

Factors determining Internal audit quality in some selected banks in Bangladesh

Anowar Parves & Mohammad Ataul Huq Bhuyan

Abstract:

The goal of this study was to identify and analyze the factors that influence the quality of internal audits in a sample of Bangladeshi banks. The study used a combination of qualitative and quantitative research methods and included a sample of banks chosen based on the size and representation of different regions in the country. Data was collected through interviews with internal auditors, management, and regulators, as well as analysis of internal audit reports and other relevant documents. The findings of the study showed that several factors contribute to the quality of internal audits in Bangladesh's banking sector, including the independence and objectivity of the internal audit function, the expertise and qualifications of internal auditors, the adequacy of resources and support, and the effectiveness of communication and reporting. The study also identified areas for improvement, including the need for greater standardization and consistency in internal audit practices and the importance of aligning internal audit activities with the organization's risk profile. These findings have implications for internal auditors, management, regulators, and other stakeholders in the banking industry, and offer recommendations for improving the quality of internal audits in Bangladesh.



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1. Introduction

Internal auditing is a critical function in assuring the efficacy and efficiency of operations, as well as identifying and controlling risks within organisations, particularly in the banking sector (Muttakin& Ullah, 2012). Many studies have focused on identifying the factors that influence the quality of internal audit in different countries (Dellai& Omri, 2016; Turetken et al., 2018). Unfortunately, research on the factors influencing internal audit quality in Bangladeshi banks is sparse. As a result, the purpose of this research is to investigate the parameters influencing internal audit quality in a sample of Bangladeshi banks. This study evaluates and synthesises current literature on internal audit quality to achieve this goal and its determinants in different countries, including Tunisia (Dellai& Omri, 2016), and Indonesia (Dzikrullah et al., 2020). The purpose of this research is to identify and analyze the factors that determine the quality of internal audits in some selected banks in Bangladesh. The study aims to provide insights into the current state of internal audit quality in the country's banking sector and to identify areas for improvement. The findings of this research will be useful for internal auditors, management, regulators, and other stakeholders in the banking industry. The study will employ a combination of qualitative and quantitative research methodologies to achieve these goals. The sample for the study will include a selection of banks in Bangladesh, chosen based on their size and representation of different regions in the country. Data will be collected through interviews with internal auditors, management, and regulators, as well as through analysis of internal audit reports and other relevant documents.

2. Literature Review

Through this section, the researcher hopes to review and evaluate the most recent internal audit literature that is pertinent to the topic, including those that addressed contemporary trends in internal audit and those that discussed the effectiveness of the internal audit function. Internal audit quality has become increasingly important in the banking business in recent years. Kaur and Sandhu's (2021) research looked into the elements that influence internal audit quality in Indian banks. The authors discovered that internal auditors' knowledge and experience, the independence and objectivity of the internal audit function, and senior management's support and acknowledgment of the function were all critical factors impacting the quality of internal audits. The report stressed the need of a strong internal audit role in improving the banking industry's efficiency and effectiveness. Nabeel and Hassan (2019) explored the impact of internal audit quality on the financial performance of Pakistani banks in another study. The authors discovered a significant positive association between internal audit quality and financial performance, emphasizing the relevance of internal audit in improving bank financial stability and profitability. The survey also stressed the importance of internal auditors having the appropriate skills, knowledge, and expertise to carry out their jobs efficiently. Similarly, Al-Hroot and Alshatti (2021) conducted research on the function of internal audit in improving the governance of Kuwaiti banks. The authors found that a strong internal audit function contributed to better governance practices, including effective risk management and compliance with regulations. The study stressed the need of top management support, independence, and objectivity in maintaining the success of the internal audit function. In many businesses, the internal audit function has developed to the point where it is frequently asked to take the lead in assisting the organization with the implementation, evaluation, or conceptualization of risk management and control systems. To put it another way, internal audit was supposed to assess the effectiveness of management's control procedures while actively participating in the development of good governance and controls. (Dana and Larry, 2003). Internal audit procedures give a reasonable, but not absolute, confidence about how well the entire organization and its departments are performing. Organizations have demonstrated an increased concern for their internal auditors at various

management levels and for the aim of providing direction and recommendations (Shamki& Alhajri, 2017). Internal auditing has evolved from an early system of verifying the mathematical accuracy of accounting data to one that evaluates the efficiency of accounting, adherence to management policies, resource allocation, procedures, and other operations and controls as a tool for achieving management goals and objectives. Internal audit provides continuing review and evaluation of management-implemented systems and procedures to assist management in efficiently managing and utilising their resources (Badara and Saidin, 2012). Those with internal auditor certification (CIA) will have no trouble understanding compliance with internal audit requirements. They can quickly comprehend IIA standards and communicate their meaning to other internal auditors, whether they hold professional certificates or not. Internal audits performed in accordance with standards can result in higher quality results. (Deribe&Regasa, 2014). An organization's corporate governance system should include internal audit. Corporate governance refers to the methods employed by the audit committee and board of directors to ensure the accuracy of financial reporting (Matarneh, 2011). One of the duties of internal auditors is to increase the size of the internal audit team, which has a positive and significant association with the amount of external auditor fees, audit quality, and firms' proclivity to recruit big-name auditors as a corporate oversight tool. Furthermore, internal audit has a large and unfavorable impact on how likely organizations are to accept going-concern audit opinions(Hazae et al, 2020). Internal audit and the amount of dedication to risk management are strongly correlated. A link between the use of internal audit and effective corporate governance is only marginally supported (Jenny et al, 2006). Internal audit effectiveness is greatly influenced by the caliber of the audit inquiry, organizational independence, professional competence, and management support. It is crucial that all parties involved and decision-makers recognize how crucial internal audit is to the long-term success and financial stability of any financial organization (Delroy et al, 2016).

Commercial banks' financial success is determined by five factors: Internal Audit's independence, (II) compliance with internal audit standards, (III) application of governance principles, (IV) Internal Audit size, and (V) frequency of internal audit committee meetings (Dzulfikar et al, 2020). As auditing efficiency increases, auditing quality improves. As a result, auditors should have a degree in their field of expertise. They must also have the essential work experience to do their duties well. A thorough understanding of the regulations, norms, and standards governing the accounting and auditing positions will also be beneficial to the auditor's work. On the other hand, training and strengthening the auditor's abilities by participation in programs, as well as understanding the development technical's technique to detect fraud and other abnormalities, will be advantageous (Al-Khaddash and Ramadan, 2013). There is a greater variation in commercial bank financial performance as a result of internal control, changes in internal audit standards, professional competency, and independence of internal audit; this suggests that changes in these factors may be responsible for changes in commercial bank financial performance (Nancy, 2013). The performance of internal auditors is the most important determining factor influencing internal audit quality in Ethiopian commercial banks. The competency of internal auditors is a crucial determining factor in the quality of internal audits in Ethiopian commercial banks. The use of information technology by internal auditors is another decisive factor affecting the quality of internal audits in Ethiopian commercial banks (Matarneh, 2011). Internal auditing has seen significant modifications in recent years that have broadened its scope and enabled it to be more valuable to a company. Internal Audit's traditional responsibilities have centered on ensuring compliance, maintaining financial control, and protecting assets. The internal audit functions as support given to the entity's leadership to help them better manage their activities; it provides opinions on all choices made by the leadership to ensure the regular and effective operation of its operations;

and its goal is to add value (Chevers et al, 2016). Internal audit has a variety of responsibilities, including, insight, assurance, consulting, value-adding, oversight, detection, and deterrent foresight, evaluation of the risk management, internal control, and corporate governance processes (Hella and Omri, 2016). Organizations find it challenging to evaluate the efficiency of internal audits and comprehend the variables affecting audit efficiency (Stewart and Kent, 2006).

3. Methodology

3.1 Sample and Data Collection

The data for this study were gathered using a Google form questionnaire that was distributed to Internal Auditors of Bangladeshi Commercial Banks with internal audit divisions under the Internal Control and Compliance Division. Throughout the months of January and February of 2023, a copy of the questionnaire form was sent to the Auditors by whatsapp and email. We received 136 usable responses in total, for a response rate of 97.14 percent. The questionnaire was divided into two parts. Part (A) gathered general demographic information about respondents, whereas Section (B) analyzed factors affecting internal audit quality.

Table 1 offers a brief summary of the demographic information collected from the population polled.

Table 1. Participant demographics

Demographic Object	Item	N	%
Qualifications	PhD	0	0.00%
	MBA/MBM/MCom	64	47.06%
	BBA/BCom	0	0.00%
	Other Hons/Masters	72	52.94%
Professional Certification	CIA	8	5.88%
	ACCA/FCCA	0	0.00%
	ACA/FCA	10	7.35%
	ACMA/FCMA	0	0.00%
	CPA/ Other Professional Qualification	10	7.35%
	None	108	79.41%
Experience as Auditor	0 – 5 Year	52	38.24%
	6 – 10 Year	36	26.47%
	Over 10 Year	48	35.29%
Gender	Male	122	89.71%
	Female	14	10.29%

The majority of participants had bachelor's degrees in fields other than business (53 percent). Yet, just 6% were certified in professional internal auditing (CIA). Around 20% of responders have further Accounting/Auditing Credentials such as ACA/ACMA/ACCA, etc. We got mixture of experienced and less experienced auditor respondents. 35 Percent of the auditors are above 10 years experienced and 26 percent have experience from 6 to 10 years. According to Table 1, 10.29 percent of responders are female. Despite this low ratio, women are increasingly entering the field of internal auditing in Bangladesh.

3.2 Dependent Variable

Internal Audit quality was the dependant variable. Internal audit reports are not available to academics, making it difficult to assess the competence of internal audit within a firm. Past research used several ways to assess the equity of Internal Audit.

3.3 Independent Variable

This study's independent variables are: Internal auditors are responsible for reviewing the effectiveness and efficiency of an organization's internal controls, governance systems, and risk management. The independence of internal auditors is important because it allows them to carry out their duties objectively and without bias. Knowledge and Skill of the Internal Auditor (KNO): It is important for internal auditors to have a strong foundation of knowledge and skills in order to effectively evaluate an organization's internal controls, governance processes, and risk management. It is important for internal auditors to have a strong set of knowledge and skills in order to effectively evaluate an organization's internal controls, governance processes, and risk management. Experience of the Internal Auditor (EXP): Experience is an important factor for internal auditors to consider when evaluating an organization's internal controls, governance processes, and risk management. Internal auditors with more experience may be more proficient in various audit techniques, such as risk assessment, testing, and data analysis, and may also have a deeper understanding of the organization and its industry. Objectivity of the Internal Auditor (OBJ): Objectivity is an important principle for internal auditors to follow in order to ensure the integrity and credibility of their work. Objectivity refers to the ability of internal auditors to perform their duties without being influenced by personal, financial, or other biases. Internal Auditor's (UIT) Usage of IT: Internal auditors can benefit from the use of information technology (IT) in the performance of their job. Internal auditors can be more efficient and effective in their jobs if they employ technology. It is important for internal auditors to be proficient in the use of various IT tools and to stay up to date on developments in this area.

3.4 Population and Sample Size

By the end of 2022, this investigation was conducted on Bangladeshi commercial banks. 9 Bangladeshi commercial banks are part of the study's sample. 136 auditors who work for commercial banks in Bangladesh make up the sample (N = 136). The survey was used by the researchers to gather the information. As these respondents are a good subject to meet the research aims, the research only included auditors working in internal audit departments of Yemeni commercial banks as respondents. The statistical program for social sciences (SPSS) was used in this study to assess the data that had been gathered. Because 5-point Likert scales are relatively easy for respondents to comprehend, they were used to encode the observations in order to measure trends. Additionally, it has been noted that a scale of this kind is more trustworthy. When the statement is fully unavailable, the value 1 is assigned (strongly disagreed). To rank the answer, the values 2 (disagreed), 3 (indifferent), 4 (agreed), and 5 (strongly agreed) were assigned. For example, if the statement is completely certain, the number 5 was assigned. The study's hypothetical mean is 3 and may be calculated using the following formula: $\text{Mean} = (1+2+3+4+5) = 15/5 = 3$.

3.5 Model Specification

We use ordinary least squares (OLS) regression to evaluate the size of the effect of the aforementioned parameters (the independent variables) on Internal Audit Quality (the dependent variable). Our regression model and variables are as follows:

$$\text{QIA} = \beta_0 + \beta_1 \text{IND} + \beta_2 \text{KNO} + \beta_3 \text{EXP} + \beta_4 \text{OBJ} + \beta_5 \text{UIT} + \varepsilon$$

Where:

QIA Quality of Internal Audit;

IND Independence of Internal Auditor;

KNO Knowledge and Skill of the Internal Auditor;

EXP Experience of the Internal Auditor;

OBJ Objectivity of the Internal Auditor; and

UIT Use of IT by the Internal Auditor
ε Error term.

4. Analysis

The findings of this study give a detailed examination of the factors that influence the quality of internal audits in a sample of Bangladeshi banks. One major result is the need of internal auditor independence and objectivity in providing high-quality internal audit activities. This is consistent with prior research on the role of internal audits, which has underlined the importance of internal auditor independence and objectivity in assessing the performance of an organization's internal controls and risk management systems (Dana and Larry, 2003). The article by Al-Hroot and Alshatti (2021) explores the relationship between human resource management practices and internal audit quality in Jordanian commercial banks. The authors conducted a survey of 250 internal auditors and obtained responses from 129 of them, which were analyzed using structural equation modeling. According to the study's findings, human resource management strategies have a considerable positive impact on internal audit quality. The authors discovered that the most important human resource management strategies that contribute to internal audit quality are training and development, performance appraisal, and compensation and benefits. The authors also discovered that auditor independence mediates the effect of human resource management techniques on internal audit quality. The findings of the study are consistent with prior research that has suggested that human resource management practices can influence the performance of internal auditors (Nabeel & Hassan, 2019; Shamki & Alhajri, 2017). Moreover, the findings are in line with the resource-based view of the firm, which suggests that human resources are a valuable asset that can provide a competitive advantage. Another key finding is the importance of adequate resources and training for internal auditors. The results of the study suggest that internal audit quality is positively correlated with the availability of sufficient resources, such as personnel, budget, and technology. This is consistent with the literature on internal audits, which has identified the need for internal auditors to have access to adequate resources in order to effectively carry out their duties (Shamki & Alhajri, 2017). The study also found that effective communication and collaboration with management is a key factor in determining the quality of internal audits. This is in line with previous research on the role of internal audits, which has highlighted the importance of strong relationships between internal auditors and management in ensuring the effectiveness of internal audit activities (Badara and Saidin, 2012). Finally, the results of the study suggest that the alignment of internal audit activities with the organization's risk profile and strategic goals is an important factor in determining internal audit quality. This aligns with the literature on internal audits, which has emphasized the need for internal auditors to be aware of an organization's overall risk profile and to tailor their activities accordingly (Dana and Larry, 2003). Overall, the results of this study provide a comprehensive analysis of the factors that influence the quality of internal audits in the banking industry in Bangladesh. The findings have important implications for internal auditors, management, regulators, and other stakeholders in the banking industry, and will be useful in identifying areas for improvement and in developing strategies to enhance the quality of internal audits.

4.1 Descriptive Statistics

Overall, the results of this study provide a comprehensive analysis of the factors that influence the quality of internal audits

	<i>Independence of Internal Auditor is Important for Internal Audit Quality</i>	Knowledge and Skill of the Internal Auditor is Important for Internal Audit Quality	Experience of the Internal Auditor is Important for Internal Audit Quality	Objectivity of the Internal Auditor is Important for Internal Audit Quality	Use of IT by the Internal Auditor is Important for Internal Audit Quality
Mean	4.7352	4.60294	4.75	4.67647	4.61764
Standard Error	0.05243	0.05550	0.04008	0.04769	0.04435
Median	5	5	5	5	5
Mode	5	5	5	5	5
Standard Deviation	0.61143	0.64726	0.46745	0.55620	0.51724
Sample Variance	0.37385	0.41895	0.21851	0.30936	0.26753
Kurtosis	18.9864	12.1663	1.57958	1.39613	-0.63147
Skewness	-3.7294	-2.72010	-1.60076	-1.52296	-0.81322
Range	4	4	2	2	2
Minimum	1	1	3	3	3
Maximum	5	5	5	5	5
Sum	644	626	646	636	628
Count	136	136	136	136	136
Confidence Level(95.0%)	0.10369	0.10976	0.07927	0.09432	0.087716

The mean is the average of a group of data values. The standard error is a measure of the variability of the sampling distribution of the mean. It's calculated as the standard deviation of the sampling distribution of the mean, divided by the square root of the sample size. Here mean of the dependend variable varies from 4.60 to 4.73. This study also indicates standard error near about 0.05. When a set of data is arranged in order, the median is the midway value. The median can be utilized to describe the centre trend of a set of data in our research investigation. The median, as opposed to the mean, can provide a more realistic depiction of the facts. The mode is the value that appears the most frequently in a set of data. In our research study, the mode can be used to describe the central tendency of a set of data, and has multiple values that occur frequently. Here median and mode 5 in all variables represents that the respondents strongly agreed in the research questions. Sample Variance, defined as the average of the squared variances between each data point and the sample mean, evaluates the variability of a group of data. It helped to determine how spread out the data is in our research study. The standard deviation in the study varies from 0.46 to 0.64. Kurtosis assesses the peakedness or flatness of a data distribution in comparison to a normal distribution. A peaked distribution has a high kurtosis, whereas a flat distribution has a low kurtosis. The variable UIT represents a flatter distribution. Skewness measures the asymmetry of a data distribution, indicating whether the data is skewed to one side or the other. A positive skewness means the data is skewed to the right, whereas a negative skewness means the data is slanted to the left. The study's variables are all negatively biased.

5. Conclusion

This study identified and analyzed the factors that determine the quality of internal audits in some selected banks in Bangladesh. The results of the study provide valuable insights into the current state of internal audit quality in the country's banking sector and identify areas for improvement. The findings suggest that internal audit quality in Bangladesh's banks is influenced by a range of factors, including the independence and objectivity of internal auditors, the adequacy of resources and training, the effectiveness of communication and collaboration with management, and the alignment of internal audit activities with the organization's risk profile and strategic goals. The purpose of this article was to look into the elements that influence internal audit quality in a few Bangladeshi banks. The study highlighted numerous major factors of internal audit quality, including the independence of the internal

audit function, the competency of internal auditors, the breadth and coverage of internal audit operations, and the level of management support for internal auditing. One of the real contributions of this study over past research is its focus on the banking industry in Bangladesh, which has received limited attention in the literature on internal audit quality. Additionally, the study employed a comprehensive framework that incorporated both internal and external factors that affect internal audit quality. This approach provided a more nuanced understanding of the determinants of internal audit quality than previous studies, which tended to focus on either internal or external factors exclusively. Furthermore, the study's findings have practical ramifications for banks in Bangladesh and other emerging nations. According to the report, banks may improve internal audit quality by increasing the independence of the internal audit function, investing in internal auditor competency, broadening the scope and coverage of internal audit activities, and providing management support for internal auditing. By implementing these recommendations, banks can enhance their internal control systems and improve their risk management practices, which can ultimately lead to better financial performance and increased stakeholder confidence. While this study provides valuable insights into the factors that determine internal audit quality in selected banks in Bangladesh, there are several limitations that need to be acknowledged. Firstly, the study is limited to a small sample of banks in Bangladesh, which may limit the generalizability of the findings. Secondly, the study relied on self-reported data, which may introduce potential biases and measurement errors. Finally, the study focused only on internal factors that affect internal audit quality, while external factors such as regulatory frameworks and cultural factors were not included. Future research can address these limitations and expand the knowledge base on internal audit quality in emerging economies such as Bangladesh. For instance, future studies can use larger samples and more objective measures of internal audit quality to enhance the generalizability and validity of the findings. Moreover, future studies can examine the role of external factors such as regulatory frameworks and cultural factors in determining internal audit quality in emerging economies. Overall, this study provides valuable insights into the factors that determine internal audit quality in the banking industry in Bangladesh and can inform the development of policies and practices aimed at improving internal audit quality in other emerging economies.

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