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THE IMPERATIVES OF INTERNAL AUDIT IN NIGERIAN BANKS: ISSUES AND PROSPECTS

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ABSTRACT

Many have argued that internal audit plays a pivotal role in enhancing corporate performance in organizations (Oseni, 1994 and Lav, 2004).This is the focus of this paper, using Nigerian recapitalized banks as a reference point. This paper empirically evaluates the relationship between internal audit and corporate performance. In pursuance of this, a survey sampling of the banks was conducted. The dependent variable was corporate performance that was measured by return on total assets (ROTA).The independent variables were the motivation of internal audit staff and the efficiency of internal controls. The data collected for the variables were subjected to the ordinary least square (OLS) regression analysis. The results indicated that motivation of audit staff positively affect bank's corporate performance; and the efficiency of the internal control was also positively related to corporate performance. It is therefore recommended that Nigerian banks should professionalize the audit departments to optimize the objectives for which they are established

KEYWORDS: Internal Audit, Corporate Performance, Motivation, Internal Control Efficiency, Internal Audit Staff

INTRODUCTION

Betty (1975) describes auditing as a branch of accounting concerned with the efficient use of resources to achieve a previously determined objective or set of objectives contained in a plan. Obazee (1997) describes internal auditing as the whole system of auditing, financial and otherwise, intended to secure management information and reliability of accounting records.

Given the introductory definition, banks form the chief cornerstone of any financial system, and indeed of the economy of a nation. At the heart of banking, is the audit function; this is evident by the fact that all other departments are linked with the internal audit department. The importance of internal audit system cannot be overemphasized where a variety of requirements, processes that are both manual and information communication technology-based (ICT) are used. Organizations have recognized internal audit function as a tool for ensuring effective workings of the internal control system. Okolo (2001) describes the internal audit function as an aspect of control mechanism, within a business, manned by specially assigned staff.

However, in Nigeria, the audit function in the banking sub-sector has not been fully tapped; consequently, cases of errors and intent to defraud and other fraud cases exist in the banking industry. It is therefore no wonder that the distress in the banking sub-sector in the nineties reflected lack of effective control mechanism of the audit function in the banking industry. The experiences of failed banks in Nigeria, and other nations, have called for the reinforcement of internal audit and the strengthening of the controls system in the Nigerian banks. This becomes relevant, given the fact that the banking institution is critical to the survival of any economy.

In the light of the above, this paper empirically evaluates the impact of internal audit on corporate performance.

LITERATURE REVIEW

In today's volatile business environment, banking sub-sector in Nigeria faces a wide array of complex business challenges. These

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challenges come in the form of regulatory compliance, litigation, competitive market pressure, changing technology, investors demand, corporate governance, business ethics and accountability. In a business environment, anyone given the opportunity and the environment can commit fraud. The internal audit staff, in a non-automated or particular environment, may be ill-positioned to investigate fraud. It is established that an internal audit staff who is professionally certificated with the right motivation and training can contribute to the efficiency and effectiveness of the audit department.Oseni's (1994) findings reveal that an effective internal audit function reduces overheads, identify ways to improve efficiency and minimize exposure to possible losses.

According to Lav (2004), the internal audit provides an independent and objective appraisal of activity for management. Katz (2002) summarizes the core activities of the internal audit as *analysis of data, recommendation, counsel and information activities.* He argues that these activities operate to accomplish the mission of banking, currency management, and customer service. Young (2005) finds out that the internal audit functions assist management in achieving bank's financial and operating goals by evaluating controls, identifying weaknesses, and providing recommendations through complete and unrestricted access to records, property and personnel.

Katz (2002) maintains that internal auditors in the banking sub-sector, until recently, had focused mostly on broad corporate controls and risk. He however argues in favour of having an internal unit that has all the coordinated methods and measures intended to safeguard organization's assets, check the accuracy and reliability of accounting data with emphasis on micro or individual controls at the level of transaction. To achieve this, it is argued, internal audit function be placed under the supervision of a committee of the board to ensure independence, promote effectiveness of the function rather than the control and direction of management. This function, according to Qslerguard (2000), should be complemented by ensuring that the audit staffs do not perform functions and responsibities outside the traditional functions of the audit staff.

On the effective discharge of audit functions, Lav (2004) summarizes his findings and suggests, along the line of his summary, those who could bring about an effective audit. This includes those with requisite technical, specialist and financial reporting knowledge. Lav (2004) believes that since different audits exist, general, broad-based and technical training is required in the performance of jobs involving bank-related audits, including financial audit, compliance audit, operational audit, information technology audit, management audit, regularity audit and value-for-money audit.

According to Ion-Bogdan (2004), financial audit addresses questions regarding accounting and the propriety of financial transactions; compliance audit determines the level of adherence to legal constraints, policies and procedures. Katz(2002) sees information technology audit as the evaluation of systems processing controls, data security, physical security, systems development procedures, contingency planning and systems requirements. Howard (2002) and Lav (2004) define management audit as the review of an independent and objective management's capabilities, skills and potentials, especially during planned change. While regularity audit verifies that expenditure has been approved in accordance with statutory and other regulations and authorities governing them (Lav, 2004). Value for money audit ensures an examination of the economy, efficiency and effectiveness in a given quantum of expenditure. Oseni (1994) corroborates these components of value-for-money audit (Obazee, 1997); and audit in banks flowing from the integrated elements of economy, efficiency and effectiveness, harps on accountability (Obazee, 1997).

Internal audit independently reviews and evaluates the adequacy of the system of internal controls and makes recommendations to management to improve these controls. Young (2005) categorizes these controls into administrative and accounting controls. Administrative controls relate to controls designed to promote operational efficiency, effectiveness and adherence to banks' policies and procedures. Accounting controls are designed to safeguard the bank's assets and ensure the accuracy of financial records

MODEL SPECIFICATION AND METHODOLOGY

The following specif--ied models were used to test the relationship stated in the hypotheses;

Model i: coop = α_{one} + β_{one} motd + U_t;

Model ii: coop = α_1 + β_2 audintcon + U_t;

Model iii: coop= α_1 +β_1 motd + β_2 audintcon + U_t;

α_1, α_2 and β_1, β_2 > 0; β_1 and β_2 are the parameters to be estimated and U_t is the error term.

Where (expected sign is in parenthesis)
Coop = Corporate performance proxied by Return on Total Assets (ROTA)
Motd (+) = motivationally-trained auditors represent internal auditors who are constantly motivated and trained in order to impact positively on corporate performance
Audintcom (+) = internal audit with an efficient internal control system;
In this study therefore, we hypothesize that:

H_1: The motivationally trained internal auditors (motd) positively affect corporate performance.

H_2: The efficiency of internal control system (audintcon) positively affects corporate performance.

H_3: The joint reaction of motd and audintcon positively affect corporate performance

The hypotheses were tested at five percent (5%) level of significance. The models specified above were used to explain the relationships. The dependent variable in each of the models i, and ii was corporate performance (coop) while the independent variables were motd and audintcon, both indicating motivation and efficiency respectively.

A cross-sectional survey research design was adopted for this study. With this design, the current views on a number of issues relating to the performance variables and internal audits of the sampled Nigerian banks were sought.The population of study includes all the twenty five recapitalized banks in Nigeria but with the sample size of seventeen (17) banks spread around Benin City, in Edo state and Warri in Delta state. The judgmental sampling method was used. Essentially, data were collected through the questionnaire, personal interview of audit staff, and auditors, and personal observation. In all, one hundred and sixty (160) copies of questionnaire were distributed and one hundred and fifty copies of questionnaire collected. The responses were synthesized for the inferential analysis

ANALYSIS Of DATA AND DISCUSSION OF RESULTS

The initial ordinary least square (OLS) result for the 17 (seventeen) branches of the twenty five banks was obtained as follows:

Table 1: Results of computer estimate of relationship between motivationally trained staff and corporate performance

Regressor	Coefficient	Standard Error	T-ratio
Intercept	-0.04	0.028	-1.3
motd	0.93	0.06	15.09*

* significant at 5%

coop=0.04+0.93 motd
(-1.3) (15.09)*

Where: R2=0.997;F-stat=52.58;D.W.stat=2.2.
The t-ratios are presented in parenthesis under the coefficients.

From the value of the R^2 (in table 1) which is 0.99, it shows that about 99% of the systematic variable in coop can be explained by the motd. The F-statistic of 52.6 is high, showing that there is a linear relationship between coop and motd-a relationship that the motivation of audit staff positively influences bank's corporate performance. Besides, motd passes its apriori sign, showing that there is a positive relationship between coop and motd. The t-value of 15.09(see table1 or appendix 1) is highly significant, thereby passing the significance test at the 5% level. A major revelation in this result is that the motd, operating independently, is a determining variable that influences the behaviour of coop in the bank. In specific further terms, a unit increase in motd will lead to about 0.93 units use in coop of the bank. The DW statistics of 2.2 calculated is the autocorrelation and the benchmark of 1.8 (Koutsoyiannis, 1977)

Table 2: Relationship between internal audit with a functioning internal control and corporate performance

Regressor	Coefficient	Standard Error	T-ratio
Intercept	-0.28	0.22	1.27
Audincon	0.24	0.48	0.51

* Significant at 5%

coop=-0.28 + 0.24audintcon
(1.27) (0.51)

Where R^2=0.40; F-stat. =0.55; D.W. stat. =2.11.

The t-values are reported in parenthesis below the coefficients.

In table 2, the DW-statistic of 2.11 shows the absence of serial correlation...The R^2 is low, having a value of 0.40 (or 40%), showing that about 40% of the variation in coop can be explained by audintcon. The F-value which is

0.55, indicate that Audintcon did not show a significance test at the 5% level, against the critical region of 18.The t-valve of audintcon (0.51) is also very low hence failing the significance test at 5%

Table 3: Joint reaction of motivationally trained staff (motd) and internal audit with a functioning internal control (audintcon) on corporate performance

Regressor	Coefficient	Standard Error	T-ratio
Intercept	0.90	0.16	0.56
Motd	0.63	0.29	-2.2*
Audintcon	1.32	0.34	3.8*

* significant at 5%

coop = 0.09-0.63motd+1.32 audintcon
(0.56) (-2.2) (3.8);

Where R^2 = 0.70;DW = 1.95; F-value (7, 4) = 1.33(see appendix 3)

The t-ratios are reported in parentheses below the coefficients. The R^2 of 0.70(or 70%) shows that about 70% of the total variation of coop is explained by the independent variables of motd and audintcon. motd was positively related to coop at 5% level of significance and audintcon was positively related at 5% level of significance. The F-value of 1.33 implies that the two independent variables considered together did not explain a significant amount of variation in coop. The DW of 1.95 shows the absence of serial correlation, which means that the error term agrees with the OLS estimation.

However, motd has an inverse relationship with coop while audintcon has a positive impact on coop. The t-value of -2.17 and 3.83 for motd and audintcon respectively, pass their t- test at the 5% level of significance, when compared with the t- critical values of 2.15. These shows that the two variables (independent variables) are major determining factors that influence the behaviour of coop.

SUMMARY OF FINDINGS AND CONCLUDING REMARKS

The data presented and analyzed reveal that motivationally trained staffs have a positive relationship with the bank's performance.This finding is consistent with the position of Okolo(2001). This is expected as staff motivation in terms of promotion, training, good packages, and other incentives, among others, could lead to high productivity. Besides, internal audit with an efficient internal control system positively impacts on corporate performance. The internal audit department functions, under the policy established by the banks, as a watchdog. Expectedly, it was found that there are functioning internal controls and regulations that support the internal audit department, which reflect the provision of the operational manual of internal audit in banking organizations, including Nigerian Banks.

Based on these findings, some fundamental policy implications are discernable: principal among them is that the policy of motivating staff should be encouraged in all organizations. This becomes a welcome position as staffs of the internal audit are seen to be value drivers, creating wealth for the organization. However, such a policy would be fortified by embracing core competency model which entails that professional staff be retained in the audit departments. The management should consider the qualities of the internal audit staff and sustain the use of professionally qualified staff to handle the technical aspects of the audit functions. This will improve and sustain the quality of work and the degree of reliance placed on such work by the external auditors.

We advocate that the internal audit staff should be properly motivated. The internal audit should not be a dumping ground for the 'never-do wells' or those without godfathers; but rather the internal audit should be made up of top-of-the-pack employees to make internal units of banks effective and efficient in order to achieve corporate goals

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APPENDIX 1

Cochrane-Orcutt Method AR (7) converged after 39 iterations

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Dependent variable is coop
17 observations used for estimation from one to 17

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Regressor	Coefficient	Standard Error	T-Ratio [Prob]
INPT	-.035868	.027683	-1.29571[.215]
motd	.92777	.061500	15.0856[.000]

****

R-Squared	.99763	R-Bar-Squared	.97865
S.E. of Regression	.032212	F-stat. F (8, 1)	52.5792[.106]
Mean of Dependent Variable	.38971	S.D. of Dependent Variable	.20196
Residual Sum of Squares	.0010376	Equation Log-likelihood	31.6776
Akaike Info. Criterion	22.6776	Schwarz Bayesian Criterion	18.9282
DW. Statistic	2.2100		

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Parameters of the Autoregressive Error Specification

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	Coefficient	Asymptotic T-Ratio
U(- 1)	-1.5251	*NONE*
U(- 2)	-1.4062	*NONE*
U(- 3)	-.99707	*NONE*
U(- 4)	-.18298	*NONE*
U(- 5)	-1.2082	*NONE*
U(- 6)	-.1526	*NONE*
U(- 7)	-1.0792	*NONE*

WARNING The above autoregressive process is unstable!
T-ratio (s) are not calculated.

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APPENDIX 2

Cochrane-Orcutt Method AR(5) converged after 8 iterations

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Dependent variable is coop
17 observations used for estimation from 1 to 17

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Regressor	Coefficient	Standard Error	T-Ratio [Prob]
INPT	.28046	.22093	1.2694 [.224]
audintcon	.24490	.48172	.508381 [.619]

****

R-Squared	.39795	R-Bar-Squared	- .32450
S.E. of Regression	.23325	F-stat. F (6, 5)	.55084[.756]
Mean of Dependent Variable	.38971	S.D. of Dependent Variable	.20196
Residual Sum of Squares	.27202	Equation Log-likelihood	5.6935
Akaike Info. Criterion	-1.3065	Schwarz Bayesian Criterion	-4.2228
DW. Statistic	2.1107		

****

Parameters of the Autoregressive Error Specification

	Coefficient	Asymptotic T-Ratio
U(- 1)	.037622	.084039[.935]
U(- 2)	-.49830	-.98621[.347]
U(- 3)	.032742	.076110[.941]
U(- 4)	-.38705	-.95937[.360]
U(- 5)	-.086299	-.18948[.854]

* Tests Statistics *	LM Version *	F version *
* A: Serial Correlation *	CHSQ (1) = *NONE*	* F (1, 14) = *NONE* *
* B: Functional Form *	CHSQ (1)= *NONE*	* F (1, 14)= *NONE* *
* C: Normality *	CHSQ (2)= *NONE*	* Not applicable *
* D: Heteroscedasticity *	CHSQ (1)= *NONE*	* F (1, 15) = *None* *

A: Lagrange multiplier test of residual serial correlation
B: Remsey's RESET test using the square of the fitted values
C: Based on a test of skewness and kurtosis of residuals
D: Based on the regression of squared residuals on squared fitted values

APENDIX 3

Ordinary Least Square Estimation

Cochrane-Orcutt Method AR(5) converged after 7 iterations

Dependent variable is COOP
17 observations used for estimation from 1 to 17

Regressor	Coefficient	Standard Error	T-Ratio (Prob)
INPT .	.902413	.16429	.56251[.583]
motd	-.63177	.29178	-2.1652[.048]
audintcon	1.3221	.34490	3.8333[.002]

R-Squared	.69957	R-Bar-Squared	.17381
S.E. of Regression	.18422	F-stat. F (7, 4) .	1.3306[.413]
Mean of Dependent Variable	.38971	S.D. of Dependent variable	.20196
Residual Sum of Squares	.13574	Equation Log-likelihood	9.8641
Akaike info. Criterion	1.8641	Schwarz Bayesian Criterion	-1.4687
DW-Statistic	1.9497		

Parameters of the Autoregressive Error Specification

	Coefficient	Asymptotic T-Ratio
U (- 1)	-.20014	-.62481 [.548]
U (- 2)	-.10069	-.48220 [.641]
U (- 3)	-.034292	-.17700 [.863]
U (- 4)	-.63821	-3.5186 [.007]
U (- 5)	.19742	.62399 [.548]