EFFECTIVENESS OF INTERNAL AUDIT IN RISK MANAGEMENT
A CASE OF KENYA TEA DEVELOPMENT AGENCY (KTDA)

BY

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STUDENT'S DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other college, institution or university other than the United States International University in Nairobi for academic credit.

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This project has been presented for examination with my approval as the appointed supervisor.

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Signed: Deputy Vice Chancellor, Academic Affairs
ACKNOWLEDGEMENT

I am grateful to God for through Him this study has been possible.

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Lastly, and most importantly, I wish to thank my husband, daughter and unborn son. To them I dedicate this proposal.

May God the Almighty bless you all for the support and contribution.
ABSTRACT

The purpose of this study was to evaluate the factors that determine effectiveness of the internal audit in risk management. We further demonstrated this by a case of Kenya Tea Development Agency. The research questions that guided this study were; how do audit quality, management support, organizational setting, auditee attributes, and the interplay among them, influence audit effectiveness in an organisation in managing its risks. The researcher of the study was trying to establish whether an organization that reviews these four factors will ensure an effective internal audit function in risk management for the organisation.

The research design that was used in this study was descriptive research as it sought to find how the four (4) factors influence the effectiveness on internal audit in risk management. The population under study was the Kenya Tea Development Agency Group and all the factories managed by the Agency. The study selected a sample of 35 factories allocated proportionally and all the Group’s subsidiaries.

The sampling technique used in the study will be stratified sampling and simple random sampling. Primary data was used with questionnaires used to collect the primary data. The coded data was analyzed using quantitative and qualitative techniques; quantitative techniques to be used was descriptive statistics which include weighted mean, frequency, percentages and standard deviations, qualitative techniques was content analysis. The data was presented graphically using tables and figures. The tool that was used for analysis is Statistical Package for Social Science (SPSS) and Microsoft Excel.

The findings established that there was a major link between the four factors namely; internal audit quality, management support, organisation setting/control environment and the auditees’ attributes and the effectiveness of the internal audit in risk management in an organisation.

Internal audit quality is fundamental in that the internal audit function should be equipped with staff expertise which can be achieved through proper recruitment of staff as well as
continuous training of staff. Scope of service is another area where the types of audits carried out by the internal audit function leads to risk identification and subsequent risk management. The understanding of the audit process by the internal audit team is also very critical to ensure the quality of the internal audit function.

Management support is an important factor to consider as response to the audit findings and recommendations is essential for an effective audit process as this ensures that management engages with the internal audit team and is able to understand the risks thereof. Management’s support of the internal audit function is critical as well as it ensures their independence and objectivity in carrying out its duties and it also spells out the tone at the top.

Organisation setting was considered in terms of the control environment in the organisation which in turn determines the risk levels of the organisation. The ideal situation would be where the control environment is strong and hence the risk levels are low indicating that there’s proper management of risk. An organisation with set policies and procedures for its process also enhances risk identification and in turn risk management.

Auditees’ attributes are an essential factor to be considered as it contributes to the major part of the audit process which is the fieldwork. The auditees’ attitude towards internal audit is essential as it determines how the field work process will be carried out in terms of availability of information and ample time to discuss procedures and issues with the auditee.

The researcher found out that the auditees’ perception of audit in the case of Kenya Tea Development Agency was not as positive as it should be and in this respect would recommend that both management and the internal audit function needs to play a role in training the auditees to understand the importance of internal audit and their role in the organisation. This is so as not to be perceived as policemen but as colleagues working towards a similar goal.
The researcher concluded that the four factors mentioned above and their interplay is important in determining the effectiveness of internal audit in risk management. Where all the factors interplay in a positive manner then the internal audit is deemed to be effective.

The researcher recommends an evaluation of these four factors on a periodic basis to determine how effective their interplay is and how it affects the effectiveness of internal audit in risk management. On the basis of the findings the researcher recommends KTDA internal audit to standardize their working papers and audit procedures to enhance internal audit’s quality. Further on management support the researcher recommends implementation of audit recommendations to be incorporated in the employees’ performance appraisals to ensure that it is done. Based on the findings the researcher would further recommend for KTDA to establish mechanisms to determine obstacles that deters the achievement of business objectives to as to enhance the organisation’s control environment. Additionally the internal audit team needs to put more effort in cultivating relationships with the auditee so as to cultivate a conducive working environment.
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LIST OF ABBREVIATIONS

EPK  Eastern Produce of Kenya
IA   Internal Audit
IAF  Internal Audit Function
KTDA Kenya Tea Development Agency
KETEPA Kenya Tea Packers
SCDA Special Crops Development Agency
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

According to Karagiorgos, Drogalas, Eleftheriadis, & Christodoulou, (2009), since the financial crisis in 2008, authoritarian and economic pressures are compelling organizations to conduct a thorough job when carrying out activity extensive risk assessments, perform strategic prospects in a risk effectual manner, boost the efficacy of risk alleviation efforts, and pay attention to a further holistic dimension to risk management. Additionally the globalization of economy, technological advancements, and intricacy of business and accusations of financial reports that are fraudulent have in recent times sharpened the ever-increasing awareness to internal controls and internal auditing (Karagiorgos et al. 2009).

Risks in any business affect performance of the organization as well as ability to meet its objectives. Risk management is therefore a vital point in business planning. The risk management process is designed to trim down or eliminate the danger brought about by occurrence of certain sort of events or having a force on the industry. Risk management being a practice of recognizing, evaluating, and prioritizing probable risks of diverse kinds is essential to any business' success (Hass, 2006).

The internal audit function is essential in this area as it should be able to identify the risks and assist in developing controls to mitigate these risks. The business world is becoming increasingly complex due to new, evolving, and emerging risks. Organizations are giving risk management more consideration. Internal audit is capable of playing an essential assurance task in the governance process of an organization, predominantly in the risk management and command areas. In various organizations, the prospects sited upon internal audit have improved and the utility is being relied on to make a significant contribution (Fraser, 2007).
This increasing task of the internal audit is also mirrored in its contemporary definition, i.e. “internal auditing is an autonomous, goal-oriented assurance and consulting actions intended to put in value and develop the operations of the company. It assists an organization achieve its objectives by carrying out a methodical, disciplined approach to calculate and advance the efficacy of governance processes, risk management, control.” (IIA, 1999a).

This definition signifies that internal audit has undergone a paradigm shift from an emphasis on accountability about the past to improving future outcomes to help auditees operate more effectively and efficiently (Nagy and Cenker, 2002; Stern, 1994; Goodwin, 2004). Since, the definition equally serves both the private and the public sector (Goodwin-Stewart, 2006), it is used in this study as a basis to analyse private sector internal audit effectiveness.

Risk is intrinsic in the assessment taken by an organization to facilitate management and control its business and business practices put up to help out in the success of its company’s objectives. Modifying the way business conduct their daily activities resulting from, for instance, opening out of the company or amendment in the regulatory structure, is capable of placing gigantic strain on a company’s control mechanisms and turn out to be major causes of risk. That explains why establishing, executing and embedding efficient threat and control essentials of the general corporate governance structure are of primary significance to all organizations (Hass, 2006).

Internal audit is effective if it meets the intended outcome it is supposed to bring about. Sawyer (1995) states, “an internal auditor’s job is not done until defects are corrected and remain corrected.” Van Gansberghe (2005) explains that internal audit effectiveness in the public sector should be evaluated by the extent to which it contributes to the demonstration of effective and efficient service delivery, as this drives the demand for improved internal audit services. Based on the results of a consultative forum that focused on improving public sector internal audit, Van Gansberghe (2005) identified insight and ownership; organization and governance agenda; conceptual structure; enhanced professionalism; legislation; and also resources as factors influencing internal audit effectiveness. Effective internal audit undertakes an independent evaluation of
financial and operating information and of systems and procedures, to provide useful recommendations for improvements as necessary.

According to Dittenhofer (2001), the effectiveness of internal audit greatly contributes to the effectiveness of each auditee in particular and the organization at large (Dittenhofer, 2001). Dittenhofer (2001) also observed that if internal audit quality is maintained, it will contribute to the appropriateness of procedures and operations of the auditee, and thereby internal audit contributes to effectiveness of the auditee and the organization as a whole. Using agency theory, Xiangdong (1997) explained the role that internal audit plays in an economy and points out that internal audit has an advantage over external audit in obtaining information quickly and finding problems at an earlier stage; and applying the theory of transaction cost economics, demonstrated how internal audit recommendations are important to the management of government organizations.

Prior literature relating to internal audit effectiveness has either focused on the internal audit’s ability to plan, execute and objectively communicate useful findings (Xiangdong, 1997; Spraakman, 1997; Dittenhofer, 2001), or taken a broader view and Internal audit effectiveness included factors that transcend the boundary of a single organization (Van Gansberghe, 2005).

This study seeks to determine the effectiveness of internal audit in identifying and mitigating risks in the company and in strengthening the control environment of the organisation as a whole. This will be done by evaluating four factors namely: internal audit quality, management support, organisation setting/control environment and auditees’ attributes. The researcher will review these factors using a case of Kenya Tea Development Agency (KTDA).

Kenya Tea Development Agency Limited is the leading management agency for the small tea farmers in Kenya. KTDA came about in June 2000 as a result of privatization of Kenya Tea Development Authority taking over liabilities, the assets, and terms of office of the Authority. The Agency is applying new terms which are in a contractual agreement entered with the autonomous tea factory companies under its custody (KTDA, 2011).
The law barred native Kenyans from growing tea in anticipation of independence when the legislation was revoked for the native people to begin growing tea. The colonial government in 1960, formed the Special Crops Development Authority (SCDA) with the role of promoting tea growing by Africans under the patronage of Agriculture. Kenya Tea Development Authority was created after Independence, under legal notice No.42 of 1964 and immediately embraced the liabilities and tasks of the SCDA to encourage and advance the cultivation of tea in small farms that were until that time considered unviable regarding expertise and finances required, as observed in the plantation sectors. As from then, tea growing practiced by small-scale sector in Kenya has carved a niche for itself in the global tea trade (KTDA,2011).

Incorporated on 15th June 2000 as a private company, Kenya Tea Development Agency Limited was in line with (CAP 486) of the Kenya laws, and has turned out to be one of the principal management agencies of private tea. As to date, The Agency handles 65 factories in Kenya under the small-scale tea sub-sector (KTDA, 2011).

KTDA offers factory unit management and support services, Sales and marketing services, financial services and Tea Management Consultancy services to the factories. Some of KTDA’s subsidiaries are Chai Trading Company Limited, Majani Insurance Brokers, KETEPA, KTDA Foundation, Greenland Fedha, KTDA Power Company Ltd among others (KTDA, 2011).

Chai Trading Company Limited was incorporated as a trading subsidiary of KTDA Ltd on the 1st day of September 2003. The company based at the Miritini Warehousing Complex, Mombasa was initiated in October 2003 with a general, mandate to carry out bulk packing, buying and selling of high quality tea to local and international destinations and customers (KTDA, 2011).

Majani Insurance Brokers was incorporated in 1976 as Kenya Tea Development Authority Insurance Agency, taking care of insurance concerns faced by KTDA. As business matured there was call to expand the exceptional insurance services to the public at large. The insurance commissioner in 1998 licensed the agency as an insurance broker.
“Majani” is an active member of the Association of Insurance Brokers of Kenya (AIBK) (KTDA, 2011).

Kenya Tea Packers (KETEPA) Ltd was register in September 1977 as a Private Company, starting doing business in January 1978. The law only allowed the company to operate only within the local market. In 1992, the law changed allowing export of tea. KETEPA as of today exports packed tea to worldwide destinations. The Head office as well as the packing factory are situated in Kericho, a town that is 270 km West of Nairobi (KTDA, 2011).

Ketepa is owned by the tea farmers of Kenya under the umbrella bodies the Kenya Tea Development Agency Limited (KTDA) and, the Kenya Tea Growers Association (KTGA). The Kenya Tea Development Agency is seen as the majority shareholder, a representative of close to 450,000 small scale tea farmers throughout the country. These farmers boast of ownership of over 60 Tea Processing Factories in the country, producing more than 60% of Kenyan Tea. Other key shareholders are James Finlay, Williamson Tea, Brooke Bond Kenya Limited (Unilever Tea), and Eastern Produce of Kenya (EPK) amongst others who collectively own 38 tea processing factories and producing close to 40% of the tea generated in Kenya (KTDA, 2011).

Another subsidiary is the KTDA Foundation, a non-profit aid organization affiliated with the Kenya Tea Development Agency (Holdings) Limited. It is a company limited by guarantee, incorporated on 17th April 2010 in regulations of the Companies Act (Cap. 486). The objective of the Foundation is to hoist funds in Kenya and overseas to start and sustain programmes that develop small-holder tea farmers’ welfare in Kenya and contribute to additional needy causes. The Foundation is the medium by which KTDA (H), Factory Companies, and Subsidiary Companies will administer corporate social accountability (CSR) activities. It will set off, co-ordinate, sustain and broadcast CSR Group activities. Other auxiliaries include Greenland Fedha an investment bank, KTDA Power Company among others (KTDA, 2011).
KTDA is one of the largest and successful conglomerates in Kenya. It has continued to grow in the recent years and in essence so has the risks associated with the Group. The Group has ventured into several industries and to ensure continued success it is important for the group to have an effective risk management oriented internal audit to ensure risks are identified and managed.

1.2 Statement of the Problem

The Institute of Internal Auditors (IIA) defines that “Internal auditing is a self-regulating, goal-oriented assurance and consulting action designed to add value and perk up operations of an organization. It helps an organization realize its objectives by putting up an efficient, disciplined approach to appraise and improve the efficacy of control, risk management, and governance processes.

The roles of Internal Auditors’ consist of assessing, monitoring and analyzing organizational peril and controls, examination and confirming information, observance of procedures, policies, and laws (IIA, 1999a).

Working in a joint venture with management, the audit committee, internal auditors given the board, and executive management ensures that perils are mitigated and that the organisation’s corporate governance is strong and effective. Where there is room for improvement, internal auditors make recommendations fro enhancing processes, policies and procedures” (IIA, 1999).

The internal audit office of KTDA exists by a charter to assist the management and the Audit Committee of the board in effectively fulfilling their responsibilities. They are charged with probing and appraising the procedures, policies, and systems in place to ensure: compliance with policies, reliability and veracity of information, strategies, the safeguarding of assets, laws and regulations, and the economical and proficient utilization of resources. Additionally the internal audit office is charged with identification of risk as well as the mitigation of these risks.

The internal audit function in KTDA is headed by a Group Head of Risk and compliance assisted by 3 managers, 2 assistant managers and 14 auditors. The research study will
evaluate how effective this team is in carrying out its mandate in the organisation based on four factors namely: Internal audit quality, management support, the organizational setting and the attributes of the auditee.

Limited studies have been done to assess whether the effectiveness or lack thereof of an internal audit function has been a contributing factor to the success of organisations and risk management. Prior literature relating to internal audit effectiveness has either focused on the internal audit's ability to plan, execute and objectively communicate useful findings (Xiangdong, 1997; Spraakman, 1997; Dittenhofer, 2001); or taken a broader view and included factors that transcend the boundary of a single organization (Van Gansberghe, 2005).

Studies on the factors that lead to an effective internal audit function in risk identification and the mitigation of these risks thereof has not been carried out. This paper attempts to shed more light on the role of internal audit in risk identification as well as the factors to be considered for an effective internal audit function.

1.3 **Purpose of the Study**

The purpose of this study was to determine how effective the internal audit function is in risk management in Kenya Tea Development Agency.

1.4 **Research Questions**

1.4.1 How does the quality of the internal audit work done affect the identification of risk and their mitigations thereof?

1.4.2 To what extent does management support contribute to the success of the internal audit department?

1.4.3 How an organization’s setting/control environment affects internal audit?

1.4.4 Does the attitude of the auditee affect the internal audit process?

1.5 **Significance of the Study**

This study will be of benefit to various categories of people. The researcher of this paper has identified four groups of people that deem to gain from the study.
1.5.1 Management of KTDA
Since the study was based on a case of KTDA this research paper will benefit the management of the company to understand the role of internal auditors in the organisation as well as how their input as management may determine their effectiveness and the success of the organisation in risk management.

1.5.2 Internal Audit Department
This research paper will benefit the internal audit function as it is hoped that the findings may help to improve the function in risk management. It may also help to identify areas of improvement as well as areas of strength.

1.5.3 Employees of KTDA
Employees/ Auditees in any organisation play a part in the effectiveness of internal audit in an organisation. Since the study is based on KTDA this research paper will benefit the employees to understand their role in relation to internal audit as well as risk management.

1.5.4 Scholars and Researchers
This research paper will also be important to future researchers on this topic and other related topics. The findings of this research can be used extensively by scholars as they do similar studies. The gaps left by this research will open up avenues for other scholars to research further on the topic.

1.6 Scope of the Study
The study looked at Kenya Tea Development Agency (KTDA) and all its subsidiaries a Kenyan private company. The study included the sixty five (65) factories managed by KTDA, its eight (8) subsidiaries and KTDA. This particular company was chosen due to its diversity to the various industries in the country. The study took place between January 2013 and June 2013.

The limitation of this study was that the findings of this study are only relevant to KTDA and thus cannot be generalized to all the private sector companies in the country.
1.7 Definition of terms

1.7.1 Effectiveness

Richard et al. (2009), connotes that organizational effectiveness entails organizational performance in addition to the innumerable internal performance outcomes by and large coupled with more resourceful or effective operations, further external measures relating to reflections broader than those basically associated with economic assessment (either by customers, shareholders, or managers), for instance corporate social responsibility.

1.7.2 Internal Audit

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, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes (IIA, 2006).

1.7.3 Risk Management

According to Douglas (2009), it is a process for identifying, assessing and prioritizing risks of different kinds. Risk management is the identification, assessment, and prioritization of risks pursued by coordinated and economical appliance of resources to curtail, monitor, and have power over the probability and/or impact of ill-fated events or to capitalize on the realization of chances. Risks can emerge from vagueness in financial markets, project letdown (at any stage in design, manufacture, expansion, or sustainment life-cycles), credit menace, accidents, legal responsibility, natural grounds and disasters as well as premeditated attack from an enemy, or uncertain or impulsive root-cause.
1.8 Chapter Summary

This chapter basically introduces the research topic starting with the background of the study, and then follows the statement of the problem and the purpose of the study. This is followed by the research questions, then the significance of the study followed by the scope of the study and finally the definition of terms.

Chapter 2 will look into the literature review related to the problem of study while Chapter 3 will state the research methodology used to carry out the study. Chapter 4 analyses the data collected from the questionnaires and presents it in a way that conclusions and recommendations can be made from the presentation while chapter 5 gives discussion, conclusion and recommendations of the findings.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

This chapter will look into the internal audit effectiveness by identifying factors within an organisation that impact on audit effectiveness. Audit effectiveness fosters the achievement of a common goal; there would be a natural incentive in an organization to improve it. We will consider four potential factors – internal audit quality, management support, organizational setting, and auditee attributes to explain audit effectiveness, and show how the interaction of these factors improves audit effectiveness.

2.2 Internal Audit Quality

Internal audit quality, which is determined by the internal audit department's capability to provide useful findings and recommendations, is central to audit effectiveness. Internal audit has to prove that it is of value to the organization and earn a reputation in the organization (Boyle, 2003). Internal audit has to evaluate its performance and continually improve its service (Ziegenfus, 2000). Audit quality is a function of the level of staff expertise, the scope of services provided and the extent to which audits are properly planned, executed and communicated.

Internal audit quality, which is demonstrated by the office's capability to provide useful audit findings and recommendations, is one of the most prominent factors on which audit effectiveness is anchored. The performance standards of the IIA (1999b) require the auditor to plan and perform the work such that he or she would be able to arrive at useful audit findings and forward recommendations for improvement. The office's ability to properly plan, perform and communicate the results of audits is a proxy for audit quality. Therefore, audit quality is arguably a function of extensive staff expertise; reasonableness of the scope of service; and effective planning, execution and communication of internal audits (IIA, 1999b).
2.2.1 Staff Expertise

The IIA's standard 1210 on proficiency of the auditor require that the internal auditors possess the knowledge, skills and other competencies needed to perform their responsibilities (IIA, 1999). At a general extent, internal auditors’ skills can be classified into two: cognitive and behavioral (Pickett, 2000). Cognitive skills comprise of technical competences. Behavioral skills incorporate interpersonal capability and communication. These skills can significantly manipulate the quality professed by the auditees (Zain, 2006).

Technical skills make sure that auditors are more in a position to offer guidance to develop the internal control system to conduct audits, to find unswerving solutions based on preceding experiences and to handle difficult and conflicting situations (mat Zain et al., 2006; Flesher & Zanzig, 2000). Previous studies emphasized that line managers repeatedly think that internal auditors lack enough knowledge to offer useful help (Griffiths, 1999; Van Peursem 2004; 2005) and, if this happens, they fail to consider their advice, therefore reducing the efficacy and success of IA (Van Peursem 2004; 2005).

According to Smith (2005), behavioral skills are necessary to auditors to ascertain a solid relationship with their auditees; interpersonal and communication proficiency make possible the understanding of audit findings and the capacity to accomplish their tasks effectively. Furthermore, competencies exhibited by auditors, both behavioral and cognitive are capable of increasing the effectiveness of the IA team through improving the identification of their role in the organization (Smith, 2005).

Staff competence is evidently branded in the professional literature as a major element in effective audit action (IIA, 2006). Standards setters have time and again highlighted the significance of internal auditors acquiring the skills, knowledge, and other competencies needed to take on internal audit obligations and responsibilities (IIA, 2006).
Eisa (2008) determined the factors affecting the quality of the internal audit function to improve the quality of corporate governance. It has revealed that the increase of eligibility of internal auditors by increasing the level of education increases the level of professional experience, and increase the level of training and rehabilitation lead to increase the quality of the internal audit. Also the increase of objectivity of the internal auditors through increasing the degree of independence leads to increase the quality of the internal audit.

Considering the Saudi environment, but in reference to external audit, the General Audit Bureau’s (GAB) abstract reports for years 2008 and 2009 recognized lack of qualified staff as one among the major problems underlying the large number of errors and indiscretions are taking place within audited organizations. From this background, there emerges this hypothesis is formulated: ‘The superior the competence of staff working in the internal audit division (in terms of educational training, professional credentials, work experience, and ongoing professional development) the more successful the internal audit.’

### 2.2.2 Scope of Service

Study of Fadzil, F.H., H. Haron, & Jantan, M. (2005) aimed to determine if the internal audit division of the companies outlined in the Bursa Malaysia complies with the Standards for the Professional Practice of Internal Auditors IIA (2000); and, to determine if compliance to SPPIA will have an effect on the worth of the company’s internal control system. It was realized that managing internal audit department; professional aptitude, objectivity and appraisal significantly sways the monitoring feature of the internal control system. Range of work and conduct of audit work radically controls the information and communication parts of the internal control system, as conduct of audit work, professional know-how and objectivity extensively run the control environment side of the internal control system.
2.2.3 Planning

Planning is generally considered a vital audit activity and it includes preparing a strategic plan, annual plans and programs for individual audit assignments. Proper planning enables accomplishment of a large number of audits in a given period by improving efficiency (IIA, 2006 b).

Internal audit should, on at least an annual basis, develop a plan of work that it will cover to provide the required assurance to the audit committee and the board. This plan should retain some flexibility to enable internal audit to respond to new issues as they arise. The audit plan should identify how internal audit will; obtain assurance on the effectiveness of the governance and risk management processes, support the development and maintenance of governance and risk management processes, challenge the board’s assessment of risk and the controls in place to manage the identified risks, evaluate and test the effectiveness of controls in place to manage the identified risks; and co-ordinate with other sources of assurance, e.g. health and safety, external auditors, etc. (IIA, 2006).

In setting the audit plan, there should be effective dialogue between the audit committee, management, internal audit and external auditors to ensure that there is adequate assurance from all sources to cover all key business risks. Audit committees need to make clear their expectations that both internal and external auditors will communicate effectively with each other about how their respective audit plans and objectives will cover these key business risks (IIA, 2001).

The IIA’s Performance Standard 2201, Planning Considerations, states that internal auditors, in planning their work, should consider the objectives of the activity being reviewed, the risks related to that activity, the adequacy and efficacy of the activity’s risk management and control systems and, the opportunities for making significant improvements to those systems.
2.2.4 Fieldwork and Quality Review

Fieldwork involves performing the tasks identified in the audit programs to collect evidence for assessment of the auditee's current operations considering identified audit criteria. The fieldwork should be recorded in audit working papers in a consistent and standardized manner (Fraser, 2007).

2.2.5 Audit Communications

According to Van Gansberghe (2005), though audit communication takes place throughout the period of fieldwork, written audit reports are issued upon completion of audits. The auditors hold an exit conference with the auditee to discuss the audit findings in the draft audit reports. Exit meetings provide an opportunity to resolve questions or concerns of the auditee on audit findings before the final audit report is released. The reports also highlight satisfactory achievements of the auditee. This helps improve the auditees' image of the auditor and hence, contributes positively to audit effectiveness since, there is a tendency for internal auditors to be seen as critics, auditors should possess the ability to criticize wisely and motivate people to improve (Sawyer, 1995). Adding a perspective on positive aspects of the auditee's operations in the audit reports, counter the tendency of auditees to consider the internal auditors as critics.

Internal auditors play a key role in monitoring a company’s risk profile and identifying areas to improve risk management (Goodwin-Stewart and Kent 2006). The aim of internal auditing is to improve organisational efficiency and effectiveness through constructive criticism.

2.2.5.1 Timeliness of Audit Reports

Lampe and Sutton (1994) proposed using timeliness of audit reports as a measure of the internal audit’s performance. Gupta and Ray (1995) identified at least two internal audit functions at major U.S. corporations who use this measure. Ziegenfuss (1998 and 2000b) found that CAEs ranked the timeliness of audit reports as one of the top ten internal audit function (IAF) performance measures. Ziegenfuss (2000a) and Frigo (2002) propose
applying this gauge in an IAF well-balanced scorecard. Knechel and Payne (2001) summed up the literature suggesting the worth of information declines because external audit delays to complete or lags behind. The Institute of Internal Auditors (2004) Practice Advisory 2420-1, in paragraph 7, affirms; ‘Sensible communications are opportune, well timed, and convenient for careful consideration by those anyone considering recommendations. The timing of the arrangement of engagement results ought to be placed without delay and with a extent of urgency in order to make possible prompt effective action.’

Obviously, the more swiftly an IAF submits its audit report the sooner management has the chance to address the issues highlighted in the report. This is predominantly important bearing in mind the SOX section 404 requirements for successful internal control systems. Prior issuance of IAF audit statements allows these parties additional time to attend to any internal control flaws identified in the report.

2.2.5.2 Follow up of Audit Reports

A lack of common reference between the auditors and the auditee would also undermine the ease with which internal auditors could undertake follow-up on the implementation of audit recommendations. Though the management should take responsibility for the risks of not implementing the audit recommendations, it should be the responsibility of the internal audit function to follow-up the results (Walker, 2004).

Keating (1995) claims that the internal audit work is only beginning when audit reports are issued he emphasizes, that follow-up is critical to bring about audit outcomes. If follow-up is weak or absent, the impetus gained by audit recommendations will be lost and the credibility of internal audit will suffer. If follow-up is absent, highlighting the status of unresolved past audit issues could minimise its effect.

No matter how well the internal auditor has planned and performed the audit or how significant the findings, the report may fall into disuse unless the audit report is of high professional quality to motivate the readers to take corrective measures concerning the deficiencies cited. In addition, since auditors use the audit reports for a preliminary
review in subsequent audits, improved quality of the reports will have a positive contribution to the quality of subsequent audits (IIA, 1999).

Although flexibility is possible in developing audit reports, it is imperative to prepare them in a standardized format. Yet, improving quality of the reports by presenting them in a more consistent format; highlighting the recommendations for improvement separately from those seeking immediate corrective action; providing a copy of the reports to the auditee and the Top management to whom the auditee reports; and reducing the seemingly voluminous appearance of the reports, could help enhance the quality of audit communications (Goodwin-Stewart and Kent, 2006).

2.3 Management Support

2.3.1 Response to Audit Findings

Audit findings and recommendations would not serve much purpose unless management is committed to implement them. Adams (1994) used agency theory to explain that it is in the interest of management to maintain a strong internal audit department. According to Van Gansberghe (2005), the implementation of audit recommendations is highly relevant to audit effectiveness and the management of an organization is viewed as the customer receiving internal audit services. As a result, management's commitment to use audit recommendations and its support in strengthening internal audit is vital to audit effectiveness. Management support is one of the two most important factors (the other being internal audit quality) influencing audit effectiveness (Sawyer, 1995).

Walker (2004) states that where there exists an internal audit function, its position and remit originates from the requirements of the organization and ought to be positioned at the helm of the business, i.e. by the audit committee and the board. There does not exhaust a distinct model for internal audit and each organization will resolve what is apposite to suit its necessities. He says that in common, internal audit might, if granted by the audit committee, inquire about assurance that; first, the business has a formal governance process operating as projected: values and objectives are time-honored and communicated, the accomplishment of goals is supervised, accountability is guaranteed
and values are preserved. Second, significant risks within the organisation are being managed and controlled to an acceptable level as determined by the board. In addition, internal audit can be used to facilitate the strengthening of the governance and risk framework within the organisation. The audit committee also needs to consider the role that has been set for internal audit within the organisation’s overall assurance framework (Van Gansberghe, 2005).

If internal audit enhances quality to the extent it elicits management’s interest, management support would be a natural quid pro quo because the management would realize the contribution of internal audit to the achievement of organizational goals. This would positively reflect on audit quality and enhance audit effectiveness (Ridley and D’Silva, 2008). The management’s commitment to implement audit recommendations improves the operation of the auditee, as a result of which the auditee attributes would improve to the benefit of audit effectiveness. Further, management retains the authority to improve the organizational setting and influence the auditee towards a positive effect on audit effectiveness, which in turn, benefits audit quality.

2.3.2 Commitment to Strengthen Internal Audit

The Internal audit remains an imperative part of the corporate governance construction in an organization. Corporate governance comprises of those oversight activities carried out by the audit committee and board of directors to guarantee the uprightness of the financial reporting procedure (Public Oversight Board, 1993). The corporate governance literature has identified three monitoring mechanisms namely, internal auditing, external auditing, and directorships (Anderson et al., 1993; Blue Ribbon Committee, 1999) and the audit committee (Institute of Internal Auditors [IIA], 2003).

The significance of internal auditing remains underpinned by the resolution of the New York Stock Exchange (NYSE), to modify listing requirements to demand that every one of listed companies in the United States (US) comprise of an audit committee (NYSE, 2003) to coordinate amid internal, external auditors and management, ascertaining the self-determination of the audit function. There is in the US proof that the Securities and
Exchange Commission (SEC) also affixes significance to internal auditing as recently
there have been issues where enforcement dealings by the SEC and subsequent
settlements have demanded the registrant to slot in internal auditors (Carcello, J. V., D. R.
Hermanson, & K. Raghunandan, 2005).

Recent changes in Australia to the Corporations Act and the Australian Stock Exchange
(ASX) Listing Rules have powerfully emphasized the significance of good corporate
governance. Given the perceived meaning of internal audit as element of good corporate
governance, these amendments are likely to increase the task and importance of internal
audit in the environment of Australia. Despite the mounting spotlight on internal audit,
there has been minute research on the profit and magnitude of this function. Studies have
used an organization cost structure to illustrate the worth importance of the internal audit
function (e.g. Carcello et al., 2005Carey et al., 2000).

While the variables of magnitude, debt or agency are not connected to the presence of an
internal audit utility in Australian family owned organizations, internal and external audit
are utilised as monitoring substitutes by these organizations (Carey et al., 2000). A recent
US study scrutinized the extent of internal audit budgets and realized that they were
positively linked to company size; financial, service, or efficacy industries; inventory;
operating power; leverage; and audit committee analysis of the internal audit budget
(Carcello et al., 2005). Results indicated that internal audit budgets were disapprovingly
related to the percentage of internal auditing that had been outsourced. The overall ending
was that organizations facing elevated risk will amplify their organizational monitoring in
the course of internal audit, showing evidence of the significance of the internal audit
function.

In current years, high profile corporate collapses have focused interest on corporate
governance and also highlights internal auditing as element of the governance process.
The IIA sees the purpose of internal auditing as both sustaining and strengthening an
organization’s governance means and, appraise and improving the efficacy of risk
management and control (IIA, 1999).
Gramling, A. A., M. J Maletta, A. Schneider, & Church, B. K. (2004) conducted a literature review on the function of internal auditing in corporate governance. This review realized that the task of an internal audit in corporate governance has been examined using the external auditors' assessment of its quality, determinants of decision to rely, the extent and character of its work relied on by the external auditor and other part of the external audit (Gramling et al. 2004). Assessment of this literature review demonstrates that the most of the research on internal audit has been associated to the perceptions of the external auditor and if the external auditor employs the internal auditor's work.

IA has become an indispensable management tool for achieving effective control in both public and private organisations (Eden and Moriah, 1996). Control mechanisms are those processes set up to monitor and to direct, promote or restrain the assorted activities of an endeavor for the purpose of seeing objectives of that enterprise are met (Sawyer 1988; Coram, Ferguson and Moroney, 2008). By detecting flaws in management operations, IA provides a starting point for correcting deficiencies that have escaped the first line of defense, prior to these deficiencies be converted into uncontrollable or are exposed in the external auditor's report (Eden and Moriah, 1996). As an example, Coram et al. (2008) established in a sample of 324 Australian and New Zealand organizations that those with an internal audit tasks are most likely to become aware of and self-report fraud through misuse of assets than those who do not.

Recently the subject of corporate governance and committees related to it and their effects on corporate performance has been unrelenting to gain widespread distinction in the capital market economy (Dittenhofer, 2001). With respect to the corporate governance process, the expectations of stakeholders have never been higher, and examination by regulators and investors never more rigorous. Attention has turned to both the effectiveness of corporate governance and the boards of directors, but also to those committees to which liability and accountability have been delegated by the business decision-making center as it accomplishes its fiduciary obligations (IIARF, 2005).
Corporate governance is defined as the systems by through organizations are administrated and controlled. It is associated with how corporations are run generally and in fastidious with the relationship involving the organization’s management and its shareholders. In this respect, numerous control mechanisms, mostly in committees, are implemented in the organization so to monitor its management actions and functioning. As a part of significant corporate governance methods, the audit committee has an oversight purpose dealing with diverse managerial actions, corporate reporting and auditing (IIARF, 2005).

This oversight consists of ensuring the value of accounting strategies, internal controls, and independent auditors to increase control mechanisms, foresee financial risks, and support accurate, transparent, and well-timed disclosure of corporate information to different clients of the organization’s financial information. In the very developed capital markets the debate on the improvement of corporate governance frameworks has highlighted the importance of an autonomous oversight board (Goodwin-Stewart, 2006). The financial disaster of recent years depicts the significance of this oversight board in the agenda of the audit committee. Following these actions, regulatory and professional bodies pressed for the worldwide adoption of audit committees on the origin of the assertions that these committees could be successful. This calls for that the necessary measures will be adopted to assure their independence and objectivity (IIARF, 2005).

The actions assumed should counter to users’ disapprovals of the lack of confidence in transparency and value of financial reporting as well as the incapacity of external auditors to make available the safeguards expected. However, the accomplishment of corporate governance structure and associated committees differ from one country to another. While the general structure is partially set by law and partially by the various agents within the business, the environment and the regulatory bodies in each one country take part in a central role in this procedure. Corporate governance and the audit committee, like any other organizational composition, are considerably affected by the financial, cultural, legal, institutional, and political circumstances in each country (IIARF, 2005).
2.4 Organizational Setting

According to Mihret and Yismaw (2007), organizational setting refers to the organizational profile, internal organization and budgetary status of the internal audit office; and also the organizational policies and procedures that guide operation of auditees. It provides the context in which internal audit operates. Thus, organizational setting can exert influence on the level of effectiveness that internal audit could achieve.

The auditee attributes relate to the capability of the auditee to meet its intended objectives. Organizational setting includes the status of internal audit in the organizational structure; the probity of internal audit office's internal organization; budgetary status of the internal audit office; and the existence of sound established criteria to evaluate auditees' practices (Yismaw, 2007).

2.4.1 Organizational Status and Internal Organization

The internal audit function of an organization should be given a sufficiently high status in the organizational structure to enable better communication with senior management and to ensure independence of internal audit from the auditees. Independence is of paramount value in providing effective internal audit service to the management, for it affords an atmosphere of objective and uninhibited appraisal and reporting of findings without influence from the units being audited. Proper internal organization is also vital to achieve audit effectiveness. In addition, independence of individual auditors is essential to the effectiveness of the internal audit function (Xiangdong, 1997).

In relation to organisational status the relationship between internal audit and senior management is important. Investigations into the impact of this relationship on internal audit objectivity are very limited (Yismaw, 2007).

Sarens and De Beelde (2006a) employed a case study approach of five Belgian companies to look at the expectations and discernment of both senior management and internal auditors with admiration to the relationship between the two parties. They found that, when internal audit maneuver primarily in a management prop up role, there is a
deficit of perceived impartiality and the rapport with the audit committee is weak. They also found that senior management’s expectations significantly influence internal audit and that the support of senior management is critical to the acceptance and appreciation of the internal audit function within the organization.

Christopher, J., G. Sarens, & Leung, P. (2009) found that independence threats associated with internal audit’s relation with management stem from the involvement of the CEO or chief financial officer (CFO) in the internal audit function’s plan and budget, management regarding the internal auditor as a partner and using the internal audit function as a stepping stone to other positions. Van Peursem (2005) in a multiple case study of six senior internal auditors in New Zealand, realized that internal auditors’ close relationship with management can position their independence from management at risk. For example, interviewees recognised a need to balance the conflicting interests of their managers with the interests of their profession and were conscious that they have a responsibility to report over their employer’s head if necessary.

The IIA stresses that the internal audit function should be given the appropriate status in the organization to enable the function to exercise organizational independence and individual internal auditors to act objectively. This is necessary because internal auditors are in a unique position as employees of an organization with responsibility to assess and monitor conclusions made by management and, also to counsel management on the adequacy and efficacy of internal controls (Sarens and de Beelde, 2006a).

It does not surprise that internal auditors can experience extensive familiarity and social pressure arising from their relationship with management. In more recent years, audit committees have embarked on an important governance task in coordinating and managing the communications between management, internal auditors, and external auditors. Gramling et al. (2004) emphasize that “a good relationship between the IAF (internal audit function) and the audit committee also aids towards giving the IAF an suitable environment and support system for exercising its own governance related activities (e.g. compliance work, risk assessment, and control assurance)” In addition, corporate governance guidelines and listing rules explicitly recognize the governance
function played by audit committees in supporting the relationships between internal external auditors and management, (Blue Ribbon Committee, 2007; Smith Committee, 2003). As such, audit committees can be analysed as a key safeguard device for internal auditors in running their professional objectivity.

Other surveys have observed the grouping of the audit committee is associated with the strong point of the relationship between the internal audit task and the audit committee. Raghunandan, K., Read, W.J. & Rama, D.V. (2001) in a survey of US chief internal auditors reviewed the joint outcome of audit committee autonomy and proficiency on the committee’s interface with internal audit. They found that autonomous committees with at least one member possessing accounting or finance skill had longer meetings and private meetings with the chief internal auditor. Goodwin and Yeo (2007) assessed chief internal auditors in Singapore and realized that audit committees encompassed solely of independent directors had extra frequent meetings and added private meetings with the chief internal auditor. Goodwin (2003) obtained akin results in a survey of chief internal auditors working Australia and New Zealand.

In contrast, however, O’Leary and Stewart (2007), in a study of Australian internal auditors’ ethical decision making, realized that the subsistence of an effective audit committee had small impact on perceptions of internal auditors’, of their willingness to operate objectively. The participation of the audit committee in assessments to discharge the chief internal auditor is an additional indicator of internal audit liberty. Prior studies have acquired mixed results in this view. For example, Goodwin and Yeo (2007) report that 72% of audit committees in their Singapore survey were involved in discharge decisions while Goodwin (2003) realized only 52% of Australian and New Zealand audit committees were equally involved. Only Goodwin (2003) built a relationship amid dismissal decisions and the autonomy of the audit committee.

According to Goodwin (2003), studies founded on in-depth interviews of internal auditors and audit committee members imply that audit committees may reinforce internal auditors’ status thereby turn their skill to stay objective and self-sufficient.
Turley and Zaman (2007) carried out interviews with a range of personnel from a big UK financial services business (of which one contender was the head of group internal audit and another, the audit committee chair). Based on these interviews, the authors disagree that an audit committee is in a position to lay down a ‘tone’ that permits internal audit to have a definite degree of authority in the organization. As such, an effectual audit committee is observed to play a critical responsibility in supporting the internal auditor’s arrangement and strengthening internal audit autonomy.

In a similar vein, Mat Zain and Subramaniam’s (2007) survey of heads of internal audit from eleven institutions in Malaysia reflects the significance of the powerful pose of audit committees in enhancing objectivity of internal audit. The study discloses that internal auditors place noteworthy trust in audit committees to perform the key questioning role in more recognized settings. This finding elevate the possibility of a cultural effect arising from the reality that Malaysia is a high power distance country Hofstede (1981) where the cultural norm calls attention to class distinctions founded on the level of authority.

Finally, the role of audit committees serving as a potential support of internal audit is also evident in James’ (2003) study. He examined the opinions of bank lending officers with reverence to the impact of reporting composition on internal audit’s capability to prevent financial statement scheme. The study became aware that internal audit purpose that report to senior management are alleged as being in a minimal position to prevent fraudulent reporting matched up to to those departments that report exclusively to the audit committee.

Van Gansberghe (2005) states that independence of individual auditors could be achieved, inter alia, by auditor rotation and not assigning auditors to engagements with which they had executive or other relationships that are deemed to compromise objectivity, e.g. consulting auditees in design and implementation of systems. On an individual level, there are seven threats to an internal auditor’s objectivity. These are self-review, where the internal auditor reviews his/her own work; social pressure, where the
internal auditor is exposed to pressure from, say, the auditee, or others on the audit team; economic interest, resulting, for example, from inducement payments or from auditing the effort of an individual who has the power to affect the internal auditor’s employment or salary; special relationship, where the internal auditor is related to the auditee; familiarity, arising from a long term relationship with the auditee together with having worked in the division being audited; racial, cultural, and gender bias arising in multinational businesses when the auditor is prejudiced or is short of an understanding of local culture and customs; and cognitive predisposition resulting from preconceived notions or the implementation of a fastidious psychological point of view when performing the audit. (Van Gansberghe, 2005). These threats can also occur at the internal audit function level, particularly when the function is involved in both consulting and assurance activities (Goodwin, 2005).

2.4.2 Organizational Policies and Procedures

In order to make internal auditing effective, there should exist clear policies and procedures against which organizational practices are to be gauged. Also, the results of the internal audit services help improve those policies and procedures (IIA, 2006).

IA effectiveness is determined by the broader organizational environment authoritarian context and risk level of the company. The dependability of laws and regulations in connection to IA efficacy is twofold: first laws and regulations form internal audit activities. In particular in those settings where the consideration to both internal controls and internal audit is current organizations’ approaches are not based on joined routines and their (re)action can be more robustly subjective to external pressures in a procedure of external conformance (DiMaggio and Powell, 1983; Meyer, 1994). Second, in many cases the internal auditors play the role of translator of the impinging authoritarian structure. Therefore conforming to a definite regulation could ultimately influence managers’ discernment of IA work.

Finally, the risk environment might have an effect on IA efficacy again at two levels. First it can influence the activities carried out by the internal auditors. The level of
menace of business process is normally a relevant issue in notifying the audit plan, therefore determining an advanced focus on definite processes. Further, it could also favor the implementation of risk-based methods by the internal auditors. Second, the risk environment has the ability to manipulate the control environment, with explicit reference to the level of awareness of managers in relation to risk-related issues. In this, the auditees’ insight of the auditors themselves can be extensively affected (Yismaw, 2007).

There are however mitigating factors that act as safeguards against the threats to objectivity. These include organizational position and policy statements which increase the status of internal auditors in the organization, a strong and supportive governance environment, and appropriate incentive schemes which reward objectivity, the use of teams, and adequate supervision of staff (Zain, 2006).

2.5 Auditee Attributes

2.5.1 Proficiency of the Auditee

To achieve effective audit work, the auditors are required to have full and unrestricted access to all activities, records and properties, and be provided with cooperation from the auditee. Auditee attributes with implications on audit effectiveness include the auditees’ proficiency to efficiently and effectively meet organizational sub-goals; their attitude towards internal audit; and the level of cooperation provided to the auditor. Since, the four factors discussed above are intricately linked, audit effectiveness is a dynamic process that results from the effect of each factor and the interplay among all (Hass, 2006).

The current trend stresses the consequence of value-added activities and shows stakeholders’ contentment as one of the critical routine categories for IA actions (Practice Advisory 1311-2). Another flow of research communicates IA effectiveness to the productivity of IA activities (Frigo, 2002), looking at the ability of IA to respond to auditees’ needs. In this context work by Ziegenfuss (2000) has drawn attention to the
survey results of auditee contentment and the percent of approvals that are implemented are the performance procedures most suitable to assess IA effectiveness.

Relating to IA efficacy, a few authors went further to the conclusion of the audit actions (i.e. the consequence of a definite output of the audit process). According to Dittenhofer (2001), “when evaluating the efficacy of the internal auditing procedure, a positive response would be awarded when the internal auditor; audits the accomplishment of the auditees’ intention and does not identify problems, and also no problems emerge following the audit; or audits and finds troubles; and proposes solutions to the problems; and the solutions resolve the problems”. From this announcement it is clear that conclusions attend to a wide range of aspects, i.e. all the fundamentals on which audit activities have an grip on. These include both competence and efficacy of the audited procedures, and corporate performances.

2.5.2 Auditee Attitude towards Internal Audit

At the level of process, for example, the impact of IA actions has been related to cost savings created by the implementation of suggested references (Cashell and Aldhizer III, 2002). At a business level, outcome can deal with the IA contribution to business performance, such as growth, profit, or share price; or its task in the avoidance of business failures by ensuring inherent corporate governance. This last issue has been accorded particular concentration in the most recent literature. Sarens (2009) suggested that IA can be measured effective when the eminence of IA function “has a positive effect on the good feature of corporate governance”. He also goes on connecting IA quality to the “capability to monitor and progress hazard management and internal control processes”.

In fact, to improve risk management and internal control processes, the internal auditors have to convince the auditees about the quality of their work, persuading managers to implement their recommendations. The internal auditors, in most of cases, do not act on the in-house control-risk management scheme “directly”. They can make out a criticism or an area of impending improvement and present managers, accountable of business
processes, with an assessment of the internal control–risk management system. Then, managers and officers have to come to a decision whether and how to endorse internal auditors’ recommendations (Fraser, 2007).

Mihret and Yismaw (2007), highlight that audit findings and commendation would not serve much function unless there is commitment by management to execute them. Implementation of audit approval is therefore exceedingly relevant to audit efficacy (Van Gansberghe, 2005; Sawyer, 1995). The outcome that internal auditors hold on accomplishment of corporate objectives (i.e. their effectiveness) is subjective to the extent to which executives reflect on internal auditors’ work important and settle on to exploiting it. In such view, the efficacy of IA is influenced by the quality professed by the auditees.

Lampe and Sutton (1994) conducted an auditee survey that IAFs could apply to measure auditees’ insight of IAF performance. Gupta and Ray (1995) acknowledged two IAFs at major U.S. corporations who at present used such an auditee survey. Ziegenfuss (1998 and 2000b) originate that CAEs ranked auditee survey consequences as one of the top ten IAF performance dealings. Ziegenfuss (2000a) and Frigo (2002) recommend using this gauge in an IAF balanced scorecard. Evidently, management have to respect and value the occupation of its IAF for the IAF to be thriving. Auditee surveys permit IAF management to assess management reaction to its audits and concentrate on any issues that may arise.

Internal auditors rely profoundly on personal interviews between managers and employees to acquire information. It is the prime means of verifying what is pragmatic in the workplace or sum up in policy and practice manuals. Audit interviews are repeatedly organized roughly lists of in print questions designed to make out, need for compliance, organize weaknesses, working inefficiencies, or other matters. As a method of obtaining information, the internal auditor’s proficiency at interrogation is not taken seriously. But, in fact, the capacity to use questions successfully is an expertise that is little understood and hardly ever tackled in the literature of internal auditing. Questions can do greater than glean information. Questions limit personal communications. They have the ability
to focus awareness on vital issues and encourage immediate action. Questions can be applied to defuse emotional reactions, minimize conflicts, and facilitate negotiation. With the correct questions, internal auditors can present the means for auditees to convince themselves of the reliability of internal audit recommendations (IIARF, 2005).

The dependability of information, however, relies upon clear communication involving internal auditors and auditees. Useful questions eventually depend upon common understanding. Sooner or later each internal auditor run into conflicts in handling auditees (IIARF, 2005).

Misunderstandings can happen whether the audit effort is good or bad, the audit commendation are far-reaching or unpretentious, the internal auditor is unbiased or neutral. Since conflicts and errors are inevitable, it is essential to know how to handle them in methods that won’t damage future communication or hamper the execution of audit recommendations (IIARF, 2005).

When inconsistencies arise the internal auditor’s outlook is gravely important. A superior outlook or critical tone of voice can challenge even the very skillful auditor. To help guarantee an appropriate attitude the internal auditor must be reminiscent on himself that the perception of winning and losing is out of place in a variance with an auditee. The only reasonable outcome of a disagreement is compromise and cooperation so that everyone feels their requirements have been met. When an auditee is critical, hostile, disobliging, the internal auditor must remain focused on the common goals uniting the auditor and auditee the must maintain a prolific working relationship and put in to the general success of the organization (IIARF, 2005).

By having a spotlight on goals instead of obstacles, the internal auditor can preserve a positive character even when others are disobliging or hostile. Above all, the internal auditor must decist from bad behaviors that add to personal estrangement, for instance verbal ultimatums, sarcasm, or personal attacks. Just one careless or trivializing remark by the internal auditor can have the effect to destroy integrity and communicate a lack of respect for the auditee (IIARF, 2005).
According to IIARF (2005), it is solely the responsibility of internal auditors to recommend constructive suggestions and counsel on ways to develop business processes and procedures. Unfortunately, the well-intentioned recommendations by the internal auditor’s may from time to time be perceived as criticisms or yet still accusations. The natural human reaction to an alleged threat is “fight or flight.” In other words, the auditee may act in response by creating accusations in opposition to the internal auditor, or by becoming defensive and giving excuses. Either way, the skillful exercise of questions can facilitate defuse emotionally charged circumstances.

2.6 Chapter Summary

This chapter has reviewed in depth the previous studies done by other researchers on the topic in study. The chapter started by a brief introduction of the chapter followed by an in-depth discussion on the four factors identified in determining the effectiveness of the internal audit function. Internal audit quality was discussed where we looked at staff expertise, scope of service, planning, fieldwork and communication. Second management support was discussed looking into response to findings and commitment to strengthen internal audit. Third we discussed the organisation setting looking into the status and internal organisation as well as an organisation’s policies and procedures and finally we discussed the auditee attributes.

Chapter 3 will state the methodology used in the study; this includes research design, population and sampling design, data collection methods, research procedures as well as data analysis and presentation methods.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction

This chapter describes the methods and procedures used to carry out the study. It describes the research design used to carry out the research and the specific techniques under the research design. It also defines the population under study and the sampling design used including the sampling frame, technique and size. The chapter will also describe the data collection methods, research procedures and the data analysis methods.

3.2 Research Design

Research design used in this study was descriptive research. Saunders, Lewis and Thornhill (2000), argue that descriptive method is used to identify and obtain information on the characteristics of a particular issue and data collected are quantitative and statistical techniques are used to summarize the information. Cooper and Schindler (2003) adds that descriptive research describes data about the population being studied and tries to discover answers to who, what, when, where and sometimes how questions. Descriptive design was used in this study to enable the researcher collect comprehensive data on the population under study and thus provide information that is relevant and specific. According to Zikmund (2003), the major purpose of using descriptive research is to provide information on characteristics of a population or phenomenon.

3.3 Population and Sampling Design

3.3.1 Population

Cooper and Schindler (2003) define population as the total collection of elements about which the researcher wishes to make inferences. The populations under study were all of similar characteristic and these were the sixty five (65) factories managed by KTDA as well as its eight (8) subsidiaries.
3.3.2 Sampling Design

3.3.2.1 Sampling Frame

A sample frame refers to a list of elements from which the sample is actually drawn and is closely related to the population (Cooper and Schindler, 2003). The sampling frame in this study was a list of all companies under the umbrella of Kenya Tea Development Agency. The factories stand at sixty five (65), ten (10) head office departments and the company’s subsidiaries eight (8).

3.3.2.2 Sampling Technique

Saunders, Lewis and Thornhill (2003) define stratified random sampling as a technique used whereby the population into two or more strata based on some relevant attributes. A stratum is a subset of the population that shares at least one common characteristic. Babbie (2001) argues that; stratified sampling as a sampling method produces a higher degree of representation. Stratified random sampling technique was used to select the sample since. The KTDA auditees comprises of the factories which they manage as well as its subsidiaries. From the sixty five (65) factories the researcher formed seven (7) strata representing the seven (7) regions on which five (5) factories in each strata were picked using random sampling. In addition the eight (8) subsidiaries and eight (8) head office departments were sampled.

According to Sekaran (2003), stratified random sampling is the most efficient among all probability design because all groups are adequately sampled and represented and comparison among the groups is possible. It is superior to random sampling as it reduces sampling error.

3.3.2.3 Sample Size

The sample size is a list that includes every member of the population. A sample size must be carefully selected to be representative of the population so as to eliminate biasness that may arise. The 35 factories as indicated in table 3.1 under KTDA were selected using random stratified sampling according to several criteria; management by
KTDA, size of their green leaf, the size of a factory, factories with satellites and the current price at the auction.

Table 3.1: Sample Size Distribution

<table>
<thead>
<tr>
<th>Category</th>
<th>Total Population</th>
<th>Actual Size</th>
<th>% Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>KTDA managed factories</td>
<td>65</td>
<td>35</td>
<td>54%</td>
</tr>
<tr>
<td>Subsidiaries</td>
<td>8</td>
<td>8</td>
<td>100%</td>
</tr>
<tr>
<td>Head Office Departments</td>
<td>10</td>
<td>8</td>
<td>80%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>83</td>
<td>51</td>
<td>61%</td>
</tr>
</tbody>
</table>

3.4 Data Collection

Data was collected from primary source on structured questionnaires. The questions were categorized into three sections based on the research questions. Part one sought the profile of the respondents. Part two related to the evaluation of the research questions by the respondents. The final part sought any general comments by the respondents.

3.5 Research Procedure

In administering the 33 research instruments, the researcher used self administered survey by use of mails and drops and pick letters. Before administering the questionnaires, the research instruments were pre-tested by the researcher to ascertain the suitability of the tool before carrying out the research. Officials in the five of the selected factories managed by KTDA were contacted to refine the questions. With the assistance of research supervisor, the questionnaires were adjusted basing on the suggestions and experiences to be met.

The questionnaires were then administered through distribution to managers and directors in the KTDA Group and the KTDA managed factory unit managers. The Managers and
directors were given three weeks to fill the questionnaires with frequent telephone and visits done to confirm the progress of the questionnaires.

3.6 Data Analysis
The study used qualitative method of data analysis. The quantitative analyses were applied using descriptive statistics. Data was analyzed using SPSS and presented using frequency tables and pie charts. To analyze the quantitative data, frequency distribution and percentages were used. Qualitative data were organized into major themes and used to draw conclusions. The data was therefore organized by the use of frequency tables. Error margins were minimized through use of coded questionnaires according to the variable under study.

3.7 Chapter Summary
In the chapter, research methodology of the study was provided. The chapter addressed the five sections of the methodology; the research design, population and sampling design, data collection methods, research procedure and data analysis methods. The next chapter will explain data analysis, presentation and interpretation of the research findings, the chapter will give an account of the processes, techniques and procedures applied to analyze, present and interpret the data gathered using the research instruments.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction
This chapter analyses the data collected from the questionnaires and presents it in a way that conclusions and recommendations can be made from the presentation. Data analysis was done following the format of the questionnaire where the demographic information was analyzed first followed by the evaluation of internal audit quality. This was followed by an analysis of the evaluation of management support, organisation setting and auditees’ attributes. Finally, a final data analysis is done to determine if the internal audit department is effective and efficient in carrying out its duties.

Primary data was scrutinized to determine its validity, consistency and credibility before it was finally summarized. Data from the open ended questions was checked for completeness and then coded for analysis. Data was collected from employees of the various KTDA factories, subsidiaries and departments.

4.2 Respondents General Information
The questionnaire started with the general information about the respondents, their department/ subsidiary/ factory and the designation of the respondent. The study recorded a good response as the researcher managed to get six five percent of the responses from the questionnaires.

4.2.1 Profile of the Respondents
The total sample composed of 49 employees all from the accounts department. The profile of the respondents was well balanced at 74% factories, and 13% on both subsidiaries and departments and that formed a good basis of the information required. All the 14 staff members of the internal audit department responded.
4.3 Evaluation of internal audit quality

The researcher sought to evaluate on the quality of the internal audit department and this was done through questionnaires distributed to all the auditors and an interview with the Group Head of Risk and Compliance of KTDA to confirm the auditors' responses as well as a review of relevant documents.

4.3.1 Staff Expertise

The audit department had 11 auditors and 3 managers all of whom had met the minimum requirements for the positions i.e. they all had a first degree with three (3) of them having a second degree and two (2) more pursuing one. They had all met the professional qualification of a Certified Public Accountant (CPA) and they all had the relevant no of years of experience in this case five (5) years.

The average staff turnover was between 3-6 years with three (3) staff members; a manager and two (2) auditors having been in the department for more than ten (10) years. All the auditors were trained on an annual basis and a budget for this was set aside annually.
4.3.2 Scope of Service

The department carried out three (3) types of audits; Financial Audits, Compliance audits as well as Special Audit. The frequency of the audits was as follows in the past three (3) years was that Financial audits were carried out after every two years, Compliance audits were carried out annually and Special Audits were carried out on a need basis or when the client requests an audit due a lapse in controls or loss of funds.

Figure 4.2: Scope of Service and Frequency of Undertakings

4.3.3 Planning

The department had an annual plan which was approved by the audit committee. This plan was for all the three sections of the department i.e. the factories audits, Head Office and Subsidiaries and the ICT.

The achievement rate of the plan was placed at between 75% - 100% with the target being at between 80% - 90% which would ensure all the high risk areas were covered.
4.3.4 Fieldwork and quality review

According to the responses received the department did not have standardized working papers for use in fieldwork. This therefore means that each auditor used their individual work papers when carrying out their field work.

There are currently three levels of reviews for field work done by the auditors. This was by the Senior Auditors, Managers and the Head of Risk.

4.3.5 Audit Communications

Audit follow ups were a requirement by the department and they were always done. The requirement was for audit follow ups to be done within 90 days after the audit report was released.

Audit reports were released once an exit meeting had been conducted and all issues were agreed upon. Management was required to provide comments to each issue on action taken and when, this was to assist in follow up.

4.4 Evaluation of Management Support

The researcher sought to find out whether; management support in an organisation played a major role in the effectiveness of the internal audit function. Sixty Eight (68%) of the respondents indicated that management ensured that audit findings and recommendations were implemented. A majority of the respondents indicated that the internal audit team rarely reported on any fraud related issues in the course of their work. The respondents indicated that the audit committee usually met on a regular basis to discuss the auditors’ findings and the management’s actions there of.
4.5 Evaluation of Organisation Setting

The researcher sought to find out how an organisation’s setting in terms of the controls in place and flow of communication in the organisation affected the internal audit functions and its effectiveness in risk management.

According to Table 4.5, a majority of the respondents agreed that the management communicated to the employees on the importance of integrity and ethical behavior in carrying out their duties. They further stated that the organisation structure provided a framework for segregation of duties.

From Table 4.5 the clarity of the objectives of the organisation as well as the understanding of these objectives by the personnel in carrying out their duties and responsibility was not clear enough as the responses were varied.

Table 4.5 shows that a majority of the respondents indicated that there were no mechanisms to address obstacles that lead to delays/ non attainment on the achievement of the business objectives. They however agreed that appropriate policies and procedures had been developed for major processes in the organisation.
According to Table 4.5, a majority of the respondents indicated that information in the organisation was communicated effectively both up and down. Further management had established performance measures for relevant processes and internal control system evaluations were carried out on a regular basis.

Table 4.1: Analysis of Organisation Setting

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neither agree nor disagree</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management’s communication of the importance of integrity and ethical behavior</td>
<td>34%</td>
<td></td>
<td>52%</td>
<td>14%</td>
<td></td>
</tr>
<tr>
<td>The organizational structure provides the framework for segregation of duties</td>
<td>10%</td>
<td>69%</td>
<td>21%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The objectives are clear and readily understood by all the personnel taking actions and responsibility for their achievements</td>
<td>33%</td>
<td>8%</td>
<td>36%</td>
<td>23%</td>
<td></td>
</tr>
<tr>
<td>Mechanisms are in place to estimate the obstacles regarding the achievement of business objectives</td>
<td>54%</td>
<td>6%</td>
<td>36%</td>
<td>4%</td>
<td></td>
</tr>
<tr>
<td>Appropriate policies and procedures have been developed and implemented for major processes</td>
<td>2%</td>
<td>35%</td>
<td>57%</td>
<td>6%</td>
<td></td>
</tr>
<tr>
<td>Review of the functioning and overall effectiveness of controls is done periodically</td>
<td>8%</td>
<td></td>
<td>60%</td>
<td>32%</td>
<td></td>
</tr>
<tr>
<td>Effective communication both up and down within the organization</td>
<td>21%</td>
<td>7%</td>
<td>38%</td>
<td>34%</td>
<td></td>
</tr>
<tr>
<td>Performance measures for relevant processes</td>
<td>2%</td>
<td>34%</td>
<td>4%</td>
<td>56%</td>
<td>4%</td>
</tr>
<tr>
<td>Evaluations of the entire internal control system are performed</td>
<td>31%</td>
<td>4%</td>
<td>59%</td>
<td>6%</td>
<td></td>
</tr>
</tbody>
</table>
4.6 Evaluation of Auditees Attitudes

The researcher sought to find out the auditees’ attitude, towards the internal audit function and whether they assist them in improvement of their processes and hence carry out their duties appropriately.

As shown in Table 4.6.1 below, the respondents felt that the auditors’ knowledge of their operations and processes was good. They further stated that audits carried out have good coverage in terms of the organisation’s high risk areas. They felt that the duration of the audit was adequate to cover the audit scope.

Table 4.6.1 below shows that a majority of the respondents felt that the relationship between the auditors and the auditees was poor and the auditors needed to engage the auditees and to build relationships. The timing of the audits was also faulted as most of the respondent felt that they were ill timed. Further the respondent felt that the adequacy and relevance of the audit findings as well as the value of audit recommendations was fair.

From Table 4.6.1, the respondents felt that the audits carried out by the internal auditors were useful in improving their operations and controls. The also felt that the recent changes in report presentations were satisfactory.
Table 4.2: Analysis of Auditees’ Attributes

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Very Good</th>
<th>Good</th>
<th>Satisfactory</th>
<th>Fair</th>
<th>Poor</th>
</tr>
</thead>
<tbody>
<tr>
<td>13 Auditors’ knowledge of operations</td>
<td>4%</td>
<td>81%</td>
<td>15%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14 The adequacy of audit coverage</td>
<td>35%</td>
<td>61%</td>
<td>4%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 Duration of the audits</td>
<td></td>
<td>63%</td>
<td>6%</td>
<td>31%</td>
<td></td>
</tr>
<tr>
<td>16 The relationship/interaction and rapport between the Auditors and auditees</td>
<td>8%</td>
<td>36%</td>
<td>33%</td>
<td>23%</td>
<td></td>
</tr>
<tr>
<td>17 Timing of the audits</td>
<td></td>
<td>35%</td>
<td>17%</td>
<td>13%</td>
<td>35%</td>
</tr>
<tr>
<td>18 The adequacy and relevance of audit findings and value of audit recommendations</td>
<td>4%</td>
<td>38%</td>
<td>6%</td>
<td>52%</td>
<td></td>
</tr>
<tr>
<td>19 Usefulness of the audits in improving operations and controls</td>
<td>54%</td>
<td>10%</td>
<td>36%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20 Changes in report presentation on clarity, observation details, cause analysis and risk rating</td>
<td>4%</td>
<td>23%</td>
<td>38%</td>
<td>35%</td>
<td></td>
</tr>
</tbody>
</table>

4.7 Evaluation of Internal Audit’s Effectiveness

The researcher sought to find out the general feel of respondents in terms of the internal audit’s function effectiveness the results showed that generally the function was effective in the carrying out its duties. However, a majority of the respondents also stated that the auditors understanding and identification of key risks in the organisations operations was low. The respondents also felt that audits should be carried out more frequently to help in identifying risky areas and therefore enhance controls to mitigate against loss of
company's funds. Further they noted that audit findings were only communicated to managers and therefore the other employees might not feel the effectiveness of the audits.

Figure 4.4: Analysis of Audit's Effectiveness

4.8 Evaluation of Internal Audit’s Efficiency

The researcher sought to find out the general feel of respondents in terms of the internal audit's function efficiency. The results showed that 60% of the respondents felt that audits are carried out within the set time while 55% of the respondents felt that the timing of the release of the reports once the audit was done was fair.

A majority of the respondents at 75% felt that the auditors had very good knowledge in carrying out their work as auditors. In general from the responses received the internal audit’s function was efficient in carrying out their work.

Respondents felt that audits had helped improve on operations greatly and thus was a value adding exercise. They however noted that it should be a consultative audit and the
function should also offer consultancy services to the departments and companies in the Group in addition to the audits carried out.

Figure 4.5: Analysis of Internal Audit’s Efficiency

![Bar chart indicating the analysis of internal audit's efficiency with four categories: Very Good, Good, Satisfactory, Fair, Poor.]

4.9 Chapter Summary

The chapter categorically outlined the results and findings from this study. It has highlighted the major factors that influence the internal audit function’s effectiveness in risk management in KTDA. In sum, the findings support the proposed linkage between the internal audit's effectiveness in attaining its objectives of risk management through management support, the organisation's control environment and tone at the top and the auditees' attributes.

The chapter has extensively highlighted the role of management and the auditees' attributes in influencing the internal auditor's effectiveness in meeting its core objective of risk management within the organisation.

Chapter five gives a discussion, conclusion and recommendations of the findings.
CHAPTER FIVE

5.0 DISCUSSIONS, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction
This chapter discusses the research findings, conclusion and recommendations of the research study. It answers the research questions asked in chapter one. The chapter summarizes all the information gathered from the data analysis, discusses the information, draws conclusions and gives recommendations of the topic at hand.

The researcher also gives room for further research on the topic or closely related topic.

5.2 Summary
Purpose of the study
The purpose of the study was to establish the effectiveness of internal audit in risk management in KTDA (Kenya Tea Development Agency).

Research Questions
The literature review, data analysis and result interpretation were based on the following research questions:

1. How does the quality of the internal audit work done affect the identification of risk and their mitigations thereof?

2. To what extent does management support contribute to the success of the internal audit department?

3. How an organization’s setting/control environment affects internal audit?

4. Does the attitude of the auditee affect the internal audit process?

Summary of the Research Methodology
The research adopted a descriptive research design which was appropriate in establishing the state of affairs in KTDA’s internal audit’s function. The target population for this study was KTDA’s departments, factories and subsidiaries with the sample being drawn
from employees in the Group. The study allocated a sample of 35 factories, 8 subsidiaries and 7 departments allocated proportionally.

The sampling technique that was used in the study was stratified sampling and simple random sampling. Both primary and secondary data were used with questionnaires used to collect the primary data while the secondary data was gotten from the KTDA website. The coded data was analyzed using quantitative and qualitative techniques; quantitative techniques used was descriptive statistics which include weighted mean, frequency, percentages and standard deviations, qualitative techniques were content analysis. The data was presented graphically using tables and figures. The tool that was used for analysis is Statistical Package for Social Science (SPSS) and Microsoft Excel.

**Summary of the Major Findings**

The findings established that there was a major link between the effectiveness of the internal audit function in KTDA and the factors such as internal audit quality, management support, organisation setting/ control environment and the auditee attitude/ attributes.

Based on the findings internal audit quality which comprises of staff expertise, scope of service, planning, fieldwork and quality review as well as audit communications determines the effectiveness of the internal audit function and its ability to meet its objectives such as risk management.

Major findings from the study could be presented in three main points as illustrated below:

1. 68% of the respondents indicated that management ensures that audit findings and recommendations are implemented. This is an important aspect of internal audit as it ensures that recommendations made are implemented which enhances the effectiveness of internal audit.

2. 60% of the respondents showed that review of the functioning and overall effectiveness of controls is done periodically. This is important as it indicates the organisation’s commitment to risk management. 33% of the respondents however indicated that objectives of the organisation were not clearly and readily understood by all. The organisation therefore needs to ensure that there is proper communication to the employees on the overall objectives of the company and how this affects their individual objectives.

3. 81% of the respondents felt that the auditors’ knowledge of their operations and processes was good. However 23% of the respondents felt that the relationship between
the auditors and the auditees was poor. The auditors therefore need to engage the auditees and build relationships and trust as this would ensure enhanced effectiveness.

In general the auditees felt that effectiveness of the internal audit function would be enhanced more where audits are done more frequently to help in the identification of risk areas to enhance controls and mitigate against loss to the company.

5.3 Discussion
This section contains the discussions based on the major findings of the study presented in chapter 4 and is structured according to the research questions. This section will compare the findings of this study to the findings of previous studies or theoretical background presented in the literature review.

5.3.1 Effect of Quality of the Internal Audit Work Done on Identification of Risk and Mitigations Thereof
The findings of this study were consistent with Mihret and Yismaw’s (2007) audit quality is a function of extensive staff expertise; reasonableness of the scope of service; and effective planning, execution and communication of internal audits. In line with this the internal audit department in KTDA has adequately qualified employees with the minimum requirements of a 1st degree, professional qualification and the year of experience in the audit field. KTDA is a good employer as they offer stability and growth hence the employee turnover rate is between 3-6 years. There are 3 staff members from the department who have been in the company for over 10 years. In line with the staff policy all auditors are trained on an annual basis and the same is budgeted for annually. Eisa (2008) determined the factors affecting the quality of the internal audit function to improve the quality of corporate governance in that the increase of eligibility of internal auditors by increasing the level of education which increases the level of professional experience and increase in the level of training and rehabilitation lead to increase the quality of the internal audit.

The KTDA internal audit department carries out financial audits once every two years for the factories and annually for the subsidiaries, compliance audits are done on an annual basis while the special audits are done on a need basis and at the request of the clients.
In the findings we noted that the special audits were reducing on an annual basis which shows that the controls being set in place were adequate to mitigate against risk and the eventual loss of funds. Further, the organisation employees are now aware of the existence of the audit department as a compliance check and also in the assistance of improvement of controls. There was a noted reduction in the special audits in the three years under review showing that the control environment in the organisation is improving significantly. Study of Fadzil, et al (2005) found that scope of work and performance of audit work significantly influences the information and communication aspect of the internal control system.

The internal audit department carries out an annual plan as well as a risk identification exercise in the Group and its related companies. The annual plan is approved by the audit committee. This is in line with IIA (2006), which states that internal audit should on an annual basis develop a plan of work that will cover to provide the required assistance to the audit committee and the board. This plan should retain some flexibility to enable internal audit to respond to any issues as they arise. The risks identified are used as a basis for work done by the auditors while carrying out field work. According to the findings the achievement of the plan is between 75%-100% while the target for the department is between 80%-90%.

From the findings the internal audit department does not have standardized work papers mainly due to the different nature of the sections in the department. This is contrary to Frazer (2007) who says that fieldwork should be recorded in audit working papers in a consistent and standardized manner. However, during the year Senior Auditors were recruited to supervise the auditors in the different sections and it is expected that there will be standardization of work papers in the different sections.

Audit communications are done through reports to management from the internal audit department once an audit has been concluded it details the findings and recommendations thereof. Follow ups are also carried out by the team as this is mandatory and a
performance measure for each auditor. The performance standards of the IIA (1999b) require the auditor to plan and perform the work such that he or she would be able to arrive at useful audit findings and forward recommendations for improvement.

Based on the above findings the quality of the KTDA internal department is very high and within the standards set by IIA (1999b).

5.3.2 Effect of Management Support to the Success of the Internal Audit Department

The findings of this research are consistent with Van Gansberghe (2005) the implementation of audit recommendations is highly relevant to audit effectiveness and the management of an organization is viewed as the customer receiving internal audit services.

According to the findings management support of the internal audit department is evident in that management ensures that implementation of audit recommendations is done. This shows commitment to internal audit as well as to improvement of the organisations control environment. Sawyer (1995) noted that, management's commitment to use audit recommendations and its support in strengthening internal audit is vital to audit effectiveness.

It was noted that reports of fraud related issues are not common within the organisation based on the findings and this indicates a strong control environment where people are held accountable for their actions and that action is taken against any employee who carries out any fraudulent activities. Walker (2004) states that, where there is an internal audit function, its status and remit derives from the needs of the organisation and should be set at the top of the organisation. He says that internal audit should first ensure that an organisation has a formal governance process and second, ensures that significant risks within the organisation are being managed and controlled to an acceptable level as determined by the board.
The findings showed that audit committees meet on a regular basis which is an important aspect of management support to the internal audit function. The audit committee ensures the independence of the internal audit team and to strengthen the internal audit function within the organisation. According to IIARF (2005), the expectations of stakeholders with respect to corporate governance process has never been higher. Attention has turned to not only the effectiveness of corporate governance and the boards of directors but also to those committees to which responsibility and accountability has been delegated by the corporate decision-making centre as it fulfills its fiduciary duties.

By ensuring that their work goes on smoothly and ensuring that they do not experience limitation of scope due to lack of information. The audit committee also acts as a watchdog to ensure that the department meets is objectives as well as ensure management implements the recommendations of the audit team. IIARF (2005) further notes that, the financial crisis of recent years demonstrates the importance of this oversight board in the framework of the audit committee. Following these events, regulatory and professional bodies pushed to the universal adoption of audit committees on the basis of the assertions that these committees could be effective. This requires necessary measures to be taken to ensure independence and objectivity.

The KTDA internal audit function is therefore adequately supported by management in carrying out its duties and ensuring its effectiveness in risk management in the organisation.

5.3.3 Effect of the Organisation's Setting/ Control Environment on Internal Audit

The study shows that there's clear communication by management on the importance of integrity and ethical behavior. This shows that actions contrary to this communication are not tolerated by management and appropriate behaviour is taken against individuals who may go against this spirit. The respondents agreed that there is adequate segregation of duties in the organisation's structure framework and clear policies and procedures. IIA (2006) states that, In order to make internal audit effective, there should exist clear policies and procedures against which organizational practices are to be gauged. The results of the internal audit services help improve those policies and procedures.
According to the study the objectives of the organisation and the actions and responsibility of the personnel in the achievement of this objectives is clearly demonstrated and communicated to the personnel. Further this can be used as a performance measure for individual performance appraisals. However it was noted that the organisation does not have mechanisms to identify obstacles in the achievement of business objectives. According to Yismaw (2007), organizational setting includes the status of internal audit in the organizational structure, the probity of internal audit office’s internal organisation and the existence of sound established criteria to evaluate auditees’ practices.

The findings show that there are appropriate policies and procedures implemented for all major processes in the organisation. This again can be used by the internal audit function in risk identification as well as planning for audits in the organisation which enhances the function’s effectiveness in risk management. Mihret and Yismaw (2007), states that the risk environment might affect Internal Audit effectiveness at two levels: first it can influence the activities performed by the internal auditors. The level of risk of business process is generally a relevant issue in informing the audit plan, therefore determining a higher focus on certain processes. Further, it could also favour the adoption of risk - based techniques by the internal auditors. Second, the risk environment can also influence the control environment, with specific reference to the level of consciousness of managers concerning risk related issues.

From the findings we see that a review of the set internal controls is done on a periodic basis as well as its effectiveness. Management has also established performance measures which ensure that employees are aware of what is expected of them and clearly outlines duties within the organisation. Proper internal organisation is also vital to achieve audit effectiveness. In addition, independence of individual auditors is essential to the effectiveness of the internal audit function (Xiangdong, 1997).
5.3.4 Effect of the Auditees’ Attitude on the Internal Audit Process

According to the findings, it was felt that the auditors’ knowledge of the operations of the organisation was good. This is effect ensures that an audit carried out would be beneficial to the auditees’ operations as well as the organisation. According to Fraser (2007), to improve risk management and internal control processes, the internal auditors have to convince the auditees about the quality of their work, persuading managers to implement their recommendations.

It was further felt that the audit coverage and duration was adequate showing that the auditees felt that the high risk areas were adequately covered. Sarens (2009) suggested that internal audit can be considered effective when the quality of Internal Audit function has a positive impact on the quality of corporate governance. He also links internal audit quality to the capacity to monitor and improve risk management and internal control processes.

The respondents felt that the relationship between the auditor and the auditee was poor this shows that the auditors need to ensure that they engage the auditees positively to ensure that the working environment thrives as well as the function’s effectiveness and efficiency. When conflicts arise the internal auditor’s attitude is critically important. A superior attitude or critical tone of voice can undermine even the most skillful auditor. To help ensure a proper attitude the internal auditor must remind himself that the concept of winning and losing is inappropriate in a conflict with an auditee. The only satisfactory outcome of a conflict is compromise and collaboration so that everyone feels their needs have been met. When an auditee is critical, uncooperative, or hostile, the internal auditor must stay focused on the common goals that unite auditor and auditee the need to maintain a productive working relationship and contribute to the overall success of the organization (IIARF, 2005).

The findings of the research were that the audit findings and value of the recommendations were fair. However the respondents felt that the audits varied out were useful in the improvement of the organisation’s operations and controls. According to Van Gansberghe (2005) and Sawyer (1995), the effect that internal auditors have on the
achievement of corporate objectives (i.e. their effectiveness) is influenced by the extent to which managers consider internal auditors’ work valuable and decide to exploit it. In such view, the effectiveness of Internal Audit depends on the quality perceived by the auditees.

There seems to be a contradiction in the two findings which shows that there auditees’ attitude to internal audit needs to be enhanced mainly through consultative audits and ensuring that the auditee’s areas of concern are addressed adequately. According to Frigo (2002), Internal Audit effectiveness relates to the output of the internal audit activities looking at the ability of internal audit to respond to auditees’ needs. In this context work by Ziegenfuss (2000) has highlighted that auditee satisfaction and the percent of recommendations that are implemented are the performance measures most suitable to evaluate Internal Audit effectiveness.

5.3.5 Evaluation of the Effectiveness and Efficiency of the Internal Audit Department

According to the findings the risk of fraud and loss in the organisation is low and this can be attributed to the effectiveness on the internal audit function in the identification of high risk areas and ensuring mitigating controls are put in place by management to manage loss to the company. According to Eden and Moriah (1996), internal audit has become an indispensable management toll for achieving effective control in both public and private organisation. Control mechanisms are those processes set up to monitor and to direct, promote or restrain the various activities of an enterprise objectives are met. Coram et al, (2008) found in a sample of 324 Australian and New Zealand organisations that those with an internal audit function are more likely to detect and report fraud through misappropriation of assets than those who do not.

The findings further state that the rate auditors’ understanding and identification of key risks in their operations as high. Mihret and Yismaw (2007), states that the risk environment might affect Internal Audit effectiveness at two levels: first it can influence the activities performed by the internal auditors. The level of risk of business process is generally a relevant issue in informing the audit plan, therefore determining a higher
focus on certain processes. Further, it could also favour the adoption of risk-based techniques by the internal auditors. Second, the risk environment can also influence the control environment, with specific reference to the level of consciousness of managers concerning risk related issues.

The findings show that the audit team’s ability to carry out its work in the set time limits was good. According to Knechel and Payne (2001), the value of information declines as the external audit takes longer to complete or lags. However they noted that the timing of the release of reports was fair in that the audit would be carried out in good time however, the subsequent release of the report would take much longer. IIA (2004) Practice Advisory 2420-1 states that, timely communications are well timed, opportune and expedient to careful consideration by those who may act on the recommendations. The timing of the presentation of engagement results should be without undue delay and with a degree of urgency so as to enable prompt effective action.

The further showed that internal audit team were knowledgeable in carrying out their work showing that adequate training was carried out to ensure that the auditors are knowledgeable in carrying out their tasks. IIA’s standard 1210 on proficiency of the auditor require that the internal auditors possess the knowledge, skills and other competencies needed to perform their responsibilities (IIA, 1999).

5.4 Conclusion

According to the researcher, effectiveness in internal audit is critical to risk management in an organisation. The more effective the internal audit function is, the more effective is the risk management in the organisation.

5.4.1 Internal Audit Quality

The researcher concluded that the quality of the internal audit function could lead to an effective internal audit in the organisation. Staff expertise which includes professional
qualifications and relevant experience are paramount in determining the quality of an internal audit function. The scope of audits carried out is important in risk identification and mitigation and this can only be done based on the work carried out by ensuring high risk areas are identified. Planning is an essential aspect of the internal audit function as it goes hand in hand with risk identification. Field work is carried out mainly by auditors and review is carried out by the supervisors in the department. It ensures all the risks have been reviewed and an assurance of the same is communicated to the auditee. Internal audit quality is therefore Key in the effectiveness of an internal audit function in terms of the staff expertise, scope of service and the audit process.

5.4.2 Management Support
According to the researcher, management support in an organisation could lead to an effective internal audit. From the study it can be concluded that management support is essential for an effective internal audit as it ensures independence of the function as well as implementation of audit recommendations. It is also important to note that a strong audit committee is important in an organisation as it ensures that the control environment in an organisation is on track and ensures that cases of fraud are dealt with immediately and in turn setting the ‘tone at the top’.

5.4.3 Organisation Setting
The researcher found that in KTDA the organisation setting in terms of the control environment is monitored on a regular basis which in turn shows that risk identification and mitigation is carried out. Further communication of the organisation’s objectives is carried out and communication up and down in the organisation is clear. It can therefore be concluded that an organisation’s control environment is essential in the effectiveness of internal audit.

5.4.4 Auditees’ Attitude
From the study it can be concluded that the attitude of the auditees towards internal audit needs to be improved in that they felt that their relationships with the auditors was not
conducive. Auditors therefore need to ensure that they engage the auditees positively as this would ensure that they are more effective in carrying out their duties. This will in turn ensure that the auditee has the right attitude towards audit for the process to be effective.

5.5 Recommendations

5.5.1 Recommendations to the Study

The effectiveness of internal audit in risk management is determined by various factors such as the quality of internal audit, management support, the organisation setting/control environment and the auditees’ attitude towards internal audit. Indeed these factors play a crucial role in the internal audit function.

The researcher found that a positive relation between all the above named factors could lead to an effective internal audit and risk management in the organisation. The researcher would therefore recommend the KTDA internal audit function to that these factors are taken into account when performing their duties as these factors would ensure their maximum effectiveness in meeting their objectives in the organisation’s risk management. Risk management is a concept that has mitigated on loss of funds in many organisations.

5.5.1.1 Internal audit Quality to Enhance Effectiveness of Internal Audit

Quality of the internal audit function is paramount in the effectiveness of the function. Staff expertise through proper recruitment and training, scope of service to ensure high risk areas are addressed and the audit process from planning to audit communications.

The researcher’s recommendations to the KTDA internal audit function is to standardize the working papers to ensure that the audit procedures carried out are all inclusive and addresses all the areas of the audit.

The annual plan achievement should be targeted to be 100% to ensure all risk has been identified and addressed. Further the reports released from the department should ensure that the needs of the auditees are addressed, ensure that the recommendations are relevant and appropriate as well as ensure that the positive aspects are documented and praised.
5.5.1.2 Management Support to Enhance Effectiveness of Internal Audit

According to this analysis, KTDA’s management has ensured that there’s adequate support to the internal audit function to enable it to carry out its duties. In the researcher’s view the implementation of audit recommendations is encouraged by management and this is done in the organisation therefore managing risk.

The researcher’s recommendation would be for management to go ahead and ensure that implementation of audit recommendations is part of the employees’ performance appraisals to further enhance implementation. Further management should be encouraged to always give responses on audit findings by the audit team.

5.5.1.3 Organisation Setting to Enhance Effectiveness of Internal Audit

The researcher would recommend for mechanisms to be established to estimate the obstacles regarding the achievement of business objectives so as to ensure that there’s proper monitoring and any obstacles can be detected and corrected in time. This can be through periodic evaluation of the achievement of the business objectives set and the impediments to their achievements. This will mitigate against business risk which is inherent in any organisation.

5.5.1.4 Auditees’ Attitude to Enhance Effectiveness of Internal Audit

Auditees’ attitude is crucial to the effectiveness of internal audit in that without the cooperation of the auditee the audit process would not be effective. Audit cannot be carried out without information and this information is from the auditee.

The researcher’s recommendation would be for the internal audit team to put more effort in cultivating relationships with the auditees. To ensure that the auditees trust them and to ensure that they value the work done by the auditors. The auditors should ensure that the
auditees feel comfortable with their presence and appreciate that audit is for the good of the organisation and not used to victimize people. Further auditors need to ensure that the recommendations made in audit reports are workable recommendations for the auditees. Further good deeds should also be documented and recognized in the audit reports.

5.5.2 Recommendations for Further Research

In order to ensure effectiveness in risk management by internal audit, further research should be conducted on the risk from information technology. Information Technology is the way forward for most organisations and especially KTDA where processes are being automated to minimise errors and enhance efficiency of the organisation. In order to ensure effectiveness in risk management the ICT risk aspect needs to be addressed and mitigating controls put in place.
REFERENCES


APPENDICES

APPENDIX I: COVER LETTER

UNITED STATES INTERNATIONAL UNIVERSITY-AFRICA
P.O. BOX 14634, 00800.
EMAIL: esmburus@yahoo.com
TELEPHONE: 0721351596 / 0725015590
NAIROBI, KENYA

Dear Respondent,

I am carrying out a research on the internal audit effectiveness in risk management in KTDA. This is in partial fulfillment of the requirement of the Masters Degree in Business Administration (MBA) at the United States International University.

This research uses the employees and directors for the companies under the management of KTDA and all its subsidiaries for its studies and you have been selected since you fulfill the criteria and I believe that you are capable of providing the study with valuable information. The result of this study will provide my research and various other interested parties the necessary information for evaluating on the effectiveness of the internal audit in risk management in the organisation.

This is an academic research and as such confidentiality is strictly emphasized. Your name will not appear anywhere in the report. I kindly ask to put apart some time to complete the questionnaire attached. Once completed, I will pick up the questionnaire personally. If you wish to have a copy of the full report once completed please inform me.

Thank you in advance.

Yours sincerely,

Esther W. Mburu
APPENDIX II: QUESTIONNAIRE

Questionnaire - Subscriber

This questionnaire is divided into six short sections that should take only a few moments of your time to complete. Please respond by ticking the appropriate box or filling in your answers in the blank spaces provided. Thank you.

SECTION A: DEMOGRAPHIC PROFILE OF RESPONDENTS
Department/Subsidiary/Factory .................................................................
Designation .............................................................................................

SECTION B: EVALUATION OF INTERNAL AUDIT QUALITY (To be answered by the Risk and Compliance Department)

1. How many of the auditors meet the minimum requirement for the positions held

   No. of auditors

   First Degree ......................................................

   Professional Qualification ..........................................

   Relevant No. of yrs of experience ..............................

2. What is the average employee turnover rate?
   □ 1-3 Years
   □ 3-6 Years
   □ 6-10 Years
   □ Over 10 Years

3. How often are auditors trained?
   □ Semi annually
   □ Annually
   □ Never
4. What types of audits are carried out?

- Financial Audit
- Compliance Audit
- Performance Audit
- Special Audit *Explain*

5. How regular are these audits carried out?

- Weekly
- Monthly
- Semi-annually
- Annually
- Other

6. What kind of audit plan does the department have?

- Monthly Plan
- Semi Annual Plan
- Annual plan
- 5 yrs plan
- Other *Explain*

7. What is the achievement rate of the plan?

- 100%-75%
- 75%-50%
- 50%-25%
- Below 25%
8. Are the audit working papers standardized?
   - Yes
   - No
   - Maybe: Explain.

9. How many levels of review are there?
   - One
   - Two
   - None
   - Other: Explain.

10. How often are audit follow ups done?
    - Always
    - Usually
    - Never
    - Rarely
    - Don’t Know

SECTION C: EVALUATION OF MANAGEMENT SUPPORT

<table>
<thead>
<tr>
<th>Evaluate the following marking X</th>
<th>Always</th>
<th>Usually</th>
<th>Never</th>
<th>Rarely</th>
<th>Don’t Know</th>
</tr>
</thead>
<tbody>
<tr>
<td>11. How often does management ensure implementation of audit findings</td>
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<td>12. How often has internal audit reported any fraud related issues</td>
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<tr>
<td>13. How often does the audit committee meet</td>
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</tbody>
</table>
### SECTION D: EVALUATION OF ORGANISATION SETTING

<table>
<thead>
<tr>
<th>Evaluate the following marking X</th>
<th>Strongly disagree</th>
<th>Disagree</th>
<th>Neither agree no disagree</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>14. Management frequently and clearly communicates the importance of integrity and ethical behavior</td>
<td></td>
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<td>15. The organizational structure provides the framework within which the segregation of duties is determined</td>
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<td>16. The objectives are clear and readily understood by all the personnel taking actions and responsibility for their achievements</td>
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<td>17. Mechanisms are used in order to estimate the obstacles regarding the achievement of business objectives</td>
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<td>18. Appropriate policies and procedures have been developed and implemented for each of your factory/department/subsidiary major processes</td>
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<td>19. Review of the functioning and overall effectiveness of controls is done periodically</td>
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<td>20. Information is communicated effectively both up and down within the organisation</td>
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<td>21. Management has established performance measures for relevant processes</td>
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<tr>
<td>22. Evaluations of the entire internal control system are performed</td>
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</tbody>
</table>
SECTION E: EVALUATION OF AUDITEES ATTITUDES

Evaluation Criteria

<table>
<thead>
<tr>
<th></th>
<th>Poor</th>
<th>Fair</th>
<th>Satisfactory</th>
<th>Good</th>
<th>Very Good</th>
</tr>
</thead>
<tbody>
<tr>
<td>23</td>
<td>How would you rate the Auditors’ knowledge of your operations?</td>
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<td>24</td>
<td>How would you rate the adequacy of audit coverage</td>
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<td>25</td>
<td>How would you rate duration of the audits</td>
<td></td>
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<tr>
<td>26</td>
<td>How would you rate the relationship/interaction and rapport between the Auditors and your Department/Subsidiary/Factory?</td>
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<tr>
<td>27</td>
<td>How would you rate timing of the audits?</td>
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<tr>
<td>28</td>
<td>How would you rate the adequacy and relevance of audit findings and value of audit recommendations?</td>
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<tr>
<td>29</td>
<td>How useful were the audits in improving operations and controls?</td>
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<tr>
<td>30</td>
<td>How do you rate recent changes in report presentation on clarity, observation details, cause analysis and risk rating?</td>
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</tbody>
</table>
EVALUATION OF EFFECTIVENESS

<table>
<thead>
<tr>
<th></th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>31</td>
<td>Has there been any fraud related cases due to lack of controls set in place how would you rate the risk on a scale of 1-5. 5 being the highest risk</td>
<td></td>
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<tr>
<td>32</td>
<td>Has there been loss to the company due to lack of controls how would you rate the loss. The highest loss being 5</td>
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<tr>
<td>33</td>
<td>How would you rate the auditor’s understanding and identification of key risks in your operations?</td>
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</tbody>
</table>

EVALUATION OF EFFICIENCY

<table>
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<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
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<tbody>
<tr>
<td>34</td>
<td>How would you rate the ability of the audit team to carry out its work in the set time limits?</td>
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<tr>
<td>35</td>
<td>How would you rate the timing of the reports released by internal audit?</td>
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<tr>
<td>36</td>
<td>How would you rate the knowledge of the internal audit team in carrying out their work?</td>
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</tbody>
</table>

SECTION F: GENERAL EMPHASIS OF EFFECTIVENESS ON INTERNAL AUDIT

37 From the above (where rating is equal to or less than 3), do you have any specific suggestions about how the Risk Assurance & Compliance Department can improve the audits? If so, please list the suggestions below.

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73
Any Other Additional Comments or suggestions.

Thank you for your time and cooperation.