

Internal Audit Effectiveness and its Determinants: A Conceptual Analysis from Selected Private Banks in Mekelle City

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ABSTRACT

An effective internal audit function is one of the foundations of good governance in banks due to their inherent vulnerability to risks and the ever-increasing regulatory compliance demands. This paper presents a conceptual and partially empirical investigation of the effectiveness of internal audit in private commercial banks in Mekelle City, Ethiopia. Descriptive evidence from a survey of 130 valid responses (out of 134 collected) from internal auditors and branch managers supports the conceptual analysis. Drawing on agency, institutional, and communication theories, the paper proposes six key determinants: organisational independence, the competence of audit staff, the quality of audit work, management support, the audit charter, and the audit committee. Management support, auditor competence, and quality of audit work emerged as the most influential determinants. It is hoped that this paper will add to the body of knowledge connected to internal audit in developing countries.

Keywords: Internal audit effectiveness, Management support, Auditor competence, Ethiopian banks, Corporate governance

INTRODUCTION

The role of internal auditing has evolved from a compliance-oriented function to a strategic partner in governance and risk management. Internationally, internal auditing is involved in providing assurance on key matters related to risk mitigation and governance processes (IIA, 2010). In Ethiopia, despite ongoing financial sector reforms, the effectiveness of internal audit remains inconsistent across institutions (Belay, 2007; Mihret & Yismaw, 2007).

Private commercial banks in Mekelle City play a significant role in the region's economic growth. However, their internal audit functions face challenges related to limited staff capacity, insufficient independence, and inconsistent management support. These threaten the internal audit departments' potential to contribute to governance and risk management.

Results of the existing studies in the context of Ethiopia reveal discrepancies. Meseret (2016) and Kebede (2017) identified management support and independence as critical factors, whereas Nebiat (2022) found management support statistically insignificant. Samuel (2023) highlighted audit charters and independence, while Mihret (2020) reported no significant relationship between independence and effectiveness.

Research GAP: In spite of the increasing number of publications in the field of literature, there is little convergence of conceptual and empirical knowledge specifically focused on the situation in the Ethiopian commercial banking sector. Most previous studies focused on isolated determinants without integrating theoretical and descriptive insights. This paper fills this gap as it combines conceptual knowledge with descriptive knowledge to study the determinants of internal audit effectiveness in private banks in Mekelle City.

Conceptual Framework

Theoretical Foundations

Agency Theory: The internal audit function serves as a monitoring mechanism to reduce information asymmetry between management (the agents) and shareholders (the principals) (Adams, 1994). The role of agency theory in Ethiopian banks is highlighted by the importance of firm independent audits, aligning interests and agency costs.

Institutional Theory: Audit practices are shaped by organisational norms, regulatory frameworks, and external pressures. According to global standards, the International Professional Practice Framework (IPPF) can be taken as the effectiveness standard for audit practices (Mihret et al., 2010). The apex body, the National Bank of Ethiopia, influences the adoption of audit practices in the Ethiopian context.

Communication Theory: The success of an internal audit is significantly dependent on effective communication between auditors and auditees. Effective communication ensures that the results attained from audit activities direct improvement efforts (Endaya & Hanefah, 2013). This is particularly relevant in hierarchical contexts like Mekelle, where cultural and structural barriers may impede open communication.

Determinants of Internal Audit Effectiveness

This section gives a detailed examination of six determining factors, bringing together theoretical perceptions, global evidence, and contextual relevance to Ethiopian private banks.

1. Organisational Independence: It is demarcated as the freedom of the audit function from operational intrusion and its direct reporting to the board or audit committee (IIA, 2024). As per the agency theory, independence reduces moral hazard and enhances credibility. In Ethiopia, however, executive influence often compromises independence (Samuel, 2023). Without it, audit findings do not have any validity.

2. Competency of Audit Staff: Includes technical knowledge, skills for analysis, and professional certifications that are required for assessing the complex nature of risks. According to Alzeban & Gwilliam, 2014, institutional theory further emphasizes the relevance of such competencies with the inclusion of global standards that are achievable through training. In Mekelle, although 72.3% of the respondents had more than 5 year of experience, the limitation towards acquiring international certifications curbs substantial strategic input.

3. Quality of Audit Work: This encompasses the whole audit cycle of planning, fieldwork, reporting, and follow-up done with rigor and in conformance with the IPPF standard (Cohen & Sayag, 2010). Communication theory emphasizes that a quality report should be clear, evidence-based, and actionable. However, resource constraints in Ethiopian banks often compromise follow-up activities.

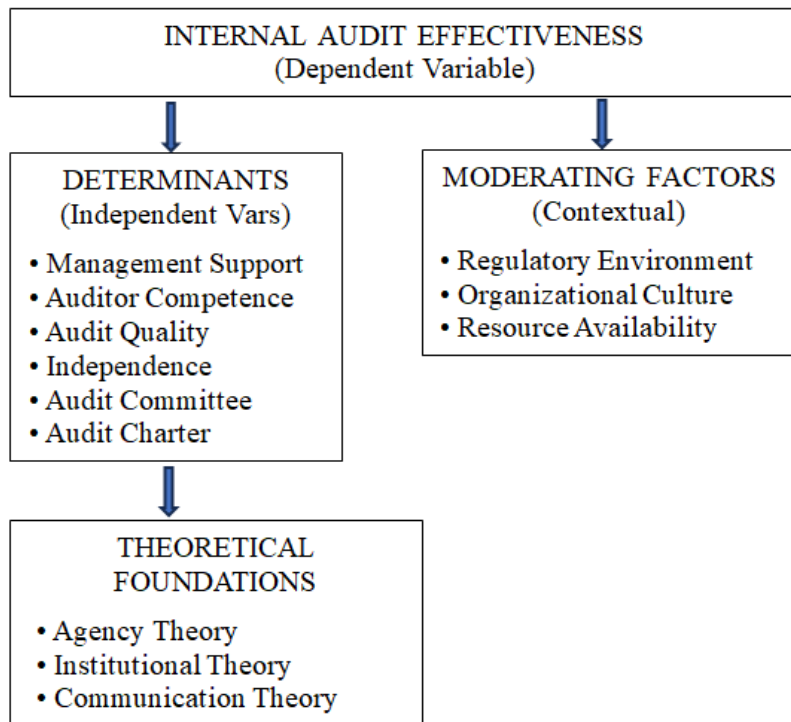
4. Management Support: Demonstrates the commitment of the top executives through budgeting, policy implementation, and follow-up on audit recommendations. According to Arena & Azzone (2009), agency theory perceives support as indicative of congruence with governance objectives. Despite 62% of respondents reporting poor responsiveness, perceived strategic importance remains high (mean 4.52), thus showing a gap between intention and practice.

5. Internal Audit Charter: A formal document that defines the purpose, authority, scope, and reporting lines of the audit function (Samuel, 2023). According to institutional theory, charters are used to attain legitimacy and standardisation. Although charters exist in the surveyed banks, they are often outdated or misaligned with IPPF standards, thereby weakening enforcement.

6. Audit Committee: This is an independent oversight body responsible for appointing auditors, reviewing reports, and ensuring follow-up (Wondwosen, 2019). According to communication theory, the accountability of the audit committee is to enhance dialogue between the auditors and the board. However, 55% of respondents reported that audit committees are subordinate to management, limiting their effectiveness.

These determinants are interdependent; improvement in one reinforces others. For example, independence doesn't work without a good charter and committee, while direct influences on audit quality include competence. Approach holistically for sustainable improvement:

Figure 1: Theoretical Framework of Internal Audit Effectiveness



Descriptive Survey Insights

A total of 134 respondents from five private banks, namely Lion International Bank, Wegagen Bank, Dashen Bank, Bank of Abyssinia, and Awash Bank, were surveyed. After removal of 4 incomplete responses, the number of valid responses was 130 (61 Internal auditors, 69 Branch managers). A 5-point Likert scale was used in this survey.

Table 1: Respondent Demographics (n = 130)

| Category | Sub-Category | Frequency | % | Cumulative % |
|-----------------------|----------------------|-----------|------|--------------|
| Gender | Male | 92 | 70.8 | 70.8 |
| | Female | 38 | 29.2 | 100.0 |
| Age | 26–30 | 40 | 30.8 | 30.8 |
| | 31–35 | 52 | 40.0 | 70.8 |
| | 36–40 | 24 | 18.5 | 89.2 |
| | Above 40 | 14 | 10.8 | 100.0 |
| Education | Bachelor's Degree | 62 | 47.7 | 47.7 |
| | Master's Degree | 68 | 52.3 | 100.0 |
| Field of Study | Accounting & Finance | 71 | 54.6 | 54.6 |

| | | | | |
|-------------------|-------------------------|----|------|-------|
| | Management | 20 | 15.4 | 70.0 |
| | Accounting & Auditing | 3 | 2.3 | 72.3 |
| | Business Administration | 15 | 11.5 | 83.8 |
| | Marketing | 4 | 3.1 | 86.9 |
| | Economics | 17 | 13.1 | 100.0 |
| Experience | ≤2 years | 15 | 11.5 | 11.5 |
| | >2 to <5 years | 21 | 16.2 | 27.7 |
| | >5 to <10 years | 49 | 37.7 | 65.4 |
| | ≥10 years | 45 | 34.6 | 100.0 |

Source: Authors' survey (2025)

Reported Challenges:

Most of the respondents indicated substantial barriers that may lead to less-than-effective internal audit processes. Specifically, 68% highlighted limited the audit activity budget, hence constraining the coverage and depth of the assessment of risks. Moreover, 62% have pointed out the absence or insufficiency of management's responsiveness to audit recommendations, which also reflects a lack of connection between their findings and actual implementations in the operational field. Additionally, 55% said inadequate autonomy of audit committees, often due to subordination to executive management, which undermines oversight and execution capabilities. These difficulties collectively reflect systemic constraints in the availability of resources, organisational culture, and the structure of governance within the surveyed banks.

Table 2: Perceived Influence of Determinants (n = 130)

| Determinant | Mean | SD | Rank |
|-------------------------------|------|------|------|
| Management Support | 4.52 | 0.61 | 1 |
| Auditor Competence | 4.38 | 0.68 | 2 |
| Quality of Audit Work | 4.25 | 0.74 | 3 |
| Organizational Independence | 3.81 | 0.89 | 4 |
| Audit Committee Effectiveness | 3.64 | 0.97 | 5 |
| Audit Charter Clarity | 3.41 | 1.03 | 6 |

Source: Authors' survey (2025)

DISCUSSION

Independence and Audit Quality

Organizational independence is the corner pillar of credible auditing, reducing agency conflict through objective reporting (Adams, 1994). The average score of 3.81, shows only a moderate level of autonomy within Mekelle

banks. This is aligned with findings by Mihret, 2020, who recognised that without active committee oversight brings limited results. Within an international scenario, Samagaio & Felício (2023) connect independence with lower audit failure, but only if paired with organizational commitment.

Audit quality-mean 4.25 is still a strong factor, which reflects laborious processes despite constraints. Communication theory would support this: high-quality reports build trust and can be acted upon. Even though Resource scarcity and time pressure, common in a developing context, can weaken follow-up, reducing long-term impact.

Competence and Training

The competence of auditors mean 4.38 and ranked second among the factors, supported by a highly qualified workforce. 52.3% hold Master's degrees, and 72.3% have more than five years of experience. This academic strength allows for state-of-the-art risk detection and strategic insight. However, an estimated international certification below 15% and barriers to training reported in 74% of cases indicate one critical gap. Alzeban & Gwilliam (2014) and Nguyen et al. (2024) point out that continuous professional development is not optional but necessary for international alignment. Without such Continuous Professional Development, Ethiopian auditors may fall behind in the rapidly digitalising financial sector.

Management Support

The mean for management support was 4.52, and it became the top determinant, a factor already noted in previous research studies by Meseret (2016), Kebede (2017), and PwC (2023). This all means that perceived strategic importance is well recognized by executives for audit as a part of the corporate governance framework. Paradoxically, 62% of them reported poor responsiveness to recommendations, which means there is a gap between perception and practice. This finding could be explained through the agency theory since, without enforcement, such support is symbolic. Closing this gap requires cultural shifts towards accountability.

Audit Committees and Charters

Structural weaknesses were reflected in the low audit committee effectiveness, with a mean of 3.64, followed by the clarity of the audit charter, which had a mean of 3.41. More than 55% of the respondents' views were that committees are subordinate to management, weakening oversight. According to Wondwosen (2019) and Samuel (2023), for the committee to be properly constituted, its authority needs to be real in appointing auditors and also in enforcing findings. Similarly, even though the audit charter is available, it is often outdated or not in line with the standards set by the IPPF, which diminishes its legitimacy. Institutional theory suggests that formal structures in the absence of empowerment lead to ceremonial compliance.

Comparative Insight

Globally, the Internal Audit function is increasingly being positioned to play strategic advisory roles in using data analytics and AI to forecast risks. In developed economies, audit functions contribute to performance evaluation and ESG reporting. Ethiopian commercial banks, however, have remained compliance-focused because of resource scarcity, political instability, and regulatory gaps challenges shared with Nigeria and Kenya (Alzeban & Gwilliam, 2014).

However, management support and auditor competence arise as global priorities., Strong executive backing is also found in the current research to correlate with better outcomes in Asian emerging markets, conducted by Nguyen et al. (2024). Ethiopian banks fill that gap through phased digital transformation and regional training hubs.

Moderating Factors Influencing Internal Audit Effectiveness

Although the six determinants explain much of the variation in perceived effectiveness, their impact is moderated by contextual factors prevalent in the Ethiopian banking environment. **Resource constraints** emerged as the most critical moderator: 68% of respondents reported limited budgets, which restrict training, technology

adoption, and follow-up activities, thereby weakening both competence and audit quality despite high educational attainment.

Organisational culture also plays a significant moderating role. Hierarchical structures and risk-averse attitudes reduce management responsiveness (62% cited poor follow-through) even when strategic support is perceived as high (mean 4.52). This cultural gap transforms strong perceived support into symbolic rather than substantive backing, aligning with agency theory's emphasis on enforcement mechanisms.

Finally, the **regulatory environment** moderates committee and charter effectiveness. While the National Bank of Ethiopia mandates audit committees, enforcement remains inconsistent, contributing to the 55% who reported insufficient autonomy. These moderating factors, resources, culture, and regulation, interact dynamically with the primary determinants, suggesting that reforms must address both direct drivers and these contextual enablers for sustainable improvement.

CONCLUSION

This study presents an effective conceptual and descriptive analysis of internal audit performance in private banks in Mekelle City, based on agency, institutional, and communication theories, with experimental findings from 130 respondents. The results indicate that management support, auditor competence, and audit quality were the greatest determinants, with mean scores of 4.52, 4.38, and 4.25, respectively. These results align with the rest of the international literature but also indicate local sensitivities, specifically weaknesses in organisational matters such as independence, committee autonomy, and audit charter congruence among well-educated employees. This suggests that there is interdependence between the factors to be used in general reform; small piecemeal reform will yield limited results. This study contributes to the limited literature on the role of internal auditing in developing African economies, with a replicable framework of application in a similar setting. Although this has improved, internal audits in Ethiopia continue to work within their resource limitations, ineffective institutional structures, and cultural barriers to accountability. Similarly, the moderate scores of organisational independence (3.81) and Audit committee effectiveness (3.64) are indicative of underlying systemic issues, which, indeed, should be subject to regulatory action. Additional research should adopt mixed-method research designs that adopt inferential statistics to determine causality and sectoral differences. The use of digital tools, such as data analysis and AI, has become a viable tool to make audits more responsive and strategic. Sealing these gaps can be used to drive internal audits beyond their compliance roles to partners in good governance, risk management, and sustainable growth. Exploring the adoption of accessible digital tools such as open-source data analytics platforms, mobile-based exception reporting, and AI-supported fraud detection models represents a practical pathway for Ethiopian banks to leapfrog traditional limitations and align with global best practices.

Practical Implications

- Emphasize CIA/ACCA certification and ongoing training.
- Empower audit committees with independent authority.
- There is a need to commit resources and act on recommendations by management.

Policy Implications

- Enforce standards of independence and competence aligned with IPPF.
- Strengthen regulatory oversight of charters and committees.

Future Research

- Nationally representative mixed-methods studies that use inferential statistics

- Sectoral comparisons (manufacturing, public sector).
- Role of AI, data analytics, and digital tools in audit transformation.

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