

1. INTRODUCTION

1.1 Background of the Study

The Institute of internal auditors (IIA, 1999a) defined as, internal auditing is an independent, objective assurance and constituting activity designed to add value and improve an organizations operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control and governance process.

The major factors assist in emergence of internal auditing was the extend span of control system faced by management in businesses (IIARF ,2003) . Today, the internal control functioning become very important for their operation and achieving the objective of organizations. The role of internal auditing is to assess the effectiveness of the internal control system and to find out whether the system is functioning as intended (Fadzil, Haron & Jantan, 2008) internal audit and internal control should be assessed separately however they should also be assessed on a complementary basis. As is understood from the assessments, the main principle of the institutionalization of an entity depends on internal control activities. Appropriate and efficient internal controls can be assessing through internal audit activities. The activities of internal audit have significant impact on the progress of every organization and Auditors have tuned into a challenge to its task and performed their duties to enable the organization to achieve its goal and objectives. According to Chen, Private companies constitute the majority of business settings in the world (Chen, Hope, Li and Wang, 2011). In the United Kingdom, private companies representing 99.6 per cent of all incorporated entities (Companies House, 2009/10). Furthermore, small and medium size enterprises(SMEs) play a major role in both developing and developed economies. SMEs account 95 per cent of all firms in most countries (Chiao, Yang and Yu, 2006) and provide close to 60 per cent of manufacturing employment in a large proportion of countries (Ayyagari, Beck and Demirgüç-Kunt, 2007).In spite of their significant economic influence on the economy in terms of both employment and contribution to Gross domestic product, little is known about the financial reporting practices by private firms (Ball and Shivakumar, 2005) and by SMEs in particular (Ayyagari et al., 2007).on the other hand business organizations face many new challenges and complexities, such as an increase in global competition, significant levels of litigation, corporate re-engineering, rapid advances in technology and global financial crisis. This led to the establishment of successful internal audit in the business organizations. Private and public firms differ across a number of important dimensions. Public firms are under scrutiny by stock exchanges, regulators, and market participants and they share the feature of

separation of ownership and control. Private firms, in contrast, are much less regulated, the nature of their agency problems is different, they are less exposed to market forces, litigation and publicity, and they operate in a much more opaque information environment. The greater heterogeneity among private firms makes the role of auditing less obvious, which is reflected by auditing being made statutory in some countries while being voluntary in others (John Christian Langli and Tobias Svanstrom 2013). Sparkman (1985) and Goodwin (2004) argued that internal auditing is both more common and perceived as more important and have high status in public organizations than in private ones. However, others like Pfeiffer and Leblebici (1973) argued that organizations which operate in a competitive business environment face more pressure than public ones, and one way they react to this pressure is by strengthening their systems of internal control. Thomas (1996) argues that control systems play a more important role in private organizations because of their dynamic and complex environments, which generate more risks for the organisation. Therefore, internal auditing should be both more important and more effective in private than in public organizations. Generally, there are six pillars that make up a strong financial reporting infrastructure: statutory framework, profession and ethics, education and training, enforcement mechanisms, accounting standards, and auditing standards. However these pillars are not well developed or implemented in Ethiopia resulting in weak auditing system or status at all (Kasahun Gilo, 2011). A weak internal audit system might result in higher information risk for stock holders which increase firm's cost of capital, higher intentional and non intentional bias is reported in the preparation of financial statements and in efficient and ineffective business operations which might harm the firm's ability to persistently earn profits and proper internal auditing system function is a base for preserving the stability of any company. In Ethiopia, Most research works focused on internal auditing in public sectors; however the result that gained from researching public sectors may not generalize to private firms and the economic importance of private firms increase through time in the country's economy. Thus my research will investigate the practices and challenges of internal audit in private limited companies in Ethiopia and provide possible recommendations on the improvement of its effectiveness.

1.2 Statement of the Problem

Internal control is a process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in various categories. Internal control is a key element of their liability of financial reporting, effective and efficient entity operations, and compliance with laws and regulations.

Internal auditing in the private sector served as a simple administrative procedure comprised mainly of checking accuracy of transactions, pre-payment verification and control, counting assets and reporting on past events to various types of management. However, in recent times Government and other stakeholders forced to reflect the higher levels of transparency and accountability in the preparation of financial reports and declaration of tax payment in line with the international accounting principles and countries tax and customs laws.

Unfortunately, According to Ethiopian revenue and customs authority (ERCA) large tax payer's office reports, financial reports declared by private companies have a lot of irregularities and errors that are resulted from unreliable and inaccurate accounting records. This in turn contributes to high tax, interest and penalty burden to the company since the tax office audited the statement after three to five years. Besides it also promotes the misuse of resources and funds, which leads a greater risk on the company's future profitability. The tax office believes that, irregularities and errors omitted by Accountants should be corrected by internal Auditors and external auditors. Even though, The internal auditor's scope of work is comprehensive and its focus on future events as a result of their continuous review and evaluation of controls and processes, its performance during the entire year and having specific missions established in according with the level of risks identified for each auditable entity, most errors and irregularities were not corrected, which indicate the capabilities of the audit unit in the companies. Due to this, the tax office stresses the maintenance of strong internal audit unit in the sector. Thus; this paper will focus on the practice and challenges of internal audit in private companies and will address the following basic research questions:

- ▶ To what extent the function of the internal audit function supported by appropriate audit policies, procedures and audit manuals?
- ▶ To what extent the recommendation and advisory service provided by internal auditors are accepted and implemented by management?
- ▶ To what extent the internal auditors independent in PLC?
- ▶ To what extent does the operation of PLC conform to regulations and internal control measures outlined by tax authority?
- ▶ To what extent can effective internal audit leads to better performance of PLC?
- ▶ To what extent internal auditors fulfill the required qualification and expertise level?

1.3 Objective of the Study

1.3.1 General objective

The study assess the practice and challenges of performing internal audit function in private companies in Addis Ababa and to suggest possible solutions for the achievement of quality internal Audit practice

1.3.2 Specific objective

- To examine the degree to which effective internal audit unit in PLC are putting the proper measures in place to ensure that the service complied with the proper procedure, rules, regulation, standards.
- To give more emphasis on the need for the company's management how to work in harmony with the auditing departments.
- Examine the independence level of internal audit unit in helping other departments in achieving their goals and objectives.
- To check the operation of PLC in conformance with regulation and internal control measures outlined by the tax authority.
- To examine effective internal audit leads to better performance.
- To evaluate the suitable qualification and expertise level in PLC.

1.4 Scope and Limitation of the study

The study will cover the practice and challenge of performing internal audit function in a manner of quality audit, independence, attitude of the companies towards internal audit unit, the attention and support of internal audit unit by the management and workers in PLCs in Addis ababa. Due to financial and time constraints the individual researcher will not cover the problem and practice in public and government organizations.

1.5 Methodology of the study

1.5.1 Research Design

To enable the researcher address the objectives of the study, a descriptive research will be used, since it will meant to present a picture of the specific details of a business setting among other things.

1.5.2 Data type and data source

For this study we use both primary and secondary data to get relevant data about the study, for Primary sources of data structured questioners will be used and for secondary source of data, a review of relevant documents such as audit plans, audit programs, working papers, audit reports and audit manuals will be used.

1.5.3 Population and sample size

In Ethiopia private limited companies categorized as large and medium tax payers and all of them organized as Federal tax payer in Addis Ababa. Large tax payers organized formally and all have internal audit units. Due to this, the researcher purposely will select sample from this categories, 1000 companies registered as a large tax payer until July 7, 2015. out of which 197 engaged in import export, 192 in whole sales, 145 in manufacturing, 90 in construction, 44 in agriculture and 332 in 15 different other sectors. The individual researcher proportionately will select 100 companies, 20 companies from import export, 20 companies from wholesale trade, 15 companies from manufacturing, 10 companies from construction, 5 company from agriculture and 30 companies from other different categories out of the total population of 1000, which are expected to show the effect of the study.

1.5.4 Methods of data collection and sampling techniques

In order to get accurate information from the study two concerned departments and employees will be selected from the above 100 companies, these are Finance and Internal audit.

1.5.5 Method of data analysis

The data for this study will be analyzed by means of tables and percentages and other statistical packages.

1.6 Significance of the Study

Different researchers have studied about the internal audit practice and challenges in different sectors in developed countries. In Ethiopia most research works focuses on the practice and challenges of public sector and small and medium government owned enterprises. And hence Study on private sector gives new opportunities for application of audit principles than testing or developing theories. In addition it gives the following valuable benefits:

- It will enable the managers to be aware of the importance and use of internal audit in achieving intended objective.
- It will help the internal auditor to know their role in the company.
- It will allow the researcher to practice a larger similar study that could be performed in other sector.
- It will used as an additional reference for other research, who wishes to conduct a research in the same area.

1.7 organization of the study

The research paper will be divided in to four chapters. The first chapter deals with the Background of the study, Statement of the Problems, Objectives, Purposes, Scope and limitation of the study and methodology. The second chapter will deal with the review of the related literature. The third chapter will follow with the data presentation and analysis, the last chapter holding the summary, conclusions and recommendations will bring us to the end of the research paper.

1.8 Time Frame

The time frame work composes a serious of consistent activities from the commencement of proposal preparation to final Project summit in the course of procedure of close alliance with the respected advisor as stated below.

S. No	Activities	Date of Completion
1	Submission of Completed proposal to the advisor	Aug 30-Sep 5, 2014
2	Data collection, Coding, editing and summarising	Sep 6/2015 –Sep 20, 2015
3	Reporting	Sep 20, 2015- Sep 30,2015
4	Submission of Chapter One, Two and Three	Oct 1- 15, 2015
5	Submission of Chapter Four	Oct 16- Oct 23, 2015
6	Submission of Chapter Five	Oct 24 –Oct 31, 2015
7	Submission of the first draft of the thesis	Nov 1-7, 2015
8	Submission of the final draft of the thesis	Nov 7-17, 2015

1.9 Budget Breakdown

The following budget breakdown illustrates the overall material requirements and costs necessitate for the accomplishment of the Project, at current price.

S. No	Material Requirement	Unit	Quantity	Unit Price(ETB)	Total Price (Cost)
1	Stationary Requirement				989.00
1.1	Paper (Duplicating)	Pack	3	90.00	270.00
1.2	CD-R	Pcs	3	10.00	30.00
1.3	CD-RW	>>	2	20.00	40.00
1.4	Flash Diskette (Sun disk)	>>	1	400.00	400.00
1.5	Pens (Bic)	>>	5	5.00	25.00
1.6	Pencil	>>	4	2.00	8.00
1.7	Ruler	>>	2	5.00	10.00
1.8	Stapler	>>	1	40.00	40.00
1.9	Fasteners	>>	8	1.00	8.00
1.10	Bag for data collector	>>	3	50.00	150.00
1.11	Steeple needles	pkt	2	4.00	8.00
2	Data and Information				855.00
2.1	Telephone/Mobile card	pcs	3	100.00	300.00
2.2	Data and Information subscription	>>	3	150.00	450.00
2.3	Data Printing and Coping	>>	150	0.70	105.00
3	Transport and other related costs				6000.00
3.1	Transport and per dime for 3 collector	day	10	200.00	6000.00
4	Secretarial Services				227.50
4.1	Typing the proposal and final report	pcs	65	3.50	227.50
5	Accessories and other miscellaneous costs				800.00
5.1	Leather Bag	Pcs	1	750.00	750.00
5.2	Binding	pcs	5	10.00	50.00
6	Hard copy development and duplicating				507.50
6.1	Proposal	pcs	15	3.50	52.5
6.2	First Draft for final report	>>	65	3.50	227.5
6.3	Final Report	>>	65	3.50	227.5
	Total				9379.00
	Contingency (10%)				937.90
	Total Cost of the Project				10,316.90

