



EFFECT OF INTERNAL AUDIT FUNCTION ON FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN NIGERIA

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ABSTRACT

This study examines the effect of internal audit function on financial performance of commercial banks in Nigeria. The specific objectives of the study are to: determine the extent internal audit control significantly improve the financial performance of commercial banks in Nigeria and ascertain the level of internal audit procedures in curbing fraud to facilitate financial performance of commercial banks in Nigeria. This study adopted survey research design. The population of the study consists of seven (7) branches each from five (5) selected commercial banks in Enugu metropolis, Enugu State of Nigeria, which comprises of managers, internal control officers, fund transfer officer, and cash officers. Data collected for the study were analyzed by the researchers using frequency counts, mean score and standard deviation. The two hypotheses were tested using simple regression statistical tool with aid of SPSS version 20.0 at 5% level of significance. The analysis revealed that internal audit control and procedures have positive effect on financial performance of commercial banks in Nigeria and this effect is statistically significant at 5% level of significance. The researchers recommended that the internal audit function in commercial banks in Nigeria internal audit department should ensure that financial fraud in their various establishments is being controlled and reduced to zero level.

Keywords: Internal Audit Function, Financial Performance and Commercial Banks.

1. INTRODUCTION

Auditing today encompasses a wide range of activities, which have different set of objectives. Traditionally, it has been a control mechanism to provide assurance that the government officials or its ministries (internal audit) and the established legislature (external audit), that public funds are received and used in accordance with the required appropriate and established relevant laws and regulations (compliance audit) and that the government financial performance reports are true and fair and they are prepared from the underlying financial records and represents its financial position (financial audit). According to (Diamond, 2002), the audit function has involved in many countries to take a more comprehensive view of the economic and social implication of government operations often termed as “value for money” or “performance audit” (Ziniyel, Otoo & Andzie, 2018).

Internal controls refer to the measures instituted by an organization so as to ensure attainment of the entity’s objectives, goals and missions (Brennan & Soloman, 2008). They are systems of policies and procedures that protect the assets of an organization, create reliable financial reporting, promote compliance with laws and regulations and achieve effective and efficient operations. By detecting weaknesses in management operations, Internal Auditing provides a basis for correcting deficiencies that have eluded the first line of defense before these deficiencies become uncontrollable or are exposed in the external auditor’s report. These systems are not only related to accounting and reporting but also relate to the organizations communication processes, internally and externally, and include procedures for preparing appropriate and timely financial reporting to board members and officers, conducting the annual audit of the organization’s financial statements, maintaining inventory records of real and other properties and their whereabouts. Tunji (2013) argues that internal controls encompass a set of rules, policies, and procedures an organization executes to provide reasonable assurance that its financial reports are reliable, operations are effective and efficient, and activities comply with applicable laws and regulations. The Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2013) framework looks at internal control as a process, affected by an entity's board of directors, management and other personnel, designed to provide "reasonable assurance" regarding the achievement of objectives in the effectiveness and efficiency of operations, reliability of financial reporting, compliance with applicable laws and regulations.

Ziniyel, Otoo and Andzie (2018) documented that internal audit practice/activity is bedrock for effective public institutions financial management and it is imperative to ensure effective and efficient operations and the appropriate application of controls. The Internal audit practice is value added if it achieves its objectives by improving the organization regarding to governance, risk management and internal controls. The work of internal auditor is not complete until irregularities are rectified and remain rectified (Sawyer, 1995). It assesses compliance with underlying financial regulations, directives and measures, appraises the efficiency of adopted internal controls; evaluates the value and usefulness with which resources are utilized; evaluates the dependency and credibility of records maintenance and reporting; examines abnormalities; guarantees that resources are brought together and reported and authenticates inventory records and their identity with physical inventory (INTOSAL, 2001).

Data from World Bank (2014) revealed that there was decline in service in all sectors of the economy including tourism. Poor financial performance of quoted companies adversely affects the economic growth of the Kenyan economy. There is however, continued poor financial performance, where budgets are not followed, rules and regulations on the use of finances are not adhered to and there are massive unaccounted funds. This has led to the risk of financial inadequacy, employee dissatisfaction and poor financial performance (Mikes & Kaplan, 2014).

Nigerian banks have several internal control systems, but there is evidence that the financial management in Nigerian banks is not up to the expected standards locally and internationally, and this may create loop hole for financial impropriety or unfair view of the financial reporting as well resulted to rapid increase in merger and acquisition of banks in recent time in Nigeria

Studies on internal audit function mainly carried out in different part of the world with limited study in Nigeria such like; Ziniyel, Otoo and Andzie (2018) who concluded that there are effective internal audit practices necessary for influencing financial performance in Ghana. Bunu and Omwenga (2017) in their study concluded that Lamu County has an effective internal audit function that plays the role of monitoring and evaluating organization activities; It has an effective and efficient internal audit function which is able to detect fraud, but it is not able to prevent and control it .Abeer (2015) found that there is the effect of the function internal Audit to improve financial performance of the Jordanian commercial banks. In Nigeria, Ejoh and Ejom (2014) conducted a study in Cross River State College of Education, Akamkpa. The study found that the internal audit department of the College is not sufficiently staffed, does not perform their duties with greater degree of autonomy and independence from management. Also, study further revealed that internal audit function has no significant effect on the financial performance of Cross River State College of Education. This present study therefore examines the effect of internal audit function on financial performance of commercial banks in Enugu State of Nigeria. The specific objectives of the study are to:

1. *Determine the extent internal audit control significantly improve the financial performance of commercial banks in Nigeria.*
2. *Ascertain the level of internal audit procedures in facilitating financial performance of commercial banks in Nigeria.*

2. REVIEW OF RELATED LITERATURE

Internal Audit Function

Internal Audit has become an indispensable management tool for achieving effective control in both public and private organizations. Control mechanisms are those processes set up to monitor and to direct, promote or restrain the various activities of an enterprise for the purpose of seeing that enterprise objectives are met. Internal audit is an internal mechanism the members of the organization use in effective discharge of their responsibilities. It's also an independent appraisal function established within an organization to examine and evaluate the effectiveness, efficiency and economy of managements control system (Subramaniam, 2006). The aim is to provide management with re-assurance that their internal control systems are adequate for the need of the

organization and are operating satisfactorily (Reid & Ashelby, 2002). It is a component of the internal control system set-up by management of an enterprise to examine, evaluate and report operations of accounting and other controls. The quality and effectiveness of internal audit procedures in practice are necessary since internal auditors cover a wide variety of assignments, not all of which will relate to accounting areas in which the external auditor is interested.

Emasu (2007) reported that the effectiveness of internal audit function partly depends on; legal and regulatory framework, placement of the function and its independence, existence of audit committees, resources allocated to the function and professionalism of internal audit staff. It is however a bitter reality that internal audit departments are rarely adequately facilitated. Regarding the size and facilitation of the internal audit function, Gerrit and Mohammad (2010) found evidence in support of the monitoring role of the internal audit function. They specifically found evidence that management ownership is positively related to the relative size of the Internal Audit Function, which is inconsistent with traditional agency theory arguments that predict a negative relationship, but more in line with recent studies on earnings management.

Internal audits controls are planned to ensure that appropriate controls over systems and software are in place to ensure that internal controls and internal checks are functioning as designed (Haylas & Ashton, 1982). Controls audits can have characteristics found into them to guarantee that falsified transactions are frowned upon or made cumbersome, if not impractical to perform. Controls audits present assurance that controls are functioning but they do not essentially identify fraud or corruption. Internal controls audit goals relay to organization plans, methods and procedures used to achieve the corporate mission, objectives and goals. Internal control also known as management controls includes planning, organizing, directing and controlling programme operations and the systems put in place to measure, report and monitor programme performance (Esmajee, 1993).

Empirical Review

Ziniyel, Otoo and Andzie (2018) assessed the effectiveness of internal audit practice on financial management. A descriptive cross-sectional research design was used to analyze the research problem. Questionnaire and interview guide were used as the sources of data collection from audit staff, account staff and heads of institution across different campuses in one of the universities in Ghana. Data were analyzed with descriptive statistics binary logistics regression framework. The study revealed that the financial performance of internal auditors regarding the mandated guidance in the university is very great as indicated by 58.8% of the respondents. The study concluded that there are effective internal audit practices necessary for influencing financial performance. Bunu and Omwenga (2017) determined the effect of internal control systems on financial performance of Lamu County. The study collected both primary and secondary data. The researcher used structured questionnaires to collect primary data. Data was analyzed using descriptive statistical methods, frequencies and percentage with the aid of Microsoft Excel. The study concludes that Lamu County has an effective internal audit function that plays the role of monitoring and evaluating organization activities; it has an effective and

efficient internal audit function which is able to detect fraud, but it is not able to prevent and control it. Mohammed, Shamsher, Taufiq and Zulkarnain (2011) examined the impact of the quality of the internal audit function (IAF), an integral part of corporate governance structure, on the financial reporting quality (FRQ) of all Saudi companies listed in the Saudi stock exchange (TADAWL) in 2009, excluding banks. Both secondary and primary information was collected through a matched survey and interview of internal and external auditors. The findings show weak association between IAF quality and FRQ. Abeer (2015) identify the impact of the internal audit function to improve the financial performance of the Jordanian commercial banks. The questionnaire was distributed to internal auditors working in the Internal Audit Department in the Jordanian commercial banks, and was analyzed by statistical package for social sciences (SPSS) program. The study found that the Jordanian banks are interested in the quality of internal audit and management of the internal audit activities and assess the risks of the internal audit process and that there is the effect of the function of internal Audit to improve financial performance. Ejoh and Ejom (2014) sought to establish the relationship between internal audit function and financial performance in Tertiary Institutions in Nigeria with particular reference to Cross River State College of Education, Akamkpa. Data was collected using questionnaires and the data were analyzed using simple percentages, tables, correlation coefficient and z-scores. The study revealed that all activities of the College are initiated by the top management. On the effectiveness of internal audit, the study found that the internal audit department of the College is not sufficiently staffed, does not perform their duties with greater degree of autonomy and independence from management. Also, study further revealed that internal audit function has no significant effect on the financial performance of Cross River State College of Education. Alkhasa (2013) determined the extent of the contribution of the internal audit function in the financial and administrative performance in local government bodies adjust to the Gaza Strip. The study relied on descriptive analytical method to describe and analyze the variables of the study and testing of hypotheses. The results revealed that the role of the internal audit function in the financial and administrative performance tuning, and that local authorities apply all the internal audit procedures to ensure the validity and accuracy of financial and administrative data. Abdali (2012) ascertained the impact of the application of the pillars of corporate governance in the quality of internal audit in industrial companies listed in Alardnellorac financial market. The results showed the presence of statistically significant effect of the application of the pillars of corporate governance in the quality of internal audit to industrial companies listed in Alardnellorac financial market. Slaves (2012) ascertained the role of the internal audit function in the environmental performance of industrial companies in Jordanian. Questionnaires were distributed to a sample of 60 employees of which 49 were valid for the analysis process. Results of the study showed that the Jordanian industrial companies based internal audit their environmental performance is average, which is reflected on its overall performance with the presence of some of the difficulties in the performance of the environmental audit process due to the lack of qualifications of internal auditors to assess. Jerboa (2005) identified areas of the contribution of the internal audit function in the financial performance tuning, and management at the Islamic University in Gaza. To achieve the objectives of the study, three questionnaires were distributed to the financial management personnel and internal auditors of university design. Results of the study showed that the areas which contributes to the internal auditor are: to identify the university needs of financial services, and administrative and advisory related to the field of control, as well as contribute to the detection of the strengths and weaknesses of the work

required, and completed, revealing deviations, disability and deficiencies in internal control systems at the university also plays an important role in the two phases of research, diagnosis, and consideration of alternatives, and to contribute to solving problems, and the analysis and design of systems and procedures.

Studies on internal audit function mainly carried out in different parts of the world with limited study in Nigeria such like; Ghana, Lamu County, Jordanian etc, and found that there are effective internal audit practices necessary for influencing financial performance. In Nigeria, Ejoh and Ejom (2014) conducted a study in Cross River State College of Education, Akamkpa. The study found that the internal audit department of the College is not sufficiently staffed, does not perform their duties with greater degree of autonomy and independence from management. Also, study further revealed that internal audit function has no significant effect on the financial performance of Cross River State College of Education.

3. METHODOLOGY

Research Design

This study adopted survey research design. This design involves the use of sample to obtain the opinion of number of respondents. It is a research design that studies the information gathered from a fraction or percentage of the population.

Population and sample size of the Study

The population of the study consists of seven (7) branches each from five (5) selected deposit money banks in Enugu metropolis, Enugu State of Nigeria, namely; First bank plc, United Bank for Africa, Fidelity bank plc, Eco bank plc and Union bank plc. The element of the population comprises of managers, internal control officers, fund transfer officer, and cash officers. The total population is 140. The researchers selected this percentage of the population for easy accessibility, considering the nature of the study which involved people's opinion through questionnaires administered to the targeted population for the study.

Method of data collection

There is a cover letter to the questionnaire addressed to the respondents, where they were assured that all information provided will be treated with utmost confidentiality and used for the purpose of the research work.

The questionnaire were close-ended questions on the research study, structured on a scale of Strongly Agree (SA), Agree (A), Undecided(UN), Disagree (D) and Strongly Disagree (SD); to give the respondents choice of ticking most perceived option. The researchers visited the banks with two assistants to administer the questionnaire to the respondents. The copies of the

questionnaire distributed to the respondents were retrieved within two weeks after administration of the questionnaires.

Method of Data Analysis

Data collected for the study were analyzed by the researchers using frequency counts, mean score and standard deviation. The two hypotheses were tested using simple regression statistical tool with aid of SPSS version 20.0 at 5% level of significance.

Decision Rule:

The decision for the hypotheses is to accept the alternative hypotheses if the p-value of the test statistic is less or equal than the alpha and to reject the alternative hypotheses if the p-value of the test statistic is greater than alpha at 5% significance level.

Model Specification

The researcher estimated model in the following form:

$$FIPFM_{it} = a_0 + \beta_1 IAC_{it} + \Sigma_{it} \dots\dots\dots(i)$$

$$FIPFM_{it} = a_0 + \beta_2 IAP_{it} + \Sigma_{it} \dots\dots\dots(ii)$$

Where:

The dependent variable: Financial performance (FINPFM) and

The independent variables:

IAC = internal audit control

IAP = internal audit procedure

a0 = slope of the model

β_1, β_2 , = coefficient of parameters.

i for the financial year ending at year *t*.

4. DATA PRESENTATION AND ANALYSIS

Out of 140 copies of questionnaires distributed, 104 were completed and returned. This represents 74%.

Table 1. Analysis of data collected on question one: To what extent has the internal audit control improves financial performance of commercial banks in Nigeria” ?

	Questions	SA	A	Un	SD	D
1	Internal controls encompass a set of rules, policies, and procedures an organization implements to provide reasonable assurance that its financial reports are reliable	33	55	5	0	11
2	Internal audit control has designed an internal audit manual that guides audit operations such as planning, , monitoring, and evaluation.	37	57	0	1	9
3	The internal audit control plays a vital role in detecting fraud in the banks.	29	61	4	0	10
4	The internal audit control assured the bank management with assurance that there are no major internal control weaknesses are reported.	31	58	3	0	12
5	The internal audit control used internal audit results to assess the work of the third parties on a regular basis.	35	65	1	0	3

Source: Field Survey, 2020

Table 2. Analysis of data collected on question two: What is the level of internal audit procedures in facilitate financial performance of commercial banks in Nigeria?

	Questions	SA	A	Un	SD	D
1	The internal audit procedures report to management on the extent of the application of accounting principles and international.	43	50	5	0	6
2	Internal audit procedures planned stages accurately reveal the extent of compliance of internal audit process.	39	58	0	0	7
3	The internal audit procedures provide timely completed of audit work and ensure that internal audit findings are reported directly to top management	34	60	4	1	5
4	The internal audit procedures ensure that internal auditors in the bank demonstrate professionalism and an objective approach.	49	50	3	0	2
5	Internal audit procedures monitor the performance of the internal auditor's management to ensure compliance with internal audit standards.	30	67	2	0	5

Source: Field Survey, 2020

Table 3. Analysis of data collected for question three: Proof of financial performance of commercial banks in Nigeria.

	Questions	SA	A	Un	SD	D
1	Financial performance gives evidence of accountability for the stewardship of the resources as well contributing to evaluation of growth of the banks.	39	60	1	0	4
2	Financial performance makes available, vital information for good control and prudent management of business activities.	43	54	0	0	7
3	Financial performance is based upon the possibility that banks had the willful relationship of beneficial resources and those giving hope to get value in return.	34	66	4	0	0
4	Financial performance provides completeness of all transactions undertaken by an entity, the level of bank's assets, products and services	41	55	0	0	8
5	Financial performance reflects the outcomes of internal control mechanisms, involving the receipt and disbursement in the banks.	36	61	4	0	3

Source: Field Survey, 2020

Test of Hypotheses

Hypothesis one

Ho: Internal audit control does not significantly improve financial performance of commercial banks in Nigeria.

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.992 ^a	.984	.979	19.42374

a. Predictors: (Constant), IAC

Table 4 above shows that the Model revealed the value of $R^2 = 0.984$ and Adjusted R^2 value is .979. This suggests that the model explains about 98% of the systematic variations in the dependent variable. This means that the regression explains 98% of the variance in the data. The value of adjusted R^2 of 98% also shows that 2% of the variation in the dependent variable is explained by other factors not captured in the study model.

Table 5: ANOVA^a

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	70218.155	1	70218.155	186.116	.001 ^b
1 Residual	1131.845	3	377.282		
Total	71350.000	4			

a. Dependent Variable: FIPFM

b. Predictors: (Constant), IAC

In table 5, it is revealed that the p-value is 0.001 which indicates that the hypothesis is statistically significant at level of significance (5%); hence p-value of the test statistic is greater or equal to alpha.

Table 6: Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	-5.835	11.844		-.493	.656
IAC	1.056	.077	.992	13.642	.001

a. Dependent Variable: FIPFM

In table 6, the regressed coefficient correlation result shows that financial performance of commercial banks operating in Nigeria of the explanatory variable (Beta Column) shows 0.992 (100%) means that internal audit control has up to 100 percent positive correlation with financial performance of commercial banks.

Decision:

Since p-value of the test statistic is less or equal to alpha, we therefore, reject null hypothesis and uphold alternative hypothesis which state that internal audit control has significantly improved financial performance of commercial banks in Nigeria.

Hypothesis two

Ho: The level of internal audit procedures does not facilitate financial performance of commercial banks in Nigeria.

Table 7: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	1.000 ^a	.999	.999	4.38338

a. Predictors: (Constant), IAP

Table 7 above shows that the Model revealed that the value of $R^2 = 0.999$ and Adjusted R^2 value is .999. This suggests that the model explains about 100% of the systematic variations in the dependent variable. This means that the regression explains 100% of the variance in the data. The value of adjusted R^2 of 100% also shows that no percentage (%) of the variation in the dependent variable is explained by other factors in the study model.

Table 8: ANOVA^a

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	71292.358	1	71292.358	3710.430	.000 ^b
Residual	57.642	3	19.214		
Total	71350.000	4			

a. Dependent Variable: FIPFM

b. Predictors: (Constant), IAP

In table 8, it is revealed that the p-value is 0.000 which indicates that the hypothesis is statistically significant at level of significance (5%); hence p-value of the test statistic is greater than alpha value.

Table 9: Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	
	B	Std. Error	Beta			
1	(Constant)	-4.096	2.644		-1.549	.219
	IAP	1.039	.017	1.000	60.913	.000

a. Dependent Variable: FIPFM

In table 9, the regressed coefficient correlation result shows that financial performance of commercial banks operating in Nigeria of the explanatory variable (Beta Column) shows 1.000 (100%) means that internal audit procedures has up to 100 percent positive correlation with financial performance of commercial banks.

Decision:

Since p-value of the test statistic is less or equal to alpha, we therefore, reject null hypothesis and uphold alternative hypothesis which state that the level of internal audit procedures facilitates financial performance of commercial banks in Nigeria.

5. CONCLUSION AND RECOMMENDATIONS

This study assesses the extent internal audit function affects financial performance of commercial banks in Nigeria. The analysis revealed that internal audit control and procedures have positive effect on financial performance of commercial banks in Nigeria and this effect is statistically significant at 5% level of significance. The outcome of this study shows that commercial banks in Nigeria have an effective and efficient internal audit function to curb financial fraud. All these indicate that Nigerian banks have good internal control systems mechanism.

These results collaborate with the views of Ziniyel, Otoo and Andzie (2018) who concluded that there are effective internal audit practices necessary for influencing financial performance in Ghana, and Bunu and Omwenga (2017) who found that Lamu County has an effective internal audit function that plays the role of monitoring and evaluating organization activities; It has an effective and efficient internal audit function which is able to detect fraud, but it is not able to prevent and control it. As well, Abeer (2015) found that there is the effect of the internal Audit function to improve financial performance. Based on the above result, the researchers recommended the followings:

1. The internal audit function in commercial banks in Nigeria internal audit department should ensure that financial fraud in their various establishments is being controlled and reduced to zero level.
2. The internal auditors should comply with the audit procedures thereby demonstrate professionalism approach in executing their audit works.

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