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Costs and Benefits of an Internal Audit Department: A Case Study of the Zimbabwean Banking Sector

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Abstract:
The purpose of this study was to establish whether it is more effective to outsource the internal audit function as opposed to having a permanent internal audit within an within an organization. The study took a case study approach of banks in Harare (the capital city of Zimbabwe where all banks' headquarters are housed), using a sample size of twenty five respondents [25] drawn from four different departments, namely the finance and administration department, the internal auditing department, the risk management department and the accounting department from each bank. The researcher gathered data through the administration of questionnaires and holding interviews. Results reflected that the internal audit department is viewed as a major cost component within an organisation. This was attributed to the initial cost of establishing the department and the documenting system of internal control, a significant cost that requires time to be recovered. Results also showed that, despite the initial costs, an effective internal audit department results in substantial benefits that outweigh the costs. Respondents regarded internal controls, to minimize financial misstatement and fraud, as critical to the organizations' ongoing success hence the need for a robust internal audit department. Other respondents also highlighted, despite the cost factor, that they have internal audit departments to meet statutory requirements as opposed to the benefits the organisation may reap from the internal audit department. The research recommended for a more proactive approach to tackling fraud and reducing misstatements by efficiently utilizing the internal audit and forensic accounting expertise at its disposal and also vulnerability analysis involving all departments across various functions of the organization in order to identify areas that are more prone to loopholes and fraud eminences.

1. Introduction

The Internal audit often serves as the first line of defense against disclosure errors, ferreting out unintentional errors caused by weaknesses in a company's internal controls and intentional errors due to fraud (Mercer, 2004). This role largely changed with the introduction of the Sarbanes-Oxley Act of 2002. The change was both in terms of assisting management in complying to requirements for evaluating and testing financial controls over financial reporting and improving internal audit's ability to perform more traditional internal audits. The Act has also prohibited outsourcing any internal audit function to external auditors due to independence issues. In recent years, internal audit activities have been extended so that the function has become a key corporate governance mechanism (Gramling et al., 2004, Cohen et al., 2004). It is common cause that, financial reporting improprieties and business failures in companies involving Enron, WorldCom and Adelphia have cost organizations and tax authorities billions of dollars between years dating 1996 and 2000 owing to the failure of the internal audit function to detect and maintain effective internal controls. Such global corporate accounting scandals have brought the role of internal audit and audit committees under increased scrutiny (Strategic Direction 2003). For instance, the Zimbabwe Stock Exchange has called for a mandatory requirement of an internal audit function for companies listed on the stock exchange market. The Basel Committee on Banking Supervision 2012 (BCBS) stresses that the banking supervisors must be satisfied as to the effectiveness of a bank's internal audit function, that policies and practices are followed and that management takes appropriate and timely corrective action in response to internal control weaknesses identified by internal auditors. An internal audit function provides vital assurance to a bank's board of directors and senior management (and bank supervisors) as to the quality of the bank's internal control system. In doing so, the function helps reduce the risk of loss and reputational damage to the bank. The BCBS (2012), further stresses that professional competence is essential to the effectiveness of the bank's internal audit function, of which professional competence depends on the auditor's capacity to collect and understand information, to examine and evaluate audit evidence and to communicate with the stakeholders of the internal audit function. Furthermore, the Reserve Bank of

Zimbabwe has also raised this requirement for all banks to have an internal audit department in response to the 2004-banking crisis. The above introductions have alarmed other organizations and various sectors in the economy to appreciate the significance of the internal audit function in guarding against theft, misappropriation of funds, fraud and financial misstatements.

1.1. Statement of the Problem

The lack thereof or poor internal control systems within organizations have seen many corporate institutions falling prey to loss. The reluctance by institutions to create robust internal audit departments stems from the perception that the internal audit is as a major cost component to an organization. Most organizations establish the internal audit department in order to conform to statutory requirements without taking into cognizance the immense contribution such a department brings in minimizing fraud and loss. Hence, this research aimed to evaluate the cost and benefits of an established or permanent internal audit towards minimizing issues of theft, loss and fraud as opposed to out sourcing the service following the requirement by the banking supervisor of Zimbabwe (Reserve Bank of Zimbabwe) for all banks to have an internal audit department in response to the 2004-banking crisis.

1.2. Research Objectives

- To establish the role of the Internal Audit
- To investigate effectiveness of the Internal Audit function versus outsourcing the Internal Audit function
- To evaluate the effectiveness of an Internal Audit Department in reducing costs, financial misstatements and corporate frauds.

1.3. Research Questions

- What is the role of the Internal Audit?
- What are the costs and benefits of the establishing an internal audit department?
- How effective is the Internal Audit in reducing costs, financial misstatements and corporate fraud.

2. Literature Review

2.1. Conceptual and Theoretical framework

Beginning with the significance and scope of the Internal Audit Department, the Canadian Comprehensive Audit Foundation (1991) defines an audit as an independent, objective assessment of the fairness of management’s representations on business performance. The Internal Audit helps an organization accomplish its objective by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

The internal audit profession has developed over the years and this may be attributed to a number of factors. Many companies have resorted to relying much on internal audit due to the high costs that are associated with an external audit. Furthermore, the increase in size of companies due to mergers and takeovers has led to management difficulties in ensuring that effective controls have been implemented hence the need for internal audits (Lynch 2004 ACCA, Study Text page 285)

The development of the profession has also been as a result of the rapid growth and ever dynamic complex IT systems coupled by intense competition thereof and lower margins requiring tighter control over all aspects of business and also the need to comply with legislation and regulation (Lynch 2004 ACCA, Study pack Text page 285)

The American Institute of Certified Public Accountants (AICPA) concurs that internal auditors are there to ensure that the company achieves its mission, among other objectives, promoting efficiency and reducing the risk of asset losses. Besides ensuring reliability of accounts, internal auditors should assist management with ideas on how to deal with rapidly changing economic environments. Hence, it is important that the Internal audit function possess key elements that make internal audit effective.

The KPMG Internal Control Review Practical Guide (2002) concurs that an effective audit function strengthens governance by materially increasing shareholder ability to hold their firm accountable. Internal auditors perform an important function in those aspects of business that are crucial in the private sector for promoting credibility. Therefore, it is crucial that the internal audit function is configured and has a broad mandate to achieve these objectives. The audit function must be empowered to work within integrity and produce reliable services, although the specific means by which auditors achieve these goals vary. The KPMG Internal Control Review Practical Guide (2002) lists key elements of an effective audit which include:

- A legal mandate. The audit function’s powers and duties should be established by the government’s constitution, charter or other basic legal document. Among other topics, this document would address procedures and requirements of reporting the obligation of the audited entity to collaborate with the auditor.
- Organizational Independence. The audit function should be independent from those it is required to audit. (i.e., the chief audit executive must report to someone outside the line of authority of the audited entity). Organizational independence allows the audit function to conduct work without interference by the entity under audit. Consequently, users can rely on the objectivity and accuracy of the auditors’ results and report.
- Stakeholder Support. The legitimacy of the audit function and its mission should be understood and supported by a broad range of elected and appointed and government officials, as well as the media and involved citizens.
- Competent Leadership. The head of the audit function must be able to effectively recruit, retain and manage highly skilled staff. Moreover the chief audit executive should be an articulate public spokesperson for the audit function.

- Competent Staff. The audit function needs professional staff equipped with collectively necessary qualifications and competence to conduct the full range of audits required by its mandate. Auditors must comply with the minimum continuing education requirements established by the relevant auditing standards.

2.2. Benefits of an Internal Audit Department

The Institute of Chartered Accountancy of Zimbabwe (2006) stresses that an internal audit function can play a crucial role in ensuring an effective accounting system, internal controls and the reporting of information that is relevant, meaningful and of significance to stakeholders.

The Price Waterhouse Coopers Guide (2006) emphasizes that a sound internal audit department identifies the skills and resources that management need to achieve its organizational objectives. Internal auditing continuously measures the level of staff proficiency as well as development progress. Lynch (2009) elaborates that the establishment of the internal audit department assist members of the executive and senior management in the effective discharge of their duties and responsibilities, furnishing management with analysis, appraisals and recommendations on the weakness of internal controls.

The essence of auditing has been further reinforced by the Institute of Internal Auditors (2006) as including reviews of the reliability and integrity of financial and operating information, the systems of internal control, the means of safeguarding assets, the efficient management of the firm's resources and the conduct of its operations. The American Institute of Certified Public Accountants (AICPA) Journal (2010) outlines that an internal audit department is beneficial to organizations as it improves the accountability, internal controls and safeguarding of companies assets and property.

The purpose of an internal audit department is to assist the management and board of directors to deliver its responsibility for the conduct of business operations and stewardship of funds under its control (Caplan 2008). The internal audit department seeks to provide assurance to the board and audit committee that internal controls are in place and the business is operating according to the rules and regulations and that assets are safeguarded against theft, pilferage or wastage.

Another advantage of an internal audit can be drawn from Ernst and Young Guide, (2006:123) which outlines that an internal audit serves as a mechanism for the detection of fraud and errors. The guide also elaborated that an internal audit acts as a deterrent to both employee and management fraud although there is little evidence to confirm this, but it is likely true that knowledge of an impending auditing exercise acts as a moral check on the employees who may otherwise be tempted to engage in embezzlement.

In contrast, there is no full proof method of detecting errors and fraud. An internal audit may be thorough but accounting and internal control systems may present problems as they have inherent limitations. The existence of an effective accounting and internal control system reduces risk of fraud and errors but may still be ineffective against fraud because of collusion by staff members and senior partners. Risk that material misstatements would remain undiscovered is much higher in cases of fraud compared to errors because it often entails action to disguise fraud. An example of such a scandal (February 2006) involved internal auditors of Dore and Legion of Singapore. The case held that there was alleged collision between the internal auditors and the management where the auditors did not exercise the professional duty to report to the audit committee as a result the losses of billions of dollars.

2.3. Outsourcing the Internal Audit Department

The BCBS (2012) states that regardless of whether internal audit activities are outsourced, the board of directors remains ultimately responsible for the internal audit function. However, the BCBS (2012) further recommends that large banks and internationally active banks perform internal audit activities using their own staff. However, outsourcing of internal audit activities, but not the function, on a limited and targeted basis can bring benefits to banks such as access to specialized expertise and knowledge for an internal audit engagement where the expertise is not available within the internal audit function. Outsourcing could also alleviate temporary resourcing constraints which might otherwise jeopardize the execution of the audit plan.

The practice of outsourcing internal audit has become increasingly prevalent (Glover et al., 2008; Ernst & Young, 2006), with internal audit services being offered by specialist providers as well as by more traditional accounting firms. While it is no longer acceptable for external auditors to provide internal audit services to their audit clients (Sarbanes-Oxley Act, (SOX), 2002), outsourcing services are provided both by public accounting firms to non-audit clients and by specialist internal audit firms (Ernst & Young, 2006). Abbott et al (2003) argue that the total ban imposed by the SOX on outsourcing of internal audit to the external auditor may lessen the cost-effectiveness and extent of overall audit coverage for some firms. It has also been argued that an in-house internal audit function may be less objective than an outsourced function as it is difficult for an employee to be truly independent of management (James, 2003, Glover et al., 2008).

Ahlawat and Lowe (2004) explored this issue in an experimental study where both in-house and outside internal audit providers assumed the role of internal auditor for the buyer or the seller in an acquisition target. They found that advocacy was less extreme amongst the outside providers compared to the in-house internal auditors. It has also been suggested that outside internal audit providers, particularly the large accounting firms, offer high quality services and may have a greater level of expertise, especially with regard to specialist knowledge such as technology skills (Caplan and Kirschenheiter, 2000). However James (2003) in support of Acciani (1995) argue that outsourcing should be outlawed as it presents a conflict of interest for the external auditor and impairs the quality of a firm's internal control structure. Further on, James (2003) posits that outside providers lack the in-depth company knowledge possessed by in-house internal auditors. There are various factors that may lead to outsourcing. Petravik (1997) describes three factors important to outsource: the reduction of redundant audit work, resulting in external audit cost savings; the professional liability insurance of the external auditor; and the prestige of the external auditor.

3. Empirical Literature

3.1. Sarens and De Beelde (2006) - *The Role and Effectiveness of the Internal Audit*

The study focused on management perception of the role of internal auditors. Sarens and De Beelde (2006) carried out a survey of 10 companies listed on the Wall Street and Belgian Stock Exchange in the USA and Belgium. They asserted that the internal audit can be of value but on the other hand can turn to be a sore when the costs of the internal audit exceed the benefits derived. They also found that financial costs of internal audit vary based on the size of the organization and goal of the internal audit function. Additionally the internal costs of the audit department were based upon the resources used to perform the work. The most significant non financial cost was found to be a negative reputation of the internal audit role throughout the organization.

3.2. Coram, P. And Ferguson, C (2006) - *The Importance of the Internal Audit in Fraud Detection*

The study was carried out in Manchester, United Kingdom, with a population of 1500 comprising of internal auditors, management and audit committee members. The sample size was 700. Eighty percent (80%) of the respondents asserted that organisations that have an internal audit department stand a better chance of detecting fraud and 20% denied that fact. The study found that for most organizations that have an IAF stand a better chance of detecting fraud in its earliest stages thus minimizing losses.

It was also in this study that internal audit was found to be beneficial to host organization in light fraud detection and prevention. For example it was also found that self-reported fraud was high in organizations with IAF than those that do not host any IAF let alone utilize internal audit services. It is again with study that we found out that major hindrance or factors that limit the IAF in fraud detection and prevention are mainly to do with the host organization rather the IAF itself. Challenges that this study revealed are inadequate resources, skills and qualifications, and underfunding.

3.3. Brown and Pinello (2007) - *Effectiveness of the Internal Audit Department in Detecting Financial Misstatements*

The study was carried out using a sample of 205 companies listed on Canada's Stock Exchange Listings. Findings gave that 188 companies out of the 205 companies that actively participated in the research reported an overall percentage of 66% of the reliability of an internal audit department in detecting financial misstatements.

3.4. Goodwin and Yeo, (2001) - *the Role of Internal Auditing at Harley Davidson*

The study was carried out at Harley Davidson Research Institute in Canada and focused on the contribution of the internal audit department in the wake of increasing demands to apply accepted governance principles in order to adhere to sound risk management. In order to ascertain the role of the internal audit function, Goodwin Yeo (2001) carried out a survey of directors and top management at Harley Davidson. The major findings were that internal audits are essential since they create the necessary corporate governance ensuring that risk management and internal control processes are followed and are successful within an organization.

3.5. Spira and Page (2003) - *Senior Management Expectation Gap on the Role of Internal Auditing*

Spira and Page (2003) conducted a study on the expectation gap that arises when audit customers do not recognize the value of the Internal Audit function. A survey using a sample of blue chip companies in Atlanta trading on the New York Stock Exchange was used. The study revealed that an internal audit department that fulfils this definition is uniquely positioned to support the board and management as an essential component of their governance mechanisms. Moreover Spira and Page found that effective oversight and sound internal controls and the value given to internal audit by management has increased.

Spira and Page suggested that in order to effectively close the expectations gap, the internal audit function and customers of audit services should possess a similar understanding of what makes internal auditing a value-adding activity. Failure to reach this understanding could result in the perception that internal audits are simply a hindrance to achieving organizational goals thus leading in underutilized audit services.

3.6. Mcnamee (2009) - *Contribution of Auditing to the Integrity of Financial Reporting*

The study was based on five companies listed on the Indian Stock Exchange. McNamee used interviews to obtain their data. The study revealed that the Internal Audit department improves the reliability and integrity of financial reporting information and ensures compliance to plans, policies and laid down procedures. It was found that eighty percent of professional expects including internal and external auditors argued that the benefits of establishing an internal audit department within the organization outweighs the costs while 20% argued that the department is an unnecessary cost because internal audit independence is compromised and recommendations from audits are not.

3.7. KPMG (2004) -*The Value of Internal Auditing in Fraud Detection*

KPMG (2004) carried out a study focused on the internal audit department and fraud detection. The study was a biennial survey of fraud cases within Australia and New Zealand. 2164 research instruments were sent to Australia and New Zealand's largest organizations and of these 45% had experienced fraud. Results also gathered that of the 45% organizations that experienced fraud cases, 67.5% reported internal audit works surfacing the fraud cases.

3.8. Holt and Dezoort (2009)-The Usefulness of an Internal Audit Report

Holt and Dezoort carried out a study on the importance of the Internal Audit Report in an experiment administered by 180 MBA students acting as proxies for non-professional investors at Weatherhead School of Management. Findings were carried out by manipulating company fraud risk and the presence of a descriptive Internal Audit Report detailing the composition, responsibilities and activities of an effective internal audit function. The study asserted 89% of investors viewing the disclosure of an Internal Audit Report to be positively related to investor confidence oversight effectiveness and financial reporting reliability. Furthermore, their results indicate that confidence in oversight effectiveness and financial reporting reliability mediates the relation between the disclosure of an Internal Audit Report and the likelihood of the investor to purchase the company's stock.

3.9. Peacock (1995) - Internal Auditing Outsourcing

Peacock (1995) posits that outsourcing internal audit projects may actually improve the quality of the audit because companies can employ external individuals with advanced degrees and technological specialization to provide the required services. In relation to internal audit outsourcing and its relation to size, a study investigated the determinants of internal auditing outsourcing using survey data on 99 companies listed on the Australian Stock Exchange, where 55% fully rely on in-house facility and 45% outsource some or all of their internal audit functions. Results suggested that internal audit outsourcing is associated with perceived cost savings and the technical competence of the external audit provider. Findings also suggested that for a subsample of firms that have previously undertaken internal audit activities before outsourcing, contrary to expectations, the larger the organization the greater the propensity to outsource.

4. Research Methodology

4.1. Research Design

Seutiz et al (1982:31) defined a design as, "a deliberately planned arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with the economy of procedure." Research design is a systematic and orderly approach which reflects how data was gathered in the most economical and feasible manner and includes measures adopted to safeguard the validity of the findings. The researcher relied on both primary and secondary data. Secondary data, largely obtained through literature review, was essential in establishing the background to the current problem and to perceive the current investigation in a wider content. A questionnaire and in depth interviews were primarily used for primary data collection.

The researcher adopted a descriptive case study in order to establish the nature of existing condition in which this research sought to do and to come up with an accurate description of the costs and benefits of the audit department in the banking sector of Zimbabwe. The population for this study was twenty-fifty (25) banks, with four (4) members drawn from four major functional departments that are directly related to the auditing function namely; the audit department, the risk management department, the accountancy department and the finance and administration department. The sample size for this study was four hundred (400) respondents drawn from the four departments of each bank. Members to form part of the study were randomly drawn from a total group of the target population using random selection of names that were contained in the departmental databases. The researcher used a simple random sampling technique to select sampling elements to select 4 participants from each department. Purposive sampling was used to select a representative sample for the structured interview. Data was collected through the use of questionnaires and interviews which were thought to be ideal for yielding the required data under study. A pilot study was carried out to improve on data reliability.

4.2. Data Presentation and Analysis

Data was presented using the various findings from the questionnaires, interviews and secondary sources of data. Presentations were in the form of graphs, frequencies, percentages and pie charts. The findings were recorded in quantitative form necessitated by the capturing of figures. Data analysis is the reduction of accumulated data to a manageable size by developing summaries, looking for patterns and applying statistical techniques. The researcher employed both qualitative and quantitative methods to analyze the data. It is through data analysis that some conclusions were drawn.

5. Data Presentation, Interpretation and Analysis

5.1. Questionnaire Response Rate

Questionnaires and interviews were used to gather data for this study. Three hundred and fifty two (352) responses were returned making a response rate of eighty eight percent (88%). Such a high response rate indicated that the respondents contributed much to the gathering of information by the researcher.

5.2. Benefits of the Internal Audit Department

Respondents were asked to identify benefits of an internal audit department. The results are highlighted in figure 4.3 below. Chief among them was improvement in internal controls. Fifty two percent (52 %) of the respondents agreed that an effective internal audit department results in improved internal controls. This is in tandem with the findings of the American Institute of Certified Public Accountants (AICPA) Journal (2010) which outlined that internal audit department is beneficial to organizations as it improves the accountability, internal controls and safeguarding of companies assets and property.

Twenty-four percent (24%) agreed that they would be a reduction in the risk of misstatements (fraud and errors) whereas fifteen percent (15%) agreed that such a department will lead to a reduction in external audit fees. Only six percent (5%) of the respondents agreed the presents of an internal audit department could lead to an improvement in investor confidence. This is in tandem with a study carried out by Holt and Dezoort (2009) who indicated that the disclosure of an Internal Audit Report increase investor confidence and likelihood of the investor to purchase the company's stock. Results also show that five percent (4%) of the respondents believed that an internal audit results in the reduction of cost of capital.

Benefit		% of Approving Respondents
A.	Improvement in internal controls	52
B.	Reduced risk of financial misstatements	24
C.	Reduction in external audit fees	15
D.	Reduction in cost of capital	4
E.	Increase in investor confidence	5

Table 1: Benefits of an Internal Audit Department

5.3. Internal Auditing in Improving Internal Control System

Research carried out gave that the major benefit in internal auditing is the improvement in internal controls which in turn result in improved investor confidence, reduction in misstatements and reduction in external audit fees. These broader social benefits are inherently difficult to quantify. A majority of the respondents (83%) revealed that the internal control system was now strong since the adoption of an internal audit department within their banks. This is also elaborated by the Institute of Internal Auditors (2006) which reflects that the internal auditing has a significant impact on internal control system, the efficient management of firm's resources and the means of safeguarding assets.

A critical examination of the responses given clearly shows that in the absence of the internal audit department internal controls are weak. It may be inferred that the internal audit department improved the internal control system within the banks. Professionals in accounting argued that a company with a good reputation for widespread accounting irregularities would necessitate a higher cost of capital when they are seeking equity financing. Reducing the perceived probability of such irregularities should tend to reduce the cost of capital. Quantification of benefits constitutes provision of quality information for managerial decisions in achieving organizational objectives. Based on the interviews it has also been proven that prudent managerial decisions are as a result of better internal controls.

However, internal controls can provide only a reasonable and not an absolute assurance that the objectives of an organization will be met. Additionally, the concept of reasonable assurance only implies a high degree of assurance constrained by the costs and benefits of establishment increment costs.

5.4. Internal Audit and Risk

Regarding the effectiveness of an internal audit department in minimizing risks, 75% of the respondents were of the view that an effective internal audit department reduces information risks due to reliable and credible information for management decision making which form part of good governance principles. Respondents agreed that internal audits ensure systems and processes that support the identification, capture and exchange of information in a form and time frame that enable organizational arms to effectively carry out their responsibilities. Also the relevant identification of risks enables the organization to counter plan on how to manage the risks thereby sustaining the organization. The assertion agrees with the findings carried out at Harley Davidson by Goodwin and Yeo (2001) which gave that internal audits play a role in creating necessary corporate governance principles which ensure that risk management and internal control processes are followed and applied effectively in an organization.

However, 27% highlighted that identification of risk does not necessarily guarantee the success of an organization. There is need for rich and applicable counter solutions to guarantee success. Unavailability of funds, human capital knowhow for effective decisions and also other external or even internal factors beyond the organizations' control can limit the deterrence of the risk brought out.

5.5. Reduction in Costs of External Auditing

In relation to respondents' views on the cost reduction as a result of setting up an internal audit department 85% of the respondents highlighted that their costs of external audit fees have since reduced owing to the effective work by the internal audits which led to external auditors relying on the work of the internal auditors. The results go hand in hand with findings from the research carried out by KPMG (2005) which elaborated that the cooperation between external and internal auditors acts as advisory capacity in the operation of an internal audit department and also the internal auditors knowledge of the entity will be of assistance to the external auditors work thus reducing the level of duplication efforts and hence a reduction in external audit fee.

However, the respondents (91%) also reflected that the establishment of an internal audit department does not necessarily result in reduction in audit fees. External auditors may choose to place limited reliance on the work of the internal auditors. More so, if the external auditors perceive the internal audit department as not competent enough they will not rely on the work of the internal auditors hence the audit work carried out will still be the same thus no reduction will result in the external audit fee.

5.6. Can benefits outweigh the Costs

The majority of the respondents (81%) believed that the benefits derived from an internal audit department outweigh costs. A total of 19% of the respondents however were of the view that the costs outweigh benefits (Figure 4.4)

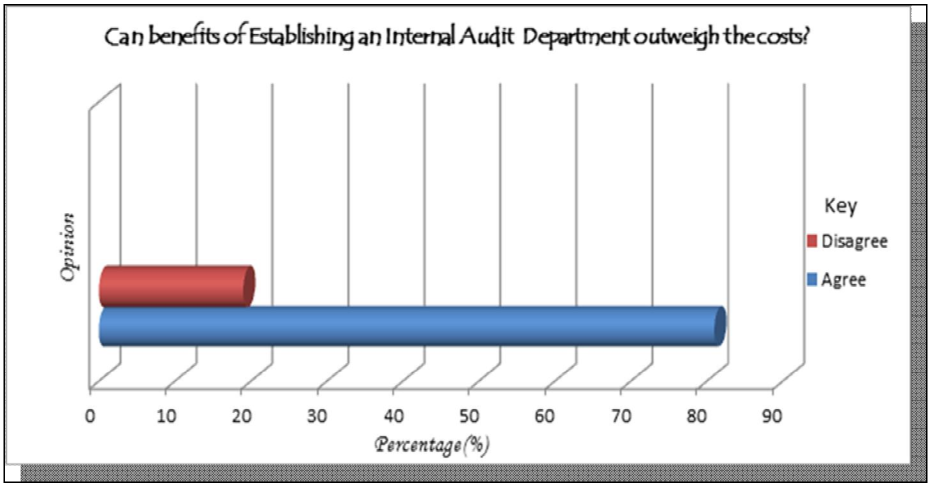

Figure 1: Can benefits of an Internal Audit Department outweigh its costs?

The findings obtained from this question are in line with the majority of the respondents interviewed in the study carried by Salem and McNamee (2009), based on five companies listed on the stock exchange gave that the benefits of establishing an internal audit department within the organization outweighs the costs.

5.7. Reduction in Misstatement

Respondents (91%) concurred that the internal audit department has uncovered some irregularities in financial statements and material errors in the organization. During the years between 2009 and 2010 thousands of dollars were saved owing to the unearthing of fraud and errors by the internal audit department.

Sixty five percent (65%) of the respondents generally agreed with the notion that an internal audit department will result in reduced incidences of misstatements in organizations financial reports, improvement in the quality of financial disclosure resulting in better corporate governance. Thirty five percent (35%) however viewed that the reduction of misstatements in financial information lies within the company policies and management attitude towards the maintenance of internal controls.

Some respondents (43%) viewed the internal audit department as an objective independent examination of financial statements that increase the value and credibility of financial statements produced by management thus increasing user confidence, reduced investors risk and consequently reduces the cost of capital of the financial statements preparer. Findings from the research support the study carried out by Brown and Pinello (2007) on companies listed on Canada' Stock Exchange which gave evidence of 66% of the participating companies reflecting the reliability of the internal auditing department in detecting financial misstatements.

However, the audit opinion, after verification of the financial statements by the internal audit department, is intended to provide only a reasonable assurance that the financial statements are presented fairly in all material aspects.

5.8. Corporate Fraud

In relation corporate fraud 45% of the respondents said the lack of effective and efficient internal audit is a cause of corporate scandals. However, 35% were of the view that the internal audit department cannot be blamed for failing to curb corporate scandals. In most cases, corporate scandals are carefully planned by management and are a result of collusion between employees hence difficult to unearth. 20% of the respondents were indifferent and not sure whether internal auditors can be blamed for failing to unearth corporate scandals.

Most respondents however approved that the internal audit department plays a pivotal role in detection and curbing of corporate frauds. Findings from the KPMG (2004) study on the value of the internal audit function in fraud detection also reported 67.5% of fraud cases detected in Australia and New Zealand large firms owing to internal audit works.

However, control processes manage the risk of fraud up to an acceptable level. The risk that senior management overrides important financial controls to manipulate financial reports is a key drawback to fraud deterrence and fraud risk management.

5.9. The level of Liaison

When asked to comment on the level of liaison between internal and external auditors, 68% said that the internal and external auditors liaise moderately. Meanwhile 27% indicated that the level of liaison is high whilst the other 5% gave to it that the level of liaison is very low. Lack of liaison increases the risk of not identifying potential significant operational risks affecting the entities' and increase external audit fees. Research carried out by KPMG (2005) elaborated that the cooperation between the internal and external auditors is of advisory capacity in the operation of an internal audit department as well as a tool to avoid duplication of effort as external auditors carry out their work.

5.10. Benefits and Costs in Relation to Size

Interview responses reflect that as an organization expands its operations; benefits of establishing an internal audit department will increase up to a point when there will no longer be any additional benefits no matter how further the organization will continue to expand. At the same time, if the organization continues to expand, the average cost of establishing an internal audit department in relation to the size of the organization is more likely to decrease. The organization will be said to be at equilibrium size (where benefits are equal to costs) and thus it will be of an indifferent opinion on whether to outsource or to establish an internal audit department from within the organization; at this point benefits are equal to costs, any size greater than the equilibrium size benefits will outweigh costs. Refer Figure 4.8 below

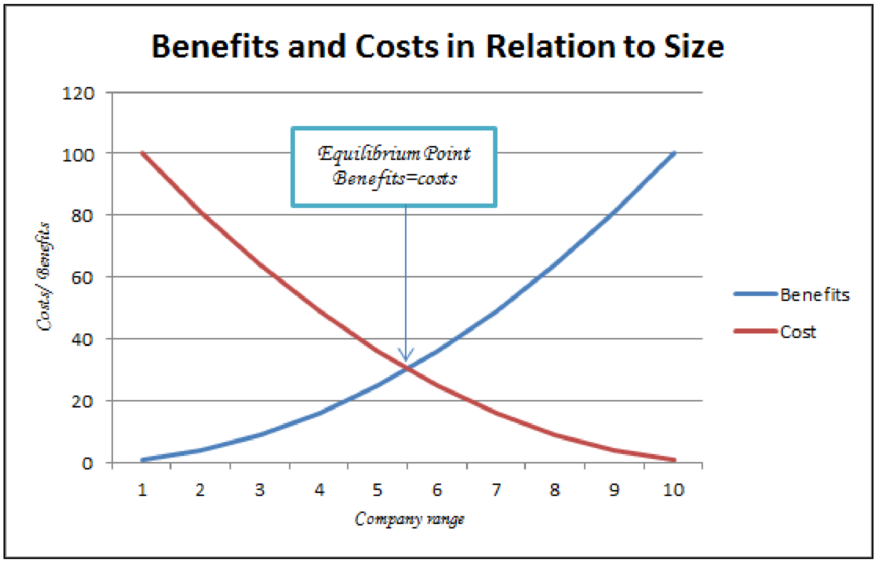

Figure 2: Benefits and Size in Relation to Size

According to the diagram above, organizations falling in the range of 1-5 are relatively small firms and do not enjoy benefits from establishing an Internal Audit Department-the costs are more likely to outweigh the benefits. The equilibrium size is at 5.5 where costs are equal to benefits. Any size above 5.5 the company would benefit from establishing the department as costs will be lower than benefits. The assertion concur with Sarens and De Beelde (2006) which provided that financial costs of internal audit vary based on the size of the organization and the goal of the internal audit department and internal costs based upon the resources used to perform the work. The size of an organization can be measured in terms of assets or turnover; however the researcher was not able to come up with figures on what size can be said to the small, equilibrium or large.

5.11. Benefits of Outsourcing or Co-sourcing in Relation to size

Respondents were of the view that benefits of setting up an internal audit department or outsourcing depends on the size of the firm. 70% of the respondents were of the opinion that the cost of establishing the internal audit department for a relatively small organization outweighs the benefits but as the organization expands in operations and increase its market share the benefits would outweigh the costs as a result of economies of scale. 30% of the respondents were of the view that the benefits of the internal audit department are enjoyed when the firm is still small as it will be manageable more efficiently than a large organization. The results concur with the research carried out using 99 companies listed on the Australian Stock Exchange which gave that the larger the organization, the greater the propensity to outsource. Results also suggested that internal audit outsourcing is associated with perceived cost savings and the technical competence of the external audit provider.

5.12. Cost of Implementation

70% of the respondents said most of internal audit recommendations are not implemented. They said most of the recommendations are discussed with management and documented but are never implemented and whenever internal auditors carry follow ups and write reports to the top management about the non-compliance of their recommendations nothing is done to implement them, resulting in the increase in operational costs and pilferage of materials and assets. Respondents highlighted that given such a scenario, the establishment of an audit department is an unnecessary cost that should otherwise be avoided. 30% said their recommendations do get implemented.

The study carried out by Spira and Page (2003) on blue chip companies' management teams trading on the New York Stock Exchange, however, gave that the value given to internal audit by management has increased hence an improved possibility that the audit recommendations will get implemented.

6. Summary, Conclusions and Recommendations

6.1. In an attempt to answer the research questions of this study, the research came up with the following findings in the research

The use or adoption of an internal audit department strengthens internal controls, reduces the risk of misstatements (fraud and errors), a reduction in external audit fees, an improvement in investor confidence as well as a reduction in the cost of capital.

The presence of internal auditors will reduce control risk as audit tests will detect weaknesses in the accounting systems and implementation of recommendations will improve controls and result in reduced risk of fraud and error.

Lack of an effective and efficient internal audit results in high occurrences of corporate scandals.

The costs of establishing an internal audit department when a firm is still small outweighs the benefits but as the organization grows and expands in operation, size and market share, the benefits outweighs the costs as a result of economies of scale. It was deduced that as an organization continues to expand, benefits of establishing an internal audit department will increase up to an optimum point beyond which there are no additional benefits regardless the size of the organization. For most banks, their sizes are big enough to allow them to enjoy the benefits of internal audit department in-house.

The internal audit department has resulted in the uncovering of some material errors as well as irregularities in the banks' financial statements.

Establishment of an internal audit department does not necessarily result in audit fee reduction but will depend on whether the external auditors perceive the work of the internal audit department as competent.

It was established from the study that the internal audit department will result in reduced occurrences of misstatements in organizations' financial reports and thus an improvement in the quality of financial disclosure resulting in better corporate governance.

6.2. Conclusions

Basing on the findings the research conclude that

- Generally, the benefits of establishing an internal audit department outweigh the costs
- The establishment of an internal audit department will result in improvement in internal controls.
- Implementation of internal auditor's recommendations reduces operation costs and pilferage of material and assets.
- The costs of establishing an internal audit department when a firm is still small outweighs the benefits but as the organization expand in operation and size the benefits outweighs the costs as a result of economies of scale. It can therefore be concluded that banks are enjoying the benefits of having an internal audit department in-house.
- The internal audit department minimizes costs by improving internal controls, reducing the risk of misstatements, reducing the cost of capital and external audit fees and an improvement in investor confidence.
- Control provide only timely information or feedback on progress towards achievement of operational and strategic objectives but cannot guarantee achievement
- Lack of an effective internal audit department increases or result in no reduction in external audit fees
- An internal audit department improves management performance in decision making due to reliable information.
- Not all audited financial statements reflect a true and fair view of a firm's operations but however the possibility of financial misstatements is greatly reduced.
- Internal auditing play a crucial role in preventing and detecting fraud and protecting the organization's resources.

6.3. Recommendations

- Due to strenuous budgets and limited funds, banks should focus more on offering suggestions that include re-evaluating underutilized existing systems within the organization which may increase business efficiency without necessarily leading to additional high costs because some recommendations are not implemented due to costs considerations which might not meet the financial status.
- Banks should carry out vulnerability analysis involving all departments across various functions of the organization. The internal audit should identify high risk areas that are more prone to loopholes and fraud eminences and put much concentration on them in order to detect and deter fraud. As a result, they are often in a position to identify deteriorating control situations before major loss to the organization occurs.
- A whistle blowing policy must be put in place to enhance the efforts of the internal audit function. This can be achieved by putting up an independent fraud management committee which reports to the audit committee. More so, banks should consider the use of an experienced outside agency managing the whistle-blower hotline to enhance the perception of confidentiality.

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