Insurance Corporation (NDIC), Securities and Exchange Commission (SEC), Nigerian Stock Exchange (NSE), the National insurance commission (NAICOM), and the Federal Mortgage Bank of Nigeria (FMBN).

2.4.1 Financial sector reforms and Corporate governance issues in Nigeria

Nigerian financial sector has been through lots of remarkable changes over time (Odeleye, 2014; Yaqub and Omobitan, 2012). The adoption of the Structural Adjustment Programmes (SAPs) by the Nigerian government in July 1986 however remains the landmark incident in the reformation of the country's financial sector. The referenced economic reform policy was a conditionality of the International Monetary Fund (IMF) and the World Bank's intervention aimed at addressing the severe economic conditions prevalent in most African countries inclusive Nigeria. SAPs were intended to restructure and diversify the nation's economy. Liberalisation of the various sectors of the economy was one of the key thrusts of the economic reform programs. Prior to the adoption of SAP by the Nigerian government under the administration of President Ibrahim Babangida, Nigerian economy was highly regulated and largely crude-oil dependent.

According to Ogun & Akinlo (2011), the economic reform program was orchestrated to address the macroeconomic imbalances in Nigeria (in form of severe balance of payments, increased debt burden, high inflation and high rate of unemployment). The economic hardship of the time was brought about by the global oil glut of 1980 and its severe impact on the Nigerian mono-product economy. The government's liberalization policy then was aimed at commercialization and privatization of some of the government's investments in corporate entities across sectors. As envisaged, aside from the fact that some private investors were given the opportunities to have equities in some public corporations, the liberalization policy also paved way for influx of foreign investors into the country particularly into the country's financial sector. Between 1988 to 1999, over 55 public enterprises were privatized (Danladi & Naankiel, 2016). This reaffirms the shift in economic regulation to deregulation in Nigeria (Ogun and Akinlo, 2011).

The financial sector in Nigeria no doubts recorded significant growth and expansion as a result of the liberalization policy. The phenomenal growth in the sector however generated mixed effects on the economy (Edo, 2012). The positive impacts of such

unprecedented expansion include increased job opportunities, remarkable growth in banks deposits, and boost in the other sectors in Nigeria. In the same vein, the need for increased monitoring and regulation on the part of the sector's regulators became so evident. As at that time, the Companies and Allied Matters Decree (CAMD) of 1990, remained the principal statute regulating companies in Nigeria (Marshall, 2015). This legislation (formerly known as the Companies Act 1968) was modeled after the United Kingdom companies Act of 1948. The statute (CAMD) has however been repealed and replaced with the Companies and allied matters Act (CAMA) 2004. The legislation made provisions regulating issues such as accounting and auditing standards, equity ownership disclosure, shareholders rights among other issues. As at this time, the Corporate Affairs Commission (CAC) and other regulators are expected to regulate companies' operations. As activities in the country's financial sector increased with the associated challenges of unethical issues among companies, the inadequacies of the various provisions of the CAMA became evident.

In order to strengthen the sector particularly following its liberalisation, efforts made by the CBN and NAICOM include continuous upward review of the required level of capitalization for companies in the sectors, and unceasing monitoring of activities of companies in the sector by the various operators. The incessant recapitalization of companies in the sector had resulted into series of mergers and acquisition in banks and non-bank financial institutions. For instance, the last recapitalization exercise of 2005, (stipulating =N=25billion as the new minimum capital base for deposit money banks in Nigeria) led to significant reduction in the number of commercial banks in the country from 89 to only 25 (Ogunsakin, 2014; Muritala *et.al.*; 2017).

Similar to what led to the phenomenal collapse of Enron and some other major corporations in United States of America and UK in early 2000s, Nigerian corporate world (inclusive of financial sector) was noted to be plagued with bad corporate governance practices. The unending systemic rot in the nation's financial sector (leading to huge non-performing loans) led to CBN's sack of the Chief executive officers and directors of eight Nigerian commercial banks in 2009. According to the CBN, the decision was taken to prevent the Nigerian financial sector from complete collapse and

also to restore investors' confidence in the sector. According to the then CBN Governor- Mallam Lamido Sanusi, the officials were removed due to high level of non-performing loans attributable to poor corporate governance practices, lax credit administration processes and the absence or non-adherence to the bank's credit risk management practices, Further to the sack of the managing directors and the takeover of the concerned bank, Assets Management Corporation of Nigeria (AMCON) was established in July 2010 to pursue the recovery of the non-performing loans (estimated at over N2trillion) in the troubled banks.

Whereas, corporate governance still remains a topical issue in Nigeria particularly in the academic and corporate environment, the country's efforts in stemming the issue of corporate mis-governance officially started in 2003 with the issuance of code of corporate governance for Banks and other financial institutions in Nigeria. Code of corporate governance sets out standards of good practice in relation to management of corporate organizations. The code was issued by the Bankers committee in August 2003. This was followed by the SEC code of 2003, the CBN code of 2006 (for banks), PENCOM code 2008 (for pension fund administrators and custodians) and NAICOM code of 2009 (for insurance companies). These codes were issued by the various regulators in the financial sector as their response to the post bank consolidation challenges. Multiplicity of codes of corporate governance has however become a great challenge facing companies in the Nigerian financial sector.

Concerned with the rising corporate governance challenges in the country and with a view to assuring the investing public that corporate reporting and governance frameworks in Nigeria were robust, the Nigerian government, through the Financial Reporting Council of Nigeria (FRCN) issued the first code of corporate governance for the country on January 15, 2019. The code (Nigerian Code of Corporate Governance – “NCCG 2018”) highlights key principles that seek to institutionalize corporate governance best practices in Nigerian companies. The FRCN established by the Financial reporting council of Nigeria Act No. 6, 2011 is a Federal government parastatal under the supervision of the Federal ministry of Industry, Trade and Investment.

The code which is principle-based consists of seven parts (focusing issues relating to Board of directors and officers of the board, Assurance, relationship with shareholders, business conduct and ethics, Sustainability and transparency). As a way of ensuring compliance, companies shall be required to report in their annual financial statement (starting in financial years ending on or before January 1, 2020) their level of compliance with the governance code. It is envisaged that the emergence of the harmonized code of corporate governance based on the principle of “apply and explain” in the country will further ease the challenge of compliance among corporate entities in Nigeria

2.5 Chapter Summary

This chapter has reflected upon various developments that brought internal auditing into the corporate governance discussion globally. In doing this, the concern on audit crunch and auditing profession’s diminishing esteem were thoroughly discussed. In a bid to establish the study’s conceptual framework, issues relating to the emergence of internal auditing as a corporate governance mechanism, and its rising stature are discussed. In the same vein, the various concepts surrounding IAF’s effectiveness are discussed.

The overarching argument here is whether IAF in its current revered status is truly positioned for its assigned roles under the corporate governance domain of developing economies.

Chapter 3: Theoretical Framework

3.0 Chapter overview

This chapter aims at establishing an appropriate theoretical framework for the study. Based on evidence obtained in the literature, three different theories are considered relevant to the study's focus. These are Agency theory, Transaction Cost Economics (TCE) theory, and Institutional theory. With a view to establishing their relevance to the study, the theories are reviewed and their various standpoints are reflected upon in relation to the study's objectives and research questions.

As part of the focus of this chapter, the limitations posed by scant theories of internal auditing is brought to fore and justifications are made for the study's theoretical underpinnings.

3.1.0 Theoretical Framework

If there is any issue confronting the practitioners of internal auditing, either in academics or in practice, the issue of scant and seeming incomplete theories to shape studies on internal auditing definitely is. Theories and research specifically devoted to internal auditing is extremely limited (Paape, 2007, 238; Swinkels, 2012; Boyle, 1993; Gendron and Bedard, 2006).

Lack of enough theories to shape researchers' direction is argued the bane of academic activities in the field of internal auditing. A limited number of academic studies use theory to position their research focus (Swinkels, 2012). Incidentally, most thrusts always initiated by the IIA do not usually seem to be theory-motivated but mostly circumstantial, reactionary and opportunistic (Swinkels, 2012, 68). While the infancy stage of the internal auditing profession was in the past, being used as a justification for scant theorization in the field of internal auditing (Vutren, 1996), major transformation and achievement is however expected to have been recorded particularly over seventy years of existence of a global body pushing for legitimacy of internal auditing

profession. So, internal audit professionals (whether in practice or in academics) cannot continue to shirk their responsibilities in strengthening the profession considering its improved visibility and bequeathed stature particularly associated with reforms in the corporate governance's domain (Carcello et al; Sarens *et al.*, 2012). Therefore, efforts geared towards broadening the horizon of theoretical lenses currently employed in internal auditing research are considered worthwhile.

Calls for theoretical refinement in internal auditing theories abound (see Spraakman, 1997; Paape, 2007; Swinkels 2012; and Mihret, 2014), and an effort in this direction, serves to further motivate internal auditing research particularly in these days of growing stature of internal auditing across climes. This may engender significant contribution to the body of knowledge in the field and an attempt capable of stimulating renewed interests in studies focusing internal auditing. Contrary to the positions maintained by some authors (e.g. Boyle, 1993) that internal auditing has no theoretical background at all, three different theories-Agency theory, TCE theory, and Institutional theory, have been identified relevant to the study. These theories are employed to give insights on studies that bother most especially on the essence of internal audit, role played by internal audit in business organisations, and decisions relating to sourcing (i.e. internalisation or outsourcing) of IAF of firms.

Agency theory, TCE theory, and Institutional theory promoted by Adams (1994), Spraakman (1997) and DiMaggio and Powell (1983), respectively, have history of application in internal audit research. The three theories are frequently applied by researchers in the field (Paape, 2007. p. 104).

The next section presents detailed discussion of the referenced theories with a view to establishing their areas of relevance in the field of internal auditing, highlighting the criticisms against their universality on issues that bother on internal auditing as a corporate governance mechanism, and justifying the adoption of the conflation of the three theories as a suitable theoretical framework for the study.

3.1.1 Agency Theory Literature

Jensen and Meckling (1976) titled “Theory of the firm: Managerial Behaviour, Agency costs and ownership structure” remains a very useful background to literature on Agency theory. The authors define an agency relationship as “a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf by delegating some decision making authority to the agent”. In this definition, it can be seen that agency contract involves not only engagement of the agent by the principal for performance of services, but also involves delegation of authority by the principal to the agent. This is necessary to facilitate the agent’s performance of the assigned function.

While presenting a review of Agency theory, Paape (2007) in tune with the above indicates that the theory is based on two essential actors: a principal and his agent and the relationship between them. An Agency relationship exists whenever a principal engages someone to make decisions on his or her behalf (Jensen and Meckling, 1976 p. 5; Armstrong, 1989. p.312). Agency theory is employed to explain contractual obligations between the owner of a business (usually called the principal) and the managers (usually referred to as agent). A contract of agency exists between owner of a firm who produces resources required for the firm’s establishment and operation on one hand, and the managers who controls, runs and manages the business affairs on behalf of the owners on the other hand. Whereas, the rewards to the principal (owner) is the return on his investments in form of profits and increase in market value of his investment, the agent (manager) is compensated through salary and other fringe benefits implied in his contract of engagement. It is assumed that each of the parties will continuously pursue optimization of his reward or compensation. It is based on this assumption that both parties are referred to by Jensen and Meckling (1976) as utility maximizers.

In the course of pursuing this utility maximization objective, divergence of interests between the principals and the agents is inherent, and consequently the principal is said to always feel skeptical of the agent acting in the best interest of the firm. Davis, *et al.* (1997) lament that agents leverage on the principals’ authority to act on their behalves

(delegation) to build their own utility at the expense of the principal's utility (wealth). They argue further that chance that agents do not share the same interest and utility choices as their principal is substantial. This feeling had earlier been echoed by Jensen and Meckling (1976 p. 1):

“The directors of such (joint stock) companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore must always prevail, more or less, in the management of such a company”

The above cynicism is enshrined in the notion that managers of the business knows more than the owners, and may capitalize on this information unevenness (popularly known as information asymmetry) to gain undue advantage at the expense of the owners (Sarens and Abdolmohammadi, 2011; Paape, 2007). In addition to this information asymmetry cynicism is the fear that the managers might not even be making the best business decisions at any point in time after all, the owners do not have full information about the business. This is what Adams (1994) interprets as “adverse selection”. This adverse selection, Culpan and Trussel (2005) argue might also be associated with different levels of risk appetite of the principal and the agent.

While positioning this theory as a basis for internal audit, Scapens (1985) as indicated in Adams (1994), argues that each party will continue to optimize his wealth at the expense of the other until an optimal level, state of efficiency (also called “pareto optimality”) is reached where neither party can enhance his wealth at the expense of other. Adams (1994) argues further that in order to ensure pareto-optimality in the agency contracting process, both principals and agents will incur contracting costs. This

contracting cost is well captured as bidirectional, on the part of both parties in the contract, and such is required to align interests (Culpan and Trussel, 2005). Adams (1994)'s position on contracting costs on the part of the two parties perfectly aligns with the Jensen and Meckling (1976)'s view that the principal can put the aberrant activities of the agent under control by establishing appropriate incentives capable of limiting divergences of intentions and actions on the part of the agent. Similarly, the authors state that it will be in the best interest of the agent to continue to retain the principals' confidence by signaling to them that divergent actions shall not be taken by them or that the principals shall be compensated for any harmful actions or decision taken on their behalf.

Whereas principal's portion of the contracting cost is in form of monitoring expenditures, such as the cost of subjecting management's annual financial reports to external audit, the expenditures on Audit committee and non-executive directors (Watts, 1988), the agent on the other hand and according to Adams (1994), incurs bonding cost which includes the cost of internal audit, engaged at least to signal to the owners/principal that they are acting responsibly and in a manner congruent to the contract of their employment. Such action, it is further argued by Adams (1994), is expected to help the managers to secure their agent's position and guarantees their salary and other fringe benefits.

While, the monitoring expenditure incurred by the principal is seen by Davis *et al.* (1997) as cost of holding the opportunistic tendencies of the agent in check, it can be contended from the argument above that it will be in the best interest of the managers to demand monitoring services like internal audit so as to mitigate the risk of the principal coming up with adverse adjustments on their compensation.

Sarens and Abdolmohammadi (2011) reemphasize IAF as a bonding cost borne by managers of company to satisfy the owners' quest for accountability by signaling to them that their investment is under control. Interestingly, that might sound superfluous but in reality it is just a theoretical conjecture; after all in reality, bonding costs are like any other operational cost of business, which are treated as first line charge before arriving

at the residue to be passed to the principal. Cost classification and its accounting treatment is however not a focus here and as such the cost of internal audit is taken theoretically as it is (i.e. bonding cost). Additional to both monitoring and bonding costs borne by the principals and the agent respectively, is the cost attributable to the divergence between principal's and agent's interests that results to diminution in the principal's welfare. This is referred to as "residual loss" (Jensen and Meckling, 1976; Culpan and Trussel, 2005).

The totality of these expenditures (i.e. monitoring expenditures by the principal, bonding expenditure by the agent, and residual loss) is what is referred to as the agency cost (Jensen and Meckling, 1976). The important idea in the agency relationship is the selection of appropriate governance mechanisms between principal and agent that will ensure an efficient alignment of principals and agent interests (culpan and Trussel, 2005).

The rationale of both monitoring cost and the need for bonding cost on the part of the principal and his agent is best appreciated within the context of diffused ownership, where ownership and control of business entities are unavoidably distinct. Jensen and Meckling (1976) argue that since the relationship between the stockholders and the managers of a corporation fits the definition of a pure agency relationship, then the issues associated with "separation of ownership and control" in the modern corporation with diffused ownership are closely associated with the general problem of agency.

In this type of business setting, information asymmetry becomes a major concern for the principal who is completely ignored on critical and regular business decisions (if not completely all). Paape (2007) appropriately captures this concerns as bothering on "hidden information" and "hidden action" of the agent. Inherent in this laxity and opportunity of hidden information and hidden actions are behavioural issues that translated to moral hazard ex-post.

An alternative approach to incurring monitoring cost is for the principal to take his destiny in his hands by adopting a "do it yourself" psyche. This certainly might not be feasible particularly within the context of firms with diffused ownership, due to issue of

uneven endowments in terms of dexterity and acumen, time constraints, and impracticability. Even where owners would prefer to self-manage their own companies and reap the maximum utility for themselves, this may evidently seem impossible in modern corporations where capital requirements might be an impediment (Davis, et al.1997). The advent of the modern corporation with diffused ownership inevitably heightened separation between ownership and control of wealth (Bearle &Means, 1932).

While the first two constraints were also indicated in Paape (2007), it is extremely inconceivable for numbers of equity holders to constitute themselves into such monitoring mechanism. Thus the inevitability of monitoring cost. Sarens and Abdolmohammadi (2011) argue that the more diffused the ownership of a company, the higher the likelihood of the divergence in owners' and managers' preferences. This implies that as the diffusion of ownership increases, so does the demand for monitoring.

Paape (2007)'s poser on who monitors the monitor as contemptible as it is, remains a concern for both the professionals and professional bodies in auditing to give serious attention, as the monitor (internal auditors) themselves are economic agents whose activities cannot be said to pass the test of altruism due to the inevitability of opportunistic tendencies.

Another issue arising from the above exposition has to do with the possibility of seeing internal audit as monitoring cost on the part of the management when viewed as having a contractual relationship (akin to agency relationship) with the employees under their management, as well as facing similar challenges of unevenness of information on operational issues within the firm. It is based on this feeling that it is worth of emphasizing that the principal-agent relationship, underlying Agency theory is actually between the owner and manager of economic resources. Jensen and Meckling (1976) also give credence to this line of thoughts by emphasizing the contractual agreements between the owners and top management of corporations.

Looking at internal auditing within the mindset above, Agency theory can then be said to offer acceptable explanation or platform for the *raison d'être* of internal audit, the “license to practice” of internal audit according to Paape (2007). Considering internal audit from another perspective under the theory, particularly reflecting on its role as a monitor, the theory also offers a good rationalization for evaluation of the unceasing agitation about IAF’s independence and its organisational status within the company on the need for auditor’s independence. Studies focusing who the internal audit boss should be extensively leverage on this paradigm.

Adams (1994) concludes his study by arguing that agency theory can help to give explanation on the existence of internal audit, the nature of IAF and the approach adopted by internal auditors to their work. From 1994 to date however, internal auditing studies found in literature to have employed Agency theory include Adams (1994), Paape (2007), Sarens and Abdolmohammadi (2011), Al-Hroot (2012); and Endaya and Hanefah (2013). These are as indicated in table 3.1 (page 105). Paape (2007) in her PhD thesis focusing on the changes brought about in internal audit due to corporate governance regulations that have been coming into effect for more than a decade, submits that Internal auditing theorization is at infancy stage perhaps because of the usual perception that internal audit is subservient to external audit. The author indicates the inadequacies of both agency theory and Transaction Cost Economics, and consequently agitates for further theoretical exploration.

Paape (2007. P.129) however forewarned that “positioning internal audit under those it is supposed to monitor is a recipe for failure”. The position maintained on this has an implication for the perceived independence and reputation of the IAF not only by the external auditor who makes a decision of reliance on internal auditor’s work, but also on other stakeholders of firm who need assurance on the effectiveness and reliability of the monitoring mechanism. The argument is though IAF is perceived to be within the orbit of “employer–employee” in a firm, with the management naturally and technically its boss, the necessity of independence of a monitor from the “monitored” amplifies the concern on management bossing IAF.

Independence is a critical attribute to be possessed by the IAF so as to strengthen such assurances from it and consequently enrich the reliability of the function. The significance of this characteristic forms the foundation and cornerstone of internal auditing profession, and is further emphasized by the IIA definition of internal auditing as:

*“an **independent**, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes”*

Millichamp and Taylor (2008) argue that an independent IAF is a significant part of the overall internal control environment. The issue of IAF’s independence is extensively discussed in chapter 4 and 6 of the thesis.

Culpan and Trussel (2005) while reviewing the Enron debacle of 2002 identified among other factors, the issue of IAF’s independence that was utterly undermined in the company. The agency costs became more complicated in the referenced case as managers were involved in a complex network of long term business deals, which involves the usage of financial derivatives such as options and forward contracts as well as creation of Special purpose entities (SPEs) for managing the company’s balance sheets. According to Healy and Palepu (2003), Enron entered into long-term fixed price transactions and adopted financial derivatives, including swaps, forward and future contracts, the company also started using off-balance sheet financing vehicles known as SPEs to finance many of the transactions. These are transaction that subjected the extant accounting standards to twisting given that such transaction model adopted “mark-to-market” accounting. Mark to market accounting according to Healy and Palepu (2003) implies that once a long-term contract was signed, the present value of the stream of future inflows under the contract was recognized as revenues and the present value of the expected costs of fulfilling the contract were expensed. Unrealised gains or losses in the market value of the long-term contracts (that were not hedged) were then required to be reported later as part of annual earnings whenever they occurred. SPEs are shell

firms created by a sponsor, but funded by independent equity investors and debt financing. Healy and Palepu (2003) disclosed that by 2001, Enron had used hundreds of SPEs. Reinstein and Weirich (2002) approximate this to be five hundred (500) in number. Therefore, Enron was able to borrow substantial sums without carrying such liabilities on its balance sheets, and as a result maintaining its high credit rating status (Doost, 2003).

According to Healy and Palepu (2003), Enron's primary challenge in using the mark-to-market accounting was estimating the market value of the contracts, which in most cases ran as long as twenty (20) years. This accounting flexibility was further complicated by the flexibility associated with treatments of SPEs transactions which Enron was able to leverage on to manipulate its balance sheets by not disclosing debts raised by it through the various SPEs.

The company's auditor Messrs Arthur Andersen, serving as both external and internal auditor to Enron, appeared to compromise his independence and Enron management capitalizing fully on this flaw was able to sway the firm at the time to their side. Therefore, given them a shield over their shady deals of creative accounting with their selfish interests. For instance, Arthur Andersen was accused of applying lax standards in their audits because of a conflict of interest (Healy and Palepu, 2003). Conflict of interest is established as part of the major threats to either external or internal auditor's objectivity.

Looking at it from another perspective, Enron case can be said to be that of an uncontrolled appetite for risk on the part of the company's management without adequate risk-based internal audit approach. While the company keeps pursuing business growth model aggressively through diversification, the risk analysis and management issue were neglected (Healy and Palepu, 2003). Rather than instituting an in-house IAF, Enron management outsourced same to Arthur Andersen. Aside from trading off their independence as internal audit firm, as argued by Smith (2002) provider of outsourced IAF cannot be fully committed to their client same way employees of an in-house IAF will do. The author also maintains that outsourced

auditors providing internal audit services to a firm often do not achieve the same understanding of the business as the in-house auditors who are perceived to have tremendous knowledge of the business that can only be gained through years of daily interactions with management and staff. Drexler (2003) contends that in-house internal auditor's familiarity with operations and insider knowledge can enable more informed, insightful audits than an outsourced IAF may be able to provide.

On the issue of commitment and allegiance, "External auditors go from client to client. Their allegiance is to their firm and the partners of the firm, not to the client. Internal auditors are employees of the company with an independent reporting structure to the audit committee. Their status as employees ensures that they are interested in the long-term good of the organisation" (Smith, 2002. P. 13).

Sarens and Abdolmohammadi (2011) in their study, adopted agency theory to assess the monitoring effects of the IAF in Belgian companies, and discovered that the explanatory power of traditional agency variables is relatively weak in a Belgian setting.

As explained earlier, this study shall also leverage on Agency theory to assess the level of independence of the IAF in the Nigerian financial sector. Various indicators or determinants of IAF's independence (such as sourcing arrangement, reporting line of the IAF in the sector etc) shall be evaluated using the various insights provided by agency theory.

3.1.2. Transaction Cost Economics (TCE) theory

TCE theory according to Huascar (2006), studies the uncertain world of incomplete contracts, inhabited by 'contractual men' – people with bounded rationality and potential opportunists. TCE theory is a variation of agency theory (Sprakman, 1997), which was developed for exploration into the field of internal auditing. The theory has its footing in the new Institutional Economics research tradition and leverages on the theory of the firm expounded by Coase (1937). The main focus of TCE is the definition of the determinants of coordination of the transactions through markets or hierarchies (Joskow, 1988). Bounded rationality, opportunism, the primacy of markets and the

action of economising are building blocks of TCE theory as formulated in the pioneering work of Oliver Williamson (Huascar, 2006). The main appeal of the theory lies in the fact that in resolving the principal-agent unavoidable rifts, internal audit apart from being one of the bonding cost incurred by management mechanism to signal conformity with the principal's intents and the organizational goals, also offers itself to the organization as a controlling device to prevent shirking and opportunistic tendencies, which certainly reduces the cost associated with information asymmetry (to be specific) inherent in the contract of agency. This expectedly increases organizational efficiency, or economizes costs, and indicating the focus on efficiency.

TCE theory applies cost of transaction in studying economic organisations. Here, transaction is regarded as the basic unit of analysis and an understanding of transaction cost economizing is central to the study of organization (Williamson, 1981). According to the author, the requirements underlying this approach are:

- i. that transactions be dimensionalised,
- ii. governance structure be described, and
- iii. that economizing is accomplished by assigning transaction to governance structures in a discriminating way.

While discussing the fundamentals of the theory, Williamson (1981) indicates that the proposition of transaction as the basic unit of economic analysis was advanced by John R. Commons in 1934 (Williamson, 1981. P.550). A transaction is said to take place when a good or service is transferred across a technologically separable interface. While some transactions are simple and easy to mediate, others according to Williamson (1981) are difficult and require special care, so the concern on how to identify factors to be used for differentiating easy and difficult transaction, identification of differing governance structures within which transactions can be organized and actualized in a transaction-cost-economising manner are the essence for which TCE theory was propounded.

When transaction occurs within an organisation, the transaction costs aside from the cost of input (raw materials and capital expenditure) can include managing and monitoring personnel, negotiating, cost of drafting agreements, as well as cost of

safeguarding any exchange or transaction that are friction-encumbered. The transaction costs of buying same good or service from an external source, within the framework of TCE includes cost of source selection, contract management, performance evaluation and arbitration (i.e. dispute resolution). From this, one might establish that organisation setting or governance structure is a factor on the determination of transaction costs. The transaction costs generally can be seen as ex-ante and ex-post. While cost of sourcing, negotiation, agreement drafting, and exchange safeguarding are ex-ante, costs of input evaluation, output measurement, monitoring cost and dispute resolution constitute ex-post transaction cost. Industrial firms worldwide continue to rationalize their operations by “right-sizing” and shedding non-core business and functions (Widener and Selto, 1999). The essence of such rationalization is to help firm focus its area of core competence so as to remain competitive. Rationalisation improves organizational operations. In this era of highly competitive business environment globally therefore, such right sizing, or rationalization of operations becomes inevitable. Widener and Selto (1999) argue further that increased competitive pressures are actually forcing business organisations to look closely at the services they maintain internally. This they do to make sure they add value and do not duplicate other services. The decision to either maintain IAF internally in organisations or outsource it can be resolved along this line of argument. Many firms are now facing the decision dilemma of whether to develop and maintain these broader internal audit capabilities internally or farm out same to external providers.

A strand of argument is that if the enhanced role of IAF (i.e. (assurance and consulting) requires diverse of skills that seem to be posing greater challenge to organisations, skills sets such as IT, interpersonal skills, communication, etc which will cost firms additional cost to acquire and maintain become inescapable, the question here is will such expenditure be in the best interest of the firm in terms of its “bottom line” and viability?. According to TCE, high market transaction costs are incentives to internalize economic activity, conversely, activities with low market transaction costs may be more economically mediated through markets, (Widener & Selto, 1999), ceteris paribus (i.e. all other considerations held equal). TCE theory argues that activities of the firm will

either be internalized or market-mediated, depending on relative transaction costs of conducting the activities (Williamson, 1979).

To have a better appreciation of the theory, Williamson (1981) made two behavioural assumptions which are assumptions of recognition of human agents as being subject to bounded rationality, and that at least some agents are given to opportunism. Simon (1978)'s explanation of the differences between bounded rationality on one hand and hyper-rationality and irrationality on the other hand, offers a better appreciation of the first assumption of TCE theory. According to his explanation, Simon (1978) captured bounded rationality as the limited endowment of an 'organization man' in terms of capability as applicable to analytical and data processing apparatus. This he nonetheless cautions should not be taken as hyper-rationality that is often attributed to 'economic man'. Opportunism within the concept of the theory is in the same vein, interpreted not as selfishness but rather 'self-interest seeking with guile', that is an effort to realize individual gains through lack of candor.

The relationship between Agency theory and TCE theory might not be unconnected with these two assumptions of bounded reality and opportunism, which can be likened to the same problems of information asymmetry and selfishness tendencies of agents under the contract of agency. Considering the bounded rationality and opportunism assumptions of TCE within the frame work of Agency theory, the opportunism tendency of an economic agent (either principals or agents), complicates the process. Williamson (1981) while emphasizing the complicating impact of opportunism argues that although it might be incomplete, universal contracting would still have been achievable but for the human agent's crafty self-interest (i.e. opportunism). This means that if agents though bounded rationally, were fully trustworthy, comprehensive contracting would still be possible, and presumably observable. Reciprocation of promises of being 'a good boy' would have been a caveat at most (i.e. principals would simply exchange with the agent, promises of behaving in good faith, with his (agent) well-mannered and steward-manship upon unanticipated events).

Such well-mannered and cooperative behavior of agents towards managements are the focus of ‘Stewardship theory’. The theory, which provides a contrary argument to Agency theory paradigm, assumes a pro-organisational and collectivistic behavior for management in a steward (agent) versus principal relationship. Davis *et al.* (1997) elucidates further by stating that stewardship theorists assume that given a choice between self-serving behavior and pro-organisational behavior, a steward’s behavior will not be divergent from his or her organization (i.e. pro-organisational). Given that the steward perceives greater utility in cooperative behavior, a steward will not substitute or trade self-serving behaviours for cooperative behaviours. Even when faced with situation where the interests of the steward and the principal are not in alignment, the steward places higher premium on cooperative behavior than defection (Davis, *et al.* 1997. p. 24). Attainment of the organizational objectives is the focus and the driving force of the steward’s action.

In the case of loosely coupled, heterogeneous organisations, or put directly, an organization with diffused ownership, stewards are assumed to keep their eyes on the ball, that is attainment of organizational goals remains the focus. Cooperative behavior of the stewards however does not indicate that stewards are self-sustaining or without ‘survival’ needs, the driving force remains the paradigm that the tradeoff between personal needs and organizational objectives facilitates achievement of organizational greater utility, through which varied personal objectives can be met altruistically.

Impliedly, enhancing stewards’ autonomy seems desirable, as doing that will result in maximization of benefits accruing from the stewards’ cooperative behaviour. In such situations, it is assumed that because stewards can be trusted, therefore monitoring incentives and or bonding costs are unnecessary. It is argued that control measures can indeed be potentially counterproductive, as such undermine the pious behaviour of the stewards (Davis, *et al.* 1997). Thus stewardship theorist focuses on structures that facilitate and empower rather than those that monitor and control.

Going by the above, and given that internal audit is understood as a control mechanism, one may therefore want to argue the limitation of stewardship viewpoint in studies

concerning internal auditing. Commenting on opportunistic tendencies of agents, Paape (2007) argues that opportunism is truly worse than self-interest in that its (opportunism's) embryonic and dignified form is lying and cheating for the benefit of one's own interests. Spraakman (1997) indicates that the assumption of opportunism may be taken as incomplete or distorted disclosure of information by agents, especially aimed at misleading, distorting, disguising, obfuscating, or otherwise confusing. Thus information asymmetry issue highlighted under agency theory earlier discussed might be taken to be a case of agent's opportunism when viewed under TCE's paradigm. In explaining TCE further, Morrill and Morrill (2003) identifies three dimensions for characterising transaction that give rise to transaction cost. These are:

- i. uncertainty;
- ii. the degree to which durable, transaction specific investments are required to realize least cost supply (assets specificity)
- iii. the frequency with which transactions recur (frequency);

The above three dimensions are as shown below:

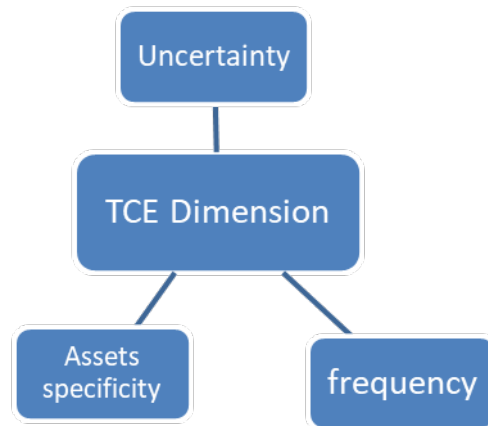


Figure 3.1: TCE Dimension (according to Morrill and Morill, 2003)

i. Uncertainty

Without the existence of bounded rationality and opportunism, Williamson (1985) argues that uncertainty would be much less of a problem because general rules would usually prevail. However with the challenges of bounded rationality and opportunism earlier discussed, contracts are difficult to write as it is very difficult to ascertain ex-ante who will indulge in pursuing self-interest ingeniously (cunningly). Fundamentally, an

inability to predict eventualities (contingencies) creates problems in writing contracts and therefore agreements are incomplete in some important respects (George and Barton, 1988 pg 341)

Uncertainty is an assumption of imperfect knowledge about a transaction. This certainly contrasts with neoclassical view assumption of existence of perfect information. Information about past, current and future assets are not known perfectly and as a result contracting becomes more complex. Williamson (1985) identifies two forms of uncertainty that have implications on transaction cost. These are environmental and behavioural uncertainties. Environmental uncertainty refers to the inability to predict all eventualities that might affect a transaction and given that economic agents are naturally beleaguered with limited cognitive aptitudes, they are constrained to write incomplete contracts. Market contracts are certainly cumbersome in the face of unforeseen contingencies as opportunistically inclined agents can try to interpret unspecified clauses of the agreements to their benefits (Morrill and Morrill, 2003).

The existence of environmental inexactness obfuscates the process of writing and enforcing contracts since the environment shifts in unpredictable manners. The fundamental challenge under the market model is that even contracts adjudged 'best' are incomplete (Sprakman 1997). So, the conclusion is that in-house production is better able to cope with because internally, organisation can cope without revisiting formal agreements. TCE theorists accordingly argue that an appropriate response to increased environmental uncertainty is to internalize transactions, given that stable, long-term administration and communication mechanisms can be developed to enhance information flow between the parties, and thus 'on line, real time' resolution of conflicts is also predicted (Morrill and Morrill, 2003).

Significant environmental uncertainty exists in the context of external audit characterized by high levels of complexity or risk, as either could impose unanticipated costs onto the external auditor either through litigation or additional audit work. If TCE theorists are correct, Morrill and Morrill (2003) infers that a complex and risky audit is associated with high transaction costs in a pure market based contractual arrangement.

The only option left therefore, is to renegotiate with the clients for increased audit fee or sub-standard audit through sordid audit (associated with controlled audit budget) in situation where the audit fee cannot be renegotiated with the auditee.

The second option certainly is not desirable given higher costs associated with poor audit particularly if certain contingencies materialize. This obviously will not be in the best interest of the two parties. In contrast, internal audit participating in the financial statement audit, faced with these same contingencies, Morrill and Morrill (2003) further argues can more easily adapt through internal administration and communication mechanisms. Transaction cost analysis posits that an appropriate response to increased environmental uncertainty is to internalize the transaction (George and Barton, 1988). Thus, internal audit's participation in financial statement audit might be offered as a recipe for controlling the transaction costs associated with a risky or complex financial statement audit.

The second form of uncertainty- behavioural uncertainty discussed by Williamson (1985) has to do with the level of difficulty involved in evaluating performance on contractual agreement and safeguarding adherence to contractual obligations. Behavioural uncertainty is associated with strategic non-disclosure, manipulation of information, and more generally-moral hazard and information asymmetry (Speckle' *et al.*,2007). Unlike environmental uncertainty which is exogenous, behavioural uncertainty is endogenous, inherent within the context of the exchange itself. Morrill and Morrill (2003) argue that in transactions ingrained with a high level of behavioural uncertainty, one or more opportunistically inclined parties might be motivated to shirk or consume excessive levels of privileges.

TCE theory is suggestive of internalization as the best strategy to deal with transactions characterized by high levels of behavioural uncertainties. This is thought so because within a hierarchical arrangement, monitoring mechanisms and performance history can be simulated. This thus aids accurate measurement of performance, consequently encouraging better performance on the part of parties to an agreement while also

facilitating easy identification of inefficient or opportunistic individuals (Morrill and Morrill, 2003).

Applying this line of argument to this study, an auditee might have bounded capability with which to evaluate the efficiency of audit, and or the quality of same, this limitation can be costly particularly if the audit transaction is carried out inefficiently or ineffectively. Therefore, leveraging on the above clarifications, one may want to advocate that internal auditor might be in the best position to handle those aspects of audit whose performance is not easy to monitor in order to take advantage of monitor mechanisms that are absent within a market setting. Consequently, discussion of internal auditor's coordination with external auditor in financial sector can be made within the framework of TCE theory.

ii. Assets specificity

Asset specificity according to Williamson (1981) is the most important dimension for describing transaction, and it occurs in organisations where assets have been customized (Spraaakman, 1991); such that the assets have little or no alternative uses (Paape, 2007). Customisation of assets restricts assets to limited usage. This thus makes redeployment of assets extremely uneasy. Morrill and Morrill (2003) explain that assets specificity is achieved when investment in transaction-specific assets is made. He further gives examples of transaction-specific investments that have been studied within the TCE literature to include investments in equipment dedicated to the manufacture of some specific product and which have no alternative applications, specialized communication hardware and software in the insurance industry, and specialized knowledge required of sales personnel in order to handle particular products. Succinctly expressed, Speckle', Elten and Kruijs (2007) indicate that asset specificity suggests the presence of opportunity losses that arise if the investments made to support a transaction are put to other alternative uses or users.

Williamson (1981) maintains that decision regarding asset specificity is critical because once an investment has been made, buyer and seller are effectively operating in a bilateral (or at least quasi-bilateral) exchange relation for a considerable period

thereafter, and the supplier is “locked in” on the transaction to a significant extent, particularly if the alternative uses of the specific assets is much smaller than the specialised use for which the customization was prompted. In the same vein, the buyer is as well committed to the transaction (boxed into a corner) as he cannot turn to alternative sources of supply and obtain the item on more favourable terms, since the cost of supply from un-customised capital is presumably excessive. Agents are usually unwilling to undertake transaction-specific investments if there is no guaranteed long-term return on the investment in view. Invariably, where assets specificity is great, both parties (buyers and sellers) will make special efforts to design an exchange that has good continuity properties (Williamson, 1981). This certainly shall be for the mutual benefits of the suppliers and buyers and is necessary because according to Morrill and Morrill (2003), each party is dependent upon the other, and therefore susceptible to opportunistic tendencies. Paape (2007) affirms the vulnerability of the parties to ‘self-interest-seeking with guile’ by stating that a cooperative attitude cannot be assumed. TCE theory, Morrill and Morrill (2003) argue further, suggests that transactions characterized by high levels of transaction-specific investments are cumbersome in a market setting.

Williams (1981) identifies three forms of assets specificity. These are:

- a) Site specificity – e.g. successive stations located in a cheek-by-jowl relation to each other so as to economise on inventory and transportation expenses. Once in place, the assets involved are difficult to move (Morrill and Morrill, 2003).
- b) Physical asset specificity – one or both parties to the transaction make investments in equipment that has design characteristics specific to the transaction and little alternative use (Morrill and Morrill, 2003). For example, specialized dies that is required to produce a component (Spraaakman, 1997).
- c) Human assets specificity – This refers to transaction-specific human capital that often arises through a learning-by-doing process

In addition to the above categorization, Morrill and Morrill (2003) included the fourth form of asset specificity as dedicated assets. This they referred to as general investments

made by a supplier that ordinarily would not have been caused but for the prospect of selling a significant number of products to a particular customer.

From the above discussion, it can be argued that TCE has offered itself a good platform upon which decision relating to internalization or outsourcing of internal audit can be made. Given the need for considerable knowledge of client's business, Transaction-specific investment in form of human asset specificity is often argued the fundamental basis of good internal audit. Firms operating in high risky domain require specialized knowledge particularly to appreciate the various inherent risks and peculiarities of vulnerabilities. Although the argument on sourcing in favour of external audit firms on the ground that most external audit firms operate a bouquet of services that are designed for diverse of industries or domains of firms' operations sound logical, where highly specialized knowledge, skills or dexterity is required however, and the industry or sector contains relatively few firms, internalizing the IAF may be cost economical. This is so considering that investment in the required skill acquisition may be less likely to be readily transferable to other clients in the sector due to fierce competition that may abound. Given that it seems there is no consensus yet on the issue of "make or buy" of IAF, the theory is considered a good platform to investigate the determinants of IAF's sourcing in the NFS, as well as how such sourcing decision affects IAF's ability to enhance quality corporate governance.

iii. frequency with which transactions recur

This is the last dimension put forward by Williamson (1981). Sprakman argues that the dimension could as well be called "Large scale production". Frequency refers to the volume and value of a particular transaction over time, and affects economic rationality of investment in assets specificity (Speckle' *et al*, 2007). TCE theorists opined that an investment on specialized assets becomes worthwhile only when there is large potential demand for the transaction. Small markets or demand demotivates assets' specificity. Thus in-house production and internal audit will be associated with large scale production (Sprakman, 1997).

The above dimensionalising factors expatiated below are what Williamson (1981) refers to as the critical dimension for describing transactions. It can therefore be argued that all the three dimensions discussed above are intertwined and have relationship with the decision on IAF's sourcing (in-sourcing or outsourcing) in organization, In summary, Paape (2007) maintains that 'Make or buy' decision of IAF are the classic problem for which TCE theory is used. .

Following Spraakman (1997)'s indication of the general applicability of TCE theory particularly to the issue of make or buy of IAF, and its adaptability even to both private and public sectors (in spite of the differing operational motives), application of the theory in internal auditing studies have started to gain wider horizon. Studies in internal auditing that have adopted the theory since then include Widener and Selto (1999), Morrill and Morrill (2003), Paape (2007), and Speckle *et al.*, (2007). See table 3.1 on page 105. All the studies identified asset's specificity and frequency as dimensional factors that are taken into consideration whenever the decision of 'buy or make' of IAF is to be made in firms.

Specifically, both Widener and Selto (1999) and its replicating study of Speckle *et al.* (2007) suggest that concerns for the transaction costs caused by dimensions of assets' specificity and frequency, both as main effects and interactions, influence the decision to outsource IAF. This implies that organisations are more likely to internalize IAF if the function require firm-specific knowledge and becomes more integrated with the management and operations of the firm.

The relevance of the frequency impacting firms decision on make or buy decision of IAF implies that larger firms and firms that are relatively heavy consumers of IAF tend to rely more on internalization of this services, whereas smaller firms that are less audit intensive are according to Speckle *et al.* (2007), more likely to farm out their IAF. The population of this study with its peculiarity in terms of size and internal audit's intensity presents an appropriate setting to verify the findings of Speckle *et al.* (2007). In terms of size, Nigerian economy is a developing one with considerably higher number of smaller firms with mild drivers of IAA. As earlier discussed in chapter 2, internal auditing as a

profession is just evolving in Nigeria. It is doubtful if any notable line of separation exists between the auditing and accounting profession in Nigeria. This is so given that auditing is perceived as an adjunct of accounting in the country. This might be responsible for the low intensity of IAA in the country.

On the impact of uncertainty on IAF's sourcing arrangements, no evidence of uncertainty (either behavioural or environmental) influence on IAF's sourcing decision is consistently found in the referenced studies.

Considering the peculiar characteristics of this study's focus, and the specificity of the knowledge required by internal auditors of Financial sectors, TCE theory shall be adopted to examine the relevance of outsourcing of IAF in the sector as it relates to adequacy of skills and expertise. Whereas the study of Widener and Selto (1999) indicate that financial institutions (banks) in United States such as Great Western Bank (Hodgson and Purchaver, 1995), First American Corporation, First Bank-Minneapolis (Verschoor, 1992), and Bank of America Illinois (Cox, 1993) are part of the country's firms whose IAFs are already being outsourced. The authors hinted that this outsourcing practice is expected to continue and that virtually all firms might outsource their IAFs in not-too-distant future. It is however doubtful if financial sector in Nigeria has embraced this development. Firms in this sector seem to have the peculiarity of high inherent operational risks and also do operate through expansive branch networks. This is an indication of transaction's high frequency and human assets specificity (in terms of specialised knowledge to discern risks while also leveraging on thorough understanding of firms' idiosyncrasies). Therefore, the likelihood of internalization of IAFs in the sector. This uncertainty shall be unraveled under the study by testing the relevant hypotheses with the guidance of TCE theory.

Looking at it from another perspective, and going by the exposition made on TCE theory above, it may be argued that the impact of outsourcing on the operational capability, competitive advantage and the bottom line of firms might be argued as enough incentives for farming out firms' IAF. The issue of dearth of the required skill sets necessary for the modern day IAF to meet its value-addition expectation of its

various stakeholders (the management, audit committee, and ultimately the shareholders) might be the motivation for outsourcing in the NFS. Outsourcing anticipatedly, might offer some respites in the sector, plagued with poor corporate governance. Poor corporate governance has become a common lexicon in the NFS (Adegbite, 2012; Babalola & Adesoji; 2011; Aileman & Ojeka, 2013). To aggravate issues, board members and management of some companies in the country's financial sector are said to be incapable of running their institutions (Aileman and Ojeka, 2013).

One of the objectives of the study is to evaluate the adequacy of the resources and expertise of the internal auditors in the sector. The essence of tailing this path of enquiry is informed by the International Standard on Auditing (ISA) 610, guidance on the level of coordination between internal auditor and external auditor as captured in Millichamp and Taylor (2008, p.264):

“How competent is internal audit function?, Does the department contain sufficient numbers of trained, competent professional accountants to carry out the role effectively. Is it well enough resourced?. Do they have professional qualifications and training programmes both for trainees and for continuing professional development?”

The impact of the endeavor cannot be overemphasized given series of financial scandals and corporate governance failures that swept through the sector in recent time, causing the Federal government of Nigeria colossal sum in the name of ‘bail out’ to prevent collapse of the nation's financial system. Skills gap is one of the challenges associated with the sector's endemic poor risk management as identified by the nation's apex bank (the CBN).

3.1.3. Institutional theory

Institutional theory provides insights into understanding of how regulatory requirements, diffusion of practices among organisations and the impact of professions generate isomorphic pressures on organisations (Mihret *et al.*, 2012). It is a theory that emphasizes the survival value of conformity with the institutional environment. Such

conformity leads, for instance, to increased stability, legitimacy, and access to resources (Ball and Craig, 2010).

That internal auditing has witnessed some radical changes in the recent time, particularly sequel to the catastrophic incidences of corporate failures since 1990 that cuts across climes (O'Regan, 2001), is not an exaggeration. The inadequacy of the external audit firms to sufficiently mitigate phenomenal financial scandals of 1990's on one hand, and the paradigm shift in internal audit from internal control only to incorporate risk management and corporate governance processes on another, contribute tremendously to the growing stature of internal auditing worldwide. Burnaby & Hass (2011), Arena *et al.* (2006), and Sarens *et al.* (2011) disclose that the significance of the internal auditing profession has grown dramatically over the last decade as the numerous frauds and whimsical practices of financial management has escalated. These shocking situations led governments in some countries to revise their regulations, particularly the financial regulatory frameworks. The most evident instance is the Sarbanes-Oxley Act (2002), famously referred to as SOX 2002.

Various regulations post-ante SOX 2002, as well as the concerted efforts of the IIA, aimed at regulation of the internal auditing professional practice are the critical factors shaping the profession of internal auditing worldwide. The IIA is dedicated to the furtherance of the state of the arts both in philosophy and practice of internal auditing (Dittenhofer, 2001). Since its inception, the institute has pre-occupied itself with the practice of quality auditing, its edicts, its statements of responsibilities and body of ethics (Dittenhofer, 2001; Swinkel, 2012).

Transformation of internal audit from mere control instrument to risk management and governance mechanism can be argued a case of deinstitutionalization of old practices and institutionalization of new ones. This institutional change perspective can provide a useful analytical framework to explain how internal audit practices develop over time as a consequence of institutional change dynamics.

While Institutional theory might be said to have been embraced limitedly in accounting and internal audit research (Dillar *et al.*, 2004; Mihret *et al.*, 2012), the theory is

gradually receiving prominence among researchers in the field of internal auditing (see Al Twajiry *et al.*, 2003; Arena *et al.*, 2006; Arena and Azzone, 2007; Mihret *et al.*, 2010; and Mihret *et al.*, 2012). These studies however focus mainly on explaining internal audit adoption and characteristics (Mihret *et al.*, 2012). Similar to other organizational activities widely accepted internal Audit practices exist as institutional norms and are moderated by the principles of institutionalization (Mihret *et al.*, 2012).

An institution is defined by Dillar *et al.* (2004. p.508) as ‘an established order comprising rule-bounded and standardization social practices; and institutionalization as ‘the process whereby the practices expected in various social settings are developed and learned’’. The idea that organizations are deeply and essentially embedded in their wider institutional environment rose to prominence in the late 1970s and early 1980s. Prior to 1970s, most organisations’ analysis involved a focus on the internal workings of organisations (Mizruchi and Fein, 1999).

The ground breaking work of DiMaggio and Powell (1983) which investigated the isomorphic behavior of organisations facing similar conditions remains the reference point under Institutional theory. Isomorphism according to Perdana and Umar (2011) means similarity in form. Mihret *et al.* (2012) describe this as the process that engenders similarity. Noting the remarkable similarity of organisations in contemporary industrialised societies, DiMaggio and Powell (1983) question the basis of organisations’ similarity. They argued that this similarity has arisen not because of competition or an objective requirement of efficiency but rather as a result of organisations’ quest to attain legitimacy within their larger environments.

This legitimacy-seeking tendency ultimately generates isomorphism (Mihret *et al.*, 2012). DiMaggio and Powell (1983) proposed three mechanisms through which institutional isomorphism occur. These are as shown below:

- i. Coercive isomorphism
- ii. Mimetic isomorphism; and
- iii. Normative isomorphism

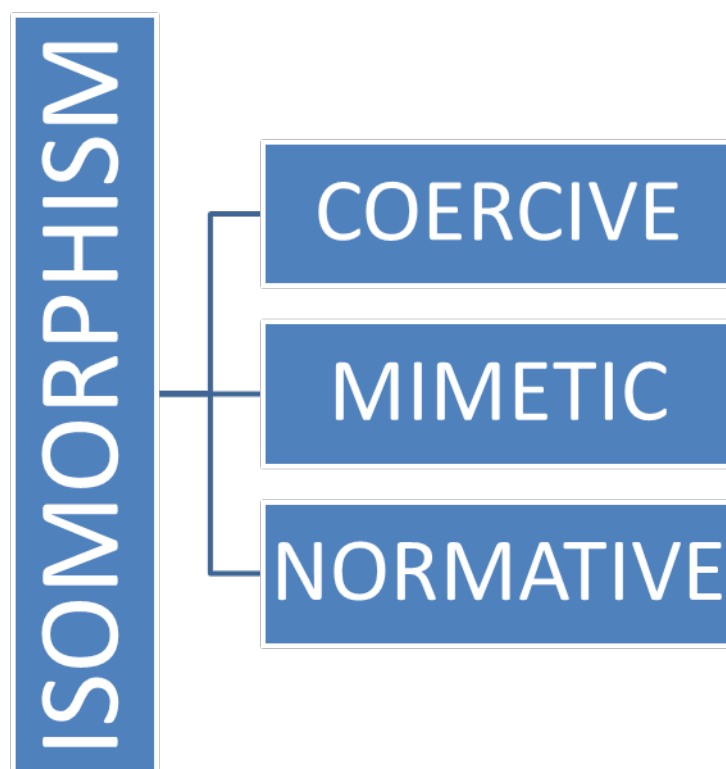


Fig. 3.2: Different forms of isomorphism

DiMaggio and Powell (1983), by indicating that coercive isomorphism is driven by two forces: pressures from other organisations on which a focal organisation is dependent and organization's pressure to conform to the cultural expectations of the larger society argue further that coercive isomorphism may result from formal and informal pressure exerted on organisations, including government's mandate. In developed economies such as USA, UK and Canada, the relevance of coercive isomorphism in the field of internal auditing cannot be overemphasised. Swinkels (2012) submits that regulatory and legislative changes are an important reason why IAFs even exist within some firms.

Al-Twajjry *et al.* (2003. p.512) added that coercion takes place through mechanisms of authority, legitimisation and the power to compel organisations to establish internal audit departments which not only review the adequacy of the internal control system but engage in a wider review of the economy, efficiency and effectiveness of the organisation's activities and their effect on organizational performance. Institutional theory endorses conformance to external rules and norms (Ball and Craig, 2010). A

quick guess here might be the view that coercive isomorphism paradigm offers a justification for rationalising possibly the essence of internal audit as well as transformation in IAA over time due to the need to respond to regulators' shifts from time to time.

The second form of isomorphism is mimicry. According to DiMaggio and Powell (1983), companies strive to model themselves on the practices of similar organisations in the same field, which they perceive to be more legitimate, or successful (Arena and Azzone, 2007), particularly as a response to uncertainty (Mihret *et al.*, 2012). This implies that mimetic isomorphism is a change process driven internally within an organisation. Prior studies have established evidence of mimetic isomorphism in companies particularly in the areas such as strategies, organizational structures, organizational processes, and technological preferences (see Haveman, 1993; Burns and Wholey, 1993). Less legitimate or successful companies imitate organisations perceived as legitimate (Arena and Azzone, 2007). Legitimacy, according to the proponents of institutional theory can be attributable to firm characteristics such as size and success. In the same vein, one may want to argue that market share, customer base, branch network, customer satisfaction, and reputation can be considered as traits of legitimacy, particularly in financial sector.

Normative isomorphism arises from an increase in professionalization within organisations (Al-Twajry *et al.*, 2003). This might be in form of influence from professional bodies and consultants (Arena and Azzone, 2007). In the field of internal auditing for instance, the IIA has greatly influenced internal auditing profession worldwide through diffusion of guidance and professional standards among its members, operating through national chapters. The institute's certification (notably CIA) obtained after passing the profession's qualifying examinations, regular workshops and conferences are designed with a view to increasing the legitimization of the profession. Similar to Al-Twajry *et al.* (2003)'s confirmation about the positive contribution of the normative isomorphic pressure of the IIA in Saudi Arabia, the practice of internal auditing in Nigeria is gradually gaining publicity through knowledge sharing focus of the institute's chapter via conferences, and seminars. Bota-Avran and Popa (2011) further emphasized the isomorphic roles of the IIA by stating that the

professional organisation of internal auditing has played a significant role not only in its evolution, but also in the process of ensuring its legitimacy. The issue of legitimization certainly plays vital roles in strengthening a profession. Looking at the internal auditing profession most especially in developing countries however, it appears the IIA still needs to do more in the area of normative isomorphism. Focusing Nigeria for instance, one might want to argue that more needs to be done in the area of advocacy in order to take maximum benefits of legitimization role of the IIA.

While expecting more proactiveness and increased activities in this direction, it is expected that this particular study will contribute in no small measure in generating insights for the IIA. Such insights are particularly anticipated in the area of advocacy. This is an area where the institute requires further normative isomorphic directives. Incidentally, the study attempts to be the first endeavor to evaluate the contribution of IAF to the country's most sensitive sector (financial sector).

Generally, from the above expositions, it can be inferred that the changes in the practice of internal auditing globally has firstly, been shaped by combination of possibly all the three isomorphic pressures (i.e. coercive, mimetic, and normative isomorphism). Coercive isomorphism is apparent in the increased visibility accorded internal auditing by the radical shift in the various regulatory frameworks- government laws, regulations, and guidelines (the Sarbanes-Oxley Act, SEC rules, etc). Mimetic, through the IIA's imitation of other notable professional bodies, particularly accounting professional bodies (such as ACCA, and ICAEW). This is in the institute's efforts to brace up to the rising challenges and opportunities thrown at it by the corporate governance's revolution in the current era. The growing chapters of the IIA membership across countries with the permeability of the institute's culture, international best practices, regular training for the member countries, is certainly a case of normative isomorphism. All the three isomorphic dimensions co-exist in each context, being deeply intertwined with each other (Arena and Azzone, 2007). Intertwining of isomorphic pressures can be interpreted as complementary and metamorphic or changeability.

The above notwithstanding, the issue of non-exclusivity of the IIA in the field of internal auditing globally is a serious concern being raised on the issue of legitimization of internal auditing profession (see Regan, 2001). That internal auditing is not a licensed profession where membership and compliance with standards is currently, purely a matter of choice, contrary to the external audit profession is a big concern. This implies that normative isomorphic pressures are not enough in lifting and legitimizing internal auditing across globe. It is considered that legal recognition and endorsement will be helpful. Other countries (most especially developing nations) might want to follow the path of California, which happened to be the first sovereign to enact a law requiring state and local government's strict adherence to the IIA standards. In clear terms, the IIA has not yet achieve a 'regulative bargain' (Macdonald, 1995, p187) with the state to obtain a jurisdiction within which it can set its terms of reference.

There is no doubt that institutional theory seems to continue to receive increased application in internal auditing studies particularly in recent time. Studies that employed institutional theories in this direction include: Al-Twajjry *et al.* (2003), Arena *et al.* (2006), Arena and Azzone (2007), Al-Hroot (2012), Mihret *et al.* (2012), Endaya and Hanefah (2013), Baker and Bedard (2014), and Elbardan *et al.* (2014). Al-Twajjry *et al.* (2003) using institutional theory provide useful insights into the development of internal audit in Saudi Arabia and discover that internal audit is yet to be fully appreciated in the country despite its numerous advantages stemming from its enhanced roles in risk management, control and governance. The study indicates that the coercive and normative pressures expected to influence the profession in Saudi Arabia is yet to reach appreciable level thus responsible for the infancy stage of the profession in the country. According to the studies, while most directors and staffs of the internal audit departments in the country are well educated, few had professional qualifications. This deficiency is attributed by the authors to the low level of affiliation to the IIA. The study therefore anticipates more coercive influence in form of government regulation as well as more normative pressure in form of aggressive advocacy particularly from the IIA. Also suggested as one of the ways forward is the need to have an Arabic version of the IIA professional practice standards, considering the language barrier observed in the country. These are considered useful hints to the IIA global.

Arena *et al.*(2006) in their case applied the theory to analyse the adoption and characteristics of internal audit departments in Italian companies. In the study, the authors found out that institutional pressures played a vital role in the growth of internal auditing in Italian companies. Industry, listing, size and membership of the IIA national affiliate are significant elements influencing the adoption and characteristics of internal audit departments in the country. This further confirms the intertwining influence of the institutional pressures on internal auditing.

Concerned further with the development in internal audit practice among Italian companies, Arena and Azzone (2007) conducted a study to examine factors driving the adoption and characteristics of internal audit departments in Italy and revealed through a survey data from 364 Italian companies (with a response rate of 63%) that institutional pressures plays significant role in the development of the profession in the country. It indicates that industry, listing (coercive forces), size (mimetic pressure) and membership of the IIA national affiliate (normative) appear significant elements in influencing the adoption and characteristics of internal audit departments. In addition to anticipating increasing activity of the IIA in Italy, the study also recommends greater attention to internal audit issues in the country's universities' curriculum. This is with a view to stepping up the required normative pressure meant to shape the characteristics of the internal audit departments in the country. The outcomes of this study is similar to the findings of Mihret *et al.* (2012) who uses same theory to examine the extent to which institutional norms determine attributes of internal audit practices and how institutional changes explain the development of these practices in Ethiopia. The tremendous impact of the coercive pressure (in form of government legislations) on the rapid development of internal audit practice in Ethiopia is however upheld by the authors.

The study of Baker *et al.* (2014) that examines the factors regulating statutory auditing in the USA, France and Canada, post Sarbanes-Oxley Act of 2002 also identified a combination of external pressures from global capital market for standardized regulatory practices, and decoupling effect of the professional regulations, as responsible for the increasing apparent similarity in the regulatory structures for statutory auditing in the three countries.

The referenced studies therefore portend valuable implications for enhancing the understanding of the adoption and development of internal audit departments at national and international levels (Arena and Azzone, 2007), and thus motivate the adoption of institutional theory for the current study. The issue of whether or not IAFs conduct their engagements in line with the IIA standards, and evaluation of internal auditors' level of proficiency, two of the objectives of the study can be explored meaningfully using institutional theory.

3.2.0 Theoretical diagnosis

From the above theoretical discourse, the following inferences can be drawn:

- i. Agency theory with its assumption of existence of contractual relationship between the owner (principal) and manager (agent) of business entity lends itself to the exploration of the reason for existence (raison d'être) of IAF in organisation. This theory has received tremendous application in internal auditing literature upon its adaptation by Adams (1994) for theorization particularly to offer explanations for the essence of internal auditing.
- ii. TCE, which is regarded as a variation of agency theory (Sprakman, 1997)'s attempt to resolve the self-interest tendencies that surround the principal-agent relationship within the fundamental assumption of bonded rationality and opportunism, offers a veritable paradigm for the "make or buy" (i.e. decision on choice of in-house or farming out) sourcing decision of IAF in organisations.
- iii. Institutional theory on its premise emphasizes the survival value of IAF's conformity with the institutional environment. Such conformity which leads, for instance, to increased stability, legitimacy, and access to resources is adopted to offer justification for the increased and enhanced role of IAF attributable to the abstraction of internal audit from external audit on one hand and the eventual professionalization of internal auditing worldwide through the establishment of the IIA in USA on November 10, 1941 on the other hand. This is in addition to the impact of the isomorphic pressure on the internal auditing profession worldwide, induced by the institutional environment mostly brought about by legislation (coercive isomorphism)

and a combination of both endogenous and exogenous imitation of international best and acceptable practices (i.e. mimetic and normative isomorphisms). The increased need for internal audit has both international and national implications as witnessed by the growth of multinational corporations and joint ventures operating under different governmental and cultural influences (Foster and Greenawalt, 1995). The various transformational developments in the field of IAF can therefore be explained using this theoretical lens.

Going from the above synopsis, it can be inferred that the existing theories in the field of internal auditing, though considered scant and still at infancy stage are not contradictory in any way but rather complementary. Considering the objectives and propositions to be tested under this study, the three theories: Agency, TCE and Institutional ('ATI') theories are considered relevant and suitable, and a conflation of the tripod theoretical lenses shall therefore be explored concomitantly for this study.

With this development, this study consequently enjoys the privilege of being the first on internal auditing to adopt an expansive theoretical paradigm (offered by 'ATI'). Successful exploration of this tripod and complimentary theoretical framework to provide verifiable solutions to the study's research questions shall be a major contribution to knowledge.

3.2.1 Extant internal auditing studies with clear theoretical framework

As scant as they are, and as mentioned earlier, presented below is a schedule of extant studies in internal auditing with clear theoretical framework:

S/N	Study	Focus	Theory(ies) adopted
1	Adams (1994)	Agency theory and the internal audit	Agency
2	Spraakman (1997)	Transaction Cost economics: a theory for internal audit?	TCE
3	Widener and Selto (1999)	Management Control Systems and Boundaries of the Firm: Why do firms outsource Internal Auditing Activities?	TCE
4	Al-Twajiry, Brierley and Gwilliam (2003)	The Development of Internal audit in Saudi Arabia: An Institutional Theory perspective	Institutional
5	Morrill and Morrill (2003)	Internal auditor and the external auditor: a transaction cost perspective	TCE
6	Arena, Arnaboldi, and Azzone (2006)	Internal audit in Italian organisations: A multiple case study	Institutional
7	Paape (2007)	Corporate Governance: The Impact on the Role, Position, and Scope of Services of the Internal Audit Function	Agency and TCE
8	Arena and Azzone (2007)	Analysis of adoption and characteristics of internal audit departments in Italian companies	Institutional
9	Spekle', van Elten and Kruis (2007)	Sourcing of Internal auditing: An empirical study	TCE
10	Sarens and Abdolmohammadi (2011)	Monitoring effects of the Internal Audit Function: Agency Theory versus Explanatory Variables	Agency
11	Al-Hroot (2012)	The relationship between the internal audit function and corporate governance: Evidence from Jordan	Agency and Institutional
12	Mihret, Mula and James (2012)	The development of internal auditing in Ethiopia: the role of institutional norms	Institutional
13	Endaya and Hanefah (2013)	Internal audit effectiveness: An approach proposition to develop the Theoretical Framework	Agency, Institutional and Communication
14	Baker and Bedard (2014)	The regulation of statutory auditing: an institutional theory approach	Institutional
15	Elbardan, Ali and Ghoneim (2014)	The Dilemma of internal audit function adaptation: The impact of ERP and Corporate governance pressure	Institutional
16	Mihret (2014)	How can we explain internal auditing? The inadequacy of agency theory and a labour process alternative	Labour process

Table 3.1: Internal auditing studies with clear theoretical framework

The schedule further affirms the extent of researchers’ exploration of theoretical lenses for studies on internal auditing. Definitely, the espoused tripodal theoretical framework –‘ATI’ for this study (shown in figure 3.3 below) anticipates to offer a further push in internal auditing’s theory exploration.

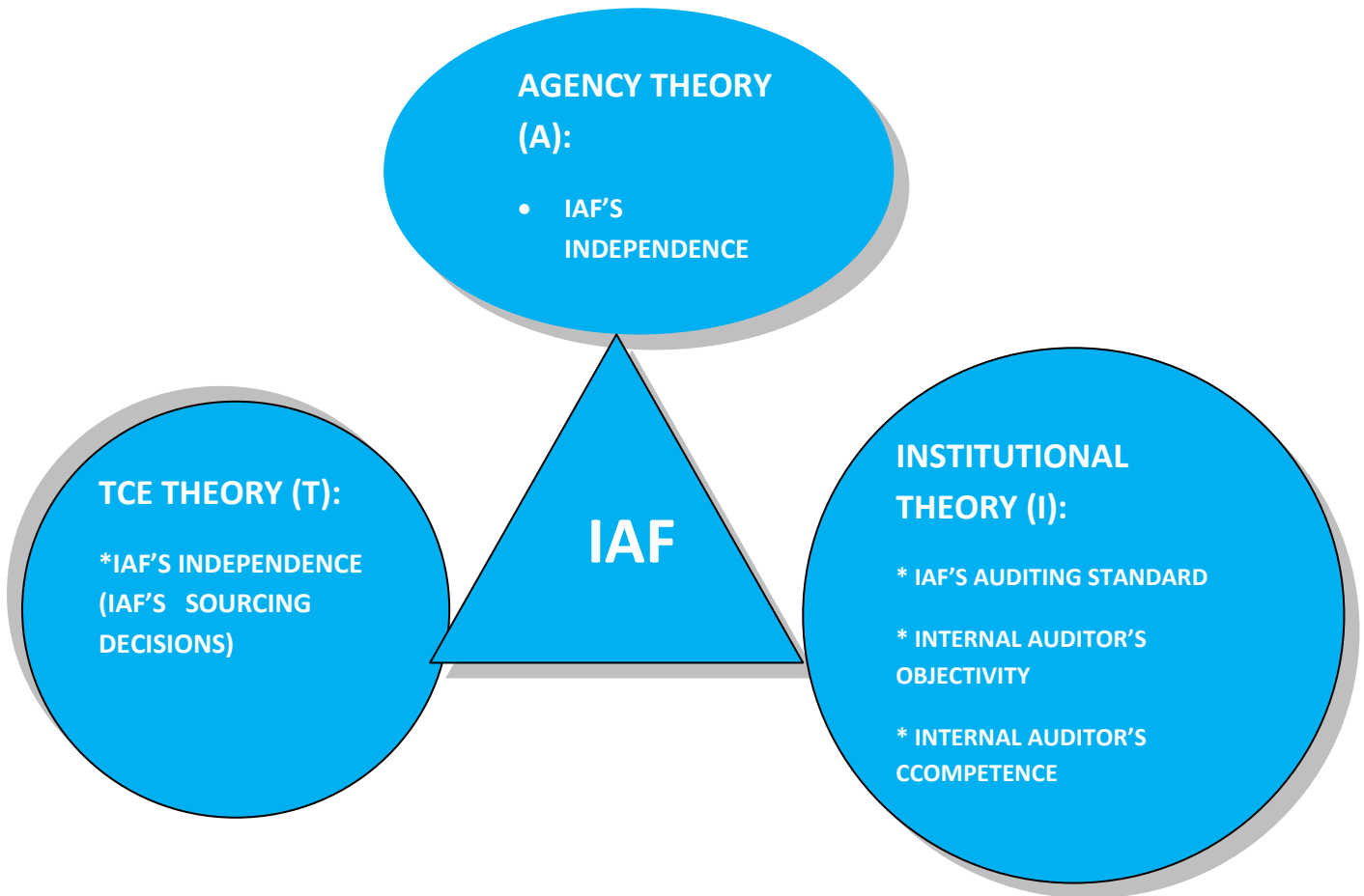


Figure: 3.3 : ‘ATI’ - Tripodal internal audit theoretical framework

3.2.2 Research objectives, the Study's conceptual and theoretical framework

The table below shows how the study's objectives (stated in chapter 1), conceptual framework (established in chapter 2) and the theoretical underpinnings (discussed in this chapter) are integrated.

S/n	Study Objectives	Research question	Focus	Concept under focus	Applicable theory(ies)
i	Investigate the level of independence of the IAF from management in Nigerian financial sector.	What is the level of independence of the IAF in the Nigerian financial sector?.	IAF's characteristics	Independence	Agency and Transaction Cost Economy (TCE)
ii	Establish the level of adoption of the IIA international standards by IAF for its engagements in the Nigerian financial sector	To what extent are the internal audit functions in the Nigerian financial sector performing their roles in conformity with the IIA standards?	Ditto	IAF's auditing methodology	Institutional
iii	Establish the level of objectivity of the internal auditors in the Nigerian financial sector.	How objective are the internal auditors of the Nigerian financial sector?.	internal auditors' characteristics	Objectivity	Agency
iv	Establish if the IAF in Nigerian financial sector have sufficient resources and expertise to fulfill their expected enhanced roles	To what extent are internal auditors in the Nigerian financial sector competent in fulfilling their expected roles?.	Ditto	Competence	Institutional

Table 3.2: Research objectives and Literature review schema mapping

3.3 Chapter Summary

This chapter through extensive discussions, and evaluation of the relevance of the existing theories that had enjoyed the embrace of researchers of internal auditing, has identified a combination of three complementary theories (Agency, TCE and Institutional), which upon integration is acronymed ‘ATI’ (a tripodal framework) as a suitable theoretical paradigm for the study. The next chapter reviews existing studies through which the study’s propositions and hypotheses are consequently synthesised.

Chapter 4: Research propositions and Hypotheses development

4.1 Chapter overview

Having discussed in Chapter 3 of the thesis, the three theories underpinning the study, this chapter aims at developing from the extant studies (both in academics and practice), the propositions to be verified and hypotheses to be tested so that answers can be provided to the study's research questions. Formulation of the hypotheses shall be based on convergence of evidences and views on the various concepts related to the subject matter of the study. This shall be achieved through critical review of the various prior studies on the area of focus (the significance of IAF as a corporate governance mechanism), addressing specifically the various propositions and missing links particularly in connection with realities from developing nations.

4.2.0 IAF's Independence

In order to have a broader view of the issue of independence of IAF, the study of Christopher *et al.*, (2009) provides a good head start. The referenced study that conducted a critical analysis of the independence of the IAF based on empirical evidence from Australia used most of the following criteria espoused in literature (see Cohen and Sayag, 2010; Lenz and Hahn, 2015; Munro and Stewart, 2011; Sarens *et. al.*; 2009, Abbot, Parker and Peters; 2010; Zain, Subramaniam and Stewart, 2006; Adel and Maissa, 2013; Zaman and Sarens, 2013) to investigate IAF's independence:

- a) Organisational status of IAF (i.e. IAF's reporting line)
- b) IAF's sourcing arrangement
- c) CAE's Hierarchy
- d) Frequency of attendance of Audit committee's meeting by the CAE
- e) Appointment and dismissal of CAE
- f) Existence of internal audit charter
- g) Existence of Audit committee
- h) EAC's membership adequacy
- i) Audit committee's meeting frequency

Therefore, from the above exposition, it can be seen that meaningful and detailed discussion of IAF's independence can be achieved by looking at the above perspectives whose schema is as shown in fig 4.1 below:

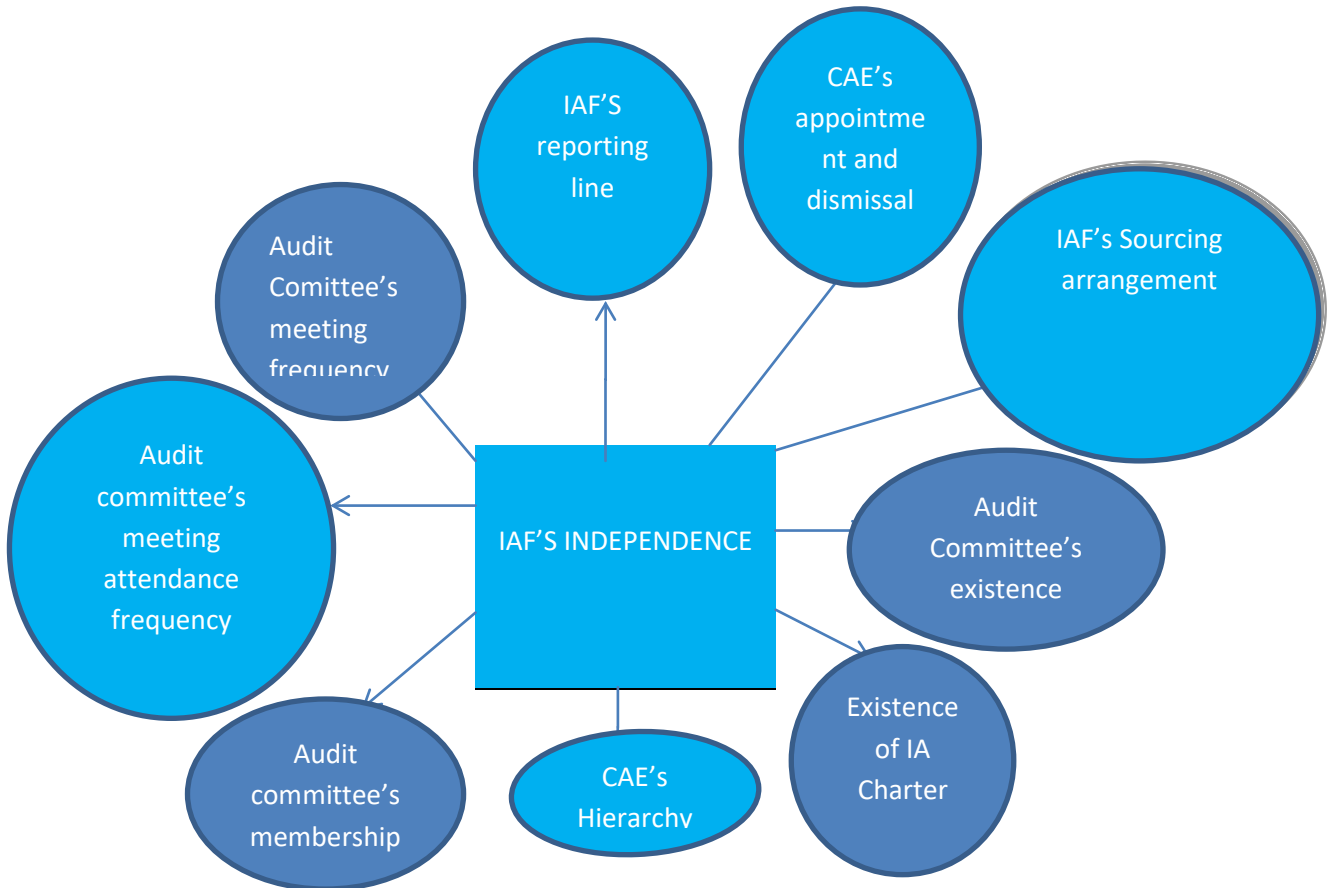


Fig. 4.1 : Schema of literature review on IAF's independence

Previous studies suggest that lack of independence is an obstacle to satisfactory internal audit performance in a number of developing countries (Alzeban and Gwilliam, 2014). This concern has been raised in developing countries such as Malaysia, Ethiopia, Sudan (see: Ahmad *et al.*, 2009; Mulugeta, 2008; and Brierley *et al.*, 2003). It is therefore doubtful if the story can be anything different in Nigeria, a terrain where internal auditing profession can be said to be nascent. Very scant academic interest in internal

audit field has also been established in the country (Abiola, 2010), a push in this direction forms part of the motivation for this study.

4.2.1 Organisational status of IAF (IAF's reporting line)

Given that independence of IAF is taken as the function's bedrock, appropriate organisational position and status is anticipated for the function to be independent and have its work and opinion free from undue influence, particularly from the management on whose activities and responsibilities IAF gives its assurance to the audit committee, and for which the function also acts as a partner through consulting or advisory activities.

Sarens and De Beelde (2006) indicate that the fact that internal auditors are the employees of the organization puts them in a serious dilemma when carrying out their expected dual roles of assurer and consultant (or advisor), and except the IAF is positioned appropriately in the organization with certain level of authority and influence, internal auditors can face considerable familiarity and social pressure threat (Stewart and Subramaniam, 2010). In order to ensure an appropriate organisational status for IAF, the IIA stresses that IAF should be accorded the appropriate status in the organization (Stewart and Subramaniam, 2010). It is further argued that unless the IAF is appropriately positioned, organization may not achieve the optimum benefits of the function (Reding *et al.*, 2013). Similarly, the external auditors desirous of leveraging on the work of the internal audit also do evaluate how the IAF is positioned before putting reasonable level of reliance on their work in performance of their independent audit.

Most studies on organisational positioning of IAF usually approach the concept by looking at reporting line of the function, i.e. whether the function is reporting to the audit committee or the management. The dual reporting relationship recommended by the IIA as enshrined in its standards for the head of the IAF (i.e. CAE) is aimed at achieving the degree of independence required for an effective IAF. Specifically, the CAE is expected to have a functional reporting relationship with the board on one hand, and an administrative reporting rapport with senior management on the other hand.

Commenting on this enhanced reporting relationship, Chambers and Odar (2015) maintain that IAF's independence from management is in jeopardy if such enhanced reporting relationship is not adhered to. While emphasizing the importance of IAF's reporting line to their independence, Denise and Denise (2009) define independent IAF as one who reports directly to the audit committee. Whereas it appears that there is not yet a full consensus on the ideal reporting line for the IAF, it seems there is a general consent on the notion that an enhanced working relationship between the IAF and audit committee is an enabler of IAF's effectiveness (Lenz and Hahn, 2015, p. 10). Notwithstanding this emphasis, it is claimed in literature that IAF's reporting line or relationship with the management serves as an important means of strengthening the function (Beassely *et al.*, 2009; Gendron and Bedard, 2006; Turley and Zaman, 2007), by way of placement in the organisation such that employees of the organisation see the function as a critical department. Thus, facilitating cooperative attitudes between line managers and their staff and the IAF, particularly in form of unrestricted access to records and information (Sarens and De Beelde, 2006).

Other areas of management's supports to IAF are through appropriate resource (particularly budget approval), and contribution of necessary inputs towards the function's audit planning. Therefore, the relationship between the IAF and the management is anticipated to be symbiotic, such as the one envisaged by Sarens and De Beelde (2006, p. 224) and illustrated in figure. 4.2 below:

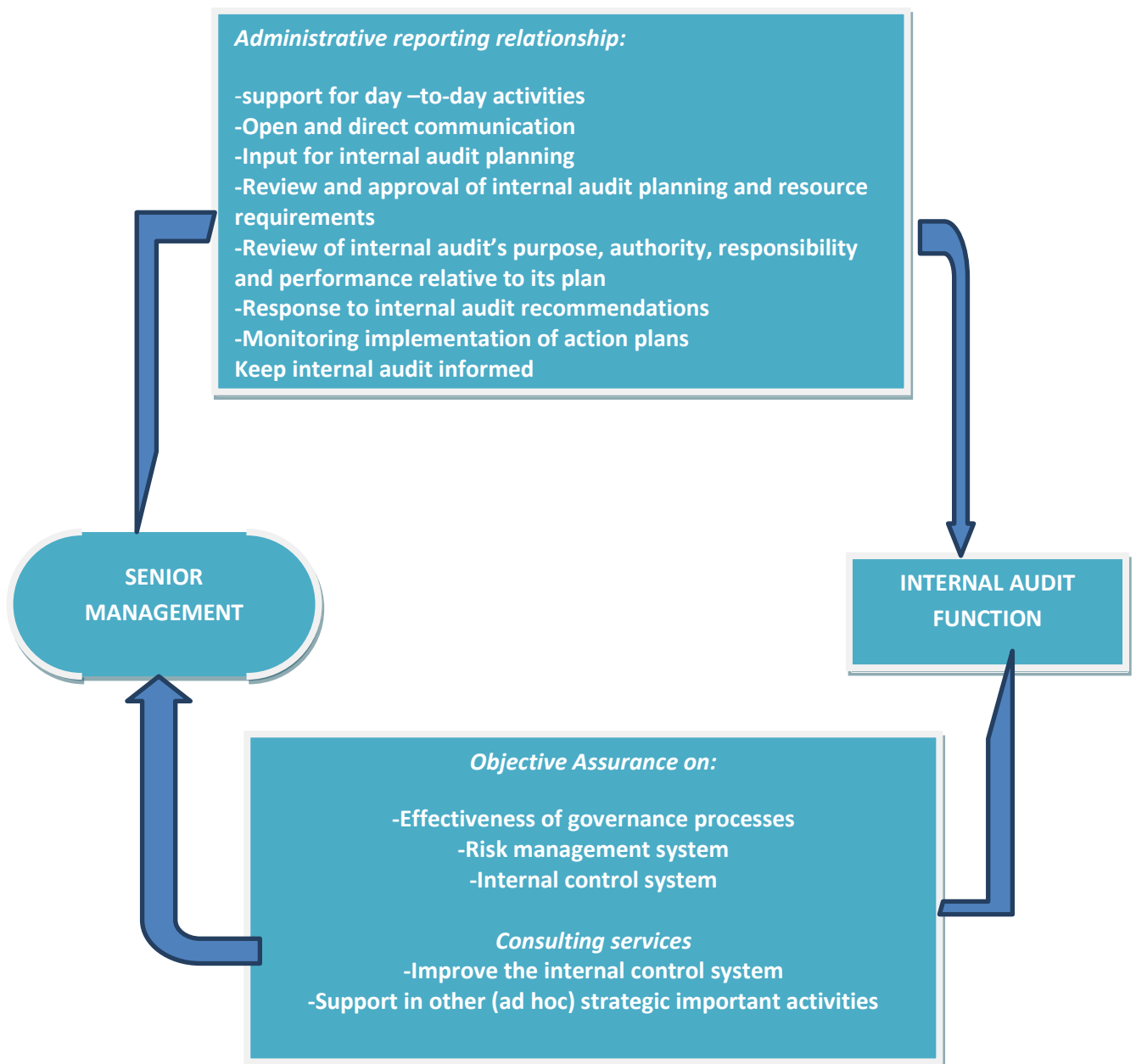


Figure: 4.2: Symbiotic relationship between IAF and Senior management (adapted from Sarens and De Beelde, 2006, p. 224)

IAF fulfills the management's assurance need in the area of various internal controls as well as proactive consulting activities covering risks assessment and mitigation. Cooper *et al.* (1993) states that internal audit can also act as a support for management in terms of reviewing operational efficiency, investigating outcomes of financial initiatives, and providing knowledge of business activities. Sometimes, the function can also be engaged to work with the management in various temporary (ad-hoc) activities such as acquisition, mergers and system development and implementation (Brody and Lowe, 2000).

However, whenever issue of independence of IAF comes up for discussion, the above relationship model does attract continuous skepticism. For instance, Drent (2002) contends that most management team still see IAF as management's instrument, perceiving IAF's functional reporting relationship with the board as mere formality, to satisfy corporate governance's formal requirements. These are some of the criticisms raised by Chambers and Odar (2015) who maintain that this dual reporting model is flawed. The issue of IAF "serving two masters" through their recommended reporting model (earlier explained) has become a serious issue or perhaps a dilemma for the internal auditing practice.

Aside from this complication of where to direct its allegiance, IAF and organisation also face the issue of perception of being valueless and irrelevant once the function is seen not to possess enough degree of independence. Studies have established that external auditors place high premium and reliance on the work of an IAF that has remarkable organisational status. This enhanced status could be through either unflinching supports from management in form of appropriateness of the function's budget or through unfettered access to the audit committee. Munro and Stewart (2011) while re-emphasising the essence of IAF's unimpeded access to the audit committee, however indicate that IAF's functional reporting relationship with audit committee, is not as essential as its regular meetings (both formal and informal (or private) with the committee. Studies such as Turley and Zaman (2007), and Zaman and Sarens (2013) underscore the impact of informal interactions of IAF with the audit committee on both

the IAF and corporate governance. Research has also indicated that regular meetings of the head of IAF with the audit committee assist greatly in improving the effectiveness of the function (see Scarbrough *et al.*, 1998; Treadway Commission, 1987).

Chambers (2008) in emphasizing the need for a functional reporting relationship of the CAE with the board argues that it is logical that internal audit's strongest relationship has to be with the top body that relies on its assurance services. He goes further by stating that if the board is to place reliance upon internal audit, then internal audit's strongest relationship must be with the board. The author however indicates that presently, IAF's strongest relationship is with management. Also, Goodwin (2004) study, where 36% of Chief internal auditors (CIAs) drawn from both Australia and New Zealand confirmed that they actually report to the CFO, affirm that most IAFs seem to have their strongest reporting relationship with management instead of with the audit committee of the board. These hints are suggestive of internal audit's subservience to the management, by subordinating its judgment to that of management.

Unsatisfied with the current situation, Chambers and Odar (2015) went further to criticise the existing reporting relationship, where IAF reports functionally to the audit committee, and administratively to the management by arguing that the reporting model is flawed and therefore envisage situation where the IAF's umbilical cord with the management is totally detached. The authors maintain that until this happens, the IAF's independence from management is in jeopardy.

“We take the view that to be a reliable provider of assurance to the board, internal audit needs to report for all purposes, including ‘pay and rations’, to the board or to a chairman of the board, He who pays the piper calls the tune” (Chambers and Odar, 2015, p.43).

It is argued in literature that IAF may not have the audacity to report management's irregularities to the board (James, 2003), even with the functional reporting right it enjoys with the board due to the fear of intimidations and harassment that may ensue.

This is exactly what Van Peurseem (2004) in Sarens and De Beelde (2006) has in mind when he submits that “*Essentially, a key issue is that internal audit would assume whatever position is in the best interests of their employer and would be reluctant to counter management, irrespective of the consequences*” (Sarens and De Beelde, 2006, p. 225). James (2003) also shares in this sentiment by stating that “*If the Chief Audit Executive says anything serious to the Chairman which he or she hasn’t already said to the CEO, the Chief Audit Executive should not expect to be around for long*”. James (2003, p. 317).

It is therefore based on these contentious positions that the objective of this study is inclusive of investigating the level of relationship between IAF and management on one hand, and between the function (IAF) and audit committee on the other hand, in the financial sector in Nigeria. Understanding the level of relationships that exist between the parties is aimed at gaining valuable insights on the level of independence of IAF in the nation’s financial sector, and consequently the level of value-addition of IAF to corporate governance in the sector.

To start with, Paape, Scheffe, and Snoep (2003) in their study on “The relationship between the IAF and corporate governance in the EU” using questionnaire survey to gather data from the CAEs across countries within the European Union (EU) also gave insights on the manner of IAF’s reporting line across countries in the EU. Using responses from 105 CAEs, the study revealed that almost half of the respondents report to the audit committee. According to the outcome of the survey, the percentages of CAEs that report to their audit committees in Belgium, Greece, Ireland, the UK and Spain range from 80% and 100%. In the other countries however, the percentage is far less, and ranges between 25% and 67%. The authors indicated that in Austria and Denmark, all respondents report to the Board of management (i.e. the senior management). The survey indicates an exceptional pattern of reporting for the Netherlands, where almost 90% of the CAEs report to the CFOs. Overall, further insight from the study indicates that relatively few (30%) CAEs report to the CFOs in the EU.

Also, Goodwin (2004)'s study earlier mentioned (a questionnaire survey of 120 CIAs drawn from Australia and New Zealand, aimed at exploring the similarities and differences between private and public sectors' internal audit) suggests that the issue of CAE or IAF's report line is not in line with the international best practice as championed by the IIA. As revealed by the study, out of the 120 CIAs (who are also IIA members) drawn from both Australia and New Zealand for the survey, none actually indicated that they have any reporting line to their audit committees. Instead, the author indicates that from the 72 CAEs from public sector, 57%, 7%, and 36% report to their CEOs, CFOs and other senior management respectively while for the 48 CAEs drawn from the private sector, 38%, 35% and 27% indicate they report to their CEOs, CFOs and other senior management respectively. This is quite puzzling as the mention of audit committee was not made at all in the survey. One is therefore wondering whether the responding CAEs are conversant with the IIA standards at all or formation of board audit committee is not fashionable in the two countries.

The referenced study of Christopher *et al.* (2009), a study that used empirical evidence obtained from an electronically-administered questionnaire survey of 34 CAEs from the Malaysia corporate sector, established the significance of IAF's reporting line, CAE's hierarchy, the use of IAF as a training ground, invitation of the CAE to the audit committee's meetings, and private contacts between CAEs and the audit committee's chair on IAF's independence. The study found that it was only in 38% of cases in the sample that their IAFs report functionally to the audit committee (in line with the IIA's standard) while 47% indicate that their IAFs report functionally to senior managers (such as CEO and CFO). The authors argued that this is a deviation from the best practices and contend that such reporting relationship constitutes serious threat to IAF's independence.

Contrarily, Abbott, Parker and Peters (2010) in their questionnaire study of 134 CAEs, selected from Fortune 1000 non-bank companies, regarding their interactions with ACs and their budget allocations for the fiscal year 2005, established that IAF appears to be reporting to both the audit committee and senior management (CFO or CEO). The

authors concluded that such dual reporting line indicates a “solid line” or functional relationship with the audit committee and a “dotted line” or administrative relationship with the CFO or CEO. Functional reporting line of IAF to the audit committee, and its administrative reporting line to management is the ideal reporting framework according to the international best practice of internal auditing as espoused by the IIA.

Similar to the outcome of Abbott, Parker and Peters (2010) on adequacy of IAF’s reporting line, Sarens, De Beelde, and Everaert (2009) in their study (titled “Internal audit: A comforter to the audit committee”) involving 4 Belgian companies, found out that the IAFs at all the four selected companies had direct reporting lines to their audit committees. Also, Allegrini and D’onza (2003), a study aimed at verifying the main features of internal audit activities in large Italian listed companies through questionnaire survey of 52 companies found that 92% of the CAEs (in their case CIAs) periodically report to the audit committee and to the board of auditors.

Evidence coming from Australia as documented in Soh and Martinov-Bennie (2011), a semi-structured interview study conducted to provide insights into the current roles and responsibilities of the IAF and the factors perceived to be necessary to ensure its effectiveness drawing evidences from Australia context also indicate that majority of the IAFs in the country report functionally to their audit committee. The authors found out that out of the 7 CAEs interviewed, 6 confirmed that they report to their audit committees while only one of them indicate that he reports directly to both the CEO and the audit committee for all functional matters.

The general notions that can be formed from the various results from the highlighted studies on the reporting line of the IAFs are that first, IAF’s reporting line is considered one of the critical measures of IAF’s independence. Second, majority of the IAFs of developed countries do enjoy functional reporting relationship with their audit committees in line with the international best practice in internal auditing, championed by the IIA. Other inference that can be drawn from the above is that IAF’s functional

reporting line to the audit committee is positively related to the IAF's independence, and the ability of the function to enhance corporate governance.

Extending the discussion to developing economies however, Al-Twajjry *et al.* (2003) through a study of the development of internal audit in Saudi Arabia, taking insights from directors of internal audit departments (i.e. CAEs), and external auditors, discovered that their IAFs report to General managers instead of their BoDs. In addition, the study of Ebaid (2011) provides evidence from Egypt. The referenced study which explores the nature and characteristics of IAFs in Egyptian listed firms using mixed methods of interview and questionnaire survey of managers of IAF (CAEs) of Egyptian listed companies (exclusive of banks and financial institutions), revealed that 48% of the CAEs indicate that they report functionally to the BoDs or audit committees while 52% indicate that they report functionally to senior management (i.e. CFO or CEO).

Also, Al-Hroot (2012) provides perspectives on this matter from Jordan. From responses to a questionnaire survey from 121 respondents, the study indicates that in only 53.7% of the cases, the IAF reports functionally to the audit committee. 28.1% of the respondents indicate an administrative reporting relationship with the CEO only. Also, about 33.9% of the respondents indicated that they report administratively to the audit committee and CFO.

Looking at evidence from the domain of the current study (Nigeria), Akinteye, *et al.* (2015) through a questionnaire survey involving 5 heads of internal audit, and semi-structured interviews of 3 heads of IAF of listed companies in Nigeria, established that 80% of the CAEs reports to their audit committees while the remaining 20% reports to their BoDs. This implies that almost all the IAFs involved in the study indicated that they report to their audit committees. This finding aligns with the results of Sarens, *et al.* (2009), where CAEs from four Belgian companies that were included in the study indicate that they all report to their audit committees.

The study (Akinteye, *et al.* (2015))'s finding on IAF's reporting model is however divergent from Christopher *et al.* (2009) on Malaysia, Al-Twaijry *et al.* (2003) on Saudi Arabia, Ebaid (2011) from Egypt, and Al-Hroot (2012) from Jordan where the practice of IAF's reporting functionally to audit committees appears yet to fully diffuse into the developing countries.

Also, in line with the findings of Akinteye *et.al* (2015) about IAF's reporting relationship in Nigeria, Barac *et al.* (2009), a study from another developing economy (South Africa) involving the Chief Executive Officers (CEOs), or the Chief Operating Officers (COOs), audit committee chairpersons (ACCs), as well as the CAEs of 30 large South African companies show that more than 50% of the companies followed the acceptable practice of having IAF with a functional reporting relationship with the company's audit committee.

The findings from Akinteye, *et al.* (2015) and Barac *et al.* (2009) notwithstanding, the overwhelming evidences on the reporting line of IAFs from developing countries seem to suggest that the international best practice on IAF's ideal reporting line is yet to diffuse fully into the developing climes. Consequently, it is doubtful if IAFs of developing countries (e.g. Nigeria) is independent based on their reporting lines (or their organisational status).

Based on the position above, the researcher is curious to investigate same issue among firms in the NFS. Therefore, the study's first proposition is stated as below:

P 1: Internal audit function of the Nigerian financial sector reporting to audit committee is positively associated with the internal audit function's independence and ability to impact positively on corporate governance.

4.2.2 IAF/CAE's Hierarchy

The issue of organisational positioning of IAF can also be discussed by looking at how the function is considered generally within the organisational organogram. Opinions

actually seem to differ on where IAF can and should be positioned so as to align with the IIA standards. One strand of this argument is that IAF should be positioned at par with the senior management so as to secure for it the necessary visibility, authority and responsibility to independently evaluate management's assessment of the organisation's internal controls, and its ability to achieve business objectives while also managing the risks that can inhibit such accomplishments (Reding *et al.*, 2013). Another extreme strand on this issue as observed by Reding *et al.*, (2013) are organizations that do not have IAF at all or positioned the function in a much lower level within the organisational hierarchy, and assigning the function non-audit daily activities (such as compliance, quality assurance).

It is argued by Reding *et al.* (2013), that in response to the IIA's new focus of assurance and consulting, many organizations have positioned their IAF as a senior management's activity that report directly to the board (through its audit committee). The authors contend that organisations that continue to position their IAF at a lower level and assign the function operational and non-audit activity render such function unable to contribute to value addition and invariably do not contribute to corporate governance's improvement. Whereas a report from PricewaterhouseCoopers (2002) discloses that inappropriate positioning of the IAF within an organisation can raise serious concerns about the overall independence of the function, it seems we still know little about the most appropriate positioning of internal audit function (Lenz and Hahn, 2015, p. 6).

Going by the IIA standards, CAE's functional reporting to the board is a way of ensuring organizational independence. From this functional reporting relationship, the audit committee or its equivalent according to Practice Advisory 1110-2 of the IIA (2004), is expected to see to the following for instance:

- i. approval of the internal audit charter
- ii. approval of the risk based internal audit plan
- iii. approval of the internal audit budget and resource plan
- iv. receiving communications from the CAE on the IAA's performance relative to its plan and other matters

- v. approval of the hiring and firing of the CAE
- vi. approval of the remuneration of the CAE; and
- vii. oversight functions on the appropriateness of scope, and adequacy of resource of the function.

Based on the above discussion therefore, the first clue that can be drawn which is relevant to the research question of the study is that organisation that has its IAF positioned at senior management's level is expected to have its independence strengthened, and thus expected to be effective as a mechanism of corporate governance.

The benefits associated with appropriate positioning of IAF within an organization is the essence of the IIA's recommendation of dual reporting lines for the function (i.e. a functional reporting line with the audit committee, and administrative reporting line with the management). The administrative reporting line recommended for the IAF is to balance IAF's relationship within an organization. This is necessary given that internal auditors are still employees in the organization. Pursuant to that status, IAF is expected to maintain a healthy relationship with the management. After all, for an effective IAF, management input is required in the IAF's audit plan. Furthermore, a healthy relationship between IAF and management is envisaged by virtue of the function's engagement by management for consultative role.

Christopher *et al.* (2009), while discussing the issue of IAF's hierarchy in organisation using Malaysian corporate sector as an evidence, found that all 32 CAEs that participated in their online questionnaire survey confirmed that their IAFs were placed at the corporate level (i.e. at par with the senior management) as opposed to being placed at the intermediate or below senior management.

In agreement with the above Malaysian perspectives, Paape, Scheffe, and Snoep (2003) a survey of internal audit practices in the European Union, also indicates that more than two thirds of the 105 CAEs that participated in the survey (i.e. over 67%) reported that their IAF is positioned at the corporate level.

Similarly, the analysis of the descriptive statistics gathered under the extensive survey of 364 Italian companies in Arena and Azzone (2007), investigating the adoption and characteristics of Italian internal audit departments revealed that half of the companies that participated in the survey have their IAFs positioned at corporate group level. According to the referenced study, in Italy, the structure which is quite common is the creation of several internal audit departments in different companies within the group, coordinated and monitored by a centralized structured, located in the parent company. This accounts for 34.57% of the whole participating companies.

Allegrini and D'onza (2003) also report that 44% of the CIAs in Italian listed companies are generally placed under the CEO, and 23% indicated as being placed under Chairperson, thus ensuring organisational independence of the IAFs.

In tandem with the above studies, Al-Hroot (2012), a questionnaire survey study also discovered that all the 121 respondents to the survey indicated that their IAF was placed at the corporate/group level, as opposed to being placed at the intermediate or local level. It was concluded that such placement, aside from being in line with the best practice guideline, is also appropriate and capable of securing for the IAFs the required level of independence.

Studies that specifically addressed IAF/CAE's hierarchical position in organisation are very limited, this is so given that researchers do apply the manner of reporting of the IAF to represent how the IAF or its head is positioned in the organisation's organogram (hierarchy). Following the pattern of Christopher *et. al* (2019) however, this study attempts to investigate how CAEs in the NFS are positioned in relation to their organisation's senior management's level. It is envisaged that response on this would give additional insights on organisational status of IAF in the NFS. Thus the second proposition as:

P2: Maintaining the hierarchy of the Chief audit executive of internal audit function of the Nigerian financial sector at par with management is positively associated with the function's independence and ability to strengthen corporate governance.

4.2.3 IAF's sourcing arrangement

Similar to what obtains on organizations' non-core activities such as taxation, legal services, facility maintenance, etc, outsourcing of IAF is becoming a common practice worldwide (Carey *et al.*, 2006; Bradon, 2010; Desai, Gerard, and Tripathy, 2011; Papageorgiou, Yasseen and Padia, 2012; Petravick 1997; Rittenburg, 1999; Ahlawat and Lowe , 2004), particularly in the USA, Canada, and Australia(see Carey *et al.*, 2006; Mathews *et al.*, 1995; Rittenberg and Covaleski, 1997; Birkett *et al.*, 1999).

This dramatic development is not limited to private sector alone but is also applicable to public sector as indicated by Subramaniam, Ng and Carey (2004). The referenced study indicates that over 80% of the Queensland public sector entities surveyed engages in either full outsourcing or co-sourcing. This position is also supported by Goodwin (2004).

Whereas theoretically, TCE offers cost benefits consideration as the basis for the practice of outsourcing of IAF by organizations (see Williamson, 1979; Widener and Selto, 1999; Sprakman, 1997; Paape, 2007; Morrill and Morrill, 2003; Carey *et al.*, 2006; Brandon, 2010) as extensively discussed in chapter 3, however, consideration for the need for IAF's independence and the technical competence (see Carey *et al.*, 2006; Shapoff, 1999), perceived to be opulent with the external providers of IAF, appear to be other factors driving outsourcing or co-sourcing of IAF. This implies that non-financial factors as well, play significant roles in IAF's sourcing decisions. This position is also argued by Subramaniam *et al.* (2004,p.93).

According to Desai *et al.* (2011), In-house IAF is a situation where a company maintains its own IAF function, while outsourced IAF is one where an independent firm (usually an external audit firm) conducts the internal audit. Co-sourcing, also referred to as strategic sourcing by Reding *et al.* (2013) is a situation where an IAF or an organisation with a view to complementing its in-house IAF, hires from outside, experts with diverse skill sets. According to Subramaniam *et al.* (2004), the main motivation for co-sourcing is transfer of knowledge. Co-sourcing allows the CAE to optimize both the skill base and IAF's budget (Reding *et al.*, 2013), while retaining the benefits of direct control over internal audit activities (Subramaniam *et al.*; 2004). Salamasick (2012, p. 19)'s view that "cost should not be the only factor involved when discussing what is best for the company..." may also be used to justify this development.

It is been argued that outsourcing of IAF may offer a solution to the problem of independence of IAF since it is difficult for an employee to be truly independent of management (James, 2003; Ahlawat and Lowe, 2004). The nature of in-house IAF with the usual employer-employee psyche is indicative of limited liability of the internal auditors *de facto*, signifying an environment of limited liability in case of an audit failure. Further, it has been argued that an outsourced IAF provider may be more independent of management than an in-house function and relatively reduces the probability of giving in to management's pressure (Del Vecchio and Clinton, 2003; Ahlawat and Lowe, 2004). Though sequel to promulgation of SOX (2002) external audit firms are no longer allowed to provide internal audit services to their independent audit client (see Brandon, 2010), outsourced IAF services are however available from public accounting and specialist firms (Ernst and Young, 2006).

SOX and related standards mandate that external auditor cannot provide internal audit or certain consulting services for their financial statement audit clients. This prohibition aims at enhancing objectivity (Desai *et al.*, 2011). Despite the prohibition of external auditor from rendering both independent audit (external audit) and internal audit (see James, 2003), it appears some countries are yet to appreciate the rationale (drawn from the Enron versus Arthur Andersen fiasco of 2001) behind Sox (2002) as revealed by

Carey et al., (2006). The study based on Australia perspectives, reveal that external auditors are still allowed in Australia to offer both external and internal audit services to their client “as long as any threats to independence have been reduced to an acceptable level” (Carey *et al.*, 2006, p. 21). How such an acceptable level of threat to independence is ascertained remains a puzzle. The question arising from such revelations is Can the Sox (2002)’s prohibition of such practice be a case of “once beaten twice shy”?.

Dickings and O’Relly (2009), a post SOX questionnaire survey of 99 CAEs (typically the directors of internal audit, of publicly traded, middle-market companies), with 14 questions relating to company’s characteristics, CAEs’ qualifications, factors influencing IAF’s independence and internal auditors’ objectivity, among others, indicate that 77% of the respondents outsource some portion of their internal audit work.

According to Caplan and Kirschenheiter (2000), Ernst and Young (2006), Brandon (2010), Desai, Gerard, and Tripathy (2011), the practice of outsourcing and co-sourcing of the IAF is gaining momentum in recent time. For instance, Carey *et al.* (2006) survey in Australia to investigate the determinants of internal audit outsourcing using survey data on 99 companies listed on the American Stock Exchange (ASX) shows that 45.5% of the 99 respondent firms surveyed, using internal audit, outsourced some or all of their IAAs. This is in tandem with an earlier survey conducted by Sharma and Subramaniam (2005).

In their own survey of Australian publicly listed firms, 50 out of the 87 companies surveyed indicated that they use internal audit, and out of this 50, 30 representing 60% affirmed that they had either fully outsourced or co-sourced their IAF. The most curious finding from Carey *et al.* (2006) survey is that more than 50% of companies that outsource internal audit have not operated an in-house internal audit department before their decision to outsource the function. While the authors attributed this to the possibility of increased awareness about IAF’s outsourcing, one may wonder what

could have informed this paradigm. The worry on the referenced findings might possibly be linked to the issue of legitimization of internal auditing profession, broadly discussed in chapter 2, and may further weaken the feeling of supremacy of professional internal auditors on IAAs.

Though, outsourcing and or co-sourcing is gaining momentum as earlier indicated, in the academic literature however, studies addressing the factors pushing decisions thereon is said to be scant (Speckle' *et al.* (2007). Carey *et al.*(2006) however synthesised four different factors debatable in literature as the main determinants of decision on sourcing arrangement. These are:

- i. cost savings
- ii. company's size,
- iii. technical competence of would-be provider of internal Audit services (whether in-sourcing or out-sourcing),and
- iv. board strategy particularly on services perceived to be non-core to the main activities of the organisation.

Whereas, the findings of the survey suggest that out of the four mentioned factors, internal audit's outsourcing is associated with perceived cost savings and the technical competence of the external provider.

James (2003) findings from a study however suggest that though increase in perceived audit expertise may occur with outsourcing, such increases may not significantly enhance user's confidence in the IAF because outsourced teams are still perceived as having less in-depth knowledge of the company than in-house IAF. On the issue of size, the referenced survey's findings suggest that the larger an organisation, the greater the propensity to outsource its IAF. This hindsight appears somehow contradictory to the conclusion in Spekle' *et al.* (2007), where the authors based on their survey predict that larger firms and firms that are relatively heavy consumers of internal audit services tend to rely more on in-sourcing, whereas smaller firms that are less audit-intensive are more

likely to farm-out their IAFs. These divergent findings are strong indication that further studies are warranted on the concept of IAF sourcing decision.

Desai *et al.* (2011), a study conducted primarily to investigate the effect of sourcing arrangement on external audit's assessed quality and reliance on the IAF suggest that external auditors place more reliance on both outsourced and co-sourced IAFs compared to in-house IAFs. The study also predicts that external auditors' reliance on co-sourced and outsourced IAFs decreases when tax services are also provided by the internal audit service provider.

Goodwin (2004) provides further insights on the type of IAF's activities that are mostly outsourced in public sector as his study on Comparison of IAF in the private and public sectors of both Australia and New Zealand reveals. Using feedback from 120 heads of internal audit (who are also members of the IIA) drawn from both Australia and New Zealand, the study indicates that the level of outsourcing IAF in the public sector outweighs that of the private sector in Australia and New Zealand. Specifically, the study indicates that a total of 49 (i.e.68%) public sector entities and (65%) private sector entities indicated that they engage in some outsourcing of internal audit activities. According to the study, information technology and systems are the commonly outsourced activities in the two countries' public and private sectors.

Going from the revelation about the commonest outsourced activities, it might be interesting to find out how these two areas of the organisational activities (which are considered very key to the financial sector due to the rapidity of pervasiveness of e-business, e- products in the NFS, in consonance with financial sectors of developed nations) are being handled via outsourcing, in case such practice has permeated the sector.

One valid conclusion that might be drawn from the above discussions is that outsourcing is here to stay!. Arel (2010) re-affirms that even the IIA recognizes that companies may outsource the IAF, given its (IIA, 2005) assertion that: '*The IIA*

*believes that a fully resourced and professionally competent staff that is an integral part of the organisation, **whether in-sourced or outsourced**, best performs the internal audit activity (IIA, 2005)’’.*

However, despite the various IAF’s sourcing arrangements, it seems there is no consensus yet on the ideal and optimal sourcing arrangement of IAF, and various guidance from the IIA do not recommend a particular sourcing arrangement as being preferable to the others (Desai *et al.*, 2011). Though in line with the changing focus of internal auditing, there is increased concern on effectiveness of the function as well as who is to provide the services (Ahlawat and Lowe, 2004). The principal interest of the global professional body however remains how to promote IAAs capable of ensuring effectiveness and achievement of organisational objectives in an efficient manner (Papageorgiu *et al.*, 2012). From the IIA’s perspectives, internal audit regardless of who provides the service should be performed in conformity with the standards. Discussion on auditing methodology and techniques discussed fully in subsequent section (section 4.3), extensively examines the current achievement of this aspiration of conformity with the IIA standards.

Given that sourcing arrangement to large extent determines the quality of internal audit services, decision on sourcing arrangement is considered a critical area that needs serious consideration. After all, the manner in which organizations manage the quality and costs of IAAs is critical to fulfillment of its responsibility towards a sound governance system (Carey *et al.*, 2006, p. 12).

In addition, IAF’s sourcing arrangement has been established as one of the critical determinants of external auditors’ reliance decision on the work of internal auditors (Arel, 2010). Given that it has been argued in literature that coordination of external and internal audit stand to enhance good financial reporting and ultimately improve organisations’ corporate governance, the internal auditors thus have a great need to strive to “up the ante” in terms of increased collaboration with the external auditors, in addition to improving continuously their competence, work performance, and

objectivity. In literature, the mentioned factors remain the key characteristics of internal audit usually put into consideration by external auditors whenever decision relating to their reliance on the work of internal auditors is to be made (Gramling *et al.*, 2004). Enhanced collaboration between the external and internal audit has also been suggested as a recipe for organisation to reduce cost of external audit, and in a way a value addition accruing from IAF to corporate governance.

Extant studies on IAF's sourcing arrangement and its impacts on IAF's independence include Carey *et al.* (2006) a study focusing internal audit in Australia, using a cross sectional, mailed questionnaire administered on the managing directors and or Finance directors (FDs) of 1030 active Australian companies listed on the country's (i.e. ASX). The outcome of the study with a response rate of 30% (i.e. 304), indicates those companies with IAF as 99, and those that do not have IAF as 205. Of those 99 companies that have IAF, 45 (representing 45.5%) outsource, while the remaining 54 companies (i.e. 54.5%) maintained their IAFs in-house. Of the 45 companies that outsource their IAFs, the study indicates that 20 companies (44.4%) do full outsourcing while the remaining (i.e. 25 companies, representing 55.5%) are into co-sourcing. In addition, the study revealed that almost 60% of those that outsource never operated an in-house IAF before their decision to outsource. This is suggestive of the fact that decision on outsourcing has no relationship with the maturity of the IAF.

While investigating the motivation for outsourcing IAF using Logit cross sectional regression analysis, the referenced study discovered that cost saving and need for technical competence are the two key motivators on outsourcing. For instance, 61% of those Australian companies that outsource did so because using external provider of IAF provides a cheaper alternative to maintaining the function in-house. Also, a greater proportion of respondents who outsource their IAFs indicate that external providers of internal audit services have "specialised industry-wide knowledge", expertise in evaluating and testing the system of internal controls, better experience and qualifications. The study also discovered that the impact of size on IAF's sourcing decision is mixed. Firms who are first time adopter of IAF through outsourcing are

smaller in size, confusingly, for firms that have previously undertaken IAF in-house before outsourcing, it was found that the larger the organisations the greater the propensity to outsource.

The study of Soh and Martinov-Bennie (2011), also from Australia involving both CAEs and ACC using semi-structured interview however showed a different result. Out of the seven organisations that participated in the study, only 2 companies (i.e. 28.6%) maintain their IAF in house. Only one company (14.3%) practiced full outsource and 4 companies (57.1%) co-source their IAFs. In summary therefore, the result of the study indicates more preference for out-sourcing (either full or partial). This might be interpreted to mean further awareness and popularity about outsourcing of IAF in the country when compared with the previous study of Carey *et al.* (2006).

To those ACCs that have preference for in-house IAF, the main reason adduced is the intimate knowledge of organisation by the in-house IAF, while ACCs that favoured co-sourcing indicated that such an arrangement allows IAF to achieve effectiveness in its performance through opportunity of access to wide range of expertise and geographical reach that was not feasible under full in-house IAF's arrangement.

Arena and Azzone (2007) examining the internal audit departments adoption and characteristics in Italian companies, used both in-depth case studies (as preliminary) and questionnaire survey on 230 respondents (mostly CAEs), drawn from 364 Italian companies to gain insights on the key issues of the study's concern. Three main types of data analysis were carried out on the study's data. These are descriptive (which provides a picture of the adoption of the internal audit departments and their main characteristics among Italian companies), correlation analysis exploring the relations among the variables addressed in the research, and finally, cluster analysis meant to overcome the limitations of the univariate analysis. From the analysis of the descriptive statistics of the survey, it was gleaned that none of the companies involved in the survey has a fully outsourced internal audit department; and only few firms outsource a limited set of activities, partially or fully. Specifically, 69.41% firms which answered the

questionnaire do not outsource any internal audit activity; 18.82% outsource a partial coverage of a limited set of activities; and 11.77% of the companies outsource few activities completely (in particular technical audits, information technology audits or environmental audits).

Lenz, Sarens and D'Silva (2014), a study carried out in Germany to identify, examine and evaluate characteristics of an IAF that distinguish between two groups of IAFs with sharply contrasting levels of perceived effectiveness also reveals the level of diffusion of the practice of IAF's sourcing in Germany. Drawing evidence from responses to a survey questionnaire, from 46 CAEs in Germany (who are also all members of German chapter of the IIA, also referred to as Deutsches Institut für Interne Revision e.v.-DIIR), clustered into 4, based on their quartile ranging (QU1-QU4) but with cluster analysis emphatically on the two extremes quartiles (i.e. QU1 and QU4), revealed that in 46% of cases in QU1, the IAF does not benefit from any co-sourcing or complete outsourcing. However all cases in QU4 have a share of co-sourcing ranging from 1 to 40%.

On the suitability of one sourcing arrangement on the other, and with a view to comparing how independent IAF, and how objective internal auditors can be when maintained in-house or outsourced, Ahlawat and Lowe (2004) through a case study involving 35 in-house internal auditors and 31 outsourced internal auditors (all members of the IIA), discovered that significant advocacy existed in the judgments of both in-house and outsource IAF, however the level of the advocacy was less severe in the case of outsourced IAF. The referenced study found evidence to support the fact that outsourced internal auditors advocated less for their client's position in a corporate acquisition scenario than in-house internal auditors. This suggests that outsourced IAF seems to be more independent than in-house IAF, and that internal auditors of outsource IAFs are more objective than internal auditors of in-house IAF.

Reflecting on the above findings, Arel (2010) indicates that truly, an in-house IAF may face different incentives or other compensations dependent on the company's performance which may impact their ability to report internal audit results. The study,

an experimental study involving 89 practicing Big 4 auditors under the supervision of research protocols at a training session for one Big 4 accounting firm, confirmed that when auditors perceive lower litigation risk, they tend to rely more on outsourced IAF than in-house IAF.

Another study on the extent of, and motivation for outsourcing in public sector is Subramaniam, NG and Carey (2004). The study concentrates only on the public sector of Queensland (an Australian state) using a combination of interview and questionnaire survey on key people (Internal audit managers or financial controllers) in charge of internal audit in 6 Queensland public sector entities. Out of the 52 useable questionnaires obtained from the survey of 120 respondents, the authors indicate that only 41 (i.e. 79%) used internal audit services. From these 41 respondents however, only 5 departments rely completely on in-house. 21 and 15 departments indicate that they rely on co-sourcing and full outsourced IAFs respectively. On the motivation for outsourcing the IAF, the study revealed that the need for technical competencies is the greatest factor while other factors include the perception that outsourced IAFs are usually more independent than in-house IAFs.

Goodwin (2004), an exploratory study comparing the practice of internal audit of public and private sectors, drawing evidences from 120 CIAs from Australia and New Zealand revealed that a total of 49 respondents out of 72 (i.e. 68%) public sector entities, and 31 respondents out of 48(65%) private sector entities indicate that they engage in some outsourcing of IAAs.

On the perception of external auditors on the independence of IAF under different sourcing arrangements, Desai, Gerard and Tripathy (2011), using five different cases synthesised for 105 experienced Certified Public Accountants (CPAs) from one Big 4 and a number of regional accounting firms, established that there is no significant difference in external audits' assessments of objectivity, competence and reliance for the outsourced and co-sourced IAF in the high inherent risk areas. It was also discovered that greater reliance on the co-sourced and outsourced IAFs is correlated

with significantly lower external audit efforts relative to the in-house IAF. Contrarily, it was observed that there is no significant difference in external audit effort for the co-sourced and out-sourced IAFs.

Coming to developing economies, the study of Ebaid (2011), an exploratory study of IAF of Egyptian listed firms using a conflation of interview and questionnaire survey indicate that all the CAEs (100%) of the firms that participated in the questionnaire survey maintained their IAFs completely in-house. This result might be an indication that the practice of IAF outsourcing is yet to gain prominence in Egypt, an emerging economy. In addition to the insight of non-popularity of IAF sourcing in the country as indicated by the participants in the survey, the referenced study also revealed that 17 respondents out of the 21 respondents that took part in the study (i.e. 81%) indicated that their IAAs are performed by formal departments specifically set up for IAFs. The remaining 4 respondents (representing 19%) indicated that such formal IAFs are yet to be put in place in their companies, and that everything related to IAAs are still subsumed in their accounting departments. This further supports the general skepticism about legitimisation of internal auditing as a profession particularly in most emerging economies.

Papageorgiou *et al.* (2012), a study exploring similarities and differences between public and private sector IAFs in South Africa, using both questionnaire survey and interview is another relevant study identified. The study, focusing mainly the CAEs and the internal audit managers revealed that majority of the respondents (52.8%) indicated that they use in-house IAF while 40.3% rely on outsourced IAF during the past year. The study however failed to establish empirically, the implication of this sourcing pattern with the IAF's independence. In addition, aside from the fact that the study compares the above findings with the results of Selim and Yiannakas (2000), a similar study but from UK, it does not attempt to establish the motivation for different sourcing arrangements.

From all the studies reviewed in this section, it can be inferred that no particular method of IAF sourcing seems to be prevalent both in developed and developing nations. It is however observed that the practice of outsourcing and co-sourcing permeates boundaries. In addition, other non-financial factors (such as the need for technical competencies, the need to ensure IAF's independence) are the most common motivations for outsourcing in addition to cost saving benefits. This suggests that the TCE theory discussed in chapter 3 might not be sufficient to explain the rationale for IAF's sourcing decisions. In addition, it appears external party, particularly the external auditors and other users of financial statements seem to attribute more independence to outsourced or co-sourced IAFs than the IAFs maintained in-house.

Deriving from the above expositions, and the gaps identified in Papageorgiou *et al.* (2012), a study of IAF's sourcing from a developing economy, this study attempts to investigate the level of diffusion of the practice of outsourcing in the NFS. In addition, the semi-structured interview to be used for this study shall attempt to gain further insights (at least from a developing economy) on the motivation of outsourcing or co-sourcing of IAFs (if such practice exists in IAFs of the NFS). Consequently, the third proposition is stated as:

P3: Outsourcing of Internal audit function of the Nigerian financial sector is positively associated with Internal audit function's independence and its ability to strengthen corporate governance.

4.2.4 CAE's regular attendance of Audit committee's meetings

The IIA's Attribute standard stipulates that the CAE must communicate and interact directly with the board. The board's audit committee meets periodically to deliberate on audit issues. Code of corporate governance of most countries as well as sectorial regulatory codes made it mandatory for the audit committee of the board to meet not less than 4 times in a year. As earlier indicated, the IIA indicates that the CAE is required to maintain direct communication with the board (i.e. the audit committee). One of the ways in which the CAE communicates directly with the audit committee is through his audit report that is usually presented formally at the audit committee's

meetings. CAE's regular interactions with the board promote independence of the IAF. In addition, regular interaction between CAEs and board audit committee facilitates an open, two way dialogue on matters of mutual interest. Direct communication is primarily achieved by the CAE when he attends regularly the audit committee's meetings and participates fully on discussions raised on auditing, financial reporting, organisational governance and control issues.

Paape, Scheffe, and Snoep (2003), internal audit study from developed economies (EU countries) provides a good perspective with which findings from developing nations on the matter of regularity of attendance of audit committee's meetings by the CAEs can be compared. The study indicates that an overwhelming majority of the cases (90%) indicate that their CAEs attend all the meetings of the audit committee. The only exception to that feedback is from France and Greece where about 70% of the cases indicate that their CAEs attend all the audit committee's meetings.

Corroborating this impressive development among developed nations, drawing further evidences from Australia, Christopher, Sarens and Leung (2008) indicate that but for only one case, all CAEs in Australia who participated in their survey on independence of the IAF are regularly invited to audit committee's meetings. The authors indicate that such meetings create avenue for the CAEs to present and discuss the internal audit plans, results and recommendations, as well as prompting necessary follow-up actions on any matter.

Al-Twaijry (2003) while evaluating the development of internal audit in Saudi Arabia (a developing economy) using questionnaire survey and interview involving 78 respondents revealed that in almost half of the companies (39), members of the internal audit department have never attended board's meetings, and that it was in only 2 companies that they do attend regularly.

For Jordanian experience, Al-Hroot (2012) using a questionnaire survey of 121 respondents, revealed that all the CAEs (except in only one case) indicate that they are

regularly invited to audit committee's meetings, and that such formal contacts enable them to present and discuss among other things, the internal audit plan, their audit reports as well as their recommendations. They also indicate that their attendance of such periodic meetings gives them the opportunity to follow-up on the audit committee and the senior management on agreed actions plans.

As critical as the need for regularity of CAE's presence at board's meetings is, studies that evaluate the regularity of such presence, likely hindrances against his attendance of such meetings and the impact of his attendance in such meetings on the function's independence seem very few. As can be seen from above, the two studies from developing economies Al-Twajjry (2003) from Saudi Arabia, and Al-Hroot (2012) from Jordan give mixed results about the issue of regularity of attendance of audit committee's meetings by the CAEs (in developing economies), unlike the seeming established pattern of impressive regular attendance in developed climes. This heightens the need for further investigation. Consequently, this study attempts to investigate how often the CAEs of the IAFs of the NFS attend the audit committee's meetings and whether or not such regular attendance of audit committee's meetings has any linkage with the function's independence, and the capability of the function to strengthen corporate governance. This is the basis of the 4th proposition formulated as indicated below:

P4: Chief audit executive's regular attendance of audit committee's meeting in the Nigerian financial sector is positively associated with internal audit function's independence and ability to strengthen corporate governance.

4.2.5 CAE's appointment and Dismissal

As established in the literature, a CAE whose career can be determined at will by company's executives definitely will not lead an IAF that will be courageous to raise unfavourable audit reports against the management. Till date, it seems the issues of

whether or not audit committee should be involved in CAE's appointment and dismissal is yet to be laid to rest in academics.

Paape, Scheffe, and Snoep (2003), in Ireland, Luxembourg, Germany and Denmark, indicate that audit committee is always involved in appointment and dismissal of the CAE. As a matter of fact, the referenced study shows that all (i.e. 100%) of the cases indicate so. However in only about 88% of Spanish case, audit committees do get involved in CAEs' appointment and dismissal decision, and 75% in Sweden, Greece and Belgium. In Italy however, findings from the referenced study indicate that in most cases (90%) of companies with audit committee, such committee do not get involved in appointment and dismissal of CAE at all. Likewise in France, where about 75% cases indicate that their audit committees do not get involved at all. However, 59% of the CAEs express their preference for audit committee's involvement in their appointment and dismissal. The CAEs representing Austria and France in the survey were however strongly not in favour of this position as indicated by 60% and 50% level of those in disagreement.

For Christopher, Sarens and Leung (2008), a study on the independence of IAF in Australia using feedback from 34 CAEs indicate that in half of the cases, the audit committee is mandated to appoint, dismiss and evaluate the head of the IAF. However, a further 21% of the respondents indicate that their audit committee carries out such appointment, dismissal and evaluation of the CAEs in conjunction with the CEO, CFO or BoDs. This implies that overall in almost three-quarter (75%) of companies, the audit committee is involved in appointing, dismissing and evaluating the head of the IAF. Nevertheless, in 21% of companies the responsibility lies with the CEO and/or CFO. This practice according to the author signals a significant threat against the independence of the IAF.

Al-Twaijry (2003) a study that employs both questionnaire survey and interview to examine the development of internal audit in Saudi Arabia discovered that out of the 78 responses obtained from the survey, it was noticeable in 47 respondents (i.e. 60%), that

the responsibility with regards to appointment and dismissal of the CAEs is vested in the hands of the officers below senior management.

From Jordan, Al-Hroot (2012) indicates that in over half of the cases (66.1% and 53.7%) respectively, the audit committee is mandated to appoint, dismiss and evaluate the CAEs, while in 33.8% and 46.3% cases, the responsibilities lie with the CEO and/or CFO. The author contends that the result is an indication of threat against the independence of the IAF.

Getting insights from Egypt, Ebaid (2011) found out from a questionnaire survey that the CFO and the CEO (senior management) have significant roles in appointing, dismissing and evaluating managers of internal audit department. Leaving the fate of a CAE determined by senior management without the ratification or involvement of audit committee is an indication of impaired independence of IAF.

The only study identified by the researcher in literature so far on the issue of appointment and dismissal of CAEs in Nigeria is that of Akinteye, York and Qudrat-Ullah (2015). The study, using insights from semi-structured interview conducted for 8 heads of IAFs indicates that 20% of the respondents indicated that the power to hire and fire their CAEs is vested in their BoDs. 20% and 60% indicate that such power is vested in the audit committee only, and in both audit committee and the BoDs. This seems appropriate. Given that the referenced study focuses all listed firms in Nigeria however, there is a need to further study this phenomenon using specific sector in the country before such a generalization can be substantiated. Thus, the curiosity of the researcher to seek further evidence on the matter from the NFS, and consequently the formulation of the 5th propositions as below:

P5: Chief audit executive's appointment and dismissal by the audit committee in the Nigerian financial sector is positively associated with the function's independence and ability to strengthen corporate governance.

4.2.6 Existence of Internal Audit Charter (IAC)

The IIA's attribute standards 1000 indicates that the purpose, authority, and responsibility of the IAF must be formally defined in an "Internal audit charter", which must be duly approved by the board, and reviewed periodically. Also expected to be included in the charter is the nature of the audit and advisory services provided by the IAF. The standards define IAC as "*a formal document that defines the internal audit activity's purpose, authority, and responsibility*". The IAC therefore establishes the IAF's position within the organization.

According to Barhman (2011), the IAC is one of the most important documents for an IAF, as it indicates board and executive management's support for the roles and responsibilities internal audit will assume. The charter is prepared by the CAE, agreed with the senior management, approved by the board and communicated to the organisation's employees. The document codifies the power and status of the IAF within an organization..

While the IIA standard is not specific about the frequency of the review of the document, Barhman (2011) suggests that the IAC should be reviewed annually and re-ratified by the board. The IIA may need to address this seeming lacuna. In addition, the fact that the charter has to be agreed with the management indicates that the CAE needs to be consultative with all the key stakeholders on the vision of the function with a view to obtaining their inputs on same. Thus one may want to argue that existence of an IAC and its completeness on matters such as positioning of IAF among others may be the starting point of evaluating the function's organisational status and in corollary how independent the function is.

Al-Twajry, Brierley and Gwilliam (2003), a study on the development of internal audit in Saudi Arabia, indicated that 60 respondents (representing 77% of the total

respondents) confirmed their IAFs have IAC, defining the purpose, authority and responsibility of the functions. 93% of those that indicated the existence of IAC for their department also indicated that the IAC contained the terms of reference already agreed with their senior management. However, there was an indication from the study that where such document exists, 45% of the respondents considered the document as partially consistent with the SPPIA. Also, in more than one-third of the department surveyed, either no such document existed (23%), or the respondent was not aware whether or not the document complied with the SPPIA (13%).

Lenz, Sarens and D'Silva (2014), earlier described also revealed that it is only in 54% case in QU1 that IAC exists while the remaining 46% cases in QU1 may not have an IAC at all, or have one that is not fully endorsed. In QU4 however, all the IAFs claimed they do have IAC.

For this study therefore, verification of existence of audit charter, and its review for completeness shall be carried out through the semi-structured interview.

Overall, going by Propositions 1-5 stated above and agency theory discussed in chapter 3, the overarching hypothesis on the independence of the IAF shall be:

H1: Internal audit functions in the Nigerian financial sector are not independent of their organisations' management

4.3.0 IAF and auditing methodologies /techniques

The methodology or techniques adopted by IAF becomes another critical area where the IIA standard is also emphatical. The increasing emphasis on IAF's methodology might not be unconnected with the paradigmatic shift in the focus of internal auditing worldwide, as envisioned by the IIA. The departure of internal audit's role from the usual compliance and internal control to assurance and consulting with great emphasis on ERM can be argued to be the driving force behind the need for risk-based internal audit methodology. The IIA standards 2010 (planning) stipulates that the CAE must

establish a risk-based plan to determine if the priorities of the IAA are consistent with the organisation's goals. This further underscores the importance of risk-based internal audit methodology and techniques. Reding *et al.* (2013) further amplifies the need for organisation's IAF not only to have a better understanding of business risks facing their organizations but also to be able to give reasonable assurance on the adequacy of the organisation's preparedness to mitigate such. *"The ability of the CAE and internal audit management to get a thorough understanding of the organisation's business risk will determine the extent to which the IAF will be able to fulfill its mission and adds value to the organisation"* (Reding et al., 2013.p. 5-8).

In literature, studies examining the association of IAF's auditing methodology and effectiveness, and impact on corporate governance appear scant. This concern is also acknowledged by Sarens (2009) who indicates that the few extant studies are descriptive without investigating the impact these techniques have on the IAF's capacity to monitor and improve risk management and internal control. For instance, Arena and Azzone (2009) consider adoption of Control risk self-assessment (CRSA) techniques as one of the risk-based audit techniques. The authors, quoting Jordan (2005), and Melville (1999) defines control self-assessment (CSA) techniques as "processes where auditors and management work cooperatively to set and evaluate standards for control through workshop and discussion". Whereas the authors indicate that adoption of the techniques signify the level of collaboration of the management and the IAF in embracing the paradigmatic shift of internal audit from compliance to risk-based, it appears empirical studies in this direction are just evolving. Notwithstanding, the mindset gleaned here can be a foundation for further studies on the matter. For the current study however, only issues relating to adoption of IIA standards by IAF is the focus, this is so given that techniques or audit methodology ideal for any engagements by IAF is expected to be in compliance with the various provisions enshrined in the IIA's standards. Therefore, the review of extant literatures herein centers on adoption of IIA standards and conduct of Quality Assurance and Improvement Program (QAIP) by IAF as indicated below.



Fig. 4.3 : IAF'S Auditing methodology

4.3.1 Adoption of IIA standards for internal audit activities and Conduct of QAIP by IAF

Studies that had investigated IAF's compliance with the IIA standards include Paape, Scheffe and Snoep (2003). From 105 CAEs that participated in the survey of EU IAFs with a view to ascertaining their contributions to corporate governance, 72% of them indicated that they are required to adhere to the IIA standards. However, while in Finland, Ireland, Luxembourg, Austria and Sweeden, the response on the matter was almost 100%, in the other countries it swung widely from 83% in Italy to 25% in Denmark.

Contrarily, in total, 28% of the respondents stated that they do not require adherence to the IIA standards. Probing the CAEs further, the study revealed that on compliance with other standards which could be national accountancy rules, 39% indicated that they are truly required to adhere to those domestic standards, and a massive 61% indicated that such adherence was not necessary.

Burnaby and Hass (2011), a study that investigated the differences in the demographics and level of compliance of internal auditors with the IIA standards in the neighbouring

regions of the USA, Canada, and many Latin American countries revealed useful insights on this matter. The study provided evidences on the application of the IIA's standards in USA, Canada and Latin America. The referenced study (which made use of the data from the Institute's Common body of knowledge (CBOK) 2006 database, developed in 2006-2007 by the IIA research foundation) indicate the average usage of the IIA standards in whole or in part in the USA as 84.4%, in Canada as 85% and in Latin America as 81%.

Abdolmohammadi (2009), investigating the factors associated with the use of and compliance with the IIA standards specifically by taking insights from the Anglo-culture CAEs using CBOK (2006) database, analysed using binary logistic regression established a positive relationship between length of membership with the IIA, and internal audit certification with the use of the IIA standards. The study disclosed that 13.5% of the 1,029 CAEs in Anglo-culture countries (who participated in the questionnaire survey) do not use the standards, and that of those who use the standards, a significant number fail to comply totally with the standards.

The referenced study of Burnaby and Hass (2011) shows a total 61.5% of the USAs, 59% of Canadians and 52% of Latin America respondents indicated their IAAs were or intended to be in full compliance on conduct of QAIP by their IAFs. In Latin America, a significantly larger number of the respondents' organisation, 27.6% compared to 16.7% in the USA and 22.2% in Canada, did not intend to comply with Standard 1300 (i.e. the IIA standard on QAIP). The authors adduced the infancy of the internal auditing of Latin America as one of the possible causes of this indifference. This is suggestive of the impact of the age of internal audit function on the level of compliance with the IIA standards.

Burnaby *et.al.* (2009), a study conducted to investigate the differences in the degree of usage and compliance with the IIA standards among IAFs in USA and IAFs of a sample of European countries using 4080 responses (from IIA CBOK 2006 database) to a questionnaire survey, discovered that many of the respondents disclosed that their IAFs

are not in conformance with the standards. CAEs' responses for the countries indicate a range of usage from a high of 90.5% in Belgium to a low of 81.7% in Italy. Among the respondents that confirmed that their IAFs are not in compliance with the standards, Italy has the highest percentage of respondents (72.9%), while the UK and Ireland respondents (31.5%) had the lowest number of IAFs that have not had an external assessment or one done but not in compliance with the IIA standards 1312.

Going by the referenced study, the reasons given by the respondents for not adopting the IIA standards in whole or in part include the following:

- a. IIA standards are not perceived by the management or board as adding value
- b. Inadequate staff in the IAF
- c. Standards are time consuming
- d. Compliance with the standards is not supported by the management/board
- e. IIA standards are not appropriate for small organisations.

On the issue of performance of external review, Burnaby and Hass (2011) indicate that Latin America respondents had a significantly larger percentage of respondents' departments noting that they never had an external review, 48% compared to 30.2% of the Canadian respondents' departments. Definitely, as the authors indicated, this is an area requiring all the three groups' improvement.

Sarens, Abdolmohammadi and Lenz (2012), a study that investigates the various factors influencing the activeness of IAF in its roles in corporate governance, using feedbacks from 782 US CAEs indicate that 29.3% of the IAFs have a QAIP currently in place. In addition, the study, by analysing the CAEs' responses to a questionnaire survey using binary logistic regression establishes that IAF having an active role in corporate governance is significantly more likely when the IAF has a QAIP in place.

The few studies on adoption of standards for internal audit engagements suggest that the maturity of internal audit has great roles to play on IAF's respect for the IIA standards in all ramifications. Take for instance, Zaman and Sarens (2013) a questionnaire survey

of 187 CAEs in UK reveals that 63.6% of the IAFs have been subjected to an external quality assessment.

In summary, compliance with the IIA standards by the IAFs on their engagements seems to be prevalent in the developed countries while studies that focus this matter from developing countries are just evolving. Thus the postulation of the 6th proposition as below:

P6: Internal audit function's adoption of the IIA standards for its engagements and performance of Quality assessment and improvement program (QAIP) is positively associated with the function's compliance with the IIA international standards and ability to strengthen corporate governance.

Emanating from the above and in consideration of the institutional theory (discussed in chapter 3 of the thesis), the second hypothesis stated as below:

H2: Internal audit functions in the Nigerian financial sector do not perform their roles in full conformity with the institute of internal auditors' standards.

4.4.0 Internal Auditors' Objectivity

As earlier discussed, internal auditors' objectivity is one of the characteristics of individuals involved in the conduct of internal audit. In order to shape discussion here, the following areas (depicted in figure 4.4) shall be looked into:

- The use of IAF as a training ground (TG)
- IAF dual role of assurance and consulting
- CAE's regular private contact with the AC's chairperson
- IAF's unrestricted access to records and information

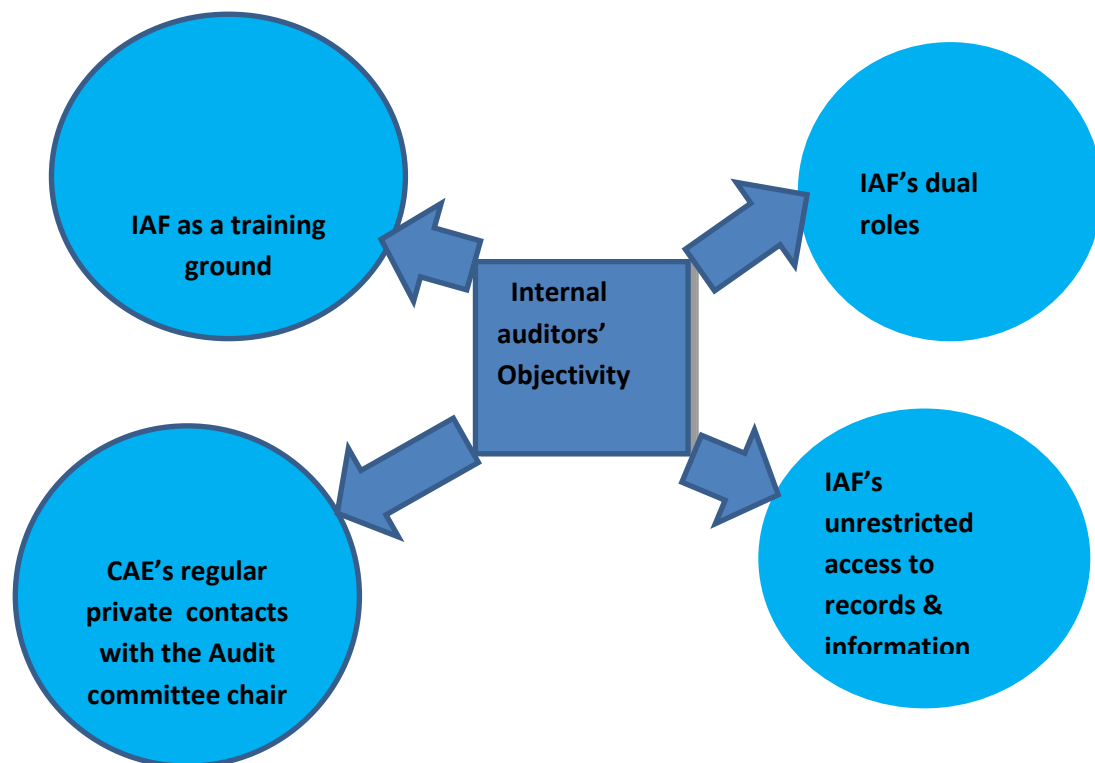


Figure 4.4: Internal auditors' objectivity

4.4.1 IAF as a Training Ground (TG)

Given the general notion that the IAF has the opportunities of having deeper insights of an organisation, the common practice is for management of organisation to second personnel from other functional areas of the organisation to IAF for a tenured period, particularly with the objective of assuming higher responsibility afterwards. In some situations, new hires (or experienced recruits meant for senior management's cadre) are posted directly into the IAF with the aim of grooming them before their final posting (Messier *et.al*, 2011). This simply means using IAF as a stepping ground or "tour of duty" (Goodwin, 2004) to position of higher responsibilities.

This practice has existed for some time (Messier *et al*, 2011; Stewart and Subramaniam, 2010). Oxner and Oxner (2006) indicate that a survey conducted as far back as 1990 indicates that 50% of the companies surveyed actually used their IAF as management training ground (MTG). Most organizations are fond of doing this based on the general perception of the IAF as “ocean of talents full of potentials”. Survey evidences affirming the popularity of this practice in United states, Singapore, Australia, Belgium, and Italy abound (see Rose *et. al*, 2013; Goodwin and Yeo, 2011; Selim *et. Al*;2003; Oxner and Oxner, 2006; Abbot *et al*, 2010; Arena *et. al*, 2006; Sarens and De Beelde, 2006).

Christopher, Sarens, and Leung (2008) state that internal auditors often are well-trained people, having a profound understanding of the different functional domain within the company. While this practice of using IAF as a training ground might be argued to be part of the value addition of the IAF (Christopher, Sarens, and Leung, 2008), by been perceived as training ground, in literature however, studies have established various concerns of same on the independence of the function.

Messier *et al*. (2011) indicate the benefits and disadvantages of the practice as follows:

Advantages

- i. affords the organisation an opportunity to train versatile, well-rounded senior managers in-house. This is also seen as a plus, a valued addition on the part of the organisation’s IAF.
- ii. exposes the managers to all areas of the organisation and thus avail them greater insights on the organisation’s business.
- iii. increases management understanding of the organisation’s internal control (see Koonce, 2013).
- iv. provides time and avenue for management to evaluate internal auditor’s ability.

Disadvantages

- i. dampens IAF's motivation to enhance its quality on the feeling that their good hands will eventually be lost to other departments
- ii. staffs of the IAF has less time to develop their audit skills. This certainly will not be in the best interest of fostering the internal audit profession.
- iii. leads to familiarity threat where staffs seconded from another department within the organisation may be biased in their judgment and opinion on audit issue concerning a department that may likely be their next desired point of duty.

In some instances, staffs of IAF do see themselves as potential candidates for management positions. This may not be in the best interest of the internal auditing profession as such practice and perception may contribute to erosion of IAF's independence and affect auditor's objectivity (Christopher *et.al.* 2008; Chadwick, 1995; Goodwin, 2004).

Messier *et.al* (2011) states that over half of all companies that have an IAF specifically hire internal auditors with the purpose of rotating them into management positions (or cycle current employees into the IAF for a short stint before elevating them into management cadres). In their survey of CAEs in Australia corporate sector, Christopher, Sarens, and Leung (2008) found that 56 per cent of the respondents indicated that their IAF is used as MTG for management position. In addition, it was found that in 60 per cent of the surveyed companies, internal auditors stay less than four years in the function. This is a confirmation that IAF is often used as training ground for future managers to advance their careers. The authors contend that long term commitment was rare in this situation. The concern is whether internal auditors in such situation can have the audacity of raising audit reports against management, knowing fully that their future career aspiration may be jeopardized because existing senior management is typically responsible for evaluations of IAF and promotion of IAF's staff to management position. So, "internal auditors who expect or hope to move into senior management's positions would never want to ruin their relationships with their future peers" (Rose

et.al, 2013, p. 1008). This certainly raises serious concern on internal auditors' objectivity and IAF's independence.

Messier *et al.* (2011), in a study they carried out using archival data to examine the effect of using the IAF as a MTG on the external auditor's reliance decision observe that the practice has a negative impact on external audit fees. External auditors perceive internal auditors employed in an IAF used as a MTG, as less objective than those in an IAF where such is not practiced, and consequently charge higher audit fees. The results of Rose, Rose and Norman (2013) indicating that internal auditors are less objective when they work in an IAF that is used as MTG, relative to when the IAF is not used as MTG, agrees with Messier *et al.* (2011) on the same subject. The authors through a laboratory experiment study that investigates the impact of using IAF as MTG on internal auditors' objectivity specifically within the context of revenue recognition practices discover that internal auditors are more willing to succumb to aggressive revenue recognition practices when they expect to move into senior management positions in the future. The authors state that:

“it appears that internal auditors who will become senior managers face strong incentives to please existing senior managers and support management's financial decisions, even when there is evidence that such decisions may not be appropriate” (Rose *et. al* , 2013, p. 1017).

Pondering on these findings, one may want to believe that the practice of using IAF as MTG may truly undermine IAF's independence and put individual auditors' objectivity in serious jeopardy. Whereas the negative impacts of using IAF as MTG has prompted the global professional body (IIA) to forbid employees transferred to internal audit to audit activities they previously performed until expiration of at least one year (Stewart and Subramaniam, 2010), the professional body is however yet to issue a guidance to apply to a scenario of employees transferred to a department or activity that they are currently auditing. Therefore, the IIA's guidance on the concern appears one-sided

(Stewart and Subramaniam, 2010). It is anticipated that further research activities may trigger additional guidance in this direction.

It is in line with this anticipation that the NFS shall also be examined critically to ascertain the general disposition of the sector to the practice of using IAF as MTG. Areas to be looked into will include assessing whether the position of the CAE in the sector is on a rotational basis, i.e. whether CAE do move from IAF to assume a higher responsibility at management cadre.

The study of Christopher, Sarens and Leung (2008) revealed that 56% of the responding 34CAEs stated that there is a culture within their organisation for internal auditors to move to other management functions within their organisation. This revelation was corroborated further by 47% of the respondents who indicated that, on average, internal auditors stay between two and four years in the IAF, with 13% indicating that internal auditors stay for less than two years. From the results of the study, a long-term commitment is doubtful. It was reported that in 60% of the companies, internal auditors stay less than four years in internal audit. In 71% of the cases where it is common to move to other functions, internal auditors remain within the IAF, on average, for less than four years. It therefore seems that only a small minority aspire to a career in internal auditing. The inference that can be drawn here is that in Australia, evidence abounds to suggest that IAF is used as a stepping stone, and a training ground for potential managers.

Goodwin (2004), another study on the internal audit practice of Australia and New Zealand, comparing the practice of the use of IAF as a “tour of duty” between private and public sector indicates that overall, 91% of the 120 participating Chief internal auditors (CIAs) indicate that their appointments as the head of IAFs is permanent, while only 9% signals that they are susceptible to the practice of “tour of duty” (i.e. MTG). When looking at the other employees of the function, 83% of the employees’ appointments seem to be permanent while 17% of the employees seem to be high fliers using IAF as a mere stepping stone. From those High fliers CIAs, majority of them are

from the private sector. The study further revealed that where CIAs are not stable, the average length of stay of CIAs are 39months, and 31 months; for the CIAs in the public and private sectors respectively. Also for the highfliers internal auditors, average stints in their IAFs are 42months and 27months; for public sector internal auditors and private sectors internal auditors respectively. The study went further to establish that the commonest departments internal auditors are usually transferred to are finance and accounting, operations and corporate services. What the results imply generally is that internal auditors in the public sector of Australia and New Zealand seem more stable than their counterparts from private sector (i.e. Public sector's IAFs tend to be staffed by more permanent employees compared to their private sector counterparts). The reason behind this difference however cannot be inferred from the referenced study. Investigating the factors responsible for instability of internal auditors of private sector than their colleagues in public sector therefore seems a potential research agenda.

Another study on the impact of the use of IAF as a training ground for potential managers is Rose, Rose and Norman (2013) who through a 2x2 experiment with 74 internal auditors examined the effects of using the IAF as a training ground for future senior managers. Though the domain of the study is not indicated for geographical reflections, the authors, using the experiment involving a synthesis of a manipulated case (controlled laboratory experiment) where a case of a company (using a percentage of completion method for its revenue recognition) was synthesised. The key issue tested in the manipulated case relates to whether or not internal auditors will be more likely to support management's attempt to aggressively report revenue when the IAF is being used as a MTG using ANCOVA methods. Two scenarios created are first where IAF is used as MTG and second where IAF is not used as MTG. Based on the analysis of the results and the authors' debriefing that ensued, the overall results of the experiment indicate that using IAF as MTG for future senior managers can impair the objectivity of internal auditors. If faced with a decision of evaluating a firm's revenue recognition practices, internal auditors would be more willing to align with aggressive revenue recognition practices when they expect to move into senior management's positions in the future. The authors further added that it seems internal auditors who are nursing the

ambition of becoming senior managers face strong incentives to please existing senior managers and concur with management's financial decisions whether or not such decisions are appropriate. The finding further revealed the negative implication of the use of IAF as a training ground despite the contrary opinion that such practice signals to the organisation the value addition potential of IAF in terms of its resourcefulness. If indeed the IAF can exhibit its level of resourcefulness by supporting advocacy for its use as MTG, then it places on the internal auditing community the challenge of identifying the necessary mitigating measures to down play on the negative implications such practice will bring on the internal auditors' objectivity.

Looking at this issue from the perspectives of the external auditors, it has been argued in literature that external auditors usually perceive internal auditors of IAF used as MTG as less objective relative to the one not used as MTG. In addition, it is contended in literature that audit fees charged by external auditors where IAF is used as MTG is usually higher than where IAF is not used as MTG.

Investigating these two positions empirically, Messier, *et.al* (2011), used archival analysis and an experiment on 43 external auditors (35 senior associates, and 8 managers) from the various Big 4 accounting firms in Norway. According to the study, the experiment task consists of participants reading a case scenario of a hypothetical company and answering questions about the company. The authors indicated that the archival analysis of the study revealed that external audit fees are significantly higher for companies that use the IAF as a MTG, and that firms pay the highest external audit fees when they use only the CAE's position as a MTG followed by using all internal audit positions as a MTG. The study also indicated that using just staff position as a MTG is not associated with internal audit fees. Likewise, the study's experimental results indicate that external auditors judge internal auditors to have lower objectivity when the client uses the IAF as a MTG.

The nexus between the results of the archival analysis and the experimental results is that while the archival results established that using IAF as a MTG impacts external

audit fees, the experimental results provide evidence to suggest that one of the factors for the higher fee could be the external auditors' perception of internal auditors' low objectivity where IAF is used as a MTG. Overall, it appears as useful as the practice of using IAF as MTG is, there lies in it the negative implication such practice can have on the internal auditors' objectivity and the resulting impacts of such implications (such as higher external audit fees).

In NFS, no study has ever attempted to investigate whether IAF is seen as a tour of duty, and MTG. Thus the inclusion of this issue under the study's concern and the formulation of proposition 7 as:

P7: Using Internal audit function of the Nigerian financial sector as a training ground is negatively associated with the internal auditors' objectivity and with the function's ability to strengthen corporate governance

4.4.2 IAF's dual role of assurance and consulting

Whereas shareholders and other stakeholders look forward to internal auditors as being in the position and possessing the capability of making an independent assessments, judgments and decisions (Mutchler, 2003), scholars such as Peurseem (2005), and Ahmad and Taylor (2009) contend that the contemporary role of the internal auditor has become progressively affected by conflict and ambiguity. Specifically, Ahmad and Taylor (2009) argue further that given the increased role of internal auditors under the corporate governance mosaic, internal auditors face issue of inherent conflict of interest. This they linked with role ambiguity associated with potential contradictions or incompatibility between their audit oversight function (assurance) for the company and management consultancy or consultative services role to the management.

“in their audit role, internal auditors must remain independent of management by not subordinating their judgment to management in audit matters. But in their consultative role, they must collaborate with and support management, including accepting the judgment

of the audit committee of the board of directors. Given the need for a close working relationship with the board's audit committee, the potential for the internal auditor to face this kind of role conflict may have been heightened'' (Ahmad and Taylor, 2009 p. 900).

In his view on the impact of the seeming incompatible roles of financial audit and consulting role of the internal auditors on independence of IAF, Mutchler (2003, p. 236) corroborates the above concern by raising his skepticism as follows:

''Management employs internal auditors, yet these same internal auditors are also often asked to review the performance of management and others. In addition, management often relies on internal auditors for consulting services and incorporates audit recommendations into the re-engineering of business processes. Auditors, in their role as assurance providers, evaluate these processes''.

Two issues that can be inferred from the above emphases remain conflict of interest arising from the dual and seeming incompatible roles of assurance and consulting assigned to IAF (based on the expanded vista) on one hand, and the issue of subordination of the function by way of line of reporting of IAF to both the management and audit committee on the other hand.

To start with, the assurance focus of internal audit presupposes and expects IAF's independence from management, whereas the consulting paradigm anticipates shared mission and partnership with management (Mihret, James and Mula, 2010). Also, in the minds of many executives and managers, internal auditors work for them (Drent, 2002). These contentions indicate serious concerns of whether an internal auditor can truly be objective once he is engaged for the dual roles of assurance and consulting.

Studies such as Stewart and Subramaniam (2010) and Cooper, Leung and Wong (2006) had earlier raised concerns on the challenges the dual roles of assurance and consulting

of IAF may have on internal auditors' objectivity, maintaining that internal auditors are uncertain as to how to balance their relationship with senior management in both roles. It is based on the above exposition and concern that the 8th proposition is formulated as below:

P8: Consulting role of internal audit function of the Nigerian financial sector is negatively associated with internal auditors' objectivity and the function's ability to strengthen corporate governance.

4.4.3 CAE's regular private contacts with the audit committee's chairperson

When IAF has opportunity of having private meetings with the audit committee, the IAF feels secured, protected and independent (Munro and Stewart, 2011), thus, improving corporate governance (Braiotta, 2004; Zaman and Sarens, 2013).

To start with, evidence of the regularity of CAE's private contacts with the audit committee's chairperson is sought from developed environments. One of the studies that had documented such evidences is Zaman and Sarens (2013). In their study that aimed at providing exploratory evidence on factors associated with informal interactions between audit committee and IAFs, using 187 responses of UK CAEs (drawn from listed and non-listed, financial and non-financial companies) to a questionnaire survey, the authors reported that a large majority of the CAEs (88.1%) indicate that they have informal (private) interactions with the audit committee chair and/or audit committee members outside the regular pre-scheduled meetings.

Christopher, Sarens and Leung (2009), a study meant to gather evidence from Australia on IAF's independence using feedbacks from 34 Australian CAEs also gathered evidence on the issue of regularity of private contacts with the auditee committee's chairperson or individual members. The authors indicated that 68% of the responding CAEs had regular private contacts with the auditee committee's chair or individual members. The CAEs utilize the opportunity of their private contacts with the audit committee to raise critical matters affecting management without their presence. This is

one of the ways internal auditors' objectivity can be achieved on their opinion on issues affecting the business generally.

Therefore, it can be contended that private contact of the internal auditors with the auditee committee or its chairperson by the CAEs has positive impacts on the level of internal auditors' objectivity. This gives them opportunity to discuss critical issues objectively with the CAEs. The researcher through this research work also intends to find out how frequent such private contacts are made by the internal auditors on the auditee committee's chair in the NFS. Thus the formulation of the 9th proposition below:

P9: Chief audit executive's regular private contact with the audit committee chairperson is positively associated with internal auditors' objectivity and the IAF of the NFS's ability to strengthen corporate governance.

4.4.4 IAF's unrestricted access to records and information

Unrestricted access to people, record and information by internal auditors has been argued one of the key factors contributing to the objectivity of internal auditors. An internal auditor that has an unfettered access to records and information is expected to form an opinion on any issue without any trepidation.

Al-Twaijry *et al.* (2003) in their study investigating the development of internal audit in Saudi Arabia through a combination of survey questionnaire and interview methods, and based on 111 responses from the survey questionnaire and feedback from 92 interviewees, investigated whether there is unrestricted access to records and information on the part of the participants of the study. The result of the study indicates that 44% of the internal audit directors considered that they did not have full access to all necessary information. This is an indication of threat to the internal auditors' objectivity, and one of the reasons the authors concluded that the IAF in Saudi Arabia is ineffective and consequently adds no value.

Using Mousa (2013), a study that evaluates the independence of the IAF using reflections on Al-Bariga oil marketing company (AOMC) in Libya applying interview method on 13 interviewees (comprising directors of internal audit, financial controllers, and internal auditors). The internal auditors indicated that they are been given the right of access to the company's accounts, records, archives, systems and to all its areas at all times. However, the feedback from the financial controller on the same matter suggests that the right of access to records and information given to the internal auditors is with some level of control because the internal auditors' areas of activities seem limited. According to the finance controller, he does not think the internal auditors can audit any subject which directly concerns the actions of the BoDs or their close circle. Certainly, this is not an unfettered access to records and information.

Therefore, the inferences that can be drawn from the two studies is that evidences from developing countries on the issue of internal auditors' free access to records and information is indicative of censored access, and therefore constitute a big challenge on the objectivity of the internal auditors. This leads to postulation of the tenth proposition as:

P10: Unrestricted access to records and information by the internal audit function in the Nigerian financial sector is positively associated with internal auditors' objectivity and the function's ability to strengthen corporate governance.

In order to verify all the above propositions (i.e. P7-10) using Agency theory, the third hypothesis is formulated thus:

H3: Internal auditors in the Nigerian financial sector are less objective

4.5.0 Internal Auditor's Competence and IAF's effectiveness

The continuous changing and widening focus of IAF certainly constitutes great concern on the appropriateness of internal auditors' skills and competencies. The modern-day requirements and enlarged horizon of internal audit landscape, as well as increased customers of IAF, with diverse expectations necessitate a varied and adequate skill set

on the part of the staff of the function. Availability of a sufficiently large number of skilled professionals is being considered a preliminary requirement for internal auditors to be able to perform their tasks (Arena and Azzone, 2009). Incidentally, bouquets of internal auditors' skills set and level of competence on matters that has to do with business risk assessment are part of the factors usually put into consideration by external auditors before determining the level of relevance of internal audit work by them (Gibbs and Schroeder, 1979; Clarks *et al.* 1981; Messier and Schneider, 1988; Maletta, 1993; Gramling and Myers, 1997; Felix *et al.*, 2001; Al-Twaijry *et al.*, 2004).

In addition, the recognition, respect and status, management and employees of organisation will accord the CAE and his entire team, and the value they will place on their roles in the organisation to greater extent depend on the level of competence of the internal auditors. According to Arena and Azzone (2009) the perception of management and employees of organisation on the dexterity of their internal auditors can also increase the effectiveness of the internal audit's team. Internal audit team that is not seen to be competent will have no respect from the management and consequently insights, advice and or recommendations from such internal audit is usually not taken serious (Van Peurseem, 2004, 2005, Reding *et al.*, 2013). The assurance and consulting services rendered by internal auditors without sufficient requisite knowledge, Skills and other competencies will be of little value, if any (Reding *et al.*, 2013, p. 2-16). Therefore, the IIA standards 1210 require internal auditors to possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. Gramling and Hermanson (2009) maintain that skilled and qualified internal audit staffs are indicative of internal audit quality. This notion had earlier been maintained by Fadzil (2005, p. 861) who indicate that professional certification and training lead to a lower need for monitoring of the internal control system by an IAF, since they are considered as able to perform audits effectively.

Although no specific arrays of skills and knowledge are specified in the IIA standards, as fundamentals skills expected to be possessed by internal auditors, some attributes are however given prominence in literature as features that can enhance the profile of

internal auditors. These to Sarens (2009) include: educational background, previous work experience, professional certifications, training and development programme, behavioural skills, technical skills; and competencies. Whereas it is usually claimed in literature that finding internal auditors with adequate profile is a challenge (Hass, Abdolmohammadi and Burnaby, 2006), yet Sarens (2009) maintains that coming up with specific competency framework for modern day internal auditors is a dilemma.

The above challenge notwithstanding, researchers do operationalize competence of internal auditors with characteristics such as professional certification, formal educational background, relevant graduate qualifications, membership of IIA, level of experience (see Arena and Azzone, 2009; Barac *et al.*, 2009). While findings from extant studies on the influence of internal auditors' competence on IAF's quality is mixed, a general inference that can be made remains that internal auditors with good and relevant educational background, and professional certification perform better than those without. While it has also been argued that majority of the internal auditors have other professional affiliation aside the IIA, it is also argued that the IIA certifications (such as CIA - certification in Internal auditing, CCSA - certification in Control Self-assessment, CRMA- certification in risk management) are indicative of internal auditors' awareness of the internal audit standards guiding the practice of internal auditing worldwide, and possession of the knowledge and competencies required to perform internal audits (Burnaby *et al.*, 2009, p. 844). This is so given the "knowledge sharing" focus of the IIA that drive the certification of internal auditing professionals through some professional examinations.

The rising stature of the IIA in this regard is giving increased awareness about all these professional certifications. Burnaby *et al.* (2009) indicate that in Belgium, certifications such as CIA are more often becoming a requirement to enter, or at least to remain in the internal audit department. It is however doubtful if this can be said of Nigeria, where only a small number of internal auditors have CIA certification. Thus, the study's curiosity to establish if internal auditors in the NFS have sufficient resources and adequate level of expertise to fulfill their enhanced roles.

According to the IIA's CIA learning system, Competencies are more than basic knowledge, skill and capabilities about a job. Competencies are transferable behaviours that are usually developed over time and represent the compilation of multiple abilities, traits, and knowledge required for success. Though competencies are personal to individual employee, however, they can be taken from one audit engagement to another, from one position to another and from one employer to another as well.

In order to have a defined focus, extant literature on internal auditors' competence shall be reviewed through the following five areas:

- a) internal auditors' educational qualifications
- b) internal auditors' professional qualifications
- c) internal auditors length of years of experience
- d) internal auditors' regular training
- e) Membership of internal auditors with the IIA

These are as shown in figure 4.5 below:

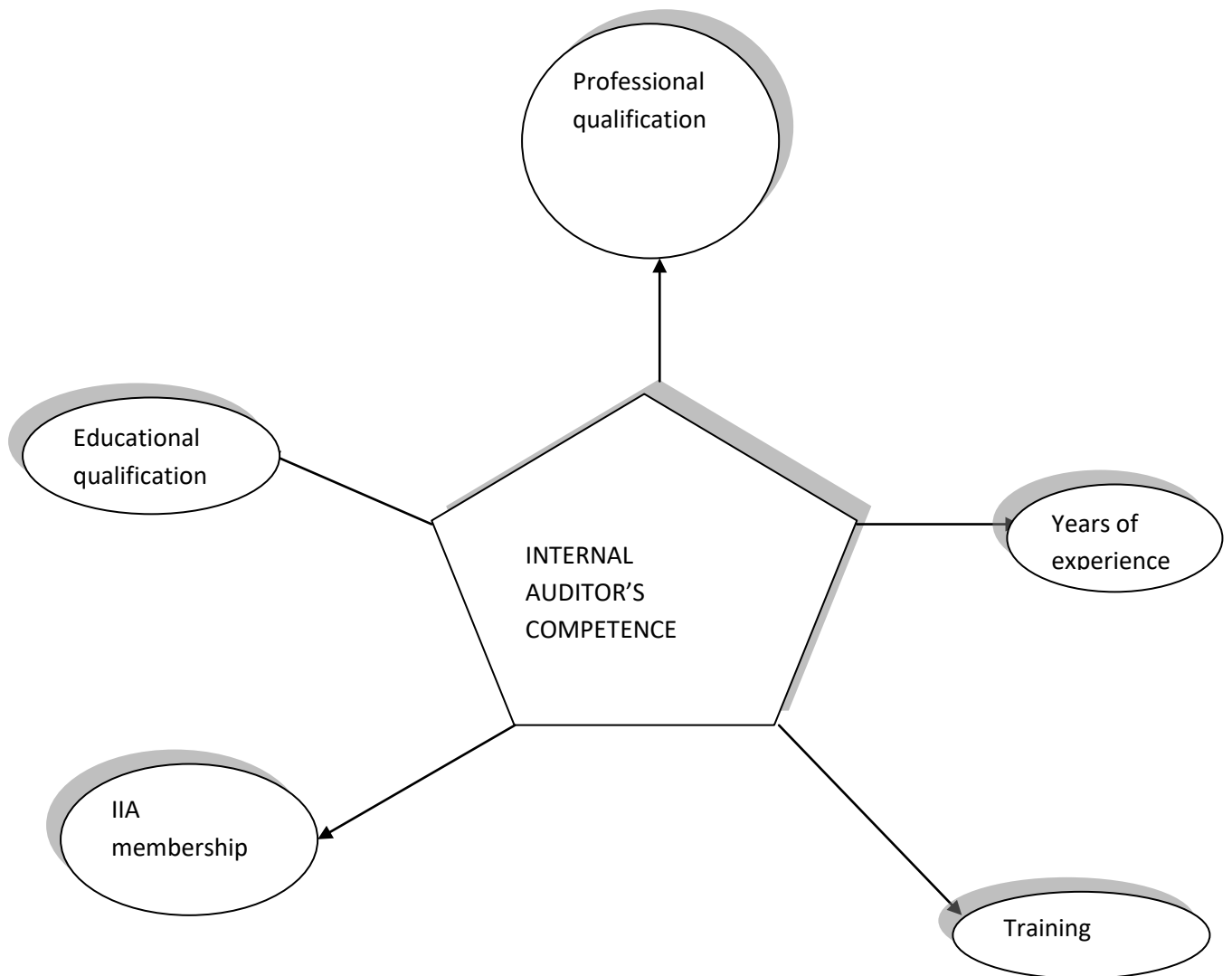


Figure 4.5: Internal auditors' competence

4.5.1 Internal auditors' educational qualification

Possession of appropriate educational qualification that would enable anybody assigned any role in internal audit to perform creditably and professionally is anticipated (see IIA standards 1210). Therefore Ebaid (2011)'s contention in his exploratory study of

Egyptian listed firms' IAF that no qualification (even though it is desirable) is normally required for internal auditors sounds confounding. The IIA standards though do not specify a particular knowledge, skills or competence, IIA standards 1210 nevertheless stipulates that internal auditors must have sufficient knowledge to evaluate the risk of fraud and the manner in which it is managed by the organisation. In the same vein, the standard also anticipates sufficient knowledge of key information technology, risks and controls, technology-based audit techniques. Consequently, it is reasoned that for an internal auditor to have sufficient knowledge in risk evaluation, and possess necessary acumen in information technology-laden audit methods, definitely, certain level of learning (education) is anticipated.

Burnaby *et al.* (2009), a comprehensive study on the usage of internal auditing standards by companies in the US and select European countries using 4,080 usable responses from internal auditors whose details and responses were used to create a common body of knowledge (CBOK) database between 2006 and 2007 by the IIA Research Foundation (IARF) provides comprehensive insights on the cross-country educational qualifications of internal auditors. Going by the study, 20.6% of Italian and 23.4% of the respondents from the UK and Ireland have secondary/higher education. The USA and Italy have the highest number of respondents with a bachelors/diploma in business with 49.9% and 42.8% respectively. The Netherland have the largest number of respondents with a masters degree (76.8%). According to the findings from the study, it seems a masters degree is the minimum requirement to enter the internal auditing profession in Belgium and the Netherlands. The study also revealed that among the countries selected for the survey, Italian respondents have the lowest number of respondents with a masters or doctoral degree and the highest number of auditors with a bachelors degree/higher school education.

Al-Twaijry *et al.* (2003), a study of the development of internal audit in Saudi Arabia, using a mixed method of questionnaire survey (of 78 heads of Internal audit, and 33 partners and audit managers in external audit firms) and structured interviews (conducted for 92 respondents from firms without internal audit) revealed that 72 out of

the 78 directors of internal audit departments (i.e. 92%) had a university degree and a significant proportion (23%) had a higher degree. This shows that most of the directors of internal audit of Saudi Arabia corporate sector are holders of first degree.

Certainly there is a positive nexus between internal auditors' educational qualification and their level of proficiency and therefore the formulation of the eleventh proposition.

P11: Educational qualification of internal auditors of the Nigerian financial sector is positively associated with the individual internal auditors' competence and the ability of the internal audit function to strengthen corporate governance in the Nigerian financial sector.

4.5.2 Internal auditors' professional qualifications

Sarens, Abdolmohammadi and Lenz (2012) in their study that investigates several variables that are theoretically associated with the IAF having an active role in corporate governance, using responses from 782 US CAEs in the CBOK (2006) database analysed with the use of binary logistic regression, establishes the positive relationship between CAE's professional certification and IAF's active role in corporate governance.

According to the authors, 56% of the CAEs whose insights were used to make inferences from the study possess at least one professional certification in internal auditing (e.g. CIA). Possession of one professional certification in internal auditing by the referenced CAEs in the US is indicative of the appreciable level of development of internal auditing as a profession in US. Unlike in other economies (particularly the developing countries) where majority of the CAEs are unaware of existence of the IIA (see Al-Twajjry *et. al* (2003), let alone its various globally accredited certifications.

Dickings and O'Relly (2009), earlier mentioned in previous section revealed that more CAEs hold the CPA designation than those who hold the CIA designation, and that 13% of the respondents reported holding both designations. However, 21% of the

respondents hold neither designation. Interestingly, the referenced study reported finding evidence to suggest that internal auditors in the financial services sector are less likely to hold CIA designations than are internal auditors in other industry. What might be responsible for the possibility of less CIA holders in financial sectors are however not discussed or suggested in the study. Ordinarily, due to the critical roles financial services sector plays in any economy, and the high regulatory framework of the sector in all economies, one would have thought that the sector would be flooded with CAEs with high profile of internal auditing endorsements (certifications). More so, that positive association between internal auditing certification and the use of IIA standards by the IAFs (and ultimately internal auditors' competence), is being proven.

Burnaby *et. al* (2009) in their study of the differences in the degree of usage and compliance with the IIA standards by organisations' IAFs located in the USA and a sample of European countries which have affiliates with the IIA also argue that professional certifications (such as CIA, MIIA, or the PIIA), is an indication that internal auditors have an understanding of the IIA standards and possess the knowledge required to perform internal audits. According to the result of the study, The Uk and Ireland, Belgium, and the Netherlands have the most respondents with internal auditing certification with 62.4%, 55.9% and 48.2% respondents respectively, confirming their one certification or the other in internal auditing. Aside from internal auditing certifications, the respondents also indicate certification in public accounting as another certification held by most respondents with the Netherlands (47.3%) and the USA (36.3%). Other relevant certifications indicated by the respondents to the surveys include certifications in Information system auditing, Control assessment, and fraud examination. These are certifications held by 8% or more of the respondents, as reported by the authors.

Contrary to the adequacy of the level of education of the Saudi Arabian directors of internal audit in corporate sector observed in Al-Twajjry *et. al* (2003), there is low level of professional qualification amongst the practitioners of internal auditing in the country. Only 29 out of the 78 heads of internal audit in the country (i.e. 37%) had

relevant professional qualifications. Surprisingly only 4 out of these professionals holds CIA while those holding Saudi CPA are 16. The study also indicates that 18 directors of internal audit (i.e. 23%) are not aware of the existence of the IIA. This revelation of non-awareness of existence of the IIA on the part of some directors of internal audit certainly speaks volume on the general awareness of the IIA on the internal auditing community of Saudi Arabia. On the individual internal auditors' level of education, the referenced study further revealed that of the 489 staff (excluding directors) employed in total in the departments surveyed, 393 (80%) were educated to degree level. In addition, only 134(27%) of the internal audit staff held professional qualifications, of which 29% are CIA holders and 53(40%) held a US or Saudi's CPA qualification.

Out of the 21 respondents that participated in a questionnaire survey of the IAFs of Egyptian listed firms, Ebaid (2011) observed that 16 (i.e. 76%) indicated that none of their internal audit staff are professionally qualified. The remaining five respondents (24%) however claimed that less than 25% of their internal audit staff is professionally qualified. The author linked the low level of professional qualification to the infancy stage of internal auditing in Egypt.

Insights from Italy as indicated in Arena and Azzone (2007) indicates that nearly 40% have CIA, while about 20% are certified accountants.

Akinteye, York and Quadrat-Ullah (2015) revealed that 40% of the respondents to their survey on IAF quality in Nigerian listed firms are associate members (i.e. ACA) of the ICAN, 40% are fellow of the institute (i.e. FCA) while the remaining 20% are associate members of the Institute of Chartered Accountants in India (ACAI). In summary, the study indicated that all (i.e. 100%) of the heads of the IAFs that participated in the survey hold professional qualifications in accounting; but none with CIA.

As presented, the result suggests the preference of the internal auditors in Nigeria to associate with the ICAN instead of with the IIA. Two reasons might be adduced for this. First it could be that there is very low awareness about the IIA and its purpose among

the internal auditing community in the country or, the internal auditors are generally not too inclined to associate with the institute given the skepticism about the professionalisation of internal auditing. Till date, particularly in most developing countries, most people (including the internal auditors) still perceive internal auditing as a mere offshoot of accounting profession.

Comparing Egyptian internal auditors' profile in terms of professional qualification of internal auditors (as indicated by Ebaid, 2011) with the profile of their Nigerian counterparts as indicated by Akinteye, York and Qudrat-Ullah (2015), one may want to argue that internal auditors in Nigerian listed firms generally are more professionally qualified than those internal auditors in Egyptian listed companies. Overall, possession of relevant professional qualifications by internal auditors have positive effect on their level of competence and consequently on their IAF's ability to enhance corporate governance. Therefore the formulation of the 12th proposition as:

P12: Possession of relevant professional qualifications by the internal auditors in the Nigerian financial sector is positively associated with the individual internal auditors' competence and the ability of the internal audit function to strengthen corporate governance in the Nigerian financial sector.

4.5.3 Internal auditors' length of years of experience

Badara and Saidin (2014), a questionnaire survey (of 350 respondents covering the internal auditors, audit committee and the Chairmen of the various local governments) of internal audit effectiveness across the local governments authorities in Nigeria, discovered that with respect to working experience, 32% of the respondents have working experience from 15years and above. This is followed by the respondents that have working experience of 6-10years which is 25.1%. Similarly, 21.7% of the respondents have the working experience of 1-5years, while 19.7% of the respondents have the working experience of the range of 11-15years, and finally, 1.4% of the respondents have the working experience that is less than 1 year. The authors asserted

that the internal auditors in the local government authorities have sufficient working experience.

Akinteye, York and Quadrat-Ullah (2015), a study from the same domain of Badara and Saidin (2014) investigating the IAF's quality in the Nigerian listed firms using interview responses from 8 respondents (Head of IAFs) also affirmed that internal auditors in Nigeria are sufficiently experienced to enable the IAFs in the country to operate effectively as a corporate governance's mechanism. The study specifically revealed that 20% of the responding heads of the IAFs has 7 years of working experience, 40% has 14years experience, 20% has 15-year experience, while 20% has 22 years cumulative experience. The working experience however includes experience in internal audit, external audit or in accounting functions generally.

The significance of working experience on the internal auditors' level of proficiency therefore cannot be overemphasised. Hence, the 13th proposition as stated below:

P13: Possession of reasonable length of years of experience by the internal auditors of the Nigerian financial sector is positively associated with the individual internal auditors' competence and the ability of the internal audit function to strengthen corporate governance in the Nigerian financial sector.

4.5.4 Internal auditors' regular training

Regular training of internal auditors is another way the competence level of the internal auditors can be enhanced. Internal auditing profession is constantly evolving. Therefore, the IIA takes the issue of training of the practitioners of internal auditing very serious. The IIA standards 1230 require internal auditors to enhance their knowledge, skills, and other competencies through continuing professional development. It is through regular trainings in form of conferences, seminars, on-the-job training, and formal trainings that internal auditors can be exposed to international best practices and frequent changes thereon from time to time. Specifically, CIAs are required to obtain at least 40hours of

training annually to meet the institute's continuing professional education (CPE) requirements for maintaining certification.

Lenz, Sarens and D'Silva (2014) also used frequency of training of the internal auditors as a factor that distinguishes one IAF from another. The referenced study observes the inadequacy of training for the German internal auditors that participated in the questionnaire survey.

Arena and Azzone (2007), in their study of adoption and characteristics of internal audit departments in Italian companies revealed that training on the job is the most popular way of exposing internal auditors to international best practices in the field. This consists of developing workers' competences in the field, for instance by introducing newly hired employees into a team of experienced employees. For the Italian CAEs that participated in the survey, those who indicated in-house training as the most important way of enhancing internal auditors' level of competences constitute 88.82%. According to the survey the next commonest form of training is through outsourced courses.

Akinteye, York and Quadrat-Ullah (2015) found the average mandatory CPE hours of Nigerian internal auditors as 36hours, which is 4hours short of the minimum 40hours recommended by the IIA for CIAs. However, the author established that 40% of the internal auditors involved in the study are Associate members of the ICAN, another 40% as Fellow of the ICAN (FCA), while the remaining 20% are associate members of the Institute of Chartered Accountants in India (ACAI). Therefore, if none of the respondents is CIA, the basis of the analysis of the mandatory CPE hours is confusing except ICAN has same requirements on the CPE with the IIA. In summary, internal auditors in Nigeria though can be said to be exposed to adequate training, the issue however is that internal auditing community in the country seems unaware of enormous knowledge sharing and acquisition available from the IIA chapter in the country. Therefore, the 14th proposition is formulated as below:

P14: Regular training of internal auditors in the Nigerian financial sector is positively associated with the individual internal auditors' competence and the ability of the internal audit function to strengthen corporate governance in the Nigerian financial sector.

4.5.5 Membership of internal auditors with the IIA

Burnaby and Hass (2011)'s study earlier discussed indicates that Latin America had the largest number of respondents (80%) that had been a member of the IIA for 5 years or less, and the lowest number (4.6%) that had been members for 11 or more years. For the US respondents, 56.1% of the respondents had been members for 5 years or less, and 23.7% had been a member for 11 or more years. In the case of Canadian respondents, 58.5% had been a member for 5 years or less, and 19.5% had been a member for 11 or more years. The highest number of respondents from USA that had become members of the IIA for 11 years or more might not be unconnected with the USA's long history of internal auditing, particularly, been the pioneer country in the history of internal auditing as a profession worldwide.

Arena and Azzone (2009), a study on organisational drivers of internal audit effectiveness used 153 responses of Italian companies' CAEs to gather insights from the CAEs on the various factors that can promote the effectiveness of internal audit. One of the three factors identified by the authors, as capable of influencing internal auditors' competence is the membership of the CAE with the IIA. As revealed by the study, while 64.71% (i.e. 99 CAEs) indicated their membership with the IIA, only 54CAEs (i.e. 35.29%) are not members. The higher percentage of CAEs who are members of the IIA is considered remarkable and as such is expected to have positive impact on the CAEs' level of competence or training activities. As anticipated, the study established that internal audit effectiveness increases when the CAEs is affiliated to the IIA.

With a view to investigating the level of the membership of the internal auditors in the NFS with the IIA, and implication of such membership on their level of competence and

ability to impact on the corporate governance in the sector, the last proposition (i.e. P15) of the study is formulated as:

P15: Membership of internal auditors of the Nigerian financial sector with the Institute of internal auditors is positively associated with the individual internal auditors' competence and the ability of the internal audit function to strengthen corporate governance in the Nigerian financial sector.

Finally, by relying on the institutional theory discussed in the preceding chapter, the fourth hypothesis under the study is formulated as :

H4: Internal auditors in the Nigerian financial sector are not to a greater extent competent in fulfilling their expected roles.

4.6 Chapter summary

This chapter focused mainly the review of extant literature on the key concepts through which answers can be provided to the four research questions of the study. At the end, fifteen propositions were made on the four key concepts (IAF's independence, IAF's auditing methodology, Internal auditors' objectivity and internal auditors' competence) shaping the study's focus. Using the three theories (i.e. Agency, TCE and Institutional), four hypotheses were formulated for testing. The next chapter provides details of the methodology adopted in carrying out the study, including a brief overview of the study's analytical methods.

Chapter 5: Research Methodology

5.0 Chapter overview

Having come up with four hypotheses to be tested, and fifteen propositions to be verified, under the study in the previous chapter, this chapter presents the approach adopted in gathering the necessary data, as well as the methods used in analyzing the data. This is done through six different sections covering the philosophical foundation of the methodology, development and piloting of the research instruments, data collection, data analysis, limitations of the methodology as well as summary of the chapter. Specifically, the chapter is arranged as follows: Section 5.1 set the tone for the philosophical foundation of the research methodology. The study's research strategy is presented in 5.2, and an overview of the development of the study's research instrument is given in 5.3. Section 5.4 gives an overview of data collection and analysis method adopted in the study. Section 5.5 highlights the limitations of the methodology, and section 5.6 summarises the chapter.

5.1. The Philosophical foundation of the methodology

The philosophical foundation of any research is the fulcrum on which the methods and strategy adopted in carrying out a research rest. In research, two strands of viewpoints are commonly used to describe the strategy or pattern of research methods. These are referred to as ‘epistemology’ and ‘ontology’.

Whereas epistemology can be seen in terms of ‘what constitutes valid knowledge and how it is obtained’, ontology can be said to be concerned with ‘what constitutes reality and how we can understand existence’. For Rose *et al.*, (2015), epistemology usually refers to questions of how we know what we claim to know, or alternatively by going along the Bryman and Bell (2011)'s school of thought, a question of whether or not the social world can and should be studied according to the same principles, and ethos as the natural sciences. Creating a domain of understanding ontology, Bryman and Bell

(2011, p. 20) elucidate that its central idea is the question of whether social entities can and should be considered objective entities that have a reality extraneous to social actors, or whether they can and should be considered social constructions built up from the perceptions and actions of social actors. These differing viewpoints are generally categorized as objectivism and constructionism. From these brief descriptions therefore, epistemological and ontological perspectives can be construed as theory of knowledge and view of reality, shaping a study's methodology.

Generally, Positivism and Interpretivism otherwise called phenomenology (see Omoteso, 2006; Bryman, 2008; Bryman & Bell, 2011), perceived within the mindset of either objectivism or constructionism, are the two dominant and recognized philosophical foundations of research methodology (Omoteso, 2006; Yekini, 2012; Adelopo, 2010; Bryman & Bell, 2011). Giorgi (2009) stresses that the primary aim of phenomenological philosophy is to develop a greater understanding of individual's experiences through the consciousness of the experience. This indicates that phenomenological research aims at greater understanding of social world by describing or interpreting human experience as lived by the experience in a way that can be used as a source of qualitative evidence (Mayor & Onwuegbuzie, 2015).

Although research can be categorised as either theory-validating (deductive) or theory building i.e. inductive (Rose et al., 2015; Bryman & Bell, 2011), the epistemological orientation of the researchers themselves appears to be the most prominent way of describing a research approach or strategy. This understanding is further extended by Rose *et al.*,(2015) and Adelopo (2010) who affirm that researchers can essentially be categorized in terms of their epistemological inclination. The concentration in this section on the two paradigms of positivism and interpretivism along both the epistemological and ontological perspectives notwithstanding, other paradigms along this bimodal orientation commonly recognised and controversially debated (Yekini, 2012; Trochim, 2006; Bryman, 2008; 2011; Saunders *et al.*, 2009) in literature include post-positivism also known as realism, relativism, hermeneutics, structuralism, post structuralism, deconstructivism, constructivism, and feminism (see Yekini, 2012. P. 95).

Aside recognizing these diverse philosophical ideologies, the focus of this study is mainly on the ones earlier espoused given their suitability and relevance to this study.

Positivism refers to the orientation of using scientific approach to conduct research whether the subject focus is inanimate or animate, and researchers that follow this line of orientation are referred to as positivists. From ontological view point, this line of epistemology is said to be embedded in objectivity, i.e. “facts are facts” (see Bryman & Bell, 2011). Interpretivism in contrast refers to the school of thought that rejects positivism by holding on to the position that pure scientific approach is unsuitable for social-science research. Interpretivists argue that there are fundamental differences between the objects of science (such as chemical and rocks) and the human being that social scientists study (Rose et al., 2015), and thus the scientific methods of positivism are inadequate if meaningful inferences are to be drawn from studies.

Contrary to the notion of stability of features, interpretivism perspective recognizes that human reasoning is unstable, and that people actively interpret the world around them and do so within a specific socio-cultural context (Rose *et al.*, 2015), “people are people”. It can possibly be argued that interpretivism is the epistemological perspective embedded in the quest for subjective knowledge. Thus indicating “subjectivity” as the ontological standpoint of phenomenology (or interpretivism). The above clarifications indicate the interconnectivity of both epistemological and ontological orientations particularly when addressing the philosophical foundation of research in business or social science, where the focal point is usually organisation or human reasoning.

Positivists and objectivists are expected to isolate themselves from the object of their research, given that the general tenet of the scientific approach of research methodology is that knowledge should be sought in a value-free manner, with the notion that objects are already embedded with meanings and meaningful realities, awaiting discovery without any interference. From their view point, only procedures through means such as data gathering and analysis similar to scientific approach used in natural science for hypothesis testing, and verification of causal relationship are ideal for such discovery.

Knowledge based on positivism standpoint is therefore assumed to be value-free, objective, and by corollary verifiable or replicable and thus generalisable.

Contrarily, the interpretivists and constructionists are of the view point that rather than being detached from the object under study in social sciences, people use their intuition to interpret the social world being studied, and that knowledge is actually fluid and subjective. This implies that researchers cannot detach themselves from the object being studied, and therefore, totally objective or value-free research seems impossible. That is ‘‘the knower and the known’’ are considered as inseparable (Rocco, *et al.*, 2003).

From the above discussions and considering the study’s objectives and research questions indicated in chapter 1, the philosophical foundation of this study could be argued to be mainly grounded in the interpretivism epistemological foundation and constructionism ontological orientation. This is so given that for the four research questions raised in the study, certain class of actors (i.e. those who are saddled with the responsibility of corporate governance enhancement, particularly, the internal auditors and management) are the identified relevant group through which the phenomenon (internal auditing) being studied could be actualized. These are animate domain, whose perceptions may not be totally value-free, aside from the fact that the domain is not totally scientific like molecules or rock. Interpretivists seek to understand human behavior from their daily interactions with the social world (Bryman, 2008).

5.2.0 Selecting the research strategy: Quantitative, qualitative or mixed methods?

Bryman and Bell (2011, p. 26) describe research strategy to mean a general orientation to the conduct of business research. Generally, the two main types of research strategies established in literature are:

- i. Quantitative, and
- ii. Qualitative

According to Bryman and Bell (2011), quantitative research on one hand can be said to be the research strategy that emphasizes quantification both in data gathering and

analysis. Qualitative research on the other hand usually emphasizes words instead of quantification in data collection and analysis. This indicates that quantitative researchers collect and analyse numeric data, while qualitative researchers use non-numeric data, which may also include images and video (Rose *et al.*, 2015). Mayoh and Onwuegbuzie (2015, p. 96) maintain that qualitative researcher views data as the product of interaction between research and participant.

Aside from the nature of data, other common attributes used to differentiate the two research strategy categories is the strategy perspective on, or relationship to theory.

While quantitative approach is usually concerned with theory testing (i.e deductive), qualitative is usually linked with theory building (i.e. inductive). In line with the Bryman and Bell (2011)'s word of caution on this line of demarcation between the two approaches, Rose *et al.* (2015) affirm that the distinction between quantitative and qualitative research strategy is not so precise, as quantitative research can as well be adopted for inductive, just as qualitative can also be deductive in some situation.

Two clear lines of distinction between the two approaches as indicated by Rose *et al.* (2015) are that:

- i. quantitative research is commonly characterized as having structured, predetermined and fixed research designs, whereas qualitative research is more flexible and evolving.
- ii. quantitative research is often characterized as "variable-orientation" by operationalizing concept of interest as measurable attributes or variables and specifying the expected linkages between them.

In addition, with a view to making a generalization from the totality of whatever is being investigated, a fractional portion of the aggregate can be drawn, investigated and findings there from used as a basis for generalization for the entire object through the process of statistical inference. Qualitative approach unlike quantitative however focuses on heterogeneity and peculiarity of individual cases, and thus a smaller group is the focus. Therefore facilitating an in-depth knowledge of a focused group. The table

below as adapted from Rose *et al.* (2015) gives a summary of the salient distinguishing features of the two approaches

S/n	Features	Quantitative	Qualitative
i.	Data type	Numeric	Non-numeric
ii.	Theory relationship	Deductive	Inductive
iii.	Procedure	Structured, pre-specified and fixed	Emergent, and flexible
iv.	Focus	Aggregate properties and statistical inference	Concerned with focused and in-depth observation
v.	Interference	No researcher interference in the process	Researcher is closely involved.

Table: 5.1: Qualitative vs Quantitative research (adapted from Rose *et al.*, 2015)

To differentiate between the two research approaches, Bryman and Bell (2011) applies the line of epistemology and ontological orientation as below:

	Quantitative	Qualitative
Principal orientation on theory	Deductive (i.e. theory-testing)	Inductive (i.e. theory generation)
Epistemological orientation	Natural science (particularly positivism)	Interpretivism
Ontological orientation	Objectivism	Constructionism

Table: 5.2: Qualitative vs Quantitative research (adapted from Bryman & Bell, 2011)

Arising from the comparison of the two research approaches as summarized in the above tables is a question of whether it is possible to apply both paradigms in a singular research work so as to take complimentary advantages such a combination can avail. Johnson *et al.* (2007) indicate that debates about singular or universal truths or approaches to viewing the world versus multiple or relative truths versus balances or

combination of same dates back to ancient western philosophy. As the debate continues so does it continue to affect how knowledge is viewed. *“This debate continues to affect how we view knowledge, what we look for, what we expect to find, and how we believe we are going to go about finding and justifying ‘knowledge’”* (Johnson *et al.*, 2007.p. 113).

In terms of relationship with theories, the approach adopted under this study is *deductive (i.e. ‘theory testing’)*. As established in chapter 3 of this study, three theories (Agency theory, TCE theory and Institutional theory) constitute the theoretical paradigm for the study. On the agency theory, the main assumption of the theory, that IAF is a contracting cost, jointly applicable to both the management (in his position as agent of the board), and to the board (as principal or nominee of the principal-the shareholders) are put to tests in this study. Specifically, and in line with the extensive discussions made under the theoretical background of the study (chapter 3), the contracting cost is borne by the principal as monitoring costs, necessitated by the need to ensure alignment of actions on the part of the agent. To agent, the cost is predicted as bonding, a necessary cost to signal to the principal that they are carrying out their instructions in line with their envisioned objectives, and also to ensure retention of their agency status. The issue of IAF’s independence positioned as the key concern to be addressed under the study’s first research question - *‘what is the level of independence enjoyed by IAF in the Nigerian financial sector’?* is addressed by testing the reliability of the fundamentals of agency theory put forward by Adams (1994) as a paradigm for the essence of IAF in organisations where principal-agency condition exists. Given the thin line of demarcation between IAF’s independence and individual IAs’ objectivity as discussed in chapter four however, the issue of IAs’ objectivity (the focus of research question 3) is also addressed using Agency theory.

Similarly, research questions 2 (*“To what extent are the internal audit functions in the Nigerian financial sector performing their roles in conformity with the IIA standards?”*) and 4 (*“To what extent are internal auditors in the Nigerian financial sector competent in fulfilling their expected roles?”*) of the study are investigated by

applying the canons of Institutional theory. The TCE is however applied for IAF's sourcing decision and its impact on IAF's independence.

Whereas deductive research stance established for the study in the above exposition may seem conflicting with its earlier epistemological and ontological direction of constructionism, and an indication towards mixed methods; the interwovenness of epistemological positions with research strategy domains is a rationalization. In addition, though the study substantially requires primary data gathered from a survey with the use of a well-piloted questionnaire administered on the sampled firms' CAEs and some senior members of their teams, a face to face semi-structured interview also conducted for the selected firms' CAEs, in the sector further indicates a combination of two data collection methods. The face-to-face interview eventually conducted with four CAEs borne out of the desire for in-depth insights implies a combination of numeric and non-numeric data sets for the study. This is what is referred to as data triangulation, an established form of triangulation according to Denzin (1978), and a pointer towards mixed method research (MRR).

Mixing of methods may occur in a study if the researcher decides it will help make the data collection and analysis more accurate or the inferences more useful (Rocco *et al.*, 2003). Consideration of interview method to complement the questionnaire survey method of collecting data for the study arose from the researcher's desire for precision and robustness of evidences for inferences. Quantitative or qualitative components may be used equally, or one may be more dominant (Rocco *et al.*, 2003. P. 22). In this study however, quantitative component is dominant considering its tremendous application on the study's research questions and the complementing application of qualitative method. The various benefits of MMR (which includes data integrity and widened research horizon) as highlighted in the next section are some of the justification for this strategy.

5.2.1 Mixing methods or data triangulation?

Whereas discussions in the prior sections either via epistemological or ontological ground attempt to delineate the various research strategies as deductive or inductive,

quantitative or qualitative (that is presenting research methodology as being mono-method oriented), studies that revolve around the two established paradigms abound. This paradigm forms the foundation of “mixed methods”. Johnson *et al.* (2007) view mixed methods research (MMR) as an approach to knowledge in terms of theory and practice that attempts to consider multiple viewpoints, perspectives, positions, and standpoints of qualitative and quantitative research. The author accordingly defines mixed methods research as “the type of research in which a researcher or a team of researchers combines elements of qualitative and quantitative research approaches (e.g. use of qualitative and quantitative viewpoints, data collection, analysis, inference techniques) for the broad purposes of breadth and depth of understanding and corroboration”. MMR can be seen as a response to the long-lasting, circular, and remarkably unproductive debates discussing the advantages and disadvantages of quantitative versus qualitative research, given the concern over their different paradigmatic foundations (Feilzer, 2010). The underlying assumption of MMR is that it engenders a fuller understanding of human phenomenon because research conducted with mixed methods is generally perceived to be stronger (Rocco, *et al.*, 2003).

Another terminology usually adopted for mixed method is triangulation. Triangulation is frequently synonymous with MMR (Archibald, 2015, p. 3). The adequacy of the term can be inferred from Denzin (1978)’s definition of triangulation as “the combination of methodologies in the study of the same phenomenon”. According to the author, triangulation can take the form of :

- i) data triangulation- use of a variety of data sources in a study.
- ii) investigator triangulation-engagement of several different researchers.
- iii) theory triangulation – use of multiple perspectives and theories to interpret the results of a study; and
- iv) methodological triangulation – use of multiple methods to study a research problem.

The above is seen as an extension of Easterby-Smith *et al.* (2002) in Omoteso (2006) where triangulation is only limited to data, methodology and theory (see Omoteso 2006, p. 110).

Whereas there are agitations in literature on the appropriateness of construing mixed method as triangulation (see Archibald 2015), given that triangulation is generally understood as a means of confirming and proving completeness of research findings (see Creswell & Plano, 2011), an overemphasis on the restrictive benefits of confirmation and corroboration of triangulation may give a conflicting appreciation of triangulation and its relevance as a nomenclature or expression of MMR, particularly within social science research. Without making attempt to joining researchers pre-occupied with the agenda of clarifying the adequacy or otherwise of triangulation as a synonym for MMR, points worth of acknowledging in the debate so far is that triangulation and MMR share same border line in terms of pluralism of methods, as well as confirmation and corroborative benefits. To further compound the confusion about the interchangeability of the two terms, Greene (2007), and Hesse-Biber (2010) re-affirm that triangulation can refer to a MMR design, the intent of which is often corroboration or confirmation.

Looking further from the issue of taxonomy, the benefits of mixing methods in research include the following as supported in literature (see: Johnson *et al.*, 2007; Rose *et al.*, 2015; Mayoh & Onwuegbuzie, 2015; Yekini, 2012; Omoteso, 2006):

- i. increases validity of data and minimization of bias. The bias inherent in any particular data source will be canceled out (Denzin, 1978), thus giving researchers more confidence about their research results.
- ii. enhances the strengths and minimizes the weakness of individual methods
- iii. promotes analysis of data from different perspectives, and thus uncovers contradictions
- iv. helps in the use of the results of one method to enhance another
- v. widens the scope of research.

The popularity of MMR is increasing particularly in business research and in the social sciences more generally (Bryman & Bell, 2011), despite the unsettled controversy about

its philosophical domain. To some, the combination of quantitative with its positivisms epistemological orientation and qualitative methods with its interpretivism epistemology creates a confusion and difficulty of locating a suitable philosophical paradigm. Rocco *et al.* (2003) define paradigm as a “worldview”. For Creswell (1998), paradigm is a “basic set of beliefs or assumptions that guide a researcher’s inquiry”. Going by Johnson *et al.* (2007, p. 113) however, the philosophical foundation of MMR is pragmatism (Feilzer, 2010; and Mertens, 2012).

Pragmatism according to Feilzer (2010) raises question on the dichotomy of positivism and constructivism and aims at a convergence of both paradigms, emphasizing the diverse layering of phenomenon, some objective, some subjective and some a mixture of the two (Dewey, 1925), and the need for a method that lends itself to the required flexibility to address the divergent layers or features of a phenomenon being studied. Thus, researchers do not have to be imprisoned under the paradigm of any particular methodological domain, even when the studied phenomenon suggests a need for reflex. The assumptions behind the adoption of pragmatic paradigm as a philosophical foundation for MMR is grounded in the notion that there is not one set of methods that is appropriate for studying a phenomenon, but rather any methods that best address research question should be adopted (Mertens 2012). Arising from the above discussions therefore, mixed method, combining positivism and constructivism paradigms is adopted for the study. A pointer towards pragmatism in line with Johnson *et al.* (2007), Feilzer (2010) and Mertens (2012).

5.3.0. Development and piloting of the research instrument

The development of the instrument used for this study is informed by the four research questions, and the four hypotheses formulated to be tested under the study. Based on the theories underlying the study and the literature reviewed in Chapter four, relevant and specific questions are built into a questionnaire that was administered on the study’s samples. At the planning stage of the survey, the instrument was divided into five different sections (Sections A-E). Section A of the instrument contains six different

questions meant to elicit respondents' bio-data. These include questions on areas such as gender, age, qualifications, etc. of respondents.

Section B focused the main characteristics of corporate governance. This section contains six questions meant to test the conformity of the respondents' firm's corporate governance with the framework and concepts reviewed under chapter four. The third section contains thirty-five questions in all and was used to test the 2 hypotheses and 9 propositions formulated on two research questions that address the issue of IAF's independence and individual auditors' objectivity. The significance of these two important concepts to the effectiveness of IAF, the crux of this study informed the volume of the hypotheses, the related propositions and the specific questions thereon. The other two sections (i.e. D and E) contain fourteen and seven specific questions respectively. These are meant to provide answers to the propositions and the two hypotheses formulated to answer the remaining two research questions.

Summary of the initial lay-out of the research instrument containing in total sixty eight (68) questions with focus on different specific objectives of the study as highlighted above is as given below:

S/N	Research questions	Focus	Question Nos.as contained in the research instrument
1.	What is the level of independence of the internal audit functions in the Nigerian financial sector	Existence of internal audit charter	C4-6
		IAF's reporting obligation to management	C9
		IAF's reporting obligation to the audit committee	B1-5 C8, C10, C17
		IAF'S support from management	C7 C13-16 C21-24, C28
2.	How objective are the internal auditors in the Nigerian financial sector?	CAE's attendance of audit committee meeting	B1-5 C7, C18-20
		IAF's sourcing arrangement	C1-6, C9-32
		IAF 's use as a training ground	C11-12, C25-27
		IAF's roles in risk management	D8-14
3.	To what extent are the internal audit functions in the Nigerian financial sector performing their roles in conformity with the IIA standards?	IAF's compliance with the IIA standards	A4-6
4	To what extent are internal auditors in the Nigerian financial sector competent in fulfilling their expected roles?	Internal auditor's competence	E1-7

Table 5.3: Relevance of questions used in the research instrument to the study's research questions

5.3.1 Piloting of the Research instrument

In order to evaluate the adequacy, capability and reliability of the research instrument, a pilot survey was carried out on nine (9) respondents selected through judgmental sampling. The sample selected for the pilot are a group of respondents considered not too divergent from the targeted respondents for the study. These include internal auditing professionals with professional certification (i.e. "CIA"- Certified Internal Auditor), auditing professionals with external audit firm, some internal auditors from the targeted population and an academic with tremendous wealth of experience in research design, as indicated below:

S/N	Category	Nos.
1	Professional internal auditors who are members of the IIA (Nigeria chapter) with CIA certification	3
2	Managing partners of external audit firms	2
3	Internal auditors from Nigerian Financial sector	3
4	Academic	1
	Total	9

Table 5.4: Details of the participants in the Pilot survey

The above approach is similar to such adopted by Munro & Stewart (2011), Ebaid (2011) and Sarens, Abdolmohammadi, & Lenz (2012). As recommended by Rose, Spinks and Canhoto (2015), the professional internal auditors with CIA certification were included in the pilot as subject matter experts so that they can give more detailed insights required for adequacy of the questions themselves.

According to Bryman and Bell (2011), piloting a research instrument is done to ensure coherence of questions, in the course of re-arrangement of questions to see how they flow, amendments in form of merging of questions, re wording of questions etc may

happen. This is with a view to improving the instrument to ensure that the survey questions operate well.

Given the desired mode of carrying out the questionnaire survey thorough online, the questionnaire was piloted by e-mailing to the selected respondents whose e-mail addresses were earlier obtained, with a covering letter indicating the objectives of the study, and guideline on how to complete the questionnaire. In addition, the respondents were informed that the survey was a trial run of a main study to be conducted after the pilot and that the opinions of the respondents were being solicited on the following areas with a view to improving the suitability and workability of the instrument:

- i. clarity or simplicity of the questions.
- ii. aptness of the wordings and ordering of the questions.
- iii. appropriateness or otherwise of the response options provided for each question.
- iv. appropriateness of the layout and structure of the questionnaire.
- v. practicability of the time taken to complete the questionnaire bearing in mind the targeted group.

5.3.2 Outcome of the Pilot study

The pilot survey which commenced on February 23, 2016 lasted about four weeks. At the end of the pilot, eight (8) out of the nine (9) respondents returned their responses with their various observations and comments on the suitability of the instrument. Whereas, it took all the respondents less than the maximum period of two (2) weeks given for them to return the completed questionnaire with their comments, the required amendments on the instrument however took about two weeks to be concluded. The significance of the pilot survey is in form of invaluable feedbacks obtained from the participants which led to a major review of the questionnaire particularly in terms of re-arrangement (mainly for the essence of coherence), re-wording of the questions, for more clarity and avoidance of ambiguity; and scaling down of the number of the questions to achieve minimal time of completion.

Overall, the initial sixty-eight (68) questions were considered too many by the pilot survey participants considering the status of the targeted audience and the challenges of likely apathy due to the usual busy schedule of CAEs (the targeted audience). Consequently, the following specific amendments were carried out:

- i. reduction of the number of questions under Section A of the instrument. Two of the questions (gender and age of the respondents) were removed as they were eventually considered irrelevant to the research objectives. At the end, the initial six (6) questions under this section were eventually reduced to four (4). Please see tables 5.5 and 5.6 below.
- ii. elimination of Section B focusing corporate governance's characteristics. Initially, there were six different questions under this section covering areas such as existence, membership, and professional qualifications of members, of audit committee, as well as the frequency of meeting of the committee. Also included under this section initially were questions meant to evaluate issues bothering on external audit practice of companies in the sector under focus. These questions were eventually restructured and included under section B, that deals with independence of IAF and objectivity of internal auditors. All these questions with the exclusion of the one on "who handles the firm's external audit" were considered part of the questions relevant to get insights on independence and objectivity of IAF and internal auditors respectively and were therefore restructured and classified as part of the questions under the new Section B.
- iii. re-arrangement and merger of some related questions particularly under Sections C-E. This revision is justified on the ground of similarity of focus between questions assessing objectivity of internal auditors and those evaluating the characteristics of internal auditors.

At the end of the review, the five sections of the initial questionnaire (A-E) were reduced to four (A-D) and the sixty-eight (68) questions on the initial questionnaire were eventually scaled down to thirty five (35) as summarized below:

S/n	Section	Focus of the questions	Nos. of questions
1	A	Respondents' biodata	6
2	B	Corporate governance's Characteristics	6
3	C	IAF's independence and internal auditors' objectivity	35
4	D	Auditing methodology	14
5	E	Characteristics of Internal auditors	7
	Total		68

Table 5.5: Summary of the questionnaire before piloting

S/n	Section	Focus of the questions	Nos. of questions
1	A	Respondents' Biodata	4
2	B	IAF's independence and internal auditors' objectivity	20
3	C	Auditing methodology	6
4	D	Characteristics of Internal auditors	5
	Total		35

Table 5.6: Summary of the questionnaire after post-piloting amendments

A copy of the research instrument is included as Appendix D to this thesis.

The interview questions were prepared after the pilot survey. This was deliberate, and with a view to ensuring that the insights drawn from the trial survey was incorporated into the interview questions. The interview guide used for the interview was drawn with considerations to the outcomes of the pilot survey. Some scholars have argued that the progressive nature of interview is enough to enable researcher to improve on interview

schedules and questions. While this was actually the experience, the results of the pilot survey initially offered invaluable inputs into the interview protocol used for the interview. The interview guide is marked appendix E

5.3.3 Target Population

Though this study focuses internal audit practices in the NFS, the heads of the IAFs in the sector were however the target. Therefore, whereas the population of the study was all the internal auditors in the NFS, this study specifically focuses the heads of the IAF in the sector. As earlier indicated in chapter 2 of the thesis, the NFS comprises of bank and non-bank financial institutions which are regulated by the CBN, NDIC, SEC, NAICOM, PenCom, FMBN and the country's Federal ministry of finance. Of all the companies identified in the sector as at the time of the survey, only sixty-eight (68) were found to be listed on the Nigerian Stock Exchange (NSE). These are as shown in the table below:

S/n		Number	Percentage
i.	Commercial banks	20	29.41
ii	Mortgage banks	7	10.29
iii	Development banks	4	5.88
iv	Merchant banks	2	2.94
v	Microfinance banks	2	2.94
vi	Insurance companies	30	44.12
vii	Funds and Assets managers	3	4.41
	Total	68	100

Table 5.7 (a): Listed firms in the NFS as at 2016

Going by the above table, and in tandem with Abiola (2012), where 10, 5, and 2 were used to estimate the average number of internal auditors/internal control staff of Nigerian banks, insurance companies and other FIs, the estimated total population size under focus is three hundred and eighty-six (386). Please see the table below:

S/n		Number	Average number of Internal audit/ internal control staff (see Abiola, 2012)	Estimated number of Internal audit staff
i.	Commercial banks	20	10	200
ii	Mortgage banks	7	2	14
iii	Development banks	4	2	8
Iv	Merchant banks	2	2	4
V	Microfinance banks	2	2	4
Vi	Insurance companies	30	5	150
Vii	Funds and Assets managers	3	2	6
	Total	68		386

Table 5.7(b): Estimates of the study's population using Abiola (2012)

Given that only the head of the IAFs in the sector and their immediate subordinate are the subject of the survey however, the sample size of the study was thus one hundred and thirty six (136), representing 35.23% of the estimated total population. This is as shown below:

S/n		Number	Percentage (%)
i.	Commercial banks	40	29.41
ii	Mortgage banks	14	10.29
iii	Development banks	8	5.88
Iv	Merchant banks	4	2.94
V	Microfinance banks	4	2.94
Vi	Insurance companies	60	44.12
Vii	Funds and Assets managers	6	4.41
	Total	136	100

Table 5.7 (c) : The study's sample size

The sampling method used for the study was therefore proportionate stratified and purposive sampling.

5.4.0 Overview of data collection and analysis method

In line with the study's focus and research questions, primary data was used for the research. The primary data were collected through questionnaire survey which was complemented by semi-structured interview carried out on four respondents that earlier participated in the questionnaire survey and voluntarily expressed their willingness to be interviewed further.

The questionnaire was administered electronically through a proprietary online survey tool known as "Survey monkey". This is an online survey development cloud-based software that has become phenomenal in recent time particularly for academic surveys. The software basically leverages on the radical surge in the use of internet. Administering questionnaire survey online has the following invaluable benefits over the physical distribution of questionnaire to the targeted respondents:

- i. it reduces the cost of questionnaire administration as the researcher is saved the hassles of making personal visits to the respondents' locations. The task of distributing hard copies of questionnaire aside from the cost of stationeries required and follow-up visits could be more herculean particularly for respondents spread across geographical boundaries. Although certain fees are payable to subscribe for the use of the software for the desired time frame, this cost is however negligible when compared with the challenges associated with physical means of administration.
- ii. online administration of questionnaire also has the advantage of ease of reaching out to respondents that ordinarily would be so difficult to reach either physically, or through telephone particularly respondents with extremely very busy schedules. As a matter of fact, when deciding the most appropriate means of administering the study's questionnaire, this is one of the key factors that prompted the choice of the online medium. This is so due

to the peculiarly busy schedules of the CAEs who are the main focus of the study.

- iii. it reduces the turnaround time owing to the speed of dispatch and ease of completion of the questionnaire on the part of the interested participants. The same consideration was noted in Christopher *et.al* (2009) where an e-mail-based questionnaire was adopted to collect data from the CAEs in Australia in a study of independence of the Australian IAF. The usual likelihood of sending and resending of hard copy of questionnaire most importantly in case of misplacement by the respondents is eliminated.
- iv. it eliminates error of data entry and coding usually inherent in manual entry of responses to questionnaire administered conventionally either by hand delivery or post. This is so given the capability of the software to automatically handle data processing through its user-friendly features. The online medium of administering the questionnaire eliminates manual process of data entry, and the usual associated human errors.

As suggested by Rose, *et al.* (2015), the following factors were put into consideration before the decision to use online questionnaire administration for the survey was arrived at:

a) the suitability of Survey monkey for the question formats

Survey money is found to be very suitable for the format of the questions for the study's questionnaire. The questions used in the questionnaire are both open-ended and close ended (with appropriate answer choices). The online survey software has the required capabilities that allow both question formats.

b) the ease of use of the software design interface and availability of support in case of difficulty.

One of the key endearing factors of the online survey tool is the availability of support services, and guides from the proprietors thus making the software user-friendly. The subscription paid for the access makes the software, a value for money package.

c) The data security policy of the software and compatibility of same with the data protection policy guiding the research work

The software is data security-conscious, and the security offering on same is found to be compatible with the data protection policy applicable on the research, most importantly on the issue of respondents' anonymity.

d) Capability of the software to handle numbers of questions and size of the respondents

The capability of the software in terms of number of questions and respondents it can handle is fabulous and categorized into different bouquets. So the researcher is given the choice of opting for premium options considered appropriate.

e) The suitability and capability of the software for data export upon completion of the survey to facilitate data analysis.

This is another critical area put into serious consideration before making the choice of Survey monkey for the questionnaire administration. The software is highly compatible with Microsoft Excel package that makes easy the exportation of the raw data. Possibility of exporting the raw data from the survey monkey software directly into excel format is considered a huge advantage of online questionnaire administration over the conventional hand delivery or telephone method. The compatibility of Survey monkey software with excel-readable file, through which the survey data can be electronically processed and analysed is considered the greatest advantage of online administration of questionnaire.

5.4.1 Collection of data

As earlier indicated, the study made use of primary data consisting of both quantitative and qualitative data collected with the aid of questionnaire survey and semi-structured interview. The study involved the internal auditors in NFS. Specifically, only the CAEs and their immediate subordinates were considered for the study. Going by table 5.7(c) in section 5.3.3, the total targeted respondents making up the study's sampling frame is one hundred and thirty six (136). Bearing in mind the online questionnaire administration method to be used for the study and with a view to ensuring good response rate, the strategy for reaching out to the targeted audience was clearly mapped out at the beginning of the survey.

First, the list of firms in the sector listed on the NSE was compiled through the personal contact made to the exchange (NSE). This was verified by the details contained on the NSE's database maintained on the exchange website in January 2016 as detailed out in table 5.7(a). In the course of building up the contacts of the listed firms' CAEs and their immediate subordinates, it came to the researcher's discovery that the CAEs in the country's banking sector subscribe to an association known as Association of Chief Audit Executives of Banks in Nigeria (ACAEBIN) with an office in Lagos, Nigerian commercial headquarter. The association, a not for-profit making body seeks to promote and foster interaction among CAEs of Banks in Nigeria, through promotion of competence, ethical standards and professional behavior amongst member organisations.

In order to get detailed contacts of all the CAEs of listed banks that belong to the association, the researcher approached the association's secretariat with a formal proposal (detailing out the research focus and the researcher's intention to reach out to the association's members through the secretariat). This was supported by two letters of reference, one from the researcher's supervisory team, and the second from the IIA Nigeria chapter (copies of these letters are included as Appendix B and E respectively to the thesis). The university 's letter of introduction details out among other facts, confirmation of the researcher's studentship with De Montfort University as a post-graduate research student in Accounting, with the focus of the research work clearly stated. The IIA's letter of support confirmed the researcher's membership of the institute (IIA), and solicited for the support of the targeted respondents. These two letters were intentionally obtained to add credibility to the research activities and also to make necessary entreaty for support from the targeted respondents.

The researcher's interaction with the ACAEBIN's secretariat and executives was quite helpful in building up a reliable database of the required contacts of the CAEs of the listed banks. Though this initially made the first contact more focused in terms of knowing the locations and the names of the CAEs to be contacted, contrary to the researcher's expectation however, it was eventually realised that securing appointments

with the CAEs was not as easy as anticipated. First, most of the CAEs were uncooperative at the beginning, taking exceptions to the manner their names and telephone numbers were obtained from the Secretariat. It was later found out that the association's secretariat actually did not give some of the members (whose details were obtained from the secretariat) prior hint about the research work and the researcher's plan to approach them individually as promised. In addition to this, the usual busy schedules of the CAEs also added to the difficulty initially encountered by the researcher.

In order to surmount this challenge, the researcher eventually formalize his approach by writing detailed proposal about the research work addressed specifically to each CAEs in the sector. From the prior and formal contact, the researcher was able to compile the list of the CAEs subordinates, telephone numbers and e-mail addresses, having confirmed the preference of the respondents for online survey questionnaire. The support of the researcher's colleagues in the sector (both former colleagues while in the banking industry, and professional colleagues –i.e. members of both the IIA and the ICAN) also assisted greatly during the preliminary contacts on the targeted respondents.

The significance of making initial contacts on targeted respondents particularly to enhance survey response is also emphasized by AL-Twajry *et al.* (2003) in their study of the development of internal audit in Saudi Arabia using institutional theory. The authors indicated that their achievement of a response rate of 58% from the Directors of the internal audit departments was aided by the initial contact on the targeted respondents.

The actual survey commenced in May 2016 and lasted for sixty (60) days. At the beginning of the survey, the questionnaire was sent to all the compiled e-mail addresses of the respondents through survey monkey platform. Considering the online prompt on each response, daily monitoring of the survey became seamless during the survey period. Throughout the period of the survey, the researcher kept making reminder calls on those who were yet to respond. At the end of the first thirty days, it was discovered

that only 40 responses had come in. This led to the researcher's decision to extend the initial thirty days subscription to Survey monkey online tool for an additional thirty days. The thirty (30) days extension was complemented with aggressive follow up through telephone calls and e-mail reminders to the targeted respondents. Responses to the survey during the period of the extension were quite remarkable particularly during the first two weeks of the additional thirty days. It was observed that throughout the last two weeks of the survey, only two responses were obtained despite the follow up calls and e-mails.

Overall, total responses obtained at the end of the 60 days survey was ninety one (91), representing 66.9% response rate. Of these 91 responses, it was discovered at the point of exporting the data into an excel-readable file, that there were three (3) incomplete responses, leaving only 88 usable responses (i.e. effective response rate of 64.7%). This response rate compares favourably with similar and related studies such as Lenz *et.al.* (2014)-34.3%; Adel and Maissa (2013)-67.6%; Zaman and Sarens (2013)-27.8%; Gras-Gil *et al.* (2012)-65.3%; Sarens *et al.* (2011)-28.08%;Ebaid (2011)- 19.3%; Ahmad and Taylor (2009)-17.9%; Zain *et al.* (2006)-20.03%; Al-Twajjry *et al.* (2003)-58%; and Morrill and Morrill (2003) -46.4%. For ease of detailed comparison, details of the referenced studies showing how they compare with the current study in terms of the survey response rates are given in Table 5.8 below:

S/N	Study	Study's objective	Study sample size (n)	Response	Response rate (%)
i.	Lenz <i>et.al.</i> (2014)-	Probing the discriminatory power of characteristics of internal audit functions: Sorting wheat from the Chaff	134	46	34.3
ii.	Adel and Maissa (2013)	Interaction between audit committee and internal audit: evidence from Tunisia	74	50	67.6
iii.	Zaman and Sarens (2013)	Informal interactions between audit committees and internal audit functions	672	220	32.7
iv.	Gras-Gil <i>et.al</i> (2012)	Internal audit and financial reporting in the Spanish banking industry	72	47	65.3
v.	Sarens <i>et.al.</i> (2011)	Monitoring effects of the internal audit function: Agency theory versus other explanatory variables	260	73	28.08
vi.	Ebaid (2011)	Internal audit function: an exploratory study from the Egyptian listed firms	109	21	19.3
vii.	Ahmad and Taylor (2009)	Commitment to independence by internal auditors: the effects of role ambiguity and role conflict	565	101	17.9
viii.	Zain <i>et.al.</i> (2006)	Internal auditors' assessment of their contribution to financial statement audits: The relation with audit committee and internal audit function characteristics	504	101	20.03
ix.	Al-Twaijry <i>et. al</i> (2003)	The development of internal audit in Saudi Arabia: An institutional theory perspective	135	78	58
x	Morrill and Morrill (2003)	Internal auditors and the external audit: a transaction cost perspective	330	153	46.4

Table 5.8: Extant studies' response rate to questionnaire survey

5.4.2 Interview

The face to face interview was conducted on four (4) CAEs who participated in the questionnaire survey and indicated their willingness to provide further insights through the interview. Whereas the initial plan was to conduct a focus group interview, or on at least 50% of the participants in the survey questionnaire, this however did not materialize given the general unwillingness on the part of the CAEs. Bryman and Bell (2011) indicate that focus group interview affords researcher the opportunity to study ways in which individuals collectively makes sense of a phenomenon and construct meaning around it. However, the issue of how to secure people's agreement to participate remains one of the key challenges on focus group interview. In all, only four out of the ninety-one (inclusive of three respondents whose responses were unusable) that responded to the online questionnaire eventually agreed to take part in the interview.

These four interviewees were therefore selected based on convenience sampling. Convenience sampling is a non-probability sampling technique where subjects are selected because of their convenient accessibility and proximity to the researcher. Whereas the advantages of convenience sampling method are mainly its promptness and cost-effectiveness, Rose *et al.* (2015) indicate that it can produce a biased and unrepresentative sample. Incidentally, the four participants represent four different industries in the sector. These are commercial banks, mortgage banks, micro-finance banks and insurance companies, all listed on the NSE, and spread across three different locations in the country. Two of these interviewees (commercial and insurance) were from Lagos, while the remaining two (Mortgage bank and microfinance banks) were from Abuja and Osogbo (Osun State) respectively. This spread minimizes the tendencies of sample bias and non-representativeness. Another comfort on the application of convenience sampling for the interview is the fact that insights there from were meant to provide corroborative evidence for the feedback from the questionnaire survey of the 88CAEs. Acceptance of convenience sampling based on the links to be forged with existing findings is one of the justifications advocated by Bryman and Bell (2007) for the use of convenience sampling method.

Due to the different locations of the interviewees, and their different time of schedules, the interview was conducted over a period of one month, specifically between mid-July 2016 and mid-August 2016. All the interviews were conducted one-on-one in the offices of the participants, and each interview lasted for an average of 45 minutes. To ensure concentration during the interview and facilitate transcription of the participants' responses, the interviews were tape-recorded with prior consent of the interviewees. A carefully prepared interview guide was also used on the entire interview so as to avoid unnecessary deviations from the subject matter of the interview on the part of the interviewer. The interview guide therefore served mainly as the companion (*see Bryman and Bell, 2011*). As a back-up against incidence of poor recording or unanticipated malfunctioning of the audio recording device used for the interview however, notes were also taken of some insights considered critical during the interview. While transcribing the recorded data, the notes taken at the time of the interview were used as reference.

5.4.3. Data Analytic procedure

i. The quantitative data

At the end of the sixty (60) days questionnaire survey period, all the responses obtained from the questionnaire administered online with the aid of Survey monkey were exported into an excel file. This was thoroughly reviewed for incidence of missing or incomplete data. Out of the ninety-one (91) responses obtained, 3 respondents were discovered to have given incomplete responses by not answering all the questions provided on the questionnaire. These 3 incomplete responses were eliminated from the data, thus leaving eighty eight (88) useful responses at the end.

Given the nature of the dependent variable of the study (i.e. whether or not IAF is playing active roles in corporate governance), with dichotomous outcomes (either Yes or No), and extant studies on the concepts being studied, Binary Logistic regression analysis (BLRA) was adopted for the quantitative data. BLRA examines the influence of various explanatory or predictor variables (or factors) on a dichotomous (or

categorical) outcome by estimating the probability of the event's occurrence. BLRA is typically employed when the dependent variable is dichotomous and the independent variables are either continuous or categorical variables. According to Gujarati and Porter (2009), this analytical method is considered suitable where the dependent variable is qualitative in nature such as “Yes” or “No”, “male” or “female”, “alive” or “dead” etc.

Logistic regression is well suited for the study of categorical outcome variables (Peng, *et al.*, 2002). Logistic regression is used to predict a categorical (usually dichotomous) variable from a set of predictor variables. Logistic regression is often used particularly where the predictor variables are a combination of both continuous and categorical variables and where the various assumptions of normality of distribution are violated, though in many cases, some features of linear regressions are still maintained.

Contrary to Linear Regression Analysis that is based on Ordinary Least Square (OLS) method however, BLRA is based on Maximum Likelihood Estimate (MLE)., and the method is suitable for non-linear relationships between the dependent variables and the independent variables. Stone and Rasp (1991) noted that many issues of interest to researchers in the field of Accounting involves explanation or predictions of mutually exclusive, dichotomous choices such as qualify/do not qualify an audit opinion, capitalize or do not capitalize a cost etc. Peng *et al.* (2002) and Raghunandan *et al.* (2001) maintain that conventional OLS regression is appropriate when the dependent variable is continuous or can assume discrete values but becomes unsuitable for a dichotomous independent variable such as whether the audit committee provides private access to the CAE or not. The objective of this research, investigating whether IAFs of the NFS has the capability to add values to the corporate governance, as one of its key cornerstones, no doubts is another example like Raghunandan *et al.* (2001)'s illustration of a dichotomous dependent variable.

Whereas under Linear regression analysis the dependent variable is continuous, and the independent variables are expected to be normally distributed, the dependent variable

under logistic regression analysis is categorical and normality of the independent variables is not a necessity. Generally, the following assumptions hold for any data on which binary logistic regression analysis (BLRA) is to be performed:

- i. linear relationship between the dependent and independent variables is not a necessity.
- ii. independent variables are not linear function of each other.
- iii. normal distribution is not necessary or assumed for the dependent variable.
- iv. normally distributed description of errors are not assumed.
- v. the independent variables need not be interval level

As highlighted by Stoltzfus (2011), the basic conditions that need to be met under Logistic regression include:

- i. independence of errors – this implies that all sample group outcomes are separate from each other(i.e. avoidance of duplicate responses)
- ii. linearity in the logit for continuous variables –there should be a linear relationship between these variables and their respective logit-transformed outcomes.
- iii. absence of multicollinearity among the predictor variables- multicollinearity is a situation of high level of interactions or associations among two or more predictor variables. As applicable under the linear regression function, multicollinearity usually leads to incidence of large standard errors for the estimated beta coefficients of the independent variables. In this situation, the coefficients estimates may change erratically in response to small changes in the model or the data. Thus indicating the unreliability of the regression model.
- iv. lack of strongly influential outliers –where a sample member’s predicted outcome is vastly different from its outcome, and there are too many of such outliers, the overall accuracy of the model could be compromised.

5.4.4 Adequacy of number of events per independent variable

Whereas in literature, little guidance is given on how large the sample size must be for logit parameter estimates to be unbiased (Stone and Rasp, 1991), Peng, *et al.* (2002) maintain that estimates for the regression coefficients become unstable for small samples. As a guide however, a rule of at least ten (10) observations per parameter or predictor variable is upheld. For a logistic regression, the predicted dependent variable is expressed as a function of the probability that a subject will be in one of the categories. Logistic regression assumes that the probability of the event is linked to a linear combination of the independent or predictor variables in the study by a logistic cumulative distribution function, which is a non-linear function (Ge and Whitmore, 2010). For instance, under the current study, where the impact of IAF on corporate governance is being investigated using two categories of outcomes of corporate governance (Yes/No), i.e. whether the IAF is impacting on corporate governance or not, logistic regression is employed to model the relationship between corporate governance and IAF as a probability that IAF will impact on corporate governance or not. As indicated by Ge and Whitmore (2010), for a binary dependent variable y , with a vector of k predictor variables X (i.e. x_1, x_2, \dots, x_k), the linear relationship can be expressed as $X\beta = \beta_0 + \beta_1x_1 + \beta_2x_2 + \dots + \beta_kx_k$, where $\beta = (\beta_0, \beta_1, \dots, \beta_k)$ is a vector of regression coefficients to be estimated.

Statistically, probability (p) is the expected value of random variable y , conditional on the values of the independent variables x_1, x_2, \dots, x_k .

i.e. $p = E(y/X)$ or $E(y/x\beta)$. Recognizing the error or deviance term ε , (i.e. the arithmetic difference between the outcome y and its expected value p), the additive error model for the binary response becomes $y = p + \varepsilon$

The logistic regression function has two common representations:

$$P = E(y/x\beta) = \{1 + \exp(-x\beta)\}^{-1} \quad \dots \text{equation (1)}$$

$$\text{Logit}(p) = \ln(p/1-p) = x\beta \quad \dots \text{equation (2)}$$

While the first equation is the logistic form of the relationship between probability p and the linear combination $x\beta$, the second representation re-expresses the probability using a logit transformation which is simply by taking the logarithm of the odds of event H happening. Ge and Whitmore (2010) maintain the two representations are correct and mathematically equivalent. Peng, Lee and Ingersoll (2002) reiterate the mathematical concept that underlies logistic regression as the natural logarithm (logit) of an odds ratio.

Analogous to the primary concerns under OLS regression analysis involving linear model such as below:

$$Y = a + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \dots + \beta_n x_n + u$$

Where:

Y = *the dependent variable,*

x_1, x_2, \dots, x_n = *the independent variables,*

a = *constant*

β = *Regression coefficients, and*

u = *error term (i.e. error of prediction of the model)*

the focus of logistic regression analysis is also to estimate the regression coefficients (β s) and in addition test the goodness of fit of the model. Under Logistic regression analysis however unlike multiple regression that employs OLS method for estimation of the constants, and the regression coefficients, estimation is based on the Maximum likelihood principle, through the process of iteration, simplified by the use of Statistical Package for Social Sciences (SPSS).

5.4.5 Evaluations of the Logistic Regression model

Similar to OLS regression model, to assess the soundness of a logistic regression model, the following areas are looked into as emphasized by Stoltzfus (2011), Peng et.al (2002):

- (a) overall model evaluation – a logistic model is adjudged to provide a better fit to the data if it demonstrates an improvement over the intercept-only model(also called the null model). An intercept-only model serves as a good baseline given that it contains no predictor. An improvement over this base line is assessed using three inferential statistical tests –the likelihood ratio, score test and Wald test.
- (b) statistical test of individual predictors – statistical test of individual predictors involves testing the statistical significance of individual regression co-efficients (i.e.βs). This is done by examining the Wald chi-square statistics and the p value of the coefficients. The effect of the predictor in the model is significant only if its p-value is less than 0.05. (i.e. $P < 0.05$).
- (c) goodness-of-fit statistics–the two prominent statistics for assessing goodness-of-fit of logistic regression model are the Hosmer-Lemeshow (H-L) test and the R^2 indices (as defined by Cox and Snell (1989) and Nagelkerke(1991)). These two R^2 indices are variations of the R^2 concept as applicable for OLS regression model. Whereas in linear regression, R^2 is defined as the variation in the dependent variable that can be explained by predictors in the model, for logistic regression however, the two R^2 do not connote (by definition) exactly R^2 as it is defined in OLS. They are therefore taken as supplementary to other more useful evaluative indices, such as the overall evaluation of the model, test of individual regression coefficients.
- (d) validation of predicted probabilities–This is typically presented in terms of percentages of correct classifications.

To analyse the research data using SPSS, the survey data was first coded in a manner suitable for exporting into the package (i.e. SPSS). To be precise, the data collected was analysed with the use of SPSS version 22. Both descriptive and inferential statistics obtained from the analysis were employed to test the study’s hypotheses

5.4.6 The Qualitative data - Interviews

To make meaningful inferences relating to the research questions from the data obtained from the interview, thematic analysis was performed on the data. This was done after

transcribing the recorded interview responses from the audible form into written texts. Thereafter, coding of the transcribed data in hierarchy was done based on their significance and relevance to the key themes of the study.

According to Rose *et al.* (2015), coding in qualitative data analysis involves looking at the data, identifying relevant themes and marking them. The essence of coding therefore is to facilitate distillation of a mass of raw data obtained in form of answers to interview. Clarke and Braun (2017) elucidate that thematic analysis is a method for identifying, analyzing, and interpreting patterns of meaning ('themes') within qualitative data. Thematic analysis, as adopted in this study, and in tandem with Fereday and Muir-Cochrane (2006) aims at establishing how the overarching themes are backed by excerpts from the raw data obtained from the interview with a view to ensuring that data interpretation is made without linkages with participants' views, opinions or expressions.

5.4.7.0 The Research variables and their measurement

The various variables formulated under the study and how they are measured are discussed below.

5.4.7.1 The variables

As applicable in most studies, where researchers desire to establish a relationship between two sets of variables (dependent and independent), this study (as can be seen in the introductory chapter), also seeks to find the relationship between IAF and Corporate governance in the NFS, by looking at how well IAF is impacting corporate governance as one of its key cornerstones. Whereas the dependent variable refers to output or outcome whose variation is being studied, the independent variables represent the potential reason for variations, i.e. the input inspiring the variations. In this study, Corporate governance is the dependent variable, variation of which, in relation to the predictor (independent) variables - IAF is being studied.

Though, IAF has been established in literature to be one of the key mechanisms of corporate governance, this study attempts to empirically establish the impact of IAF on firms' corporate governance specifically in the NFS. From the review of literature carried out in chapter 4 of the thesis, the impact of IAF on firms' corporate governance is to be explored using the following key predictor variables:

1. Independence of IAF,
2. IAF's Auditing methodology,
3. Objectivity of internal auditors, and
4. Competence of the internal auditors.

The above four key explanatory variables, based on the conceptual framework, and the hypotheses of the study are assessed from the chosen sector in Nigeria using four models comprising of the various predictor variables shown in the table below:

	IAF's Independence (IAFIND)	Internal auditors' objectivity (IAsOBJ)	IAF's Auditing methodology (IAFAUMET)	Internal auditors' Competence (IAsCOMP)
i	CAE hierarchy(CAEH)	Regular Private Contacts of the CAE with the audit committee chair(CONT)	Compliance with IIA standards (ADP)	Educational qualification of IAs (EDUQ)
ii	IAF Sourcing arrangement (SAR)	IAF's unrestricted access to records and information (ACCESS)	Regularity of QAIP(QAIP)	Membership of the IIA (MEM)
iii	Audit Committee meeting attendance frequency(ATT)	Use of IAF as a training ground(TRAIN)		Internal auditors professional qualification (PROQ)
iv	CAE appointment and dismissal(APDI)	Engagement of internal auditors in consulting activities(CONS)		Internal auditors length of years of experience (YEAR)
v	Reporting line of the IAF (REP)			Regularity of training for the internal auditors (REGT)
vi	AC existence (ACE)			
vii	AC membership adequacy (ACMAD)			
viii	AC meeting frequency (ACMF)			
ix	Existence of IA charter (IACE)			

Table 5.9 (a): Research variables definition

Whereas the overall relational model of the study's objectives is:

CORPORATE GOVERNANCE = f(IAF's Independence, Internal auditor's Objectivity, IAF's Auditing methodology, Internal auditors' Competence),

i.e. **CORPGOV = f(IAFIND, IAFAUMET, IAsOBJ, IAsCOMP)**

The following four models are formulated from the above predictor variables to investigate the impact of the key variables on corporate governance as below:

5.4.7.2 Model Specification

Model I: (Independence of the IAF)

$$CORPGOV_IAFIND = \beta_0 + \beta_1(REP) + \beta_2(CAEH) + \beta_3(SAR) + \beta_4(ATT) + \beta_5(APDI) + \mu$$

Where:

CORPGOV_IAFIND is effect in Corporate Governance influenced by IAF's independence)

REP - reporting line of the IAF

CAEH - CAE's hierarchy

SAR- IAF sourcing arrangement

ATT- CAE's attendance of the audit committee meeting

APDI - Appointment and dismissal of the CAE

Model parameters $\left\{ \begin{array}{l} \beta_0 \text{ is the model constant} \\ \beta_1 \text{ coefficient of covariate REP} \\ \beta_2 \text{ coefficient of covariate CAEH} \\ \beta_3 \text{ coefficient of covariate OUT} \\ \beta_4 \text{ coefficient of covariate ATT} \\ \beta_5 \text{ coefficient of covariate APDI} \\ \mu \text{ is the error term or residual} \end{array} \right.$

Model II: (IAF's compliance with the IIA's standards)

$$CORPGOV_IAFAUMET = \beta_0 + \beta_1(ADP) + \beta_2(QAIP) + \mu$$

Where:

CORPGOV_IAFAUMET = Effect in Corporate Governance influenced by IAF's auditing methodology

ADP = IAF's adoption of the IIA standards for its engagements

QAIP = IAF's performance of Quality assessment and improvement program

Model parameters $\left\{ \begin{array}{l} \beta_0 \text{ is the model constant} \\ \beta_1 \text{ is the coefficient of ADP} \\ \beta_2 \text{ is the coefficient of QAIP} \\ \mu \text{ is the error term or residual} \end{array} \right.$

Model III: (Internal auditors' objectivity)

$$CORPGOV_IAsOBJ = \beta_0 + \beta_1(TRAIN) + \beta_2(CONS) + \beta_3(CONT) + \beta_4(ACCESS) + \mu$$

Where:

CORPGOV_IAsOBJ is effect in Corporate Governance influenced by Internal auditors' objectivity

TRAIN = use of IAF as a training ground

CONS = internal auditors role in consulting

CONT = CAEs' regular private contact with the audit committee chairperson

ACCESS = Unrestricted access to records and information by the internal auditors

$$\text{Model parameters} \left\{ \begin{array}{l} \beta_0 \text{ is the model constant} \\ \beta_1 \text{ is the coefficient of TRAIN} \\ \beta_2 \text{ is the coefficient of CONS} \\ \beta_3 \text{ is the coefficient of CONS} \\ \beta_4 \text{ is the coefficient of CONS} \\ \mu \text{ is the error term or residual} \end{array} \right.$$

Model IV: Internal auditors' competence

$$CORPGOV_IAsCOMP = \beta_0 + \beta_1(EDUQ) + \beta_2(PROQ) + \beta_3(YEAR) + \beta_4(REGT) + \beta_5(MEM) + \mu$$

Where:

CORPGOV_IAsCOMP is Effect in Corporate Governance influenced by Internal auditors' competence

EDUQ - Educational qualification of the internal auditors

PROQ - professional qualifications of the internal auditors

YEAR - Length of years of experience by the internal auditors

REGT - Internal auditors' regular training

MEM - Internal auditors' membership with the IIA

$$\text{Model parameters} \left\{ \begin{array}{l} \beta_0 \text{ is the model constant} \\ \beta_1 \text{ is the coefficient of EDUQ} \\ \beta_2 \text{ is the coefficient of PROQ} \\ \beta_3 \text{ is the coefficient of YEAR} \\ \beta_4 \text{ is the coefficient of REGT} \\ \beta_5 \text{ is the coefficient of MEM} \\ \mu \text{ is the error term or residual} \end{array} \right.$$

5.4.7.3. Variables Measurements

Variables:	Measurement/Coding
(a) Independent CORPORATE GOVERNANCE	Yes =1, No= 0
(b) Independent	
CAEH	Above management =1 Below management level =0
SAR	Outsource =1 In-house or Co-sourced =0
ATT	4 times per year =1 3 times or less per year =0
APDI	AC =1 Management =0
REP	AC=1; CEO/CFO/Management =0
ACE	Yes =1; No =0
ACMAD	Agreed =1; Disagreed =0
ACMF	4 times =1; 3 times or less =0
IACE	Yes =1; No=0
CONT	Agreed =1; Disagreed =0
ACCESS	Always =1; Barely =0
TRAIN	Barely =1; Always =0
CONS	Rarely =1; Always =0
ADP	Always =1; Rarely =0
QAIP	Yes=1; No=0
EDUQ	HND=1, B.Sc=2; MSc/MA/MBA =3; PhD=4; Others =5
MEM	Yes=1; No=0
PROQ	0-24%=1; 25-49% =2; 50-74=3; 75 and above =4
YEAR	Less than 5 years =1; 5-10years =2; Greater than 10 years =3
REGT	Once =1; twice =2; three times =3; Four times =4; More than 4 times =5

Table 5.9(b): Model variables' measurement

5.5 Limitations of the Methodology

Whereas the researcher is mindful of various alternative methodologies that could have been applied for the study, from the research design to analysis stage, the selected methodology is considered the most appropriate under the circumstances surrounding the current study as discussed below.

To start with, the researcher chooses cross sectional research design due to its suitability and applicability to the study in terms of timing and financial requirements. Experimental design could not have been a better option considering its peculiarity of the need to manipulate the independent variables to assess the impact of such variations on the dependent variables. Under the current study, such manipulations on the various independent variables involving firms in the sector or the individual internal auditors under focus is not achievable and thus is not contemplated.

While it could be argued that the issue being studied lends itself to time-effect, and could have been better handled using longitudinal design, issues of sample attrition, cost implication and time requirement are the challenges envisaged against the adoption of longitudinal design for the study. Bryman and Bell (2011) highlight that longitudinal research design consumes time and money. The other available options of case study and comparative design are also considered unsuitable on the ground of timing and financial requirements. The need for timely completion of the study is one of the key factors considered in the choice of the selected research design.

On the method of data collection, instead of administering the study's questionnaire online, the questionnaire could have been administered in hard copy form possibly through postal method or by the researcher approaching the targeted respondents physically himself. Neither the postal or direct means of distributing the questionnaire could have been as effective as the online platform (survey monkey) used for the study given the cost implications and the likelihood of low response which the online option attempts to improve upon. Physical distribution of the questionnaire was also considered inappropriate given the envisaged difficulties of securing physical contacts

with all the respondents. This is in addition to the burden of the cost of traveling up and down necessary for making contacts with the numerous respondents as well as for follow up and pick-up of the completed questionnaire. It is also worth stating that the postal service in Nigeria is currently terribly poor and unreliable, and as such online platform is considered most suitable.

It could as well be contested that the limited number of the interviewees under the study could have been more manageable under focus group interview setting. The interview was however conducted on one by one basis as a result of some challenges associated with access. Although, focus group interview was initially conceived while planning the data collection for the study due to the formalised grouping of the CAEs in Nigeria particularly those in the banking industry of the sector, under the aegis of the ACAEBIN, it was however later discovered that it would be practically and extremely difficult to get all the CAEs to assemble at a particular location for the group interview as a result of the members' heterogeneous schedules, and geographical issues relating to respondents' locations. For instance, inviting the CAEs from Abuja to Lagos or vice versa for the group interview might be too daunting. Hence, the rationale for the individual interview for the few ones that were eventually persuaded.

Whereas some existing and relevant studies suggest the use of Linear regression method for data analysis, BLRA is however considered appropriate and adopted for the data analysis in consonance with the various assumptions or criteria for adopting same as discussed in section 5.4.3. The dichotomous nature of the dependent variable above all, and the non-suitability of OLS regression for non-linear relationship (Peng *et.al*, 2002) form the major rationale for BLRA. Extant and relevant studies that apply BLRA from which this study takes clue include Carey, *et al.* (2006); Abdolmohammadi (2009); Sarens, Abdolmohammadi, and Lenz (2012); Zaman and Sarens (2012); Raghunandan, Read and Rama (2001); and Stewart and Kent (2006).

5.6 Chapter summary

This chapter has established the methodology adopted for the study and also finds a suitable philosophy to rationalise the methodology. A combination of positivism and interpretivism paradigms popularly known as MMR shapes the study. Though till date, debates on the philosophical foundation of MRR are continuous, however pragmatism seems to be the currently accepted philosophy of the chosen method.

Further to establishing the study's methodology, an overview of the sampling techniques for the study is given, while description of the research instrument of the study, as well as BLRA carried out on the quantitative data, and thematic analysis adopted on the qualitative data is also made. Finally, a critique of the methodology of the research was made by considering other alternatives available.

The next two chapters shall be used to present the empirical results with respect to the study's four main research questions.

Chapter 6

Data Analysis I (Internal audit function's characteristics)

6.0: Chapter Overview

The next two chapters of this thesis deal with the analysis of the primary data collected through both the questionnaire administered on eighty eight (88) CAEs and their immediate subordinates, as well as the one-on-one in-depth interview (fully discussed in chapter 5) conducted for the four CAEs. In carrying out the analysis, the following four cardinal research questions (addressed through the four hypotheses) remain the focus:

- i. What is the level of independence enjoyed by the internal audit functions in the Nigerian financial sector?
- ii. To what extent are the internal audit functions in the Nigerian financial sector performing their roles in conformity with the IIA standards?
- iii. How objective are the internal auditors in the Nigerian financial sector?
- iv. To what extent are internal auditors in the Nigerian financial sector competent in fulfilling their expected roles?.

The research data analysis in this chapter and the next is patterned in line with the study's empirical literature review agenda adopted in chapter four of the thesis. As indicated in chapter 4, the research agenda and review of relevant literature thereon is looked into through the following two perspectives:

i. IAF's characteristics:

- (a) Independence of the Internal audit function; and
- (b) Conformity of the internal audit function's methodology with the IIA standards

ii. Individual internal auditor's characteristics:

- (a) Objectivity of the internal auditors; and
- (b) Internal auditors' competence

Consequently, the analysis of the research hypotheses is carried out through two chapters (i.e. Chapters 6 and 7). The first chapter of the analysis deals with the hypotheses and propositions on the IAF's characteristics while the second chapter of the data analysis focuses hypotheses and propositions on individual internal auditors' characteristics.

To begin with, the summary of the respondents' responses to questions A1-5 focusing the bio-data of the respondents (specifically, the respondents' line of business, educational qualifications, professional qualifications, positions in organisations, and their perceptions about IAF's role on corporate governance) are generally, firstly presented in form of descriptive statistics. This is followed by analysis of the descriptive statistics of the variables incorporated into the formulated models. The descriptive analyses of quantitative data are elaborated with the various insights from the qualitative data (using thematic analysis). Thereafter, the BLRA results are presented and analysed to test the validity or otherwise of the study's hypotheses and propositions.

Therefore, the pattern of the mixed methods adopted for the data analysis is as presented below:

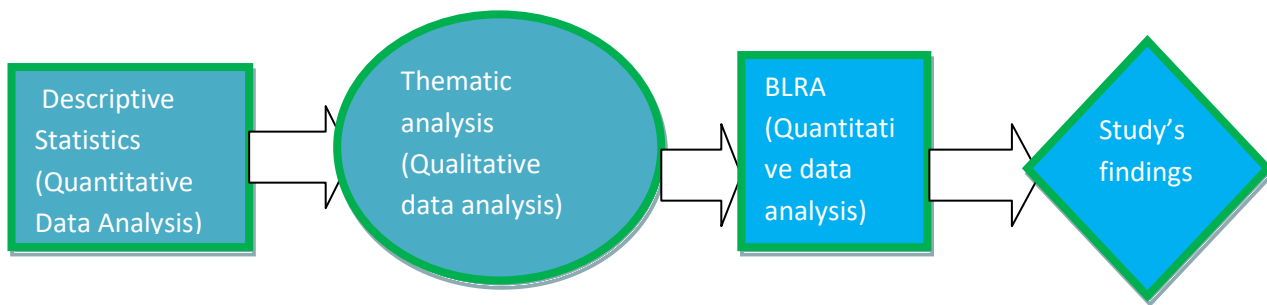


Figure 6.1: Sequence of the mixed methods for the study's Data analysis

In line with the above therefore, the current chapter deals with analysis of data relating to the research questions 1 (i.e. **whether IAF in the NFS is independent and impact positively on the sector's corporate governance**) and 2 (**whether IAFs in the NFS do adopt IIA standards for their engagements and therefore impact positively on the sector's corporate governance**).

6.1 Descriptive Statistics

The Descriptive statistics of the respondents to the field survey are presented with a view to providing detailed information on them.

6.1.1 Respondents' line of business

	Frequency	Percent	Cumulative Percent
Commercial banking	25	28.4	28.4
Mortgage Banking	12	13.6	42.0
Development Banking	7	8.0	50.0
Insurance	41	46.6	96.6
Others	3	3.4	100.0
Total	88	100.0	

Table 6.1: Table showing Respondents' line of business (Source: Survey 2016)

Of the 88 CAEs eventually considered for this analysis, 46.6% of them are from insurance industry, while CAEs from Commercial banking constitutes 28.4%. This is followed by the respondents from Mortgage banking and development banking that constitutes 13.6% and 8% respectively. Respondents from other categories such as microfinance banks etc. classified as "others" constitute only 3.4% of the survey's participants.

The respondents' distribution presented in the above table is a reflection of the companies in the NFS (listed on the country's stock exchange as at the time of this study). Following the various past recapitalisation exercises of the country's banking industry, particularly the last recapitalisation exercise of the industry in the year 2009, the number of commercial banks in the country (hitherto over 80) was significantly reduced to 24, out of which only 20 are listed on the country's stock exchange at the time of this study. The low level of required capitalisation of insurance industry, and the

larger number of insurance companies in the country, explains the higher number of insurance companies represented in the survey. Whereas the capital requirement of banks in Nigeria since 2005 is =N=25billion (i.e. about £45.5million), only =N=2billion(i.e £3.6million),=N=3billion (i.e £5.5million) and =N=5billion (i.e. £9.1million) is required for life, non-life and composite insurance company in the country.

6.1.2. Educational Qualifications

	Frequency	Percent	Cumulative Percent
HND	25	28.4	28.4
B.Sc	27	30.7	59.1
M.Sc/MA/MBA	36	40.9	100.0
Total	88	100.0	

Table 6.2: Respondents' educational qualifications (Source: Survey 2016)

Looking at the educational background of the respondents, the above table indicates that majority of the CAEs and their subordinates are holders of first degree (either Higher National Diploma or B.Sc degree) and none with PhD degree. While 59.1% of the CAEs that participated in the survey are holders of first degree, CAEs with Master degree (either MA/M.Sc or MBA) are 40.9%.

6.1.3. Professional Qualifications

	Frequency	Percent	Cumulative Percent
None	7	8.0	8.0
ACA/FCA	53	60.2	68.2
ACCA	15	17.0	85.2
ACIB/FCIB	3	3.4	88.6
CIA	9	10.2	98.9
Others	1	1.1	100.0
Total	88	100.0	

Table 6.3: Respondents' Professional qualifications (Source: Survey 2016)

Of all the respondents, 7 representing 8% of the total respondents indicate that they do not belong to any professional body. Of the remaining, 77.2% (68) are members of either the ICAN or ACCA, the global Accounting body founded in 1904. Respondents who are members of Chartered Institute of Bankers (either as Associate members or Fellows of the institute) and the IIA are 3.4% and 10.2% respectively. The higher number of members of the ICAN above other professional bodies explains further the general impression among practitioners of internal audit in the country about the supremacy of Accounting over internal auditing as a profession.

6.1.4. Respondents' positions in organisations

	Frequency	Percent	Cumulative Percent
CAE	58	65.9	65.9
CAE'S SUBORDINATES	30	34.1	100.0
Total	88	100.0	

Table 6.4: Respondents positions in organisations (Source: Survey 2016)

Out of the 88 respondents, 58 representing 65.9% are CAEs while the remaining (i.e. 30), representing 34.1% are the subordinates of the CAEs. This distribution is in alignment with the pattern of the skewedness of the population of the respondents in favour of the CAEs whose insights on the subject matter of the study are considered very important.

6.1.5. CAE's perceptions about IAF's role on Corporate governance

	Frequency	Percent	Cumulative Percent
NO	23	26.1	26.1
YES	65	73.9	100.0
Total	88	100.0	

Table 6.5: CAE's perceptions about IAF's role on Corporate governance (Source: Survey 2016)

The above table indicates that while 73.9% of the respondents indicate that their IAF plays significant and positive role on their organisation's corporate governance, 26.1% are of the contrary view. Whereas IAF has been established as one of the key cornerstones of corporate governance, the authenticity of this position particularly from developing countries remains the crux of this study, and its verification, the essence of the analysis in the current and next chapter of the thesis.

6.2.0. IAF's Independence and corporate governance

As discussed fully in Chapter 4 of the thesis, the independence of IAF remains its main attribute when it comes to the value it can add to organizations' corporate governance. In order to examine how independent the IAF of the NFS is, the first hypothesis and five propositions (indicated below) are subjected to empirical verifications. Triangulation of data analysis method involving both quantitative and qualitative data (with the aid of both BLRA and thematic analysis) is employed for the empirical verifications. In finding answers to the various propositions, summary of the respondents' responses on the explanatory variables are first presented in tabular form prior to the BLRA and the thematic analysis on same. The sequence of the empirical verifications is as indicated in figure 6.1.

HI: Internal audit functions in the Nigerian financial sector are not independent of their organisation's management.

The related propositions are:

- i. Internal audit function of the Nigerian financial sector reporting to Audit committee is positively associated with the Internal audit function's independence and ability to impact positively on corporate governance
- ii. Maintaining the hierarchy of the Chief Audit Executive of Internal audit function of the Nigerian financial sector at par with management is positively associated with the function's independence and ability to strengthen corporate governance.
- iii. Outsourcing of internal audit function of the Nigerian financial sector is positively associated with internal audit function's independence and its ability to strengthen corporate governance.
- iv. Chief Audit Executive's regular attendance of Audit committee's meeting in the Nigerian financial sector is positively associated with Internal audit function's independence and ability to strengthen corporate governance
- v. Chief Audit Executive's appointment and dismissal by the Audit committee in the Nigerian financial sector is positively associated with the function's independence and ability to strengthen corporate governance.

6.2.1 IAF's functional reporting line

	Frequency	Percent	Cumulative Percent
CEO/CFO/Management	5	5.7	6.8
Audit committee	83	94.3	100.0
Total	88	100.0	

Table 6.6: IAF's Functional reporting line (Source: Survey 2016)

The above table shows that 94.3% of the respondents (i.e. 83 respondents) indicated that their IAFs report to their companies' audit committees, while only 5.7% (5 respondents) disclosed that they report to their management. The very strict regulatory framework and mandatory oversight saddled on audit committees in the NFS by the sector's regulators (such as the CBN, NDIC, and SEC) might be a motivating factor for the observed high level of compliance.

Leveraging on the TA carried out on the qualitative data of the research, and in support of the above, all the CAEs interviewed indicated that they maintain administrative reporting line with their MDs and functional reporting line with their boards.

“We report to the MD administratively, but with hard line reporting line to the board Audit committee. So to that extent nobody influences what we do or how we do it”.-CAE1

For the CAE4, the issue of functional and administrative reporting line is emphasised in his response.

“my report actually goes to the audit committee. My department maintains functional reporting line to the audit committee and the administrative reporting line to the management”-CAE4

Stressing the benefits of maintaining functional reporting line to the board, one of the CAEs interviewed (CAE1) indicated that functional reporting line to the board ensures there is no undue influence from the management. This amplifies the significance of CAE 's reporting line on the independence of IAF.

“...to that extent nobody influences what we do or how we do it”.-CAE1

The above comment from the CAE1 interviewed indicates the significance of appropriate reporting line on the independence of IAF. Any IAF that reports functionally to the audit committee is free from undue influences and interferences from

the management and thus has unimpeded independence. What the above implies is that majority of the IAFs of the NFS report functionally to their audit committees and therefore can be said to be independent of management. Only a few reports functionally to their management and therefore may not be independent.

Overall, the finding on the reporting line of IAFs of the NFS aligns perfectly with Akinteye, *et al.* (2015) whose study discovered that 80% of the heads of the IAFs of listed companies in Nigeria report to their BoDs. This level of diffusion of international best practice is an indication of positive development in Nigeria. The finding shows an improvement over the manner of IAFs reporting lines from some developing countries like Malaysia, Saudi Arabia, Egypt and Jordan as indicated in Christopher, *et al.*, 2009; Al-Twaijry *et al.* (2003); Ebaid (2011); and Al-Hroot (2012). The percentages of IAF that maintain functional reporting line with their audit committees are reported as 38%, none, 48%, and 53.7% respectively by the referenced studies. With the enhanced reporting line of the IAFs to audit committees in the NFS, one anticipates high level of independence of IAFs in the NFS.

6.2.2: CAE's hierarchy

	Frequency	Percent	Cumulative Percent
Below Executive Management level	55	62.5	62.5
Parallel to the Executive Management/Above Management level	33	37.5	100.0
Total	88	100.0	

Table 6.7: CAE's hierarchy (Source: survey 2016)

Most (62.5%) of the internal auditors that took part in the field survey indicated that they have their CAE's hierarchy maintained below their organisation's management

level while 37.5% (i.e. 33IAs) have their CAE's hierarchy maintained parallel or above management level. As argued in literature, this connotes negative implication on the independence of the IAF in the Nigerian financial sector. It is discovered that whereas in terms of organisational structure, the CAEs are meant to be at par with management, however, in reality and based on the interview conducted, some of the CAEs are placed on positions that do not actually reflect they are part of their organisations' management cadre. Certainly, this would have negative implications on the way the CAE as well as the entire IAF are perceived by the staff of the organisation, particularly in connection with their status and ultimately their independence. Surprisingly, but in corroboration with the above results from the questionnaire survey, of the four CAEs that took part in the interview, only one (CAE1) was sure of his actual stature in his organisation's organogram.

'Am also part of the executive committee of the bank, so am senior enough in the system, nobody pushes me around. Of course, the bank's audit committee have input into my appraisal. Not just management appraisal, audit committee also does my appraisal. So the way we stand today, nobody can fire me unless they (Audit committee) support it. So to that extent am reasonably protected'.-CAE1

From the above emphasis from the CAE1, particularly on the involvement of the bank's audit committee in his periodic appraisal, it is quite clear that the implications of appropriate positioning of the CAE in the firm's organogram are very clear and unambiguous to him. The remaining three CAEs (CAE 2, CAE3 and CAE 4) however seem unsure of their status. It was noted that where they are positioned on management cadre, in reality, they are not treated at par with management; they are subservient to other management staff. To them, the issue of CAE's hierarchy is just a matter of expectation based on operational standard and official appellation but without any true connotation. For instance, the response of CAE4 on the matter clearly displays this level of perception.

‘I am but not fully, because by standard, I think by now I should be on management grade but meanwhile, I am management by grade’.- CAE 4.

The result of this study on the CAE’s hierarchy therefore is at variance with Christopher *et al.*(2009), Paape, Scheffe, and Snoep (2003), that indicate that 100% and over 67% of CAEs in Malaysia have their positions maintained at their companies’ corporate level. It is documented in the literature that where the CAE is inappropriately positioned in the organisational organogram, issues such as his appointment, appraisal and dismissal might be compromised and therefore the entire IAF’s independence utterly threatened. Going by Peurseem (2004), without having certainty of their authority or if they do not enjoy a clear level of authority (as suggested by the comments of CAE4 above), internal auditors may not be in a position to counter management’s pressure.

6.2.3: Sourcing of the IAF

	Frequency	Percent	Cumulative Percent
In-house	86	97.7	97.7
Outsourced	2	2.3	100.0
Total	88	100.0	

Table 6.8: Sourcing of the IAF (source: Survey 2016)

86 out of the eighty eight 88 respondents that participated in the survey, representing 97.7% indicate that their IAFs are maintained in-house, while only 2 respondents (representing 2.3%) disclosed that their IAFs are outsourced. This implies that unlike other non-core activities in the sector (such as security, tellering and marketing) the practice of outsourcing of IAF might just be evolving in the sector and possibly in the country as a whole. The non-popularity of the practice of outsourcing of IAF in the NFS notionally has negative impact on the level of independence enjoyed by the function (i.e. IAF).

Corroborating the result of the survey as shown above, the thematic analysis carried out on the qualitative data also reveals that all the interviewed CAEs indicated that their IAFs are maintained in-house. This further lends support to the fact that both outsourcing and co-sourcing of IAF is not common in the country's financial sector. As one of the CAEs interviewed puts it, no bank in the country currently practices outsourcing.

“In Nigeria I don't think that there is anybody that outsourced his IAF. It doesn't make sense to do that”. “ I have not seen any bank that outsource. You can do co-sourcing which means you give part of it out ... and retain certain aspect, I don't think there is any bank that outsources its internal audit, but some may outsource their internal control.....” –CAE 1

The above comment supports the initial findings from the quantitative data where 97.7% of the survey's respondents indicated that their IAFs are maintained in-house. The unpopularity of the practice of outsourcing in the country's financial sector might be due to the fact that risk management is considered the core business of the sector, and the need for greater commitment on the part of the IAF is also held very crucial in the sector. The issue of commitment as one of the rationale for maintaining IAF fully in-house in the NFS is emphatically emphasised by a CAE of one of the mortgage banks in the country.

“Organisation wants commitment. In outsourcing, you can't get enough commitment because the outsource company will only be driven by their profit motive, ...by what they are going to make, but if you have somebody who is resident, you will be assured of his commitments in terms of time and resources”.-CAE 2

The significance of loyalty or commitment of IAF certainly cannot be trivialised whenever a decision on IAF's sourcing comes up for discussion. While independence remains the key thrust for outsourcing of IAF, consideration for commitment is a factor at the other side of the sourcing decision (Barry and Chang, 1993). Ordinarily, it is

expected that internal auditors of an in-house IAF who see their career and future hinged on the success of their organisation would want to go extra mile in their audit engagements so as to improve their organisation's operational efficiency than outsourced internal auditors. The issue of commitments emphasised by the CAE2 above notwithstanding, the practice of in-house IAF in the NFS may be viewed as a great threat on the function's independence. This is so given the general argument that an in-house IAF is usually easy to manipulate by management. This argument is part of the basis for the low esteem usually accorded IAF maintained in-house by the external auditors, particularly in a situation where their work is being assessed with a view to leveraging on same for their engagements.

It has been documented in literature that internal audit source (whether in-house or outsourced) affects the external auditors' reliance decision (see Desai, Gerard and Triparthy, 2011). Glover *et. al* (2008) indicate that external auditor has the tendency to rely more on the work of outsourced IAF particularly when inherent risk is high in a financial statement audit. This position was also corroborated by Gramling and Vandervelde (2006). In addition, Carey, *et.al* (2006) indicate that size matters in IAF sourcing decision, i.e. the larger the organisation the greater the propensity to outsource. In terms of capitalisation, the key determinants of sector's size, the NFS certainly is one of the biggest sectors in the country yet does not embrace IAF's outsourcing as the result of the survey and the interview had revealed. This therefore raises curiosity on the applicability of the referenced study's results to the NFS's context.

As indicated under the study's theoretical underpinnings in chapter 3, Firms operating in high risky domain require specialized knowledge particularly to appreciate the various inherent risks and peculiarities of vulnerabilities. Therefore, the fundamentals of human assets specificity of TCE theory might be argued the key rationality for prevalence of in-house IAF in the NFS. In general therefore, where highly specialized knowledge, or skills is required, and the industry or sector contains relatively few firms, internalizing the IAF may be cost effective irrespective of its size. This is so given that investment in the required skill acquisition may be less likely to be readily transferable

to other clients in the sector due to fierce competition that may abound (see Speckle' *et al.*, 2007)

The non-popularity of outsourcing or co-sourcing in the NFS revealed by this study is similar to what obtains in Egyptian IAFs as discovered by Ebaid(2011). The author established that 100% of the Egyptian firms that participated in a study involving combination of questionnaire survey and interview, exploring IAFs of Egyptian listed firms indicate that their IAFs are maintained in-house. Also, Papageorgiou *et al.* (2012) indicate similar phenomenon among majority of the South African IAFs. Therefore, the finding of the non-popularity of outsourcing and or co-sourcing of the IAF in NFS might be extended to most developing countries. Generally, the infancy stage of internal auditing profession in majority of the developing countries might be the key explanation. Contrarily, developed countries have good account of the practice of outsourcing, and co-sourcing of IAF (see Dickings and O'Relly, 2009; Carey, *et al.*,2006; Subramaniam, 2005; Goodwin, 2004; Martinov-Bennie, 2011; Arena and Azzone, 2007).

6.2.4: Regularity of CAE in audit committee's meetings

	Frequency	Percent	Cumulative Percent
Barely or Never	64	72.7	72.7
Always	24	27.3	100.0
Total	88	100.0	

Table 6.9: Frequency of CAE's attendance of audit committee's meetings (Source: survey 2016)

64 out of the respondents, representing 72.7% indicate that their invitation to, and attendance of the audit committee's meetings is not regular while only 24 respondents (representing 27.3%) disclosed that they do always attend their audit committee's meetings. Existing studies had established that regular attendance of audit committee's

meetings by the CAEs strengthens IAF's independence. The opportunities such meetings do avail CAEs include development of mutual and enduring relationships with the members of the audit committee. Another benefit of such meetings to the CAEs are in the areas of getting them updated about their work while also creating avenues to provide further clarifications on their audit reports (and other matters affecting the organization) before the audit committee.

Contrary to the above results however, all the interviewed CAEs disclosed that they do attend board (audit committee)'s meetings, where they present their reports and make necessary clarifications where required. Attendance of audit committee meeting by the CAE though perceived more of compliance issue, serves dual purposes of strengthening the IAF's independence and helping the audit committee members to strengthen their capacity by having deep understanding of issues relating to internal audit. The feedback obtained from the CAE2 on the matter further indicates that the audit committee members avail themselves greater opportunity to deepen their understanding of the internal audit issues by seeking direct clarifications from the CAE at the meeting rather than reading only their formal reports.

“...Probably because they believe that there will be something that internal auditor will have to put them through on. Like the report may not be able to speak the whole mind of the internal auditor, but when the internal auditor is present, the committee members can actually understand the issues raised in the reports by asking questions and clarifications and by still getting from the internal auditors things that are not incorporated into the reports”.- CAE2

The inconsistency in the results obtained from the internal auditors through the questionnaire survey and the in-depth interview of the CAEs gives some concerns. Given that only the heads of IAFs participated in the in-depth interview unlike under the questionnaire survey however, the result of the in-depth interview is given pre-eminence. Also, the opportunity the interview availed the researcher to validate the interviewees' responses by their gesture (i.e. their body language) is another basis for the ascendancy of the insights from the interview over the feedback from the

questionnaire survey. Omoteso (2006, page 237-238) indicates that where there is an area of divergence between findings from questionnaire survey and interview, such area of discrepancy is better resolved based on logical rationality and underlying contexts of the responses such as respondents' status and experience, as well as the nature of the organisation they work for.

The above notwithstanding, the mixed results especially the unfavourable finding from the questionnaire survey suggest the need to critically re-focus this area or concept in possible future survey. From the literature review made in chapter 4, whereas CAEs from most developed countries do regularly attend audit committee's meeting, the studies of Al-Twajjry (2003) evaluating the development of internal audit in Saudi Arabia, and Al-Hroot (2012) evidence from Jordan indicate mixed results about the regularity of CAE's attendance of audit committee's meetings. It is however troubling that the practice of CAE's regular attendance of audit committee's meetings is yet to be fully fashionable in developing countries in spite of various codes of corporate governance that stipulates such international best practice.

In developed countries however, attendance of audit committee's meeting by CAEs seems obligatory. For instance, Paape, Scheffe, and Snoep (2003) indicate that out of the 105 CAEs in EU countries that participated in their study, 90% disclosed that they do attend all the meetings of their audit committees; and that 70% of CAEs from France and Greece do attend their audit committee's meetings. Also, Christopher, Sarens and Leung (2008) reported that all CAEs that took part in their study with the exception of only one case indicate that they are regularly invited to audit committee's meetings.

6.2.5: CAE's appointment and dismissal

	Frequency	Percent	Cumulative Percent
Management/Others	18	20.5	20.5
Audit Committee	70	79.5	100.0
Total	88	100.0	

Table 6.10: CAE's appointment and dismissal (Source: Survey 2016)

79.5% of the respondents indicated that their CAE's appointment and or dismissal are handled by their audit committees while only 20.5% indicated that such responsibilities are handled by their management. A situation whereby the CAE cannot be fired at will by the management indicates high level of independence of the IAF. The significance of this audit committee's oversight function was re-emphasised by Bariff (2003) who maintains that the independence of the IAF is at risk if an auditee (management) is responsible for hiring and firing the CAE.

Contrary to the above results, the responses obtained from the interview suggests, that the expected board's influence on the matters of appointment, appraisal and dismissal of the CAEs is yet to be in place in the NFS. While some of the CAEs indicate that their appointment, appraisal and discipline are handled by the board, one of the CAEs (CAE3) disclosed that more (particularly in the area of CAE's appraisal) is still expected from the board in this regard.

“The appraisal issue, to be frank with you, we are not there yet!. The appraisal is being done by the MD sometimes when I told the board the MD is not meant to appraise me, they say No” –CAE3

For one of the CAEs (CAE1) however, the board also has input in his appraisal.

“Of course, they have input into my appraisal. Not just management appraisal. They also do my appraisal. So the way we stand today, nobody can fire me unless they support it. So to that extent am reasonably protected” –CAE 1

Overall, it appears boards of firms in the NFS are yet to fully appreciate the extent of their oversight functions in the areas of appointment and dismissal of their CAEs. This gap could be due to less awareness on their parts. The negative impact of this deficiency on IAF's independence can therefore be imagined. According to Christopher *et al.* (2009), where senior management can determine the career of a CAE, ordinarily, one

would expect the CAE to be biased towards management and avoid raising unfavourable audit reports about them.

The above finding from the NFS compares reasonably with studies from other developing countries (such as Al-Twajjry, 2003; Al-Hroot, 2012; and Ebaid, 2011) as espoused in chapter 4, and also with the study of IAFs of Nigerian listed firms by Akinteye, *et al.* (2015). All the referenced studies, coming from developing countries indicate that more positive shifts are necessary on the matter of audit committee's involvement on matters affecting appointment and dismissal of CAEs. Doing this is necessary to further strengthen CAEs' stature and consequently enhance the IAF's independence in this environment.

6.2.6 The Control variables

The other variables on which responses were obtained but which are not directly related to any of the hypotheses being tested are classified as control variables. These include: (i) existence of audit committee; (ii) adequacy of audit committee members based on governance codes from the CBN, SEC, and other relevant regulatory codes; (iii) frequency of audit committee's annual meetings; and (iv) existence of IAC.

Whereas, these variables are not directly linked with any of the study's propositions or hypotheses, for further insights however, responses thereon are also presented as summarised in the tables below:

i. Existence of Audit committee

	Frequency	Percent	Cumulative Percent
Yes	84	95.5	95.5
No	4	4.5	100.0
Total	88	100.0	

Table 6.11: Existence of audit committee in the NFS (Source: survey 2016)

Though, the operating codes of corporate governance applicable to firms in the NFS (particularly, the SEC codes, and the CBN codes), as well as the Nigerian codes of corporate governance mandate all listed firms to have functional audit committee. The result of the survey (shown in the table above) indicates that 4.5% of the respondents disclosed that their organisations do not have audit committee while the majority 95.5% of the respondents indicates that their organisations have functional audit committees.

As expected however, all the four CAEs that participated in the in-depth face to face interview disclosed that they have functional audit committee as required by both the CBN and the SEC. Therefore, the feedback from those few internal auditors that maintain that they do not have audit committees in place is quite strange as this suggests an exception to the regulators' rules in the sector.

ii. Adequacy of Audit committee's membership

	Frequency	Percent	Cumulative Percent
Strongly agree	15	17.0	17.0
Agree	52	59.1	76.1
Disagree	17	19.3	95.4
Strongly disagree	4	4.6	100.0
Total	88	100.0	

Table 6.12: Adequacy of audit committee's membership in the NFS (Source: survey 2016)

On adequacy of members of the audit committees in line with provisions of governance codes from the CBN, SEC, (and other relevant regulatory codes) in total, 76.1% of the respondents expressed their agreements (both agree and strongly agree) that their audit committees' members are considered adequate. 23.9% however rated members of their audit committees as inadequate based on the provisions of the governance codes of the sector's regulators. This is suggestive of the need for more monitoring on the part of the concerned regulators in the sector. The complementing roles of audit committee to IAF

in firms cannot be overemphasised and only well-constituted audit committees are in the position to add values to both their IAFs and their organisation’s corporate governance ultimately. Adequacy of members of the audit committees are assessed in terms of size of such committee, its composition in terms of diversity of experience, etc.

iii. Frequency of Audit committee’s annual meetings

	Frequency	Percent	Cumulative Percent
Once	1	1.1	1.1
2 times	0	0	1.1
3 times	2	2.3	3.4
4 times	62	70.5	73.9
More than 4 times	23	26.1	100
Total	88	100.0	

Table 6.13: Frequency of Audit committee’s annual meetings in the NFS (Source: survey 2016)

Both the CBN’s and the SEC’s codes of corporate governance require firms in the NFS to meet compulsorily not less than 4 times in a year, and that the head of the IAF (i.e. the CAE) must also be in attendance in all such meetings to make formal presentation of his reports to the board. The above table indicates that 96.6% of the respondents confirm that their audit committees actually do meet 4 times and more in a year in conformity with the statutory requirements. 3.4% of the respondents however indicated that their audit committees do meet less than the required four times in a year. In admittance of the audit committee’s meeting not less than 4 times in a year as being mandatory, CAE4 emphasised as below:

“the audit committee statutorily meets four times in a year”-CAE4.

As a result, indication of audit committee’s meeting of less than 4 years annually by 3.4% of the respondents is clearly a case of deviation from the regulations. This is a clear indication that some companies listed on the NFS still circumvent the regulators’ requirement on the frequency of audit committee’s annual meeting.

iv. Existence of internal audit charter

	Frequency	Percent	Cumulative Percent
Yes	71	80.7	80.7
No	17	19.3	100.0
Total	88	100.0	

Table 6.14: Existence of IAC in the NFS (Source: survey 2016)

As discussed extensively in chapter 4 of the thesis, the IAC is a fundamental document to any IAF. The power and responsibilities of internal audit department are encoded in the document. Therefore the expectation is that no IAF exists without having a charter backing its existence. It is however observed from the survey (as can be seen from the above table) that 19.3% of the respondents' CAEs and their subordinates in the NFS disclosed that their IAFs operate without such charter. Only 71 respondents out the 88 that participated in the questionnaire survey indicated that they operate with IAC. This revelation certainly has implication for both the internal auditing professional body in the country as well as the regulators of the NFS. It is unthinkable that an IAF will exist without the 'essence' of its existence. Incidentally, similar revelations were made by Al-Twaijry, Brierly and Gwilliam (2003), a study on development of Saudi Arabian internal audit, and Lenz, Sarens and D'Silva (2014), a study probing the discriminatory power of characteristics of German IAF, both indicate that 23% and 54% of their IAFs seem to be operating without IAC. This speaks volume on development of internal auditing in developing nations and the need for the IIA's increased advocacy and attention in this environment.

As expected however, all the four CAEs that participated in the in-depth interview indicated that they have IAC. The CAEs appreciate the essence of IAC as they all emphasised same as a must for all IAFs. The comments made by both CAE1 and CAE4 below clearly depict the significance of the documents to the CAEs and their full appreciation of its importance

“internal audit charter is about .. is a documents that shows the relationship between the department and the organisation”-CAEI

“If you don’t have a charter, there is an issue because charter tells you what to do”- CAE4.

Existence of IAC and its completeness on critical matters such as the mandates of the IAF, its relationship with other corporate governance’s mechanisms etc. therefore remain the starting point of evaluating how effective the department is as a cornerstone of corporate governance.

6.3.0 Binary Logistic Regression Analysis of Hypothesis 1

In order to carry out BLRA on the first hypothesis on which five different propositions are postulated, the following binary logistic regression model indicated in Chapter 5 is adopted:

$$CORPGOV_IAFIND = \beta_0 + \beta_1(REP) + \beta_2(CAEH) + \beta_3(SAR) + \beta_4(ATT) + \beta_5(APDI) + \mu$$

Where:

CORPGOV_IAFIND is effect in Corporate Governance influenced by IAF’s independence)

REP - reporting line of the IAF

CAEH - CAE’s hierarchy

SAR- IAF sourcing arrangement

ATT- CAE’s attendance of the audit committee meeting

APDI - Appointment and dismissal of the CAE

Model parameters $\left\{ \begin{array}{l} \beta_0 \text{ is the model constant} \\ \beta_1 \text{ coefficient of covariate REP} \\ \beta_2 \text{ coefficient of covariate CAEH} \\ \beta_3 \text{ coefficient of covariate OUT} \\ \beta_4 \text{ coefficient of covariate ATT} \\ \beta_5 \text{ coefficient of covariate APDI} \\ \mu \text{ is the error term or residual} \end{array} \right.$

As indicated earlier, BLRA is conducted to test hypotheses 1, and the related 5 propositions indicated earlier:

6.3.1. Test of Multicollinearity

In order to avoid occurrence of Type II error, where a null hypothesis that is untrue is not rejected, test of multicollinearity was first carried out on all the predictor variables. This is with a view to ensuring that predictor variables that are linearly related in the model are eliminated prior to estimating the correlation coefficients. Gujarati and Porter (2009) indicate that whereas the term “Multicollinearity” originally means the existence of a perfect, or exact, linear relationship among some or all explanatory variables of a regression model, today, the term is however extended to situation of imperfect linear relationship among the predictor variables. Whether the collinearity is perfect or not, it impacts on the coefficient estimates. As indicated further by Gujarati and Porter (2009), the impact is indeterminate regression coefficient with infinite standard errors in the case of a perfect linear relationship among the explanatory variables. Where the explanatory variables are not perfectly related, the regression coefficients though determinate, possess large standard errors. Thus, implying that the regression coefficients cannot be estimated with high level of accuracy.

Although the predictive power of a model is not affected by the problem of multicollinearity, it however affects calculations pertaining to each individual predictor variables. This means that valid results about each individual predictor may not be obtained. The clarifications above emphasise the need for test of multicollinearity prior to estimating the regression coefficients.

As indicated by Gujarati and Porter (2009), possible causes of multicollinearity problem are:

1. data collection method employed – e.g. sampling over a limited range of the values taken by the regressors in the population
2. constraints in the model or in the population being sampled
3. inappropriate model specification

4. over-determined model. A model is said to be over determined when it has more explanatory variables than the number of observations.

Whereas a quick check of the data and the model for incidence of the above indicates no likelihood of any of the above defects, the data was subjected to scientific test of multicollinearity using Variance Inflating Factor (VIF) test.

VIF shows the level of inflation of the variance of the correlation coefficients as a result of the problem of multicollinearity. VIF is measured and interpreted using a band of 1 to 10. While a VIF of 1 implies no multicollinearity, a VIF of 10 indicates high level of multicollinearity and requires detailed investigation. A VIF value between 1 and 5 is considered moderate and acceptable as indicated below. The benchmark of tolerable level of muticollinearity is as shown in the table below:

VIF	Status of predictors
1	Not correlated
$1 < \text{VIF} < 5$	Moderately correlated
$\text{VIF} > 5 \text{ to } 10$	Highly correlated

Table 6.15 : VIF indicator

The VIFs obtained from the test of multicollinearity conducted on the data are all below 2. The lowest VIF is 1.020 (obtained for the predictor **SAR** against **ATT**) and highest of 1.625 (obtained for the predictor **REP** against **SAR**) as indicated above. These factors (between 0 and 2) imply the existence of a moderate collinearity between the predictors.

6.3.2 Results of the BLRA

The results of the BLRA in form of the coefficients of the individual predictor variables (β s), Wald statistics (Wald), Odd Ratio and significance (Sig) as well as summary of the key statistics from the results of the analysis are as presented below:

Block 1: Method = Enter

Omnibus Tests of Model Coefficients

		Chi-square	df	Sig.
Step 1	Step	3.107	5	.683
	Block	3.107	5	.683
	Model	3.107	5	.683

Table 6.16: Model fit

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	98.001 ^a	.035	.051

a. Estimation terminated at iteration number 4 because parameter estimates changed by less than .001.

Table 6.17: Model summary

Classification Table^a

	Observed	Predicted		Percentage Correct	
		CORPGOV No	Yes		
Step 1	CORPGOV No		0	23	.0
	V Yes		0	65	100.0
Overall Percentage					73.9

a. The cut value is .500

Table 6.18: Model classification table

Correlation Matrix

	Constant	SAR	ATT	APDI	CAEH	REP	
Step 1	Constant	1.000	-.430	-.104	-.244	-.775	-.348
	SAR		1.000	.143	.015	.112	-.101
	ATT			1.000	-.011	.056	-.145
	APDI				1.000	.126	-.577
	CAEH					1.000	.172
	REP						1.000

Table 6.19: Correlation Matrix

		Variables in the Equation					95% C.I.for EXP(B)		
		B	S.E.	Wald	df	Sig.	Exp(B)	Lower	Upper
Step 1 ^a	SAR	-.165	.308	.286	1	.593	.848	.464	1.551
	ATT	.673	.637	1.117	1	.291	1.961	.563	6.834
	APDI	-.029	.774	.001	1	.970	.971	.213	4.426
	CAEH	-.344	.309	1.242	1	.265	.709	.387	1.298
	REP	-.319	.860	.138	1	.710	.727	.135	3.918
	Constant	2.108	1.158	3.312	1	.069	8.235		

a. Variable(s) entered on step 1: SAR, ATT, APDI, CAEH, REP.

Table 6:20: BLRA result

From the above results, none of the predictor variables is significant at 5% level of significance. This implies there is no enough evidence from the data to warrant the rejection of the null hypothesis. In addition, of all the five explanatory variables of the model, SAR, APDI, CAEH, and REP have negative regression coefficients of -0.165, -0.029, -0.344, and -0.319 respectively, while ATT have a positive regression coefficient of 0.673.

The Nagelkerke R^2 of **0.051** in the Model Summary indicates that the model is fair. *Cox & Snell* R^2 shows that there is **3.5% probability** of variation in the predictors that are explained by the logistic model. The next table is the classification results, with **73.9%** correct classification predicted, this indicates that the model slightly improves when the predictors entered.

Concerning the hypothesis, the model does not have enough evidence to reject the null hypothesis. Therefore, Hypotheses 1 (**Internal audit functions in the Nigerian financial sector are not independent of their organisation's management**) is confirmed.

For propositions 1-5 applicable under the hypothesis, the following results are inferred:

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- i. There is an inverse relationship between IAF's sourcing arrangement and IAF's independence in the NFS. This indicates that outsourcing is positively associated with IAF's independence and ability to impact on corporate governance, whereas maintaining IAF in-house or co-sourcing it negatively impacts IAF in the NFS. This result reflects the positions of Glover *et al.* (2008) and Gramling and Vandervelde (2006).
- ii. The frequency of attendance of the CAE in the AC's meetings is positively associated with the independence of IAF of the NFS and its ability to impact on corporate governance. This suggests that the more frequent the CAE attends audit committee's meetings, the more independent the IAF becomes and the more likely it impacts on corporate governance in the sector.
- iii. Adequate positioning of the CAE within the organisation's hierarchy in the NFS is negatively associated with IAF's independence and its ability to impact on corporate governance. This implies that the more appropriate the CAE is positioned in an organisation, the less independent the IAF becomes and the less their ability to impact corporate governance. This result appears strange.
- iv. The negative regression coefficients of **APDI** indicates that involvement of the AC in the appointment and dismissal of CAE in the NFS has negative association with the function's independence and ability to impact on corporate governance in the NFS.
- v. The negative regression coefficient obtained for **REP** suggests that there is a negative relationship between the reporting line of the CAE and the IAF's independence where the CAE reports functionally to the audit committee and vice versa where CAE reports functionally to the management. This finding implies that the more the CAE reports functionally to the audit committee, the less independent the function becomes. This finding is unusual and contradicts the existing paradigm that CAE's functional reporting line to the audit committee enhances IAF's independence and ability to strengthen organisation's corporate

governance. This warrants further investigation and has consequently been identified as potential area of future studies.

Going by the above regression coefficients of the predictors as shown in table 6.21, the formulated model thus becomes:

$$CORPGOV_IAFIND=2.108-0.319(REP)-0.344(CAEH)-0.165(SAR)+0.673(ATT)-0.029(APDI)+\mu$$

6.3.3 Discussion of findings

Based on the defined parameters set to assess the level of independence enjoyed by the IAFs in the NFS, the various findings above indicate that the IAFs of the NFS cannot be said to be totally independent from the influence of management. Therefore, the current level of independence of the IAFs in the NFS warrants tremendous improvement so as to bring it in line with the international best practices as being championed by the internal auditing professional body (i.e. the IIA).

Of the five variables set to evaluate the current level of IAF's independence in the sector (i.e. **sourcing arrangement, the frequency of Audit committee's meeting attendance by the CAEs, CAE's stature within organisational hierarchy, the manner of appointment and dismissal of the CAE, and the reporting line of the IAF**), the results only indicate satisfactory reporting line and sourcing arrangement for the IAFs in the NFS. These positions are also corroborated by the results of the TA of the qualitative data.

The general finding indicates that the IAFs in the NFS truly reports functionally to their audit committees, and administratively to their management. This is considered to be in accordance with the international best practice of internal auditing, regardless of the strange negative relationship between IAF's functional reporting line (to auditing committee). Attribute standard 1110 of the IIA (organisational independence) states that "The Chief audit executive must report to a level within the organisation that allows the internal audit (function) to fulfill its responsibilities ...and confirms to the board, at

least annually, the organisational independence of the internal audit (function).” In the same vein, standard 1111 of the IIA standard requires the CAE to “communicate and interact directly with the board”. These areas of the standards amplify the essence of reporting line on organisational independence of any IAF and also support the assertion and conclusion in the preceding paragraph.

In addition, it is established from this study that the practice of outsourcing is not prevalent among IAFs in the NFS. IAFs in the sector predominantly maintain their internal audit departments in-house. The practice of co-sourcing is also found to be practically alien in the sector. Though, guidance from the IIA does not recommend any single sourcing arrangement as being preferable to the others (Desai *et al.*, 2011), yet studies and contemporary discussions seem to ascribe higher level of independence to IAAs sourced from outsider firm. The general impression is that outsourced IAF will be more difficult for management of organisations to manipulate than in-house IAF. However, the peculiarity of the sector under consideration when viewed from asset specificity perspective as earlier discussed makes the practice of in-house IAF fashionable in the NFS and the credibility of the sourcing arrangement derived from the commitment, familiarity with the idiosyncrasy of the sector and economic rationale its continuous motivation.

As a departure from the above, the IAFs in the sector appear to be deficient in the remaining three areas (i.e. **appointment and dismissal of CAEs, the stature of CAEs within the organisational structure, and regularity of attendance of the CAEs in their audit committees’ meetings**). Incidentally, these three areas are usually considered very critical whenever independence of IAF is being assessed and discussed in literature and of course in practice. The results of this study suggest that the audit committees of organisations in the NFS play very minimal role in the appointment and dismissal of CAEs in the sector. Thus, leaving the heads of the IAFs in the sector to be subjected to the whims and caprices of their management. It is therefore not surprising to see most of the CAEs in the sector being placed below management level within their companies’ organisational structures. The extent to which an IAF can be independent

depends on the relative status of the function within the organisations (Reding *et al.* 2013). As indicated by Reding *et al.* (2013), inappropriate positioning of the IAF increases the risk of conflicts of interest that impair the function's ability to proffer objective assessments and advice.

The last area of weakness of the NFS's IAFs revealed in this study is the irregularity of attendance of audit committee's meetings by the heads of IAFs in the sector. Regular attendance of audit committee's meetings by the heads of the IAF creates values to both the audit committee and the IAF itself in terms of timely and value-adding information exchange and insights proposition. A CAE that is not given the opportunity of attending audit committee's meetings is denied the opportunity of being apprised of strategic and operational developments in his organisation. In turn, the audit committee members are likewise deprived of timely foresights on business risks and control issues from their supposed internal consultants. Irregularity of invitation to audit committee's meetings signals that organisations' board are yet to see IAFs in the sector as capable of adding any further value than their assurance roles.

As also indicated in chapter 7 under discussion of findings on the objectivity of internal auditors, majority of the IAFs in the sector do not engage in consulting activities for their organisations. Consequently, the general impression will be that hindsight is the best return from IAFs and therefore, audit committees in the sector may not see any justification for creating "a seat at the table" for their CAEs. In support of Chambers (2014), audit committee (Board)'s table is not a training ground. Therefore, CAE will only be invited to such meeting when the audit committee is convinced that the CAE is knowledgeable.

Therefore, from the summary of the analysis and the above exposition thereon, there is no enough evidence to indicate that the IAFs of the NFS are independent of management. Unfortunately, the IIA standards provide no guidelines that can be applied to address the specific areas of defects on IAF's independence. To be more elaborate, there is no standard that dictates who should appoint and dismiss the head of

IAF (i.e. the CAE). The guidance offered in the IIA standards only encourages the audit committee to be involved in the matter. Also, the Institute's standard is considered ambiguous in its recommendation on the level where the IAF or its head should be positioned in the organisation. The Institute's attribute standard 1100 only requires that the CAE must report to a level within the organisation that allows the IAF to fulfill its responsibilities. A more precise position in this direction would be helpful and therefore desirable. The same is also applicable to standards and guidance on invitation of the CAEs to audit committee's meetings.

6.4.0 Auditing methodology and Corporate governance

As discussed extensively in chapter 4 of the thesis, the auditing methodology adopted by the IAF of a firm to a large extent impacts on its corporate governance. Whereas the various issues relating to internal audit's methodology are addressed through questions C25-30, for ease of analysis and focus however, issue of internal auditing methodology is addressed by looking at the conformity of the IAFs in the NFS with the various standards issued by the IIA, and performance of QAIP in particular. Therefore, the proposition below (postulated in chapter 4), is put forward to investigate the impact of the IAF's auditing methodology on its ability to enhance corporate governance:

P6: Internal audit function's adoption of the IIAs' standards and performance of Quality assessment and improvement program (QAIP) is positively associated with the function's compliance with the IIA's international standards and ability to strengthen corporate governance.

In order to evaluate the above proposition, the second hypothesis re-stated below shall be tested

H2: Internal audit functions in the Nigerian financial sector do not perform their roles in full conformity with the institute of internal auditors' standards.

In order to test the above hypotheses, reference is made to model 2 as indicated in chapter 5 of the thesis. i.e.

$$CORPGOV_IAFAUMET = \beta_0 + \beta_1(ADP) + \beta_2(QAIP) + \mu$$

6.4.1 IAF's adoption of the IIA standards for its engagements

	Frequency	Percent	Cumulative Percent
Rarely	45	51.1	51.7
Always	42	47.7	100.0
Total	87	98.9	
Missing System	1	1.1	
Total	88	100.0	

Table 6.21 Conduct of Internal Audit in accordance with international standards (Source: Survey 2016)

The above table shows that 51.1% of the respondents to the survey indicated that their IAFs rarely adopt IIA standards for their engagements. This implies that less than half of the internal auditors that participated in the survey do take cognisance of the IIA standards for their internal audit engagements. This result is far below the 70% of the IAF in the UK that fully conforms to the IIA standards as reported by Zaman and Sarens (2013), and also far less than 86.5% of those internal auditors that comply with the IIA standards in the Anglo-culture countries as reported by Abdolmohammadi (2009). Burnaby et.al (2009), A comprehensive cross-countries survey of the usage of IIA standards by companies in the United States and select European countries shows the percentage of IAs that use IIA standards as 87.1%, 84%, 72.1%, 79.9%, and 84.4% for Belgium, Italy, The Netherlands, UK and Ireland, and USA respectively.

On probing further, the major reasons adduced for non-adoption of the IIA standards by some of the internal auditors that participated in the survey include:

- i. non-familiarity with the standards

- ii. the standards are seen as too time-consuming

The in-depth interview with the CAEs also indicates that the internal auditors in the NFS do not seem to be well-informed about the IIA standards. Out of the four CAEs interviewed, only one of them (CAE1) seems to have limited knowledge about the IIA standards.

“There is IIA standards by the Institute of Internal auditors which from time to time we try to comply with”.-CAE 1

However, when interrogated if his IAF’s level of compliance with the IIA is full or not, his response shows the limited level of the depth of his appreciation of the IIA standards. As far as he is concerned, he does not see any strong reason for full adoption of the standards for their engagements. He insists there will always be gaps in the standards adoption due to environmental issues.

“What do you mean by is not fully?, ...what do you mean by not fully?. There will always be gaps because the environments are not the same”.-CAE 1

For the other CAEs, the issue of IIA standards seem strange to them as revealed by their responses.

“There is one ...okay, we look at this one being used by the financial institutions, we adopt, we now marry it with the one by the professional body which is ICAN in Nigeria”.-CAE2

‘I used to google it, ... is not that that we are actually following a particular standard because if we are writing our reports, we based it on IIA standards’.-CAE3

Surprisingly, to the CAE3, internal auditing standards are erroneously interpreted as mere checklist:

‘‘Yes we have, we....even one of my staff sent something to me this morning on review. We have a checklist because in modern day audit... even in our bank we are fortunate to have international partners. They come here from time to time and we have learnt a lot from them. So because as an auditor we don’t have everything here. So what you need is a checklist. If for instance, you are going to audit a branch now, I have a checklist on what to look out for. If am in cash area, I know what to look out for, customer service I know what to look out for, credit I know what to look out for, in fund transfer, I know what to look out for. So, there is a standard checklist’’-CAE3

From the above accounts therefore, it seems the CAEs in the NFS are generally not conversant with the IIA standards guiding internal audit activities and therefore, do not conduct their internal audit engagements in compliance with the IIA standards. Non-compliance of the sector’s IAFs with standards particularly the IIA standards implies non-uniformity of approach on engagements in the NFS’ internal audit community.

The above further implies that most of the internal auditors in the NFS are totally ignorant of the IIA standards, and for those few who are aware that standards actually exist for internal audit engagements, such standards are perceived as time consuming. This is an indication of the likelihood of less value-addition from the IAFs to their companies’ businesses in the sector. Burnaby *et al.* (2009) hinted that the value contributed by the IAF to the organisation’s success may be compromised or diminished if the IIA standards are not followed.

According to Abdolmohammadi (2009), the length of IIA membership and internal auditing certification are positively related to use of standards. As can be seen from chapter 7, only 14.8% of the internal auditors in the NFS indicate that they are members of the IIA, and out of these few IIA members, 69.2% of them became members of the institute within the last three years. This finding is clearly in agreement with the positions established in Abdolmohammadi (2009). Aside from membership with the IIA, another area that may influence adoption of the IIA standards by the internal auditors in the NFS might also be the level of knowledge and expertise of the CAEs

(Abdolmohammadi, 2009). A situation where the IIA standards are being interpreted as ‘checklist’ by a CAE indicates the shallowness of knowledge on the part of the head of IAF.

The observation of low membership of internal auditors with the IIA and lack of depth of knowledge on one of the CAEs interviewed warrants an urgent attention and certainly suggests the need for increased advocacy on the part of the IIA in the country. This is a gap that also requires definite position and remedial actions by both the concerned regulators and policy makers in the NFS.

6.4.2. IAF’s performance of QAIP.

	Frequency	Percent	Cumulative Percent
No	47	53.4	54.0
Yes	40	45.5	100.0
Total	87	98.9	
Missing System	1	1.1	
Total	88	100.0	

Table 6.22 : IAF’s performance of QAIP (Source: Survey 2016)

The above table indicates that majority of the IAFs (53.4%) in the NFS do not perform QAIP as recommended by the IIA standard 1310. Performance of internal and external assessments of the IAF, covering all aspects of the internal audit (such as engagement planning and supervision, standard working practices, working paper procedures and sign off’ report reviews, and identifying and addressing weaknesses and areas in need of improvement) is with a view to determining their conformance with the definition of internal auditing, the Code of Ethics, or the standards (Reding *et al.*, 2013). Whereas the internal assessment includes on-going monitoring of the performance of the IAF, and periodic self-assessment, or assessment by other persons within the organisations with sufficient knowledge of internal audit practices, external assessment by a qualified, independent assessor or assessment team from outside the organisation is required to be

conducted at least once every five years. The issue of “who audits the internal auditors?” has always been in the fore front of discussions on internal audit globally.

A similar study by Zaman and Sarens (2013), involving the CAEs in the UK indicates that up to 63.6% have been subjected to QAIP. A cross country study by Burnaby (2009) also indicates the proportion of internal auditors that indicate that their IAFs had never had any QAIP as 52.1%, 72.9%, 56.3%, 31.5% and 42.3% for Belgium, Italy, The Netherlands, UK and Ireland and USA respectively. Also, Burnaby and Hass (2011) indicating a total 84.4% of the USA, 85% of Canadians and 58.1% of Latin American respondents confirmed that their IAAs were or intended to be in full compliance of conduct of QAIP by their IAFs.

As indicated by CAE 1, it appears where QAIP engagements are being conducted, they are handled by the major external audit firms in the country. This is considered appropriate given the level of expertise, and resources at the disposal of such major external auditors.

‘As explained to you, we just finished an exercise with Ernst and Young who reviewed our processes as a department. We are awaiting our final report. That also speaks to the question of who audits the auditors?. So they have come to look at our processes and the standards we are following and all that to see areas of improvement and whether we are complying’-CAE1.

For the CAE3,

‘This type of external assessment is backed by our external auditor because they will come, they will appraise the internal audit as well and report to the board about the effectiveness of the internal audit’-CAE3.

Non-conduct or irregular conduct of QAIP is firstly an indication of non-compliance with the IIA standards and a pointer to poor internal audit practices in the NFS. QAIP is to ensure quality control of IAF activities and engagements and therefore non-

compliance with the IIA standards on QAIP certainly has implications on corporate governance in the sector. From the literature reviewed in chapter 4 and the finding from the NFS reported above, it appears conduct of QAIP and conformance with the IIA standards on internal audit engagements has a direct association with maturity of the internal audit.

6.5 Binary Logistic Regression Analysis of Hypothesis 2

In carrying out the BLRA on the 2nd hypothesis, the 2nd model (indicated in chapter 5) is the focus. i.e.

$$CORPGOV_IAFAUMET = \beta_0 + \beta_1(ADP) + \beta_2(QAIP) + \mu \quad \text{--model (2)}$$

Where:

CORPGOV_IAFAUMET = Effect in Corporate Governance influenced by IAF's auditing methodology

ADP = IAF's adoption of the IIA standards for its engagements

QAIP = IAF's performance of Quality assessment and improvement program

$$\text{Model parameters} \begin{cases} \beta_0 \text{ is the model constant} \\ \beta_1 \text{ is the coefficient of ADP} \\ \beta_2 \text{ is the coefficient of QAIP} \\ \mu \text{ is the error term or residual} \end{cases}$$

6.6 Test of Multicollinearity

In order to establish the possibility of any association between the two explanatory variables (*ADP* and *QAIP*) established under the model formulated to investigate the second hypothesis, incidence of multicollinearity was first investigated by computing the VIF of the variables.

The result of the test implies non-existence of collinearity of the two variables and therefore portends no challenge to the BLRA. The VIFs of the two variables are 1, which is a standard threshold for no collinearity as discussed in section 6.3.1.

6.7.0 The results of the BLRA

Block 1: Method = Enter

Omnibus Tests of Model Coefficients		Chi-square	df	Sig.
Step 1	Step	1.434	2	.488
	Block	1.434	2	.488
	Model	1.434	2	.488

Table 6.23: Model fit

Model Summary			
Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	99.064 ^a	.016	.024

a. Estimation terminated at iteration number 4 because parameter estimates changed by less than .001.

Table 6.24: Model summary

Classification Table ^a				
Observed		Predicted		Percentage Correct
		CORPGOV No	CORPGOV Yes	
Step 1	CORPGOV No		0	23
	V Yes		0	64
Overall Percentage				73.6

a. The cut value is .500

Table 6.25: Model classification table

Correlation Matrix				
		Constant	ADP	QAIP
Step 1	Constant	1.000	-.370	-.456
	ADP		1.000	-.369
	QAIP			1.000

Table 6.26: Correlation Matrix

		Variables in the Equation					95% C.I.for EXP(B)		
		B	S.E.	Wald	Df	Sig.	Exp(B)	Lower	Upper
Step	ADP	.622	.534	1.359	1	.244	1.863	.655	5.305
1 ^a	QAIP	-.325	.528	.378	1	.539	.723	.257	2.035
	Constant	.893	.363	6.061	1	.014	2.442		

a. Variable(s) entered on step 1: ADP, QAIP.

Table 6:27: BLRA result

The above results indicate that at 5% level of significance, none of the two variables is found to be statistically significant to warrant rejection of the hypothesis being tested. However, of the two independent variables, **QAIP** is found to have a negative regression coefficient of (-0.325) contrary to its apriori positive regression coefficient. For the second variable (i.e.**ADP**), the result of the analysis indicates a positive regression coefficient.

Table 6.24 includes the Chi-square goodness of fit test with the null hypothesis that intercept and all coefficients are zero. The Nagelkerke R^2 of **0.024** in the model summary indicates that the model is fair. This level of precision is certainly low and a reflection of the limited number of explanatory variables identified in the study to explain the dependent variables. This is suggestive of the need to include more variables if this model is to be adopted for further research in future. The problem of limitation of number of explanatory variables and the need to refine same for future study is part of the study's limitations highlighted in chapter 8 of the thesis.

Cox & Snell R^2 shows that there is **1.6%** probability of variation in the predictors are explained by the logistic model. The next table is the classification results, with **73.6%** correct classification predicted, it means that the model slightly improves when the predictors entered.

Overall, the model does not have enough evidence to reject the null hypothesis that *Internal audit functions in the Nigerian financial sector do not perform their roles in full conformity with the institute of internal auditors' standards.*

Therefore, with reference to the proposition 6, the following findings are established:

- i. IAF's adoption of the IIA standards for its engagements is positively associated with IAF's auditing methodology, and the function's ability to strengthen corporate governance
- ii. IAF's regular performance of QAIP is negatively associated with IAF's auditing methodology, and the function's ability to strengthen corporate governance. This is a strange result and warrants further validation in future studies. The results contradict findings of Sarens, Abdolmohammadi and Lenz(2012), where a positive association is found between IAF having QAIP and IAF having active role in corporate governance. The strange negative association between IAF's regular performance of QAIP and IAF's auditing methodology and ability to strengthen corporate governance might however be due to the low level of awareness of internal auditors in the sector about the IIA standards.

Deriving from the above results of the regression coefficients of the explanatory variables –QAIP andADP, model 2 thus becomes as below:

$$CORPGOV_IAFAUMET = 0.893+0.622(ADP)-0.325(QAIP)+\mu$$

6.8 Discussion of findings

Generally, the study showed that the auditing methodology of the IAFs in the NFS' is not in tandem with the new order of internal audit practice. This revelation is not surprising and is a reflection of multiple factors. Firstly, and as would be seen in the next chapter, where matters relating to the characteristics of the individual internal auditors in the sector are investigated, most internal auditors in the NFS are not conversant of the various, and continuous developments in the field of internal auditing

globally. As far as they are concerned, old order could be said to be guiding their engagements. For instance, internal auditing is yet to be embraced as a stand-alone profession in the country and till date majority of the internal auditors still sees Internal auditing as a mere offshoot of Accounting, the practice of which is construed to be under the oversight of the ICAN.

Whereas Internal auditing profession like any other profession is constantly evolving, and requires an internal auditor to keep himself abreast of the continuous shifts through regular update of knowledge and skills, the internal auditors in the NFS are yet to appreciate this need. They currently seem entrenched in the psychology that their trainings and knowledge in the field of accounting is enough to acquaint them to all the proficiencies and capabilities required to practice internal auditing in the current time. Internal auditors in the NFS consequently, are yet to take the many advantages of knowledge sharing particularly as available under the IIA's training and educational offerings (in form of interactions through seminars, conferences and most importantly necessary certifications in the field). As the study revealed, this is indeed the major factor behind the perceived level of ignorance in this regard and as a result, their insensibility to various standards guiding the practice of internal auditing globally.

To tackle the above problem, internal auditors need to stay informed about improvements and current developments in internal audit standards, procedures, and techniques. The IIA chapter in the country therefore, needs to increase their efforts on advocacy so as to further make itself more visible and relevant to the internal audit professionals. Various strategies recommended to achieve this are fully discussed in chapter 7, as also listed in chapter 8 (under the implication of the study's findings on the Internal auditing profession). Extensive educational offerings make it easy for internal audit practitioners to cope with the rapid changes in the field, and thus able to meet the value expectations and exceed performance standards.

Emanating from the issue of knowledge gap discussed above, is the potentials that abound for various external audit firms to begin to explore the huge opportunities that

abound in the area of external QAIP to firms in the country, particularly to those companies that are mandatorily expected to have IAF. Certainly, there is limitation to how much the IIA-Nigeria chapter can achieve in this direction if the identified knowledge gap is to be bridged in good time.

6.9: Chapter summary

This chapter begins the data analysis by concentrating on the research questions relating to IAF's independence and the auditing techniques being adopted by the function in the NFS. Both the quantitative and qualitative data collected on the study were analysed and in all, the two hypotheses related to the two concepts (i.e. H1 and H2) were tested using BLRA. In addition, insights from the thematic analysis carried out were also used as corroborating evidences particularly on the six propositions.

Overall, evidences were found to suggest that the IAF in the NFS does not appear to be independent and the approaches of carrying out internal audit engagements by the function are not in tune with the international best practice as being championed by the IIA. Following the evidences derived from the analysis, areas that need to be improved upon include audit committee's involvement in the appointment and dismissal of the CAEs, regularity of attendance of audit committee's meetings by the CAEs. In addition, the low level of awareness about the IIA activities on the part of the internal audit practitioners in the country also needs to be addressed.

The next chapter focuses analysis of data required to test the hypotheses 3 and 4 developed in chapter 4 in relation to internal auditors' objectivity and competence.

Chapter 7

Data Analysis II (Internal auditors' objectivity and competence)

7.0: Chapter Overview

In continuation of the data analysis that commenced in the previous chapter, this chapter focuses issues relating to the characteristics of the individual internal auditors in the NFS. The characteristics of the internal auditors are examined through two lenses. First, by looking at the objectivity of the individual internal auditors and second, by considering the level of competence of individual internal auditors in the IAF. The analyses here are aimed at providing answers to the following two research questions:

- i. How objective are the internal auditors of the Nigerian financial sector?.
- ii. To what extent are internal auditors in the Nigerian financial sector competent in fulfilling their expected roles?.

Similar to the structure of the previous chapter, first, summary of the descriptive statistics of the relevant explanatory variables of the formulated models are presented. This forms the preliminary quantitative data analysis. Findings from the preliminary quantitative data analysis are then elaborated by the various insights drawn (through thematic analysis) from the in-depth interview with the CAEs. This is followed by the BLRA of the quantitative data that was adopted to evaluate the related propositions and test the two hypotheses put forward to find answers to the above two research questions.

7.1.0 Internal auditors' Objectivity

In order to investigate empirically how objective the individual internal auditors in the NFS are, and the impact of such level of objectivity on the sector's corporate governance, the following four propositions (P7-10) earlier postulated in chapter 4 of the thesis are subjected to analysis:

- i. Using internal audit function of the Nigerian financial sector as a training ground is negatively associated with the internal auditors' objectivity and with the function's ability to strengthen corporate governance.
- ii. Consulting role of internal audit function of the Nigerian financial sector is negatively associated with internal auditors' objectivity and the function's ability to strengthen corporate governance.
- iii. Chief audit executive's regular private contact with the Audit committee's chairperson is positively associated with the internal auditors' objectivity and the ability of the IAF of the Nigerian financial sector to strengthen corporate governance..
- iv. Unrestricted access to records and information by the internal audit function in the Nigerian financial sector is positively associated with internal auditors' objectivity, and the function's ability to strengthen corporate governance.

7.1.1 Using IAF as a training ground

	Frequency	Percent	Cumulative Percent
Always	16	18.2	18.2
Barely	72	81.8	100.0
Total	88	100.0	

Table 7.1: IAF as a training ground (Source: Survey 2016)

Analysing the quantitative data collected on the study, the above table indicates that only 18.2% of the respondents disclosed that their IAFs are being used as training ground for employees of other departments in their organisations. The practice of using IAFs as training ground is usually through habitual rotational transfers of employees from other departments within their organisations to the IAF for some time (say two to three years). Alternatively, IAF is often used as the first duty post for new hires with the intention of exposing them to all departments in the organisations. The rationale is usually to enable them to have a better view and understanding of the entire

organisation before been given permanent posting therein. 81.8% of the respondents indicated that such practice is very rare in their organisations. This clearly suggests that the use of IAF as a training ground is very rare in the NFS. This finding is corroborated by the feedback from all the CAEs interviewed.

“You can take in people from other departments but I have not had cause to send internal auditor to other departments except management directs that people should move out”. –CAE1

Generally, it appears the practice of transferring internal auditors from IAF to other department in the NFS is very rare. The comments of one of the CAEs on the issue suggest that the usual practice in the NFS is to take in staff of other departments into the IAF and not vice versa. Going by the insights from the interview, this practice is premised on the general expectation that internal auditors are expected to have gathered wide-ranging experiences in other departments before they can perform well in the IAF of the sector.

“...before you can come to the department, you must have touched all the departments so that you know at least what is being done. If you say you want to add value to your organisation as internal auditor, you must actually know what is going on in other departments. This is to enable you to identify, the risks and make suggestions to mitigate risks”.-CAE3

“Is like you must have known... at least have idea of what is available in other departments before you can come to internal audit function because if you don't have idea, how do you want to add value”?-CAE3

Going by the above, it appears the issue of using IAF as a training ground seems inapplicable in the country's financial sector as most of the CAEs interviewed indicate that they do not post their staff to other departments but rather do take in staff of other departments but do not practice rotational transfer. The general view of the CAEs is

that any potential staff of the IAF ought to have gathered experience in other departments within the business before they can be a value-adding internal auditor. So, rather than serving as a training ground for other departments, the IAF of NFS expects that a would-be valuable internal auditor is the one that has gathered experience in other departments of the organisation before joining the IAF. Retention of internal audit staff ordinarily is expected to contribute to the career potential of internal audit professionals and therefore expected to boost the esteem of IAF as a specialised area where people are groomed as internal audit professionals.

The practice of using IAF as a training ground in organisation has been established in literature to have the tendency of impacting negatively on the internal auditors' objectivity and ultimately affecting the function's ability to strengthen corporate governance (see Lenz and Hahn, 2015; Christopher, *et al.*, 2008; Rose *et al.*, 2013; Messier, *et al.*, 2011). Messier *et al.* (2011) contend that over 50% of all the companies that have an IAF specifically hire internal auditors with the aim of rotating them into management positions (or cycle current employees into the IAF for a short stint before promoting them into management positions).

As discussed extensively in chapter two of the thesis, the usual short term tenor of internal audit staff in organisation's IAF arising from rotational transfers (in-and-out) of staffs of IAF and the impression that the department is in most cases the organisational "incubation centre" for potential line managers are some of the issues brought forward by O'Regan (2001) to argue against the professionalization of internal auditing.

In addition, Messrs *et al.*(2011) established that internal auditors of IAF used as management training ground are usually perceived by external auditors as less objective.

7.1.2 IAF and its consulting role

	Frequency	Percent	Cumulative Percent
Always	3	3.4	3.4
Rarely	85	96.6	100.0
Total	88	100.0	

Table 7.2: IAF and its consulting role

Whereas, modern day internal audit involves both assurance and consulting, however, as can be seen from the above table, most internal auditors in the NFS indicated that they are rarely engaged by their management for consulting activities. While only 3.4% of the respondents disclosed that they are always being requested to perform consulting activities for their organisations, 96.6% of the respondents maintained that they are rarely required to carry out consulting activity in their various organisations. This finding might be interpreted to indicate that the issue of objectivity of the internal auditors of the NFS being affected as a result of engagement in consulting activities is very remote. This position notwithstanding, the finding may also be interpreted to mean that majority of organisations in the NFS are yet to tap fully into the potentials of the IAF when it comes to its value addition in the area of insights. Abiola (2012) in his study on the relevance of internal auditors in corporate governance of Nigerian banking sector anticipates that internal auditors in the sector would be more engaged in consulting activities for their organisations. The current study however shows that this expectation is yet to materialise. Relying on the IAF for assurance only might be taken as a signal that the new paradigm of IAF as “assurer” and “consultant” is yet to be fully explored in the NFS.

Ordinarily, one could have argued that the usual perception of likelihood of conflict of interest might be responsible for the non-popularity of consulting activities among the IAFs in the NFS, the feedback from the CAEs interviewed however ruled out this thought. When asked whether there could be incidence of conflict of interest if an IAF

engages in both the traditional function of assurance and the additional function of consulting as reasoned in the literature, the CAEs interviewed are of the opinion that they do not see any area where combination of the two roles can lead to conflict of interest.

“Conflict?, I don’t see any conflict there. If you are an auditor you are expected to know it all because you will be advising an institution to improve performance and what is your basic job as an auditor?,... if not to give assurance to management that everything is going according to plan, policies are strong enough to protect the institutions. So, consultancy is for the auditor to be on top of his game, knowing what is happening in the environments”.-CAE1

If internal auditors are aware that venturing into consulting will make them to be on top of their game, can we then say management of organisations do not have much interest in engaging internal auditors for consulting role?. Can it be assumed that management do not see them having such proficiency that will enable them add additional value through consulting?. Or could it be that the management themselves are not fully tapping into the potentials of their IAFs due to their unconsciousness of the huge potential from IAF’s consulting activities?. The present study going by its focus certainly cannot address these posers and therefore these areas of uncertainty, particularly the motivation for firm’s engagement of IAF for consulting, are highlighted as potential areas of future research.

Whereas the general impression is that the two roles of assurance and consulting are mutually exclusive, it seems internal auditors in the NFS view the two roles as complimentary and inseparable.

“Honestly assurance cannot be done without consulting; and consulting cannot even be done without assurance. They are embedded. Assurance is embedded in internal audit and consulting is also embedded in internal audit. There is no way you can do auditing without consulting and there is no way you can do it without assurance”. CAE4

For one of the CAEs interviewed, consulting activity is seen as old as assurance.

“It has been a long time combination of activities. So it is just a change of nomenclature”.-CAE3

For all the CAEs interviewed, the general opinion is that internal audit cannot be complete without recommendations, and that internal audit has always been a combination of both assurance and consulting. According to them, consulting is embedded in assurance and the CAEs do not envisage any likelihood of conflict of interest in the dual roles. This position aligns with the view of the internal auditors in Malaysia as reported in Ahmad and Taylor (2009), a study conducted to test the effects of role theory on internal auditors’ commitment to independence through a survey of 101 Malaysian internal auditors. The referenced study indicates that Malaysian auditors also do not perceive any conflict between their dual roles of oversight (assurance) and advisory (consulting).

The issue of desirability of consulting activities within the context of internal auditors’ objectivity is yet to be laid to rest in literature (see Arena *et al.*, 2006; Allegrini *et al.*, 2006; Allegrini and D’Onza, 2003; Paape *et al.*, 2003; and Selim *et al.*, 2009). Therefore future research that will focus organisations’ executives and audit committees in Nigeria, most especially along industry line, for their insights on this concept is being contemplated by the researcher. Stewart and Subramaniam (2010) also hint that there could be industry differences on perceptions and experiences on the matter. In addition, identification of factors that might mitigate any potential threats of bias when internal auditors engage in the dual roles of consulting and assurance also forms part of the proposed research agenda aimed at elaborating the on-going discourse.

7.1.3 Regularity of CAE's private contact with the Audit committee's Chairperson.

	Frequency	Percent	Cumulative Percent
Disagreed	65	73.9	73.9
Agreed	23	26.1	100.0
Total	88	100.0	

Table 7.3: Regularity of CAE's private contact with the Audit committee's Chairperson

The above table shows that majority of the internal auditors that participated in the survey indicated that their CAEs do not enjoy the privilege of having private contacts with the chairperson of the audit committees of their organisations. Whereas 26.1% of the respondents confirmed that their CAEs do enjoy regular private contacts with the chairpersons of their audit committees, 73.9% indicated that such opportunity currently eludes their CAEs. It has been strongly contested that the objectivity of the staffs of the IAF is enhanced through regular private contacts between the CAE and the audit committee's chairperson. It is anticipated that such regular private contacts will enable the CAE to discuss in details issues that are considered germane to the success of the organisation without any interference from the management. Adel and Maissa (2013) also indicate that such informal interactions enable the IAFs to communicate their findings honestly and objectively.

The above finding suggests the absence of robust relationship between the CAEs and the Chairpersons of audit committees in the NFS. Extant studies particularly from developed economies produced contradicting results. For instance, Zaman and Sarens (2013) revealed that majority (88.1%) of the CAEs in UK indicated that they enjoyed informal interactions with the audit committee's chair and/or audit committee's members. Also, Christopher *et.al* (2009) showed that 68% of the responding CAEs had

regular private contacts with the audit committee's chair or individual audit committee's members.

Drawing insights from the interview, it appears the issue of CAE's having private contacts with the chairperson of audit committee is truly not too popular and considered highly necessary among the IAFs in the NFS. Only one out of the four CAEs that took part in the in-depth interview acknowledged the significance of such un-official contacts with the audit committee's chairperson.

“Certainly I do. Aside from the formal meeting, I normally catch up with him to discuss any issue requiring his attention. Occasionally the chairman of the audit committee personally invites me to his office where we discuss and rub mind together on issue pertaining to the organization” –CAE4.

Zaman and Sarens (2013) study that focuses informal interactions between audit committees and IAFs indicate that the proportion of the independent audit committee's members and particularly the background of the audit committee's chairperson are factors that promote positive association with the existence of informal interactions between audit committee and IAFs. Also, Raghunandan *et al.* (2001), investigating Audit committee's composition, “Gray directors” and interaction with internal auditing among the Chief Internal Auditors in the US manufacturing companies, found evidence for positive relationship between the audit committee with independent members, and with at least one member having an accounting or finance background and informal meetings between the IAF and audit committees.

If the finding of the referenced study is taken as reported, then it might be desirable to investigate further the number of independent audit committee members in the NFS as well as the antecedents of the people occupying the position of the audit committees' chair in the sector. The question included in the study's questionnaire however appears inadequate to generate detailed insights on the specific attributes of the audit committee's members in the sector. Therefore, the respondents' views on adequacy of

audit committee’s membership in section 6.2.6 might be subjective and inadequate to verify the positions in both Zaman and Sarens (2013) and Raghunandan *et al.* (2001). Although, UK is known to have a long history of existence of audit committee as well as matured IAF, nonetheless, the result obtained from the questionnaire survey as reported above, suggests that these areas present an opportunity for future research.

7.1.4 IAF's Access to records and information.

	Frequency	Percent	Cumulative Percent
Barely	20	22.7	22.7
Always	68	77.3	100.0
Total	88	100.0	

Table 7.4: IAFs access to records and information

From the table above, 77.3% of the respondents indicated that they do always have unrestricted access to records and information. Only 22.7% of the respondents indicate they barely have such unrestricted access to records and information in the NFS. Having unrestricted access to records and information by the internal auditors is indeed one way the objectivity of internal auditors can be assured. Stewart and Subramaniam (2010) contend that restriction of access to records and information constitutes impairment to objectivity.

Considering the feedback gathered from the interview, the CAEs of the NFS do not seem to have any issue on their access to records from the business units. This might be a product of enhanced relationship management between them and the various business units, and appreciation of the continuous paradigm shift as far as internal auditing is concerned. Internal auditors are now moving away from the usual posture of ‘‘corporate detectives’’ to corporate partner. Whereas the IIA standards maintain that internal auditors should be objective, only the CAE that cultivates good relationship with line managers and other personnel of the organisation will be able to easily break

barriers of access to information and documents. From the above table and insights from the in-depth interview therefore, it is apparent that the CAEs in the NFS seem to have robust interpersonal relationships with the auditees in the NFS and consequently break barriers of restrictions particularly barrier of access to their organisation's records and useful information. This is considered good as it indicates that the required objectivity of the internal auditors in the sector does not seem to be in doubt. To maintain a balance between objectivity and rapport with the auditees requires good interpersonal relationship. An internal auditor with good interpersonal relationship profile will certainly get approval of the staff of his organisation and consequently has no difficulty in performing his roles objectively.

7.2.0 Binary Logistic Regression Analysis of Hypothesis 3

In order to carry out the BLRA on the 3rd hypothesis, and the associated four propositions (P7-10) listed in 7.1.0, the quantitative data collected is analysed following the binary logistic regression model formulated in Chapter 5 as indicated below:

$$CORPGOV_IAsOBJ = \beta_0 + \beta_1(TRAIN) + \beta_2(CONS) + \beta_3(CONT) + \beta_4(ACCESS) + \mu$$

Where:

CORPGOV_IAsOBJ is effect in Corporate Governance influenced by Internal auditors' objectivity

TRAIN = use of IAF as a training ground

CONS = internal auditors role in consulting

CONT = CAEs' regular private contact with the audit committee chairperson

ACCESS = Unrestricted access to records and information by the internal auditors

$$\text{Model parameters} \left\{ \begin{array}{l} \beta_0 \text{ is the model constant} \\ \beta_1 \text{ is the coefficient of TRAIN} \\ \beta_2 \text{ is the coefficient of CONS} \\ \beta_3 \text{ is the coefficient of CONS} \\ \beta_4 \text{ is the coefficient of CONS} \\ \mu \text{ is the error term or residual} \end{array} \right.$$

7.2.1. Test of Multicollinearity

As done in chapter 6, possible interrelationships between the explanatory variables were first examined by testing for their multicollinearity using VIF indicator as shown below.

Predictor Variables	VIF
CONT	1.068
ACCESS	1.076
TRAIN	1.09
CONS	1.09

Table 7.5: Collinearity Statistics

The VIFs of the independent variables computed as reported in the table above indicate that all the VIFs of the variables are between 1.068 and 1.09. This implies a moderate level of correlation of the variables with one another which is acceptable in line with the table of threshold of VIF in chapter 6 as repeated below.

VIF	Status of predictors
1	Not correlated
$1 < \text{VIF} < 5$	Moderately correlated
$\text{VIF} > 5 \text{ to } 10$	Highly correlated

Table 7.6: VIF indicator

7.2.2 Results of the BLRA

In tandem with the approach adopted for the analysis carried out in chapter 6, the results of the BLRA are presented below.

Variables in the Equation

	<i>B</i>	S.E.	Wald	Df	Sig.	Exp(β)
Step 1 ^a ACCESS	.653	.584	1.247	1	.264	1.921
TRAIN	.650	.646	1.011	1	.315	1.915
CONS	2.123	1.384	2.353	1	.125	8.353
CONT	.847	.692	1.497	1	.221	2.332
Constant	-2.191	1.511	2.102	1	.147	.112

Table 7.7: Variables in the Equation

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	94.747 ^a	.070	.102

Table 7.8: Model summary

From the analysis above, at 5% level of significance, none of the predictor variables is found to be statistically significant to warrant rejection of hypothesis 3. In addition, all the four explanatory variables (**CONT**, **ACCESS**, **TRAIN**, **CONS**) have positive coefficients of regression. Of the four independent variables however, both **TRAIN**, and **CONS** failed to meet the a-priori negative signs of their regression coefficients.

The above results are also interpreted in terms of the relationships of the variables to internal auditors' objectivity as follows:

- i. CAE's regular private contact with the audit committee's chair is positively associated with individual internal auditors' objectivity. This implies that the more regular the private contacts made by the CAE with the audit committee's chairperson in the NFS, the more the individual internal auditors are objective and the more the IAF is able to strengthen the sector's corporate governance. This aligns with extant studies such as Zaman and Sarens

(2013). The referenced study, a questionnaire survey of CAEs in UK provided evidence of positive association between CAE's informal interactions with the audit committee and internal auditors' objectivity.

- ii. IAF having unrestricted access to records and information in the NFS is positively associated with individual internal auditors' objectivity, and the IAF's ability to strengthen corporate governance in the NFS. The direction of this association suggests that unrestricted access to information and records of organisations by the internal auditors enhances the objectivity of the individual internal auditors, and in turn increases the IAF's ability to strengthen the organisation's corporate governance in the sector.
- iii. Using IAF of the NFS as a training ground in the NFS is positively associated with internal auditors' objectivity and the IAF's ability to strengthen corporate governance in the NFS. The practice of interdepartmental transfer of internal auditors, though not prominent in the NFS, interestingly turned out to have positive relationship with the internal auditors' objectivity in the NFS. This indicates that the more frequent internal auditors are rotated across departments in organisations in the NFS, the more the individual internal auditors become objective, and the more the likelihood of IAF's ability to strengthen corporate governance in the sector. This finding is however not in tune with the general notion that the use of IAF as a training ground affects internal auditor's objectivity.
- iv. Consulting role of IAF of the NFS is positively associated with the individual IAs' objectivity and the likelihood of the IAF's ability to strengthen corporate governance. Whereas it is established through the survey data (presented in table 7.2 and discussed in section 7.1.2 of the thesis) that the IAF of the NFS is yet to fully embrace consulting activity. Consulting (One of the two components of modern day IAAs) is however found to have positive relationship with the objectivity of the individual internal auditors.

The predictive power of the model of 10.2% indicates that only 10.2% of the variations of internal auditors' objectivity are explained by the four variables in the model.

7.2.3 Discussion of findings

Objectivity as defined by Chambers (2014) is ‘an unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they believe in the work product, and accept no compromises in the product’s quality’. Going by the descriptive statistics presented in section 7.1.1 to 7.1.4 of this chapter, the discussions thereon, the results of the BLRA presented in the previous section, it is evident that the internal auditors in the NFS cannot be said to be objective. It is believed that the current level of objectivity of the internal auditors in the sector can be enhanced particularly by addressing the issue of irregularity of private contacts between the CAEs and the audit committee or audit committee’s chairpersons.

As discussed earlier, the non-popularity of seeing and using the IAFs in the sector as training ground for potential executives or managers in the sector is seen as one of the key parameters that is currently contributing to the impartiality or neutrality of internal auditors in the sector in the discharge of their duties. The internal auditors are therefore not imprisoned by their conscience in expressing their minds on matters affecting their assessment of effectiveness of their organisations’ governance, internal control, and risk management. The non-popularity of the use of the IAF as training grounds in effect has reduced the threat of conflict of interest or appearance thereof on the part of the internal auditors and consequently promotes the credibility of the internal auditors in the sector. According to Reding (2014), the following events are parts of circumstances that can lead to potential conflict of interest:

- i. a senior manager from another area of the organisation is asked to be the CAE
- ii. an employee moves into the IAF from another area of the organisation or rotates through the IAF as part of his or her training regimen
- iii. an internal auditor with specialised accounting expertise is asked to assume a temporary accounting position

- iv. an internal auditor with management experience is asked to fill a vacant management position while the organisation searches for a suitable replacement.

It is very important that the concerned stakeholders see the internal auditors as having the courage to review any area of the organisation without being biased themselves or been compromised by others. Although another strand of argument support the use of IAF as training ground, claiming such practice will enhance the outlook of the function, the negative impacts such practice connote on the function's objectivity has been established to outweigh its benefits.

Also, unhindered access to records and information; and less engagement of the internal auditors in consulting role in the sector are good indicators of cooperation from the auditees and avoidance of conflict of interest on the part of the internal auditors. Auditees' enthusiasm about IAF's roles in the organisation is a sign of shared mission on the part of the line managers, and possibly a reflection of appropriate tone from above on the beneficial roles of IAF. Such positive development, combined with internal auditors' unprejudiced mind are very vital to stimulate internal auditor's objectivity in the sector.

Whereas, the BLRA indicates a positive association between CAE's regular private contacts with the audit committee's chairperson and individual internal auditors' objectivity, yet the study indicates that the CAEs in the country's financial sector are yet to appreciate the benefits associated with their private contacts with the audit committee's chairperson. Absence of regular private contacts between the CAEs and their audit committee's chairpersons implies that the entire IAF might not have the privilege of gaining the full support of the audit committee. If there is any relationship a CAE should be desirous of fostering to ensure his ability to make impartial or unbiased judgments, it is his rapport with the chairperson of the audit committee.

7.3.0 Internal Auditors' competence

As indicated in chapter 6, competence is the second characteristics of internal auditors, and the analysis under this section is meant to provide answers to the fourth research questions (i.e. to what extent are internal auditors in the Nigerian financial sector competent in fulfilling their expected roles?). The five propositions to be evaluated here are as presented below:

- i. Educational qualification of internal auditors of the Nigerian financial sector is positively associated with the individual internal auditors' competence and the ability of the internal audit function to strengthen corporate governance in the Nigerian financial sector.
- ii. Possession of relevant professional qualifications by the internal auditors in the Nigerian financial sector is positively associated with the individual internal auditors' competence and the ability of the internal audit function to strengthen corporate governance in the Nigerian financial sector.
- iii. Possession of reasonable length of years of experience by the internal auditors of the Nigerian financial sector is positively associated with the individual internal auditor's competence and the ability of the internal audit function to strengthen corporate governance in the Nigerian financial sector.
- iv. Regular training of internal auditors in the Nigerian financial sector is positively associated with the individual internal auditors' competence and the ability of the internal audit function to strengthen corporate governance in the Nigerian financial sector.
- v. Membership of internal auditors of the Nigerian financial sector with the Institute of internal auditors is positively associated with the individual internal auditors' competence and the ability of the internal audit function to strengthen corporate governance in the Nigerian financial sector.

7.3.1 : Educational qualification of the internal auditors of the NFS.

	Frequency	Percent	Cumulative Percent
HND	25	28.4	28.4
BSc	27	30.7	59.1
MSc/MA/M	36	40.9	100.0
BA			
Total	88	100.0	

Table 7.9: Educational qualification of the internal auditors of the NFS

The analysis of the respondents according to their level of educational qualifications shows that majority (59.1%) of the internal auditors in the NFS possess only first degree (i.e. either HND or B.Sc.). Substantial proportions of them (40.9%) however possess post-graduate degrees (i.e. Master degree). This is anticipated given the category of the respondents and the focus of the research. Higher level of educational qualification is actually expected of anybody that occupies the position of CAE (and/or their subordinates) of organisations in the sector.

7.3.2(a) Professional qualifications of the internal auditors in the NFS

	Frequency	Percent	Cumulative Percent
None	7	8.0	8.0
ACA/FCA	53	60.2	68.2
ACCA	15	17.0	85.2
ACIB	3	3.4	88.6
CIA	9	10.2	98.9
Others	1	1.1	100.0
Total	88	100.0	

Table 7.10: Professional qualifications of the internal auditors in the NFS

Whereas only 7 internal auditors representing 8.0% of all the respondents indicated that they do not possess any professional qualifications, those respondents that are members of professional bodies considered highly relevant to the profession of internal auditing (i.e. the IIA, ICAN, and ACCA) constitute 95.1% of those that belong to one professional bodies or the other. Of these people, those that are members of the ICAN as either associate member (with professional appellation ‘‘ACA’’) or Fellows (‘‘FCA’’) account for 68.8% while those with CIA qualifications are just 11.7%. This indicates that majority of the internal auditors in the NFS are members of ICAN, whereas CIA, the premier certification sponsored by the IIA, remains the only globally accepted certification for internal auditors (Reding *et al.*, 2013). Akinteye, York and Ullah (2015) also documented that majority of the internal auditors of firms listed on the Nigerian Stock Exchange hold professional accounting qualifications.

The above finding is also established to be in tandem with the results from the in-depth interview. As the interview revealed, all the interviewed CAEs are members of the ICAN. In addition, the interviewees indicated that most of their team members are members of ICAN.

‘‘I can tell you that at least 80% of my staff are qualified accountants’’.-CAE1

When interrogated on the possible explanation for this skewedness of professional membership highly in favour of the ICAN, the general opinion is that membership of the ICAN is enough to practice as internal auditor.

‘‘No. I am not a member.... I think once you have ICAN I don’t think IIA is a strong... They are just new. They are trying to get membership; they are trying to penetrate the market’’.-CAE1

‘‘Am not a member’’ –CAE2.

‘Am not even a member of IIA.....and I don’t think any of my staff are members. Am a member of the Institute of Chartered Accountant of Nigeria’ –CAE4

It is observed that internal audit professionals in the sector are yet to appreciate the invaluable and numerous benefits that can be derived from their membership of the IIA. Rather, they all see the IIA as a foreign and new professional body that is just trying to penetrate Nigeria given their limited membership.

‘Yes, IIA is not that strong. Their membership is not that strong’-CAE1

This impression perhaps explains both the shallow understanding about internal audit profession and the position of the internal audit professionals in the country on the relevance of the IIA to the internal auditing profession. The general impression in the country is that internal auditing is an offshoot of accounting and not a separate profession.

‘Yes, IIA is not that strong. Membership is not that strong. We have not gotten to that level where we will say if you are not an IIA member you cannot be an auditor’.-CAE1

7.3.2(b): Percentage of team members with relevant professional qualification

	Frequency	Percent	Cumulative Percent
0-24%	5	5.7	6.0
25-49%	17	19.3	26.2
50-74%	32	36.4	64.3
75% and above	30	34.1	100.0
Total	84	95.5	
Missing System	4	4.5	
Total	88	100.0	

Table 7.11 *Percentage of team members with relevant professional qualification*

The above table shows that majority (36.4%) of the IAF in the NFS confirmed that between 50-74% of their team members (staff) possess one relevant professional qualification or the other. Under the study, professional qualifications considered relevant include ACA, ACCA, ACIB, CIA, CRMA, CISA, CCSA, CRISC, CFSA etc. In addition, 34.1% of the IAF in the NFS indicated that 75% and above of their team members are members of relevant professional bodies.

The result of the in-depth interview conducted also corroborated the above findings. One of the CAEs interviewed emphatically stressed that being a member of one professional body or the other is considered critical for his team members:

‘‘I can tell you that at least 80% of my staff are qualified accountants. In the IT audit, they have to be certified. CISA-qualified and with IT background’’-CAE1

As also indicated by Akinteye *et al.* (2015), where 100% of the internal auditors that participated in a survey investigating the IAF’s quality in Nigerian listed firms possess one accounting professional qualification or the other, it appears internal audit practitioners in the NFS considered possession of relevant professional qualification very important. This is considered inspiring.

7.3.3 Length of years of experience of the internal auditors of the NFS

	Frequency	Percent	Cumulative Percent
Less than 5 years	11	12.5	12.5
5-10 years	65	73.9	86.4
Greater than 10 years	12	13.6	100.0
Total	88	100.0	

Table 7.12: Length of years of experience of the internal auditors of the NFS

On the issue of length of year of experience, 73.9% of the respondents have between 5 to 10 years of experience in internal audit while 13.6% indicate that their length of years of experience in the practice of internal audit is more than 10 years. Corroborating the above findings, all the interviewed CAEs were of the opinion that their team members have reasonable length of years of experience.

‘By experience, all my staffs are well-experienced; that I can assure you of’-CAE4.

The issue of experience through on-the-job training is emphasised by the CAE2.

‘By experience, it is believed that one learns on the job as well but they are taught some operational areas too at least to a manageable extent, they are okay’.-CAE2

Truly, internal auditing like any other profession is expected to be learned more primarily by doing, after all, nobody is an expert upon graduating from college.

7.3.4(a) Internal auditors’ membership with the IIA

		Frequency	Percent	Cumulative Percent
	No	72	81.8	84.7
	Yes	13	14.8	100.0
	Total	85	96.6	
Missing	System	3	3.4	
Total		88	100.0	

Table 7.13: Internal auditors’ membership with the IIA

The above table shows the number of respondents who are, and who are not members of the IIA in the sector. Only 13 of the internal auditors representing 14.8% are members of the IIA. The disparity of this number with those that have CIA qualification (as indicated in table 7.12), is due to the opportunity extended by the IIA to prospective or

practicing internal auditors to become member of the institute prior to writing of any of the institute’s professional and qualifying examinations for certifications . Such qualifying examinations include Certified Internal Auditor (CIA), Certified Government Auditing Professional (CGAP), Certified Financial Services Auditor (CFSA), Certification in Control Self-Assessment (CCSA), and Certification in Risk Management Assurance (CRMA)). When probed further, it was discovered that 9 out of the 13 IIA members (i.e. 69.2%) actually became members of the institute (IIA) within the last three years while the remaining 4 members joined the institute more than 3years ago as shown below:

7.3.4(b) Length of years of internal auditors’ membership with the IIA

	Frequency	Percent	Cumulative Percent
since a year ago	2	15.38	15.38
since 2years ago	2	15.38	30.76
since 3years ago	5	38.46	69.22
More than 3years ago	4	38.46	100
Total	13	100.0	

Table 7.14: Length of years of internal auditors’ membership with the IIA

The above finding however is not unexpected considering the state of infancy of the institute in the country, the non-popularity of the IIA as a professional body in Nigeria and the uncertainty about the legitimisation of internal auditing as a profession in general.

7.3.5

Regularity of training of internal auditors in the NFS

	Frequency	Percent	Cumulative Percent
Once	26	29.5	29.5
Twice	43	48.9	78.4
Thrice	13	14.8	93.2
Four times	3	3.4	96.6
More than four times	3	3.4	100.0
Total	88	100.0	

Table: 7.15 Regularity of training of internal auditors in the NFS

Frequency of training of the internal auditors in the NFS is shown by the above table. Majority of the respondents (48.9%) indicated that they had attended formal training two times over the last 24 months. 26 respondents representing 29.5% of the respondents disclosed that they attended just one training over the last 24 months. This implies that majority of the internal auditors in the NFS do attend training once in a year on the average. Those who indicated that they attended training up to four times or more over the last 24 months are just 6, representing 6.8%. These findings suggest that attendance of training by the internal auditors in the NFS is not as regular as expected, and contradicts the positions of the CAEs interviewed as reflected in the response below.

“Yes, there is always training and re-training and according to this organization policy, it is compulsory for each staff to attend at least one training per year” - CAE4.

According to the CAEs that participated in the semi-structured interview, internal auditors do attend training regularly to enrich their knowledge particularly in the areas of IT and communication.

7.4 Binary Logistic Regression Analysis of hypothesis 4

The five propositions (i.e. P11-15) related to the fourth hypothesis made on the study as listed in 7.3 were analysed using BLRA. To do this, reference was made to model 4 formulated and discussed in chapter 5.

Model IV: Internal auditors' competence

$$\text{CORPGOV_IAsCOMP} = \beta_0 + \beta_1(\text{EDUQ}) + \beta_2(\text{PROQ}) + \beta_3(\text{YEAR}) + \beta_4(\text{REGT}) + \beta_5(\text{MEM}) + \mu$$

Where:

CORPGOV_IAsCOMP is Effect in Corporate Governance influenced by internal auditors' competence

EDUQ - Educational qualification of the internal auditors

PROQ - Professional qualifications of the internal auditors

YEAR - Length of years of experience of the internal auditors

REGT - Internal auditors' regular training

MEM - Internal auditors' membership with the IIA

$$\text{Model parameters} \left\{ \begin{array}{l} \beta_0 \text{ is the model constant} \\ \beta_1 \text{ is the coefficient of EDUQ} \\ \beta_2 \text{ is the coefficient of PROQ} \\ \beta_3 \text{ is the coefficient of YEAR} \\ \beta_4 \text{ is the coefficient of REGT} \\ \beta_5 \text{ is the coefficient of MEM} \\ \mu \text{ is the error term or residual} \end{array} \right.$$

7.4.1. Test of Multicollinearity

As launched in chapter 6, possible interrelationships between the explanatory variables were first examined by computing their multicollinearity using VIF indicator. The VIF for the variables ranges from 1.007 to 1.117. This implies that the level of relationship between the explanatory variables poses no threat.

7.4.2 Results of the BLRA

Presented below is the result of the BLRA carried out on the data using model 4. The table shows the coefficients of the individual predictor variables (β s), Wald statistics, and the significance of the variables. In addition, the summary of the model indicating the level of precision of the model is also presented.

		Variables in the Equation						95% C.I. for	
		B	S.E.	Wald	df	Sig.	Exp(B)	EXP(B)	
								Lower	Upper
Step 1 ^a	EDUQ	-.024	.317	.006	1	.939	.976	.524	1.817
	PROQ	-.108	.228	.226	1	.635	.897	.575	1.402
	MEM	.200	.731	.075	1	.784	1.222	.291	5.122
	YEAR	-.412	.516	.637	1	.425	.663	.241	1.821
	REGT	-.099	.265	.139	1	.709	.906	.538	1.524
	Constant	2.281	1.346	2.869	1	.090	9.782		

a. Variable(s) entered on step 1: EDUQ, PROQ, MEM, YEAR, REGT.

Table 7.16: BLRA result

Block 1: Method = Enter

Omnibus Tests of Model Coefficients				
		Chi-square	Df	Sig.
Step 1	Step	1.152	5	.949
	Block	1.152	5	.949
	Model	1.152	5	.949

Table 7.17: Model fit

Model Summary			
Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	96.058 ^a	.013	.020

a. Estimation terminated at iteration number 4 because parameter estimates changed by less than .001.

Table 7.18: Model summary

Classification Table^a

		Predicted		
		CORPGOV		Percentage
Observed		No	Yes	Correct
Step 1	CORPGOV	No	0	22
		Yes	0	63
Overall Percentage				74.1

a. The cut value is .500

Table 7.19: Model classification table

Correlation Matrix

		Constant	EDUQ	PROQ	MEM	YEAR	REGT
Step 1	Constant	1.000	-.400	-.203	-.065	-.759	-.265
	EDUQ		1.000	-.277	-.013	.031	-.127
	PROQ			1.000	-.094	.011	.189
	MEM				1.000	.117	-.180
	YEAR					1.000	-.144
	REGT						1.000

Table 7.20: Correlation Matrix

The above results validates hypothesis 4. This is so because none of the predictor variables is significant enough at 5% level of significance to warrant rejection of the hypothesis. Looking at the direction of relationship of the predictor variables in relation to the dependent variable (*IAsCOMP*) however, the regression coefficients of the variables indicate that only **MEM** is positive. The remaining four variables (**EDUQ**, **YEAR**, **PROQ** and **REGT**) turned out to be negative contrary to their apriori expectation of being positive.

The Nagelkerke R^2 of **0.020** in the Model Summary indicates that the model is fair, *Cox & Snell* R^2 shows that there is 1.3% probability of variation in the predictors are explained by the logistic model.

The implications of the reported direction of relationship of the independent variables with the dependent variable on the five propositions (P11-15) are as below:

- i. Membership of the internal auditors of the Nigerian financial sector with the IIA is positively associated with individual internal auditors' level of competence. This implies that internal auditors' membership with the IIA enhances their level of competence.
- ii. Possession of relevant professional qualifications by the internal auditors is negatively associated with the level of competence of individual internal auditors. There seems to be no significant relationship between professional qualification and internal auditor's level of competence in the Nigerian financial sector according to the analysis.
- iii. Educational qualification of the internal auditors is negatively associated with the internal auditors' competence.
- iv. Average length of years of experience of the individual internal auditors is negatively associated with the level of competence of the internal auditors in the sector.
- v. There is a negative relationship between the number of formal training attended annually by internal auditors and their level of competence.

The direction of the relationship of the variables **PROQ**, **EDUQ**, **YEAR** and **REGT** established in the above analysis contradicts the expectation and deviates from the results documented in literature and consequently creates avenue for further detailed study.

In addition, the predictive power of the model appears very low. If variation of about 98.7% in internal auditors' level of competence cannot be explained by the five independent variables considered in the current study, it means other variables might need to be developed and included in the model so that its predictive power can be improved upon. The possible imperfection of all the models formulated under the study is acknowledged and highlighted in chapter 8 of the thesis (under the limitation of the study). Therefore, improvement of the models in future studies is anticipated.

Interpolating the above results in the model 4 above, the model becomes:

$$CORPGOV_IAsCOMP=2.281-0.024(EDUQ)-0.108(PROQ)-0.412(YEAR)-0.099(REGT)+0.2(MEM)+\mu$$

7.4.3 Discussion of findings

According to the IIA standard 1200 (proficiency and due professional care), internal audit engagements must be performed with proficiency and due professional care. To elaborate this requirement, the IIA standard 1210 requires that internal auditors must possess the knowledge, skills and other competencies needed to perform their individual responsibilities. Knowledge, skills and other competencies is a collective term interpreted to mean the professional proficiency required of internal auditors to effectively carry out their professional responsibilities. Internal auditors by these standards are encouraged to pursue their proficiency by obtaining appropriate professional certifications and qualifications (Reding *et al.*, 2014). Under this study, proficiency or competency is conceptualised to revolve around the following five attributes:

- i. internal auditors' educational qualification
- ii. internal auditors' professional qualifications
- iii. internal auditors' length of years of experience
- iv. Regularity of internal auditors' training; and
- v. internal auditors' affiliation with the IIA

As the descriptive statistics and the thematic analysis in this chapter revealed, internal auditors in the NFS have appropriate level of education and professional qualifications. For instance, the minimum educational qualification of the internal auditors in the sector was discovered to be first degree. As a matter of fact, 40.9% of the internal auditors possess postgraduate degree, and only 8% of them do not possess any relevant professional qualification. This is considered appropriate though those with CIA certification (10.2%) is considered low and an evidence of disposition of internal

auditors to the ICAN as a professional body, considered to be the most recognised accounting professional body in Nigeria.

In terms of years of experience of the internal auditors in the practice of internal audit, over 70% of them have been in the practice for a period of between 5-10years while only 12.5% have been in the practice for less than five years.

The two areas of serious concern arising from the study's findings are irregularity of annual training for the internal auditors and the low level of their membership with the IIA. These are key areas that warrant attention and immediate remedial actions particularly on the part of the internal auditing community in the sector and in Nigeria generally. It is considered that increased interest of the internal auditors in the IIA membership may further create the consciousness of regular training in the minds of the internal audit professionals in the sector. The low level of CIA certification of the internal auditors in the sector revealed by the study can also be improved upon by increased membership of the institute (i.e. the IIA). The rare opportunity of becoming a member of the IIA prior to any of the institute's certification is a good strategy of promoting interest in the professional body. It is however uncertain if internal auditors in the country are aware of this very rare opportunity.

7.5 Chapter summary

This chapter being the concluding chapter of the analysis of the research data, focused the research questions related to the characteristics of the internal auditors. These are internal auditors' objectivity and competence. The two hypotheses (H3 and H4) formulated to provide clues on the two research questions related to internal auditors' objectivity and competence were tested through the comprehensive analysis of both the quantitative and qualitative data obtained from the questionnaire survey and the semi-structured interview. The overall finding here is that the study provides no evidence to indicate that the internal auditors in the Nigerian financial sector are objective and competent.

The results of the analyses indicate irregularity of private contacts between CAEs and the audit committee's chairperson. In addition, the study provides evidence of low level of awareness of developments in the field of internal auditing on the part of the internal auditors in the NFS. This is revealed by the low level of the IIA membership of the internal auditors in the sector. The above findings therefore indicate the need for improvement on internal auditors' objectivity and their level of competence. Specifically, the issue of irregularity of private contacts between CAEs and the AC's chairperson on one hand, and the low membership of the internal auditors with the IIA on the other hand require prompt attention.

The next chapter which is the final chapter of the thesis summarises the whole research work and also identifies potential areas of future research endeavours discovered under the study.

Chapter 8

Conclusion and Recommendations

8.0 Chapter Overview

This is the concluding part of the Thesis. This chapter summarises the whole research work and also highlights areas opened up for future research endeavours discovered in the course of the study. The chapter is structured as follows: Section 8.1 details an overview of the work done under the study; section 8.2 summarises the major findings of the study in line with the study's focus and within the conceptual and theoretical frameworks set out in chapters 2 and 3 of the thesis. The potential implications of the study's findings for both academic and the profession of the IA in Nigeria and generally in the world are discussed in section 8.3. While Section 8.4 highlights the limitations and challenges encountered on the study, section 8.5 presents future research opportunities uncovered during the study. Finally, section 8.6 reflects on the study's objectives as set out at the beginning of the research with a view to demonstrating how the study's objectives have been met at the end.

8.1.0 General overview of the research work

This research work sets out to find empirical evidence from the NFS, of the contributory power of the IAF as one of the four cornerstones of corporate governance. Whereas studies investigating the relationship between IAF and corporate governance abound, such studies, aside from concentrating on developed nations with matured internal auditing history, also produced tenuous results. In addition, financial sectors of such economies are usually excluded. The curiosity of extending such findings to the developing countries with special focus on financial sector which hitherto suffered attention spurs this study. In addition, the study also aims at establishing the ideal profile of any IAF that desires to add value to organisational corporate governance.

With a view to addressing the study's objectives in an organised manner, this thesis is divided into three main parts. The first part is covered in chapters 1-4 of the thesis.

Chapter 1 introduces the main focus of the research work and lays out the background to the identified problem which the study attempts to provide solution to. This is done by setting out the research objectives and the research questions to be answered by the study in chapter 1. These are restated below:

- i. to investigate the level of independence of the IAF from management in the Nigerian financial sector.
- ii. to establish the level of adoption of the IIA international standards by IAFs for their engagements in the Nigerian financial sector
- iii. to establish the level of objectivity of the individual internal auditors in the Nigerian financial sector.
- iv. to establish if the internal auditors in the Nigerian financial sector possess the required level of proficiency to fulfill their expected roles.

In addition, the chapter also discusses the originality and the main result of the study.

Chapter 2 of the thesis presents the background for the concern about internal auditing as a corporate governance in the NFS. This is with a view to appreciating the need to include financial sector whenever IAF and corporate governance issues are to be discussed. The chapter establishes the study's conceptual framework. As part of the first section of the thesis, chapter 3 focuses the study's theoretical underpinnings. In establishing the study's theoretical framework, a combination of three theories (namely Agency, TCE, and Institutional theory) was adopted (see Figure 8.2 on page 297).

Extant studies on the study's subject matter were reviewed in chapter 4. The chapter consequently shows the gaps to be filled by this study. Overall, 4 hypotheses were formulated for the study. In formulating the hypotheses, the study's conceptual framework, and theoretical underpinnings were integrated as shown in figure 8.1 below:

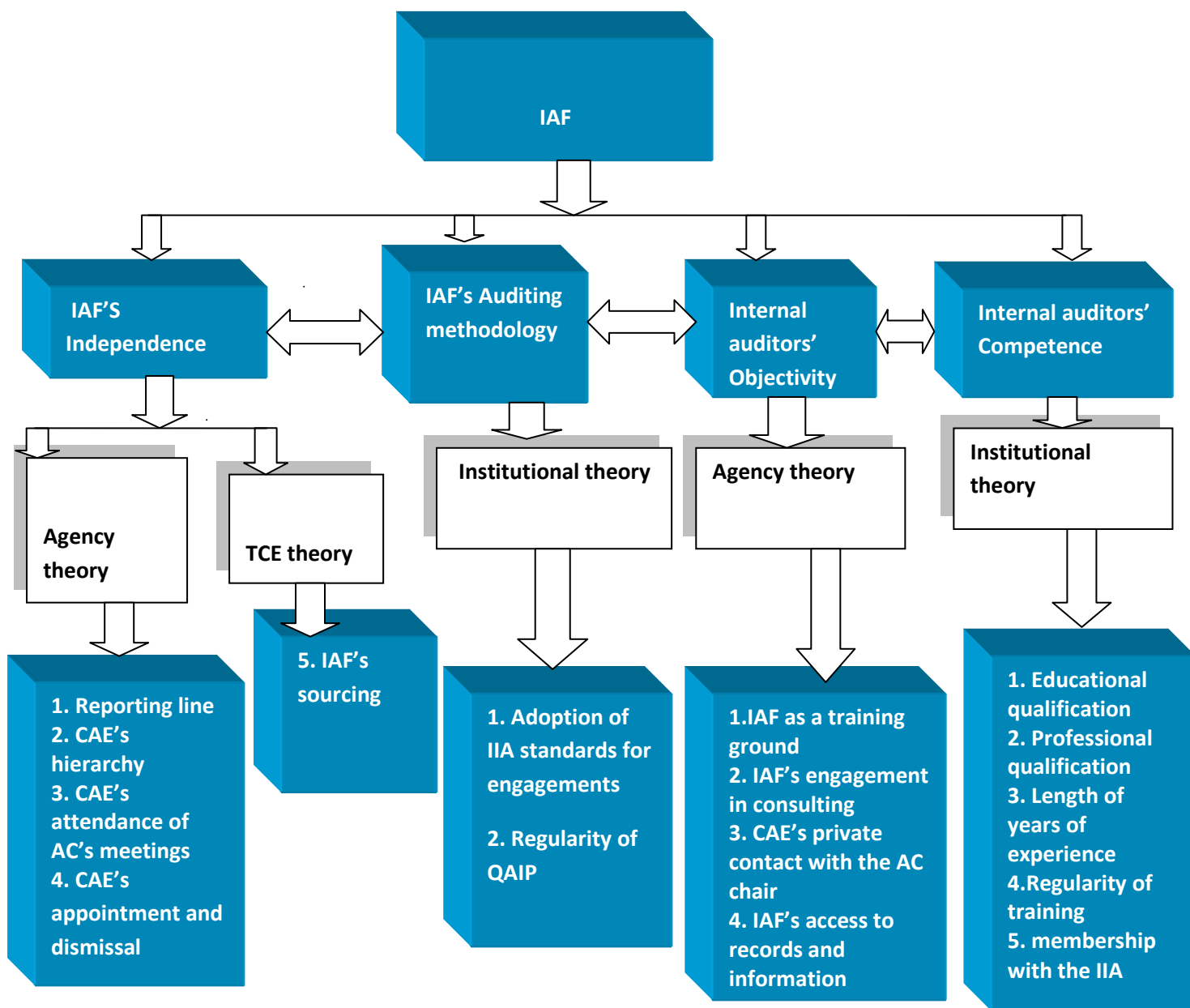


Figure 8.1 Summary of the study's theories and concepts

As can be seen from the above figure, propositions and the postulated hypothesis on IAF's independence are examined using both agency theory and TCE theory. Propositions and hypotheses on IAF's auditing methodology and internal auditors'

competence are examined and discussed based on only institutional theory, while agency theory guides the discussions on internal auditors' objectivity.

The second part of the study, a chapter (chapter 5) deals with discussion of the study's methodology. In addition to discussing the study's philosophical view point, the choice of mixed method involving both quantitative and qualitative methods was justified. Also, justification and discussions of both the data collection and analysis method was made. The rationale for the researcher's use of both questionnaire survey and interview methods for data collection, and BLRA and thematic analysis for data analyses instead of other available methods of data collection (such as case study and focus group) and analysis (e.g. OLS) , are detailed out. In general, the researcher was able to appreciate the fact that the choice of research methodology for any study depends on the focus of the study, the type of data required, as well as the antecedents of extant studies.

The third part of the thesis (consisting of chapters 6 and 7) deals with the analysis of the research data and discussion of the results of the analyses. The study's empirical analyses in chapters 6 and 7 employed both descriptive and statistical analyses methods. This involves both BLRA and thematic analysis, and the results of the two analyses are compared and eventually integrated to make inferences on the 4 hypotheses formulated in relation to the research questions.

8.2.0 Findings and conclusion

8.2.1 Main findings

Following the discussions in chapters 6 and 7 of the thesis, and considering the study's objectives (as stated in chapter 1, and restated in section 8.1.0 of this chapter) the main findings of this research work are summarised below:

First, the study provided strong evidence to indicate that the IAFs of the NFS cannot be said to be totally independent from the influence of management. The results of both the thematic analysis and BLRA of the qualitative and quantitative data showed that the

current level of independence of the IAFs in the NFS warrants significant improvement so as to align with the international best practices as being championed by the internal audit professional body (i.e. the IIA).

Of the five indicators set to evaluate the current level of IAF's independence in the sector, the study showed that the IAFs in the NFS are only satisfactory in their reporting lines and the manner they are sourced, maintained or operating. Evidences from the study show that the IAFs in the NFS are deficient in the remaining three areas (i.e. appointment and dismissal of CAEs, the status accorded the CAEs within their organisational structure, and the frequency of their attendance of audit committee' meetings). Evidences from the study suggest that the audit committees of companies in the NFS play very little role in the appointment and dismissal of CAEs in the sector. This has the potential of undermining the independence of the IAFs in the sector. This anomaly is also reflected in the inappropriate positioning of the CAEs in the organisational's hierarchy in the sector. In addition, the study provided evidence of irregular attendance of audit committee' meetings by the heads of IAFs in the sector.

Second, the study has established that the AM of the IAFs of the NFS is not in tune with the new order of IA practice (i.e. IIA standards). It is revealed in the study that some CAEs and their team members are not conversant at all with the IIA standards let alone adopting them for their engagements.

Third, whereas, the study provided no evidence to contest that the internal auditors in the NFS are objective, no evidence of using the IAFs in the sector as MTGs for potential executives or managers in the sector was however found. In addition, the IAFs in the sector were found to have uncensored access to records and information and presently do not render consulting services for their organisations. It was however discovered that the CAEs of the IAFs in the sector are yet to appreciate the benefits of maintaining unofficial private contacts with the chairpersons of their audit committees. The study indicates that such private rapport is not prevalent in the NFS.

Finally, evidence from the study is not strong enough to conclude that internal auditors in the NFS are proficient. Irregularity of training on the part of the internal auditors and their low membership with the IIA are the two critical areas of concern established in the study.

8.2.2 Situating the Findings within the Context of Applicable Theories:

(i) IAF's independence and Objectivity of the internal auditors

As discussed in chapter 4, the major theories underpinning this study are Agency theory, TCE theory and Institutional theory.

As shown by figure 8.1, both Agency and TCE theories are employed to test hypothesis 1 and 3 formulated under the first and third objectives (i.e. to establish the level of independence of the IAF from management, and to establish the level of objectivity of the individual internal auditors in the NFS) of the study. Whereas only Agency theory ordinarily would have been employed to address the various issues raised on the IAF's independence and internal auditor's objectivity, TCE is however, also employed to complement agency theory in addressing IAF's independence. This is simply due to the issue of IAF sourcing arrangement that was included as part of the factors determining IAF's independence. As the overall results about IAF's level of independence and internal auditors' objectivity in the sector indicate, the non-independence of the IAF from the management is an affirmation of the agency theory on the essence of internal auditing. According to Agency theory, IAF is the instrument of bonding initiated by the agent (i.e. management) to signal to the owners of the business (i.e. the principal) that they are doing their biddings. Drent (2002) contends that most management team still perceives IAF as management's instrument. The theory indicates that internal audit is instituted by the management as one of the bonding costs to demonstrate their continuing allegiance to the principal so as to retain their confidence and bonding (Adams, 1994). With this argument, one would ordinarily expect that such an instrument of bonding instituted by the agent should be under the control and influence of the agent (management), and thus should be reliant on its initiator.

Argued in another way, internal audit unlike external audit that is part of the principal's instrument of maintaining balance in the principal-agent's contract is theoretically initiated by management to moderate the principal's cynicism about their loyalty. If this position is tenable, then the expectation of independence of IAF from management as well as the objectivity of internal auditors truly do not seem logical, and might therefore be argued as unfounded. After all, whoever pays the piper, they say is expected to dictate the tune.

Arising from the above position on the relevance and adequacy of Agency theory on the justification of the essence of internal auditing is a concern on the IIA's continuous standpoint that internal auditing is an independent activity. Agency theory has indeed justified the reason the umbilical cord between IAF and management remains ever strong and un-detachable. If indeed internal auditing is independent, the question would then be "independent of who"?, definitely not of management as this study has proved. In the same vein, can an IAF whose independence is in doubt guarantee objectivity for its staff?

Therefore, further reflections on the IIA's stance of IAF's independence and internal auditors' objectivity within the context of Agency theory are warranted. Else, the issue of IAF's independence might forever remain a myth. Except such an allegory is demystified, the rationale behind the IIA's avowal of internal audit as an independent activity, and the foundation of internal auditing as a profession would remain vulnerable to unending disparagement. Consequently, the results of the study particularly the confirmation of lack of independence of IAF from management and the established doubts about internal auditors' objectivity had clearly validate the assumptions of agency theory.

As applicable to this study, TCE theory remains the only viable theoretical platform on which the issue of IAF's sourcing can be analysed. As shown in chapter 7 of the thesis, cost economy, and asset specificity remain the key consideration in decision relating to IAF's sourcing in the NFS. The prevalence of in-house IAF in the NFS has its

justification in the fundamentals of human assets specificity of TCE theory fully discussed in chapter 3. Where highly specialized knowledge or skills is required, and the industry or sector contains relatively few firms, internalizing the IAF has been found to be cost-effective irrespective of its size. This is so given that investment in the required skill acquisition may be less likely to be readily transferable to other clients in the sector due to fierce competition that may abound (see Speckle' et al., 2007).

Overall, combination of both agency theory and the TCE theory applied to shape the evaluation of the study's first and third research questions turned out to be appropriate and the findings from the study had also confirmed the validity of the various assumptions of the two theories. In addition, the study has demonstrated the suitability of multi-theories in addressing issues relating to IAF's independence and objectivity of internal auditors.

(ii) IAF and Auditing standards

Till date, IIA remains the only global professional body that is in charge of regulation of the practice of internal audit worldwide. This is achieved primarily through standardisation of the various activities of the practice. The IIA provides regular guidelines on the practice of internal audit. Members of the institute are provided with an International Professional Practice Framework (IPPF) to guide their professional practice and ensure the highest-quality internal audit results in widely diverse environments. The IIA standards are principles-based mandatory guidance.

The standards are meant to achieve the following:

- i. delineate basic principles that represent the practice of IA.
- ii. provide a framework for performing and promoting a broad range of value-added internal auditing
- iii. establish the basis for the evaluation of internal audit performance
- iv. foster improved organisational processes and operations

As discussed in chapter 3, Institutional theory provides insights on how regulatory requirements, diffusion of practices among organisations and the impact of professions generate isomorphic pressures on organisations (Mihret *et al.* 2012). Similar to other professions, most of the guidelines codified as standards are sometimes in response to certain incidences and developments affecting the profession. Promulgations from security and exchange Commissions (SECs), industry regulators etc, are part of the critical factors shaping the internal auditing profession worldwide. The isomorphic behaviour of organisations facing similar conditions remains the reference point under Institutional theory. According to DiMaggio and Powell (1983) the three mechanisms through which organisational isomorphism occur are: coercive, mimetic and normative. These can be interpreted to mean standardisation by ways of legislation, voluntary imitation of successful peers and influence from enviable professional bodies respectively.

The efforts of the IIA in providing guidelines for the practice of internal audit worldwide is a clear example of normative isomorphism, and has definitely gone a long way in legitimising internal auditing as a profession worldwide, and in stimulating international best practice among internal auditors globally. The current low level of diffusion of the IIA's guidelines on the practice of internal audit in Nigeria, particularly as demonstrated by the low level of internal auditors' membership of the IIA is identified as the major factor for the internal auditors' low regards for, and adoption of the IIA standards for internal audit engagements in Nigeria. Efforts aimed at addressing this defect definitely can be fashioned out based on Institutional theory.

The various transformational developments in the field of IAF can be explained using this theoretical lens. In addition, the theory actually offers itself a good platform for the various recommendations in this chapter.

(iii) Internal auditors' competence

Internal auditors are by the IIA standards 1210 encouraged to demonstrate their competence by obtaining appropriate professional certifications and qualifications (Reding *et al.*, 2014). Continuous educational offerings of the IIA in form of

conferences, seminars, workshops etc. (aimed at unceasing knowledge sharing on international best practices of internal auditing), and the various certifications programs of the institute are part of the institutional endeavours of the IIA to raise the standard of internal auditing profession globally. This is similar to efforts of notable accounting professional bodies such as ACCA, and ICAEW. Therefore, past, present and future efforts in these regards can best be explained using institutional theory.

The intertwining of the Agency, TCE and Institutional (“ATI”) theories in the study of IAF’s contributions to corporate governance as applied to the study is as shown in the figure below.

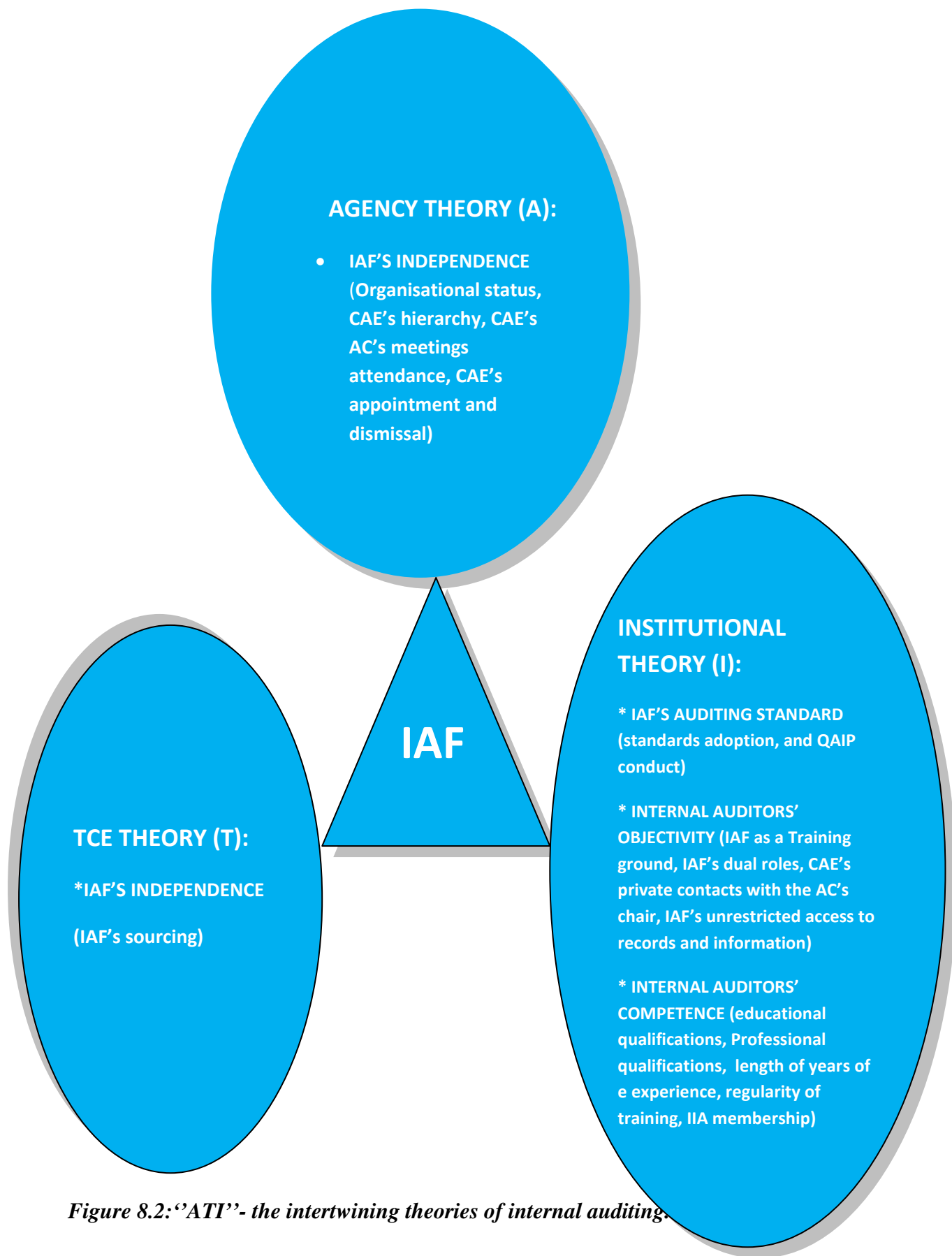


Figure 8.2: 'ATT' - the intertwining theories of internal auditing.

In general, the above expositions had demonstrated the suitability of multi-theory approach of the study and also affirmed the complementary roles of the ‘‘ATI’’ theories adopted for the study. In summary therefore, this study has proven the need for multiple theories in internal auditing research.

8.2.3 Conclusions

The conclusions to be drawn from the above findings are in two folds. One fold relates to the set objectives of the study while the other strand has to do with improvement in the theoretical underpinnings of studies on IAF and its relevance in the corporate governance’s mosaic. Evidences drawn from the study indicate that the IAFs of the NFS are not independent, and the activities of the functions in the sector are not carried out in conformity with the IIA standards. Also, the individual internal auditors in the sector are also not found to be objective and fully competent.

In addition, a key contribution of this study is the new paradigm of theory integration adopted. The multi-theory framework (‘‘ATI’’) espoused is considered an enhanced platform through which further research activities in this context can be explored.

Also worth of mentioning as a contribution to knowledge is the development of an elaborate conceptual framework and the originality involved in developing workable models based on the expansive concept for accessing both the quality of IAF and profile of internal auditors of IAF desirous of playing its expected roles as a corporate governance mechanism in the contemporary era.

8.3.0 Implications of the study’s findings

No doubts, the findings in this research work have some consequences for the internal auditing community (i.e. both the academic researchers and the professionals of internal auditing), as well as for the policy makers of the NFS and financial sector of any developing country. This section is therefore aimed at presenting to the readers of the thesis the implications of the study’s findings to the mentioned stakeholders.

8.3.1 Implications for researchers in internal auditing

To start with, the framework developed by the researcher in chapter four of the thesis and adopted for the study has opened up a new research agenda in internal auditing studies. This new paradigm revolves around IAF's characteristics and the characteristics of the individual internal auditors (as shown below).

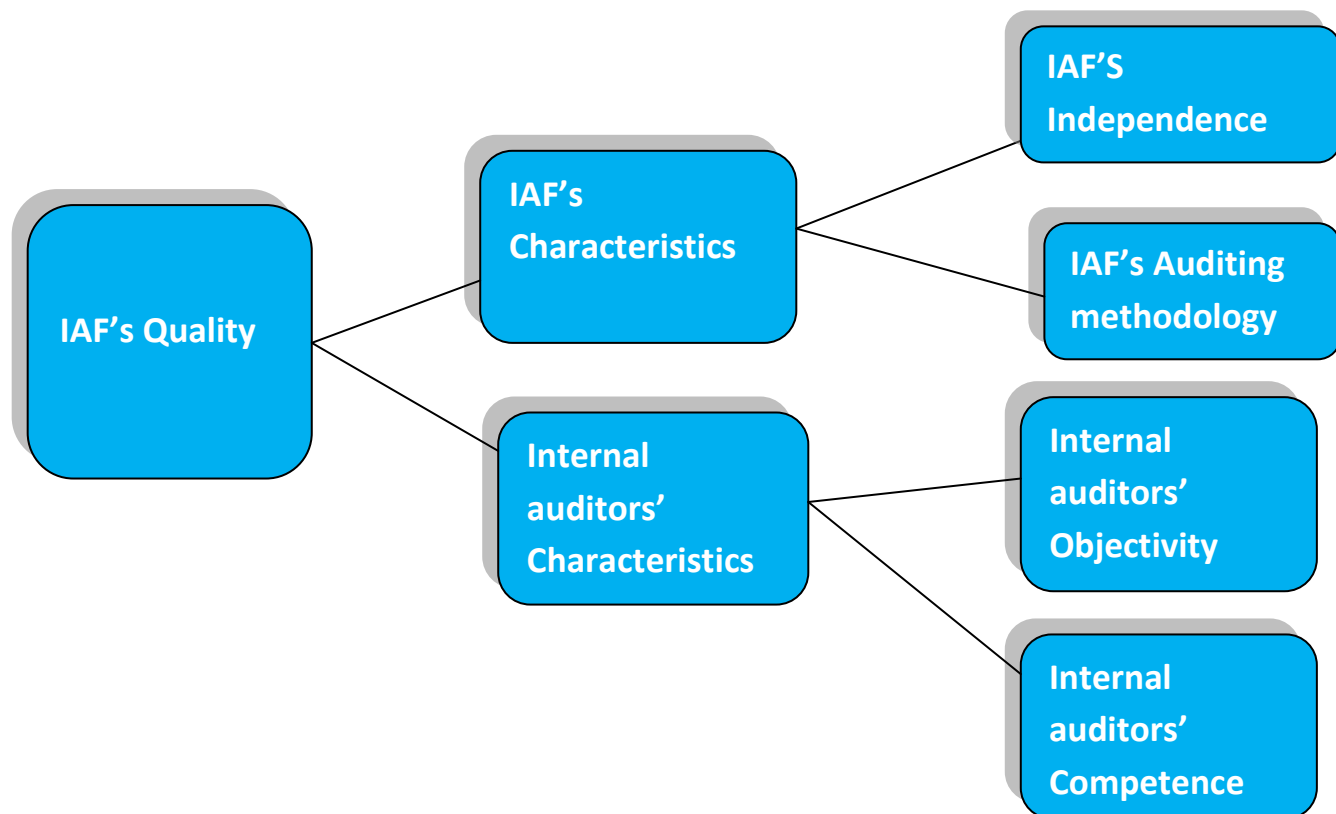


Figure 8.3: Conceptual framework for studies on IAF and Corporate governance

The espoused research conceptual framework is a response to calls in academics to turn new leaf in internal auditing research (see Sarens, 2009). The expansive conceptual framework which offers a fresh idea in internal auditing research articulates the various viewpoints aimed at advancing internal auditing research in this contemporary period. The framework no doubts brings together the various disjointed thoughts and approaches offered by scholars pre-occupied with the objectives of shaping research works in response to the extended vista of internal auditing being championed by the IIA.

Furthermore, the three-layered theoretical model –ATI espoused in this study (see figure 8.2) offers a more robust theoretical underpinning for future research in internal auditing. This study while proving the relevance of Agency, TCE, and Institutional theories to studies on internal auditing, has reasonably demonstrated the inadequacy of a singular theoretical lens to evaluate the relevance of IAF in the corporate governance’s mosaic. This study attempts to be the first to investigate the relevance of IAF to corporate governance using a conflation of theories on one hand, and the first study to concentrate only on financial sector which hitherto suffered neglect from researchers, on the other hand. It is therefore anticipated that both the conceptual framework and the new “ATI” tripod theoretical framework will shape the directions of future research activities in the field. Application of the multi-theory model is expected to bring tremendous improvements in future studies in internal auditing over the extant studies with singular theoretical perspectives and tenuous findings.

In addition, the four models developed under the study and applied to test the study’s hypotheses empirically while awaiting rigorous scrutiny and possible refinement, is considered a modest attempt to open a new path for future studies on internal auditing. The anticipated improvement of the models in future study will no doubt push further the agenda initiated under this study.

8.3.2 Implications for the Internal auditing profession

For the internal auditing community in Nigeria, this study has shown serious concerns on the acceptance of the legitimacy of the internal auditing profession even amongst the internal audit practitioners in the country. The issue of low membership of internal auditors with the IIA, justifies the general perception of internal auditing as an offshoot of accounting in the country. To begin with, contrary to what obtains in some developed countries with matured profile of internal auditing as a profession (e.g. USA) where internal auditing is offered as a discipline, till date, internal auditing as broad as it is, continues to be offered as a sub-topic in “Auditing “. This is commonly at intermediate level in our tertiary institutions. Same phenomenon plays out at graduate level for those

pursuing post-graduate degree in Accounting. Institutionalisation of internal auditing as a full-fledge course in curriculum of the country's educational institutions (particularly universities) possibly at both the graduate and postgraduate level is strongly recommended. As part of her advocacy towards sensitising internal audit professionals in the country, on the full fledge professional status of internal auditing, this recommendation can be championed by the IIA Nigeria chapter. A case of reference is inclusion of Corporate Governance as a topic in "Business policy", a mandatory course at intermediate level in most universities and Polytechnics in the country. This is with the aim of preparing the minds of the young undergraduates on what obtains in the corporate world as they prepare to end their undergraduate trainings. The consciousness this stint of corporate world image do create in the minds of potential business executives cannot be overemphasised.

In addition, with a view to fostering her advocacy of the legitimisation of the internal auditing as a discipline, increased advocacy on the part of the IIA (Nigeria chapter) may take the form of strategic partnership with one or two reputable tertiary institutions in the country with very high status in research activities. To make the task achievable in good time, the Nigeria chapter of the IIA may want to consider a strategic coalition with relevant stakeholders in the field. For instance the institute may form strategic alliance with ACAEBIN, The Institute of Directors (IoD), and Audit Committee Institute of Nigeria (ACIN) to float an enduring endowment or Research Chair in internal auditing in any of the reputable universities in the country. The recommended strategic alliance could then be used towards advancement of research activities specifically in internal auditing. This expectedly will deepen interests of scholars and researchers in research endeavours that can break new grounds in the field and consequently boost the image of the profession in the country. Similar successful efforts in this regards is the recent strategic alliance between Lagos State Internal revenue services (LIRS) and University of Lagos in instituting a research chair known as "*Lagos State Professorial chair of Tax and Fiscal matters*". This is aimed at stirring interests in research activities capable of enhancing the revenue generation potential of LIRS. Mimicking such initiatives is also expected to be helpful.

8.3.3 Implications for the regulators

First, whereas existence of well-constituted and functional audit committees is usually taken for granted in the NFS (just like any other country) given its very strict regulations from time to time from different regulators, insights from the study about the CAEs' limited interactions with either the committee or its chairperson however suggests a need for policy enhancement. The argument here is of what benefits would the existence of audit committee and the functional reporting line of the CAEs to the committee be if the required access to such committee through formal and informal means are not guaranteed?. As a way out therefore, the various regulators of the sector, particularly the CBN, NAICOM and the FRCN might want to come out with specific measures capable of promoting unfettered access between the heads of IAFs and their organisation's audit committees, or at least the chairpersons of such committees.

Arising from the internal auditors' unconsciousness about the significance of the IIA's efforts in regulation of the practice of internal auditing globally is the need for standardisation of the practice in the country. Activities of the Financial reporting council of Nigeria –FRCN (an agency of Federal government of Nigeria established by FRCN Act no.6, of 2011, operating under the supervision of the Federal ministry of Industry, Trade and Investment) is an example of antecedents in this direction. FRCN is saddled with the responsibility of developing and publishing accounting and financial reporting standards to be observed in the preparation of financial statements of public entities in Nigeria. Regulators of the NFS and other key stakeholders may want to push for a sustainable platform to pursue the recommended standardisation of the practice of internal audit in the country. It is not impossible that the identified defects in this sector's IAF may also be inherent in other sectors of the nation's economy. After all, the issue of corporate disorders that pervaded the nation and led to revision of most of the governance codes in the country was not peculiar to only the financial sector. No doubts, regulators, such as the SEC, CAC, CBN etc. have critical roles to play in instituting good corporate governance practices (Adebite, 2012). Therefore, prompt regulatory policy responses are anticipated in this regard.

Synergetic alliance needs to be fostered between the IIA, Nigeria chapter and the concerned various regulatory bodies. The need for collaboration between accounting and auditing professional bodies, and regulators in the country's financial sector to ensure corporate order is part of the recommendations of Adegbite (2012).

Another important area of policy direction is the need for NFS' regulators particularly the CBN to get involved in the appointment (or ratification of appointment) of CAEs for firms in the sector. This suggestion is borne out of the identified ambiguity in the IIA guidance and provisions of the various corporate governance codes on appointment of CAE. The recommendation here is similar to the CBN's current position on appointment of executives, and Chairmen of BoDs of banks in the country. This is to further enhance the status of CAEs in the sector and prevent them from antics or inimical acts from management capable of compromising their objectivity.

8.4 Limitations of the study

All research has limitations (Margerison, 2015), and as expected, there are a number of limitations of this study as well which should be borne in mind. These are as discussed below.

First, the sample size of 88 for the study's quantitative data is relatively small. This is however so given that the study only concentrated on the CAEs and their immediate subordinates in the NFS, who in the researcher's view, are in the best position to provide meaningful perceptions on the issue in focus. This limitation definitely poses the challenge of generalisation of the study's findings. Inclusion of other players particularly from the remaining three key mechanisms of corporate governance in the sector (i.e. audit committee members, external auditors, and management) aside from giving future researchers opportunity of improving on the sample size, may also produce reinforced evidence for generalisation of findings. A larger spectrum (inclusive of other participants in the corporate governance's domain) was initially contemplated for the study but the idea was later jettisoned due to constraint of time and finance. The

response rate of 64.7% to the study's questionnaire survey is however considered a compensating factor.

Associating with the above drawback is the concern on the non-randomness of the sampling method for the respondents that participated in the questionnaire survey and the semi-interview. Participants in the questionnaire survey and semi-structured interview were selected based on judgmental and convenience non-probability sampling methods. As much as random sampling is known for its high level of statistical precision, the targeted respondents for the questionnaire survey are known in advance and as such their selection required no scientific method. Likewise, the CAEs that participated in the survey were selected based on their willingness to give further insights after the questionnaire survey.

Third, the views of the four CAEs that participated in the semi-structured interview meant to generate qualitative data required for corroborating the results of the questionnaire survey is considered scant. Future study may adopt focus group instead. As indicated in chapter 5, focus group option was initially contemplated by the researcher due to the formalised grouping of the CAEs in Nigeria particularly those in the banking industry of the sector, under the aegis of the ACAEBIN. It however became obvious in the course of the data collection that the busy schedule of the targeted interviewees may not make focus group feasible particularly within the time frame budgeted for data collection on the study. Getting all the targeted CAEs to assemble at a particular location for the group interview was impracticable under the situation considering the CAE's heterogeneous schedules, and geographical issues relating to respondents' locations. It is however worth noting that the semi-structured interview is to generate corroborating evidence for the study's quantitative data. Nevertheless, more robust corroborative evidence is envisaged from focus group interview.

Fourth, all the explanatory variables and the formulated models adopted for the study were defined, and originally formulated by the researcher. As indicated by the predictive powers (i.e. NagelkerkeRsquare) of the models, all the four formulated

models can be improved upon significantly either by inclusion of additional explanatory variables, or refinement of the definitions of the current variables.

8.5 Future research opportunities

Whereas this study investigates the contributory roles of the IAF in the corporate governance's domain of a developing country-Nigeria, using a conflation of theories (ATI) and through four different models, application of this theoretical and conceptual framework for future research (particularly in developed countries) will be helpful in validating or improving the formulated models, as well as the 'ATI' theoretical framework espoused in this study.

Till date, the only notable study of interrelationship of IAF and corporate governance from developing countries remains Barac and van Standen (2009) a study conducted in South Africa, which raises doubts about internal auditing's role as a corporate governance mechanism. The outcome of this study with the contradicting position necessitates further examination of the contributions of the IAF to corporate governance in developing nations. The fact that the data collected under this study is exclusively limited to the NFS, further amplifies the need for a cross-cultural (particularly within developing countries) approach to the study so as to determine the applicability of the study's results in other developing nations.

Also, similar study but with focus on other sectors aside from the financial sector are anticipated in Nigeria. Findings from such study may be used to prove the outcome of this research work. Alternatively, as earlier suggested, instead of relying on the feedback from the CAEs and their immediate subordinates on the various attributes used to assess the IAF's contributions to corporate governance in the study, other corporate governance's mechanisms (both internal and external) such as external auditors, audit committee members and management can be approached for their insights on the concepts investigated in the current study. Doing this may produce a divergent outcome capable of further deepening existing understanding of the contributory power of IAF to corporate governance.

Furthermore, this study revealed internal auditors' very low interest in affiliating with the IIA. This observed low level of association with the internal auditing's global professional body was linked with the CAE's dearth of knowledge of the IIA standards. Contrarily, majority of the internal auditors in the sector are members of the ICAN, the accounting professional body in the country. It is therefore desirable to investigate empirically, the main reason for the low membership of the IIA among the internal auditors in the country. The result of such studies will certainly be of immense contributions to the Nigeria chapter of the IIA. In the same vein, a study that investigates the perception of management about the use of the IIA standards for their internal audit engagements will be an interesting endeavour and will throw more light on the motivation for embrace of international best practices of internal auditing by IAFs in the country.

Another important potential area of study uncovered under this study relates to the level of coordination between the IAF and audit committee. Specifically, association of Existence of audit committee (and adequacy of the committee's membership) with IAF's independence require further investigation. The basis of the negative relationships observed between audit committee's existence and IAF's independence, between adequacy of audit committee's membership and IAF's independence needs further verification. These areas need to be explored further particularly bearing in mind the limited formal and informal access of the CAEs to audit committee or audit committee's Chairperson in the sector.

Finally, part of the findings of this study is that IAF of the NFS do not engage in consulting activity for their organisation. It would be interesting to know whether management of firms in the sector are yet to appreciate the benefits their organisations can get from such consulting activities from their IAF, or the internal auditors themselves do not possess the required skills for this seeming new role, or they do but are not marketing their consulting competency to management possibly because of the potential threats of conflict of interest that may arise. Also, it is not impossible that the

IAF's non-engagement in consulting activity do contribute to internal auditors' level of objectivity. The situation might be different if the IAFs in the sector do engage in consulting activities for management. A study of internal auditors' objectivity, focusing specifically on IAFs that carry out consultancy for their management (say in other sector) is also desirable to clear this doubt.

8.6 Reflections on the research objectives

As indicated in chapter 1 of the thesis, the research work was embarked upon to achieve four main objectives: first to investigate the level of independence of the IAF from management in the NFS, and second to establish the level of adoption of the IIA international standards by IAFs for their engagements in the NFS. These two research objectives have been met. In chapter 6 of the thesis, the researcher employed a combination of Agency, TCE and Institutional framework (acronymed 'ATI') theories, in conjunction with the models 1 and 2 formulated by the researcher in chapter 5 to discuss the results of both the quantitative and qualitative data analyses in testing the 2 hypotheses on the objectives. The findings of the investigation indicate that the IAFs of the NFS could not be said to be independent, and the engagements of the functions are also not in alignment with the IIA international standards.

The third and fourth objectives of the study were to establish the level of objectivity of the individual internal auditors in the Nigerian financial sector, and to establish if the internal auditors in the NFS possess the required level of proficiency to fulfill their expected roles. These objectives were pursued vigorously in chapter 7 of the thesis through the 2 hypotheses formulated thereon. Here, only the Agency and Institutional theories provided the required guidance. At the end, it was established that internal auditors in the NFS are not objective and also do not possess the required level of proficiency.

The eventual conflation of theories adopted for the study has greatly enhanced the initial understanding about internal auditing theorisation. In addition, the study, by carefully leaning on Sarens (2009) on the ideal paradigm through which the contributory power

of IAF as a corporate governance's mechanism can be studied, has resulted in a more concise conceptual framework that revolves around IAF's characteristics and the characteristics of the individual internal auditors. Thus, paving way for meaningful and focused approach to studies on IAF in this present era when increased attention is directed towards internal audit as a mechanism of corporate governance.

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APPENDIX A : ETHICAL APPROVAL FOR THE STUDY

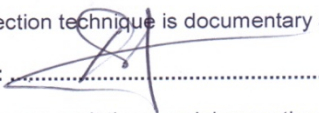


Tracking No:
Date approved:
Initials:

Faculty of Business and Law Application to Gain Ethics Approval for Research Activities

All research activity conducted by members of staff or students within the Faculty of Business and Law requires ethics approval. To gain ethics approval this form should be completed and submitted to the appropriate designated officer (see below). Students should complete this form in consultation with their supervisors.

Applicant	
Last Name: BABATUNDE TITUS	First Name: ADEJUMO
DMU Email Address: p1103724x@myemail.dmu.ac.uk	Staff/student no: P1103724X

SECTION 1. The Research										
Title: The Internal Audit Function as a Corporate Governance Mechanism in Developing Economy: An Empirical Study of Nigerian Financial Sector.										
Aims of the research: The aim of the study is to assess the efficacy of IAF as a mechanism of corporate governance in a developing country, Nigeria, plagued with corporate governance issues such as falsification of financial statements, executive recklessness, and abuse of corporate office, but with budding internal auditing profession.										
Principal data collection methods (delete as applicable) <table> <tr> <td>a) Interviews</td> <td>Yes</td> </tr> <tr> <td>b) Questionnaires</td> <td>Yes</td> </tr> <tr> <td>c) Observation</td> <td>No</td> </tr> <tr> <td>d) Documents/archives (inc. doctrinal law)</td> <td>No</td> </tr> <tr> <td>e) Other (please specify)</td> <td>_____</td> </tr> </table>	a) Interviews	Yes	b) Questionnaires	Yes	c) Observation	No	d) Documents/archives (inc. doctrinal law)	No	e) Other (please specify)	_____
a) Interviews	Yes									
b) Questionnaires	Yes									
c) Observation	No									
d) Documents/archives (inc. doctrinal law)	No									
e) Other (please specify)	_____									
Participants Will your research involve human participants? If YES then proceed to section B. If NO then proceed to section A. A – No human participants I confirm that my data collection technique is documentary and will not involve human participation: Signature of Researcher:  Date: 26-10-15 In these circumstances you can omit the remaining sections of the form. Please forward to the appropriate designated officer for approval B – Human Participants What is the research population? The survey shall cover all Nigerian commercial banks, mortgage banks, insurance companies and discount houses listed on the country's stock exchange (Nigerian Stock Exchange (NSE)). Currently this consists of one hundred and twenty (120) companies.										

How will participants be selected?

Stratified purposive sampling method shall be adopted for the survey. Total respondents of two hundred and forty (240) are anticipated for the survey. To achieve this, each of the strata above constituting the study population is expected to produce two respondents which shall be the Chief Audit Executives (CAEs) and his immediate subordinate. The assumption made here is that an Internal Audit Function (IAF) has only one CAE, and that the target respondents have reasonable length of experience on the subject of the survey.

SECTION 2. Research ethics and the protection of participants' interests.

NB. Participants should suffer no harm as a result of participation in the research

Please confirm the following by deleting as applicable.

[If you are not able to confirm any of the statements please provide further information in the section below].

Participation in the research will be:

Voluntary yes
Based on informed consent yes

Participants' identities will be protected via:

Confidentiality with respect to the data yes
Anonymity in terms of any reported findings from the research yes

The research process will:

Respect the privacy of individuals and avoid undue intrusion yes
Avoid emotional harm or upset to those taking part yes

Data from the research will:

Be stored securely in line with data protection principles yes
Not passed on to third parties yes

The research be conducted with integrity including:

Fair and honest treatment of the data yes
Open dealing with participants yes
Declaring any sponsorship or vested interests yes
Avoiding any plagiarism yes

The research complies with the law in all relevant respects

yes

Further comments relating to the checklist above: **None**

SECTION 3. Additional Codes of Ethics

Which Code of Research Ethics will be adhered to during the course of your research?

Examples of Codes can be found at <http://www.dmu.ac.uk/research/ethics-and-governance/ethics-and-research/ethics-and-governance/responsibilities.aspx>

Name: **RCUK Policy and Guidelines on Governance of Good Research Conduct**

Web address: <http://www.rcuk.ac.uk/RCUK-Prod/assets/document>

Some types of research activity require additional advance ethical approval to be given from the relevant governing body. For example, advance NHS approval is required where participants include NHS patients or social care users. It is the responsibility of the researcher to ascertain whether such approval is required and to obtain this where necessary.

My study requires additional approval **No**

I have obtained additional approval from **N/A**

Reference number: **N/A** Date of approval: **N/A**

SECTION 4. Declaration and Signatures

I have read the **Responsibilities of the Researcher** guidelines at <http://www.dmu.ac.uk/research/ethics-and-governance/responsibilities-of-the-researcher.aspx> and I will comply with them.

Signature of Researcher:  Date: **26-10-15**

Students Only

This form must be agreed with your Supervisor prior to authorisation by the Designated Officer and a copy of the research proposal (Application for Registration (RDR-F) form) must be attached to this application

Programme of Study: **PhD (Accounting)**

Name of Supervisor: **Ashok Patel**

Signature of Supervisor:  Date: **2/11/15**

Signature of Designated Officer:  Date: **14/12/15**

Designated officers:

Staff: Faculty Head of Research	Prof Steven Grigg
Research Students: Faculty Head of Research Students	Prof Gavin Dingwall
LBPG 5017 Dissertation Module Students: Module Leader	Dr Hulya Oztel
Other Masters Students	Dissertation Module Leader:

APPENDIX B: DMU INTRODUCTORY LETTER FOR DATA COLLECTION



28th February 2016

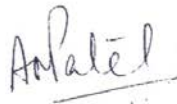
To Whom It May Concern

**Letter of Introduction for Research Data Collection:
Mr. Babatunde Titus Adejumo**

I write as the supervisor of Babatunde and confirm that he is registered on our doctoral programme in the Department of Accounting & Finance, Faculty of Business & Law, De Montfort University, Leicester, United Kingdom. The proposed title of his thesis is, "The Internal Audit Function as a Corporate Governance Mechanism in Developing Economy: An Empirical Study of the Nigerian Financial Sector". He has made steady progress in reviewing the literature and designing his research. He is now ready to start collecting data.

According to the University Research Regulations, he has systematically addressed ethical issues, including assuring confidentiality to the respondents, where it is requested or where there is a possibility of repercussion on the respondent. In the thesis itself, all references to the respondents would be anonymised. He is bound by oath to follow the University's code of ethics. I, therefore, have no hesitation in requesting you to kindly support his research effort and please afford all the possible co-operation.

Yours Sincerely



Ashok Patel BA BCom MSc AICWA ADMA MBIOS FHEA
Director of CAL Research and Principal Lecturer

CAL Research & Software Engineering Centre, 3.56 Hugh Aston Building, The Gateway, Leicester LE1 9BH.
Tel/Fax: (0116) 257 7193 / Email: apatel@dmu.ac.uk



APPENDIX C: LETTER OF SUPPORT FROM THE INSTITUTE OF INTERNAL AUDITORS

The Institute of Internal Auditors Nigeria
8A, Reeve Road, Off Glover Road
Ikoyi, Lagos, Nigeria.
Email: info@iia-nigeria.org
Web: www.iianigeria.org



March 21, 2016

To Whom It May Concern

Survey on Internal Audit and Corporate Governance in Financial sector:


We are pleased to inform you that **Mr. Babatunde Titus Adejumo**, a member of the Institute of Internal Auditors (IIA) Nigeria, and currently a Doctoral student of Department of Accounting and Finance, Faculty of Business & Law, De Montfort University, Leicester, United Kingdom is currently conducting a research on "**The impact of Internal Audit Function as a corporate Governance Mechanism**", with special focus on Nigerian financial sector.

The significance of sound corporate governance in organisations cannot be over-emphasised particularly in the country's financial sector, faced with the huge challenge of meeting corporate objectives and stakeholders' varied expectations most especially in this time of increasing business risks and declining profitability. The continuous debate on how to ensure good corporate governance in the conduct of business transactions has led to the increased awareness of the important roles internal audit function plays in contributing to achievement of corporate objectives in organisations. These roles include providing independent assurance and advisory services to both management and the board of directors. The research, which is purely for academic purpose is designed to empirically examine the contributions of internal audit function to corporate governance in Nigerian Financial sector.

It is anticipated that the findings of the study shall provide valuable inputs to both the internal audit profession and the Nigerian financial sector. Feedback from you and your organization is however vital to the success of the survey. We are aware Mr. Babatunde Adejumo has undertaken an oath of his university to ensure adherence to ethical issues pertaining to research as well as to ensure confidentiality of information to be collected from participants in the survey. No names of individuals or organisations will be revealed.

I therefore on behalf of the Institute of Internal Auditors (IIA) Nigeria solicit your cooperation and encourage you to kindly support his research effort.

Regards,


Humphrey Okorie
Chief Executive Officer

The Institute of Internal Auditors (IIA) Nigeria

APPENDIX D: THE RESEARCH INSTRUMENT

QUESTIONNAIRE ON A RESEARCH ON “THE INTERNAL AUDIT AND CORPORATE GOVERNANCE”.

The questionnaire

This questionnaire is categorised into four different sections (A,B,C,& D). Whereas section A is on respondent’s bio-data, the remaining sections focus on different areas of the research as indicated below.

Section B.

This section addresses the issue bothering on **Independence of the Internal Audit Function (or department), hereafter referred to as “IAF” and Objectivity** of individual Internal Auditors in Nigerian Financial sector.

Section C

Auditing methodology as recommended by the International Standards for the Professional Practice of Internal Auditing hereafter referred to as “Standards” adopted by the Nigerian financial sector’s IAF is addressed under this section.

Section D

This section focuses the **characteristics of individual internal auditors.**

SECTION A

1. Organisation’s line of business:
(a) Commercial Banking [] (b) Mortgage Banking [] (c) Development banking []
(d) Insurance [] (e) others [], Please Specify
.....
.....
2. Respondents’ highest Educational Qualifications: (a) HND [] (b) B.Sc. []
(c) MSc/MA/MBA [] (d) Ph.D. []
3. Professional qualification: (a) None [] (b) ACA/FCA [] (c) ACCA []
(d) ACIB/FCIB [] (e) CIA [] (f) others [], Please Specify
.....
.....
4. What is your position in the organisation?
(a) Junior Officer []
(b) Intermediate/Supervisor

- (c) Manager []
- (d) Senior Manager []
- (e) Chief Audit Executives []

5. Can you say your Internal Audit function is playing active roles in your organisation's Corporate governance?
- (a) Yes [] (b) No []

SECTION B (Independence of IAF and Objectivity of internal auditors)

6. How is your organisation's Internal Audit Function structured?
- (a) Fully in-house []
 - (b) Fully outsourced []
 - (c) Co-sourced (i.e. partly in-housed, and partly outsourced) []
7. Does your company have a functional Audit committee?
- (a) Yes [] (b) No []
8. In your opinion, are the members of your company's Audit committee suitably qualified based on the CBN or Securities and Exchange Commission (SEC)'s Code of corporate governance?
- (a) Strongly agreed [] (b) Agreed [] (c) Disagree [] (d) Strongly disagree []
9. How often does your Audit committee meet annually?
- (a) Once [] (b) 2 times [] (c) 3 times [] (d) 4 times []
 (e) more than 4 times []
10. How often is your company's CAE invited to Audit committee's meetings?
- (a) Always [] (b) Most of the time [] (c) Occasionally [] (d) Rarely []
 (e) Never []
11. In your opinion, do you think on annual basis, the audit committee of your company usually devote enough time to discuss internal audit issues/reports?
- (a) Strongly agreed [] (b) Agreed [] (c) Disagree [] (d) Strongly disagree []
12. The CAE has regular private contacts with the audit committee (Chair/or individual members).
- (a) Strongly agreed [] (b) Agreed [] (c) Disagree [] (d) Strongly disagree []
13. Who is mandated to appoint, dismiss and evaluate the head of your organisation's internal audit function?
- (a) Audit committee [] (b) Management []
 (c) Other (Please specify).....
14. Who approves the internal audit budget?

- (a) The CEO []
- (b) The CFO []
- (c) The Board or Audit Committee []
15. What is the hierarchical level of the Head of your Internal Audit Function?
- (a) Below Executive Management level []
- (b) Parallel to the Executive Management level []
- (c) Above Management level []
16. Does your organisation have Internal audit charter?
- (a) Yes [] (b) No []
17. If your answer to question 16 above is “Yes”, is your Internal audit charter approved by the board (or audit committee) and annually represented?
- (a) Yes [] (b) No []
18. What is the staff strength of your internal audit function?
- (a) less than 10 [] (b) between 10-20 []
- (c) between 21-40 [] (d) Greater than 40 []
19. In your opinion, is there a separation between the CAE’s functional and administrative reporting in your organisation?
- (a) Yes [] (b) No []
20. If your answer to question 19 is “Yes”, to whom does your organisation’s Internal Audit Function report functionally?
- (a) The Chief Executive Officer (CEO) []
- (b) The Chief Finance Officer (CFO) []
- (c) The Head of Risk Management []
- (d) Audit Committee []
21. Does your department have full and unrestricted access to records and information required in the course of carrying out your work?
- (a) Always [] (b) Most of the time [] (c) Occasionally [] (d) Rarely []
- (e) Never []
22. Is it common for management to implement internal audit’s recommendations?
- (a) Always [] (b) Most of the time [] (c) Occasionally [] (d) Rarely []
- (e) Never []
23. Is it common for internal auditors to be posted to other functions within your organisation?
- (a) Always [] (b) Most of the time [] (c) Occasionally []
- (d) Rarely [] (e) Never []
24. Does your IAF engage in consulting activity for the management?

- (a) Always [] (b) Most of the time [] (c) Occasionally [] (d) Rarely []
- (e) Never []

SECTION C (Auditing methodology)

25. Who approves your annual audit plan?

- (a) Management [] (b) Audit Committee [] (c) The CEO [] (d) The CFO []

26. Are your internal audit engagements conducted in accordance with the International Standards for the Professional Practice of Internal Auditing ?

- (a) Always [] (b) Most of the time [] (c) Occasionally [] (d) Rarely []
- (e) Never []

27. If your answer to question 26 above is not “ALWAYS”, what is or are the reason(s) for not using IIA’s International standards for the Professional Practice of Internal Auditing

- (a) Not familiar with the standards []
- (b) Standards or practice Advisories are too complex []
- (c) The standards are too costly to comply with []
- (d) IIA’s standards are too time consuming []
- (e) Inadequate IAF staff []
- (f) Due to other reason[], please specify.....
.....
.....
.....
.....

28. Have you performed a quality assurance on the Internal Audit Function in the past five years?

- (a) Yes [] (b) No []

29. Does your organisation have a formalised enterprise wide risk assessment Framework?

- (a) Yes [] (b) No []

30. Does your organisation have a formal risk management department?

- (a) Yes [] (b) No []

SECTION D (Internal Auditors’ Characteristics)

31. Are you a member of the Institute of Internal Auditors (IIA)?

Yes [] (b) No []

32. If you are a member of the IIA, how long have you been a member of the institute (IIA)?

(a) Since a year ago [] (b) since 2 years ago []

(c) Since 3 years ago [] (d) more than 3 years ago []

33. What percentage of your team has one or more relevant professional qualifications such as ACA, ACCA, ACIB, CIA , CRMA, CISA, CCSA,CRISC, CFSA etc?.

.....

...

34. In your opinion, what is the average length of years of experience of your team?

(a) Less than 5 years []

(b) 5-10years []

(c) Greater than 10 years []

35. On average, how many formal training have you attended over the last 24months period or since you have been in the IAF if less than two years?.

(a) 1 time [] (b) 2 times [] (c) 3 times [] (4) 4 times []

(d) more than 4 times []

APPENDIX E: THE INTERVIEW GUIDE

INTERNAL AUDITING AND CORPORATE GOVERNANCE IN THE NIGERIAN FINANCIAL SECTOR

INTERVIEW GUIDE

(A) INDEPENDENCE OF INTERNAL AUDIT FUNCTION

- 1. Could you kindly describe the organisational structure of your internal audit function :**
 - i. If In-house**, when was the department established, and why?
 - ii. If Outsourced**, why and what motivate the decision
 - iii. If co-sourced** (what areas of engagement are retained in-house and why?)
- 2. What are the composition and professional background of your audit committee members (are there any documents that can show the information?)**
- 3. From your experience how is your Audit committee strengthening your internal audit function?.** (AC's input to your audit plan, regularity of private contacts between the CAE and the Audit committee Chair, involvement in appointment, evaluation and dismissal of Chief Audit Executive)

(B) OBJECTIVITY OF INTERNAL AUDITORS

- 1. Could you please describe the career path of internal auditors in your bank** (How frequent are your internal auditors transferred to other department within the bank)
- 2. How is internal audit activities perceived in your bank?** (Particularly on areas of Governance, Risk management and Control).
- 3. What is your position on combination of assurance and consulting (do you envisage any conflict of interest arising from the dual role?)**

(C) AUDITING METHODOLOGY

- 1. What standards do you apply in the conduct of your internal audit engagements?** (If International Standards for the Professional Practice of Internal Auditing, to what extent do you comply with the standards?)
- 2. What is the level of your Quality Assurance and Improvement Program (QAIP)?** (How often do you conduct both internal and external assessment, and how do you normally address any issue discovered during such activities?)

(D) CHARACTERISTICS OF INDIVIDUAL INTERNAL AUDITORS

- 1. What are the composition and experience level of internal auditors in your bank?** (adequacy of number of staff, team members years of experience, skills, qualifications, industry expertise of the team members)
- 2. Overall, what is the level of your internal auditors that belong to the Institute of Internal Auditors?** (In addition, how frequent do you send your staff for training, and what type of skills do you consider important for your staff)

***What roles do you think your internal audit function is playing on your organisation's Corporate governance, and how do you assess the contribution of your internal audit department to your organisation?**

****Is there anything else you think I should know about your internal audit function?**