

1 Internal Auditing and Performance of Government Enterprises: 2 A Nigerian Study

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6

7 **Abstract**

8 Purpose : The purpose of this paper is to assess the internal auditing practices on the
9 financial performance of government-owned companies (GOCs) and to consider the The effect
10 of a contextual factor-Political influence â???" on this relationship. While Much emperical works
11 have given diverse reasons for the poor financial performance of GOCs, research evidence of
12 the impact of internal auditing practices on the financial performance of GOCs in the Nigerian
13 context is scanty. Design/ Methodology/Approach : The study adopted a nomothetic
14 methodology (quantitative approach). Data were collected from key informants using a
15 research instrument. Employing the Statistical Package for Social Sciences (SPSS) Version
16 13.0, returned instruments were analyzed using frequency tables, Pearson's and Stepwise
17 Regression Method. Finding : The study found no strong association between internal
18 auditing practices and financial performance of GOCs and thattt political influences do not
19 significantly impact this relationship. The weak association between internal auditing
20 practicesand financial performance is attributed to these enterprises? inadequacy and poor
21 implementation of internal auditing practices. Where internal auditing is de-emphasized it
22 cannot impact positively on performance. Practical Implications : The paper recommends the
23 need for the establishment of an Audit Department where it is non-existent, taking into
24 consideration the size of the Enterprise as well as the strenghtening of the Department by
25 according it the necessary Professional independence and employing adequate number of
26 experienced and qualified staff. Originality/Value : This pape has provided useful insights and
27 fresh emperical evidence of the relationship between internal auditing practices and financial
28 performance of government enterprises in the Nigerian context.

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30 **Index terms**— Internal Auditing ; Government â?"owned Companies ; Political Influence ; Financial
31 Performance ; Nigeria.

32 **1 INTRODUCTION**

33 Design/ Methodology/Approach : The study adopted a nomothetic methodology (quantitative approach). Data
34 were collected from key informants using a research instrument. Employing the Statistical Package for Social
35 Sciences (SPSS) Version 13.0, returned instruments were analyzed using frequency tables, Pearson's and Stepwise
36 Regression Method.

37 Finding : The study found no strong association between internal auditing practices and financial performance
38 of GOCs and thattt political influences do not significantly impact this relationship. The weak association
39 between internal auditing practicesand financial performance is attributed to these enterprises' inadequacy and
40 poor implementation of internal auditing practices. Where internal auditing is de-emphasized it cannot impact
41 positively on performance.

3 LITERATURE REVIEW A) INTERNAL AUDITING

42 Practical Implications : The paper recommends the need for the establishment of an Audit Department
43 where it is non-existent, taking into consideration the size of the Enterprise as well as the strengthening of
44 the Department by according it the necessary Professional independence and employing adequate number of
45 experienced and qualified staff.

46 Originality/Value : This paper has provided useful insights and fresh empirical evidence of the relationship
47 between internal auditing practices and financial performance of government enterprises in the Nigerian context.

48 Keywords : Internal Auditing ; Government -owned Companies ; Political Influence ; Financial Performance
49 ; Nigeria. State participation in economic activity is a worldwide phenomenon. In Nigeria, the government at
50 all levels is active participants in economic activity such as being involved in business activities through the
51 floating of Government-Owned Companies (GOCs). GOCs in Nigeria are expected to operate like their private
52 counterparts; obeying the rule of incorporation according to the company laws of Nigeria and making enough
53 business profits to survive business competitions (Fubara 1982). However, quite a number of these companies
54 are "sick" and some are in the process of becoming so. Concerned about the negative financial performance of
55 majority of GOCs in Nigeria, Fubara (1982) examined the reasons for the prolonged abysmal GOCs' financial
56 performance and established that GOCs perform very poorly in terms of profitability criteria set for them. He
57 attributed the poor performance to inept management, insufficient funds, paucity of technology and incongruent
58 management organization-government objectives.

59 The unsatisfactory performance of GOCs in Nigeria had been blamed on diverse reasons. Makoju (1991) had
60 blamed the poor performance state to the bureaucratic red-tapism and lethargy of the civil service which is still
61 intact in the management and operations of such companies. The Federal Ministry of Finance Incorporated
62 (2006) had identified high incidence of fraud, government's employment of staff based on political connections
63 rather than on ability to perform, parliamentary control and financial indiscipline as causes of poor performance.
64 Dogo (1990) has alleged that the accounting systems of GOCs in Nigeria do not seem to guarantee proper and
65 up to-date financial records thus making auditing difficult, if not impossible. A BPE report ??2003) states that
66 only 160 of the 590 federal government-owned public enterprises were involved in economic activities and that
67 their rate of return was less than 0.5 percent.

68 A company's accounting control practices (such as internal auditing) is widely believed to be crucial to the
69 success of an enterprise as it acts as a powerful brake on the possible deviations from the predetermined objectives
70 and policies. This means that an organization that put in place an appropriate and adequate system of accounting
71 controls is likely to perform better (in financial terms) than those that do not. As Okezie (2004) puts it, "an
72 enterprise's internal audit function can significantly affect the operations of the enterprise and may have an
73 impact on the ability of the entity to remain a going-concern. Conrad (2003) had portrayed Enron's demise as the
74 consequence of a "few unethical 'rogues' or 'bad eggs' acting in the absence of negatively affect an organization's
75 success. According to Hermanson and Rittenberg (2003) the existence of an effective internal audit function is
76 associated with superior organizational performance.

77 Although prior research (for example, Mak, 1989 and Simons, 1987) suggest a link between accounting control
78 practices and financial performance, majority of prior studies had concentrated mostly on the budgeting aspect
79 of accounting controls. This aside, the available studies so far had dealt exclusively with large privately-owned
80 companies especially in the advanced countries. Little is known, at present, about the influences of internal
81 auditing practices on the financial performance of GOCs in Nigeria. It was in an attempt to fill this gap that we
82 set out to assess empirically the impact of internal auditing practices on the financial performance of GOCs in
83 Nigeria and to consider the effect of political interferences on this relationship.

84 2 II.

85 3 LITERATURE REVIEW a) Internal Auditing

86 Internal audit is a long-standing function and an effective tool of management in many organizations. It has been
87 a recognized component of organizations in both the public and private sectors and in most industries for many
88 years. Internal auditing is often seen as an overall monitoring activity with responsibility to management for
89 assessing the effectiveness of control procedures which are the responsibility of other functional managers. The
90 internal audit function is not limited to the operation of any particular function within an organization. Rather,
91 it is all-embracing and accordingly is structured in the organization as a separate entity responsible only to a high
92 level of management. As Okezie(2004) puts it, the main objective of internal auditing is "to assist management
93 in the effective discharge of their responsibilities by furnishing them with analysis, appraisal, recommendations
94 and pertinent comments concerning the activities reviewed".

95 Internal auditing which is often seen as constituting a large and significant aspect of an organization's financial
96 control system is a vehicle to success and survival. According to Rittenberg and Schwieger (1997) "internal
97 auditing is taking on increased importance in many of today's global organizations by assisting management in
98 evaluating controls and operations and thereby providing an Important element of global control". Venables and
99 Impay (1991) also recognized the control role of internal auditing when they stated:

100 It is generally recognized that the proper organization, staffing and methodology of internal audit presents the
101 board with the best means of focusing on its obligation to ensure proper controls in the business However, the
102 need for an internal audit function will vary depending on company specific factors including the scale, diversity

103 and complexity of the company's activities and the number of employees as well as cost/benefit considerations
104 (ICAEW, 1999). Moreover, Venables and Impey (1991) had argued that for an internal audit function to be
105 effective to enable an organization realize its full benefits, the function must have clearly defined objectives,
106 authority, independence and appropriate resources.

107 **4 b) Corporate Performance**

108 Performance is a term that is often discussed but rarely defined. Indeed, some writers see the term as highly
109 ambiguous capable of no simple definition (Emmanuel et al 1990; ??tley, 1999). Earlier, Emmanuel et al (1990)
110 had observed that the frequent use of the term suggests that it may more often be used to avoid precise definition
111 of what is meant. According to Euske (1984), the most common definition of the term can be "accomplishments
112 of the organization". Thus, an organization that is performing well is one that is successfully achieving its goals
113 and is effectively executing suitable strategies.

114 GOCs are the creations of the government with government as shareholders holding these shares in trust for
115 the general taxpaying public. Although, it is true that GOCs may be evaluated in the same way like their private
116 counterparts (Mazzolini, 1979), it is equally important to remember that these companies were established also
117 to promote government's socioeconomic policies. Viewing it from this dimension, some scholars (for example,
118 Lal, 1980) have argued that the evaluation of government investment should employ social/cost benefit analysis.
119 In this circumstance, the performance of GOCs would be measured in terms such as employment which has been
120 provided, assistance given in training manpower, standards of living improved and other welfare matters. These,
121 no doubt, are important matters. But there is another side to this argument. Fubara (1982) had established that
122 the major objective of GOCs in Nigeria was "to make profit in order to remain in business". That means all other
123 objectives such as providing employment and giving assistance to the community are regarded as secondary. If
124 profit-making is the major objective of GOCs in Nigeria it follows that these companies should be evaluated using
125 profitability criteria employed by privately-owned companies. Moreover, prior studies of GOCs' performance, for
126 example, Prasad and Rao (1989), Fubara (1982), Hope (1982) and Rosete (1981) all employed profitability criteria
127 in evaluating performance. Mazzolini (1979) had noted that economic derived from or directly related to chart
128 of accounts and found in a company's profit and loss statement or balance sheet. According to Emmanuel et al
129 (1990), financial performance measures serve two purposes: they measure the return given to the providers of
130 finance (such as shareholders) and they present an assessment of the overall capabilities of the organization as a
131 whole. The performance indices -profits, return on investment and return on equity -were, thus, adopted in this
132 study.

133 **5 c) Political Influence**

134 Political influence or ministerial interference has been identified as the major curse on GOCs (Prasad and Rao,
135 1989 ?? Akinsanya, 1992, Babu and Rao, 1998). These authors contended that the Supervisory ministry(ies)
136 wants (want) to retain tight control over these enterprises and no enterprise was ever permitted to function as
137 an autonomous body. Bjorkrnan (1998) had argued that an influence relationship may develop in any context
138 whenever one party can persuade others of his ascendancy through his own resources. Political influence is
139 generally seen in the matter of appointment of board members and of high officials to these enterprises and in
140 policy formulation. As argued by Prasad and Rao (1989), the men on the board of an undertaking is of vital
141 importance since the success or failure of an undertaking largely depends upon the constitution and composition
142 of its higher levels of management. Further, Akinsanya (1992) had observed that political interference through
143 the appointment of board members is not a bad idea in itself so long as it is done on merit. However, in Nigeria
144 the main problem is appointing as board members not only those who failed woefully at the polls but also party
145 faithful who tend to place their interests and those of their parties before those of the enterprises they serve.
146 What this means is that if board members have no other means of livelihood they are likely to play politics before
147 the interests of the enterprises. Thus, they will interfere with corporate management rather than lay down broad
148 policies for management.

149 **6 d) Internal Auditing and Corporate Performance**

150 Most internal audit professionals argue that an effective internal audit function correlates with improved financial
151 performance. According to Bejide (2006), an effective internal audit service can, in particular, help reduce
152 overhead, identify ways to improve efficiency and maximize exposure to possible losses from inadequately
153 safeguarded company assets all of which can have a significant effect on the bottom line. Similarly, Venables and
154 Impey (1991) had stated that internal audit is an "invaluable tool of management for improving performance".
155 Fadzil et al (2005) had also noted that internal auditors help run a company more efficiently and effectively
156 to increase shareholders' value". And Hermanson and Rittenberg (2003) had argued that the existence of an
157 effective internal audit function is associated with superior organizational performance.

158 At the empirical level, a survey conducted by KPMG (1999) found that the internal audit function in
159 organizations where it exists, contributes substantially to performance improvement and assist in identifying
160 profit evidence in corporate disasters, particularly financial fraud consistently documents an association between
161 weak governance (e.g. less independent boards or the absence of an internal audit function) and the incidence

10 C) MEASUREMENT OF VARIABLES

162 of problems (e.g Dechow, et al 1996; Beasley , 1996, Beasley et al 2000; Abbott et al 2000). Thus, internal
163 audit by acting as a watchdog could save the organization from malpractices and irregularities thus enabling the
164 organization to achieve its objectives of ensuring high level of productivity and profit.

165 Greenlay and Foxall (1997) note that although studies have found an association between accounting control
166 systems and performance theory also predicts that these associations will be influenced by external environmental
167 influences. Thus eventhough GOCs are intended to be insulated from politics they are however linked with politics
168 through the powers vested in the respective Ministers, Commissioners or Deputy Governors. These powers,
169 according to Akinsanya (1992), include power to appoint the Chairmen, Chief Executive Officers and members
170 of the boards as well as power to offer advice or suggestions or make requests. Akinsanya (1992) contends that
171 board members of GOCs in Nigeria are appointed not because of any requisite experience but largely because
172 of political reliability. Hence, board members not only interfere with corporate management but also use their
173 positions to promote the interests of their favourites with dire consequences for the enterprise's performance.

174 7 These considerations lead us to the following hypotheses:

175 H o1 : There is no significant relationship between the existence of an internal audit function and profit level in
176 GOCs.

177 H o2 : There is no significant relationship between the existence of an internal audit function and returns on
178 investment in GOCs.

179 8 DATA AND METHODOLOGY a) Research Design

180 The study adopted the survey research design. We considered this method appropriate as it is useful for H o4 :
181 Political influences on the management of a GOC do not significantly influence the internal auditing practices/
182 performance relationship.

183 the study of non-observable events such as opinions, attitudes preferences or dispositions ??Soyombo, 2002,
184 Fubara andMguni, 1995). Specifically, the study was a correlation, non-contrived and cross-sectional survey
185 having individuals (officials of GOCs) as unit of analysis. The design was such as to discover vital predictive
186 relationship and degrees of association among variables.

187 9 b) Population, Sample Size and Questionnaire Administration

188 The study population consisted of all companies established and operated by the various state governments in
189 the South-South region of Nigeria. Thus the study population was made up of the 65 stateowned companies
190 listed in the 2008 updated company directory sourced from the Port Harcourt office of the Federal Ministry
191 of Finance Incorporated (FMOFI). Our choice of GOCs in the South-South states alone was premised on the
192 fact that GOCs in Nigeria have much similarity with respect to size, structure, operation and management
193 (Akinsanya, 1992). It is expected therefore that the findings of the study will have equal applicability to these
194 enterprises in other states in Nigeria. The FMOFI list shows the total and percentage shareholding in each
195 company by the various state governments. Of the 65 companies listed, 50 are fully-owned (100 percent) by
196 government while the rest 15 had "mixed ownership". Since we were interested in the government fully-owned
197 companies, the 50 companies fully-owned by government were taken to constitute the sample size for the study.
198 The survey questionnaire was, accordingly, mailed to the key financially knowledgeable persons in each of the
199 50 companies making up the sample size. These individuals comprising accountants, Chief Accountants, Chief
200 internal auditors, internal auditors and finance managers constituted the respondents of this study. One copy of
201 the closedended questionnaire each were administered on the 50 GOCs thus making 50 copies of questionnaire
202 distributed. Respondents were allowed two months to respond with an additional two weeks for late responses.
203 Of the 50 copies of questionnaire distributed, 47 were returned while 2 were discarded as these were not properly
204 completed by the respondents. Thus, 45 copies of the questionnaire constituting 90 percent of the total number
205 administered were admissible and used for the study.

206 10 c) Measurement of Variables

207 The predictor variable (internal auditing practices) was measured on a 5-point scale from the end points of
208 Strongly Agree to Strongly Disagree. The criterion variable (corporate financial performance) was measured
209 adopting the subjective approach whereby respondents were required to indicate on a 5-point scale ranging from
210 5 = definitely better to 1 = definitely worse, how their company had performed over the last five years relative
211 to their major competitors on each of the following performance criteria: profit level, returns on investment
212 and return on equity. As Falshaw et al (2006) had noted, these financial performance measures (as adopted in
213 this study) are typically employed to measure performance as they are of interest to and accessible to powerful
214 external stakeholders of an organization such as shareholders (in our study, the government). The construct,
215 political influence, was measured in terms of government appointment of Board members. Respondents were
216 asked to indicate on a 5point scale the extent to which they agree that this variable affect the company's
217 financial performance.

218 Although "size" was not one of the variables tested in this study, respondents were required in the research
219 questionnaire to indicate the size of their organization. Adopting the classification criteria offered by the National

220 Council of Industries in July 2001, enterprises with a labour force of not more than 300 employees were classified
221 as "small" while those with a labour force of over 300 employees were classified as large. Respondents were asked
222 to indicate the category to which their enterprise belonged. It was considered necessary to evaluate the size of the
223 enterprises under survey since previous studies (Carcello et al 2005; Stewart and Kent 2006) had found internal
224 auditing to be associated more with large than with small companies.

225 **11 d) Validity and Reliability of Research Instrument**

226 Attention was accorded the validity of the research instrument. Validity, according to Cooper and Schindler
227 (2001), is the ability of research instrument to measure what it is expected to measure. It is a measure of
228 degree of accuracy. The validity of the scales used in this study was assessed for content and construct validity.
229 The content validity measured the extent to which it provides adequate coverage of the investigative questions
230 guiding the study. In this study, this was enhanced through the combined processes of logical validation and
231 expert opinion in the accountancy field. Scales of the study variables were tested for construct validity to ensure
232 that they measure the intended theoretical construct or trait that it was designed to measure. Thus, when
233 there is a relationship between a property being examined and other specified variables, a construct validity is
234 said to exist ??Black and Champion, 1976). The correlation among the components of the Global Journal of
235 Management and Business Research Volume XII Issue VI Version I 8 study variables provided sufficient evidence
236 of the construct validity.

237 The reliability question was also addressed in the study. The reliability of a questionnaire refers to the
238 consistency of responses that it elicits as perfectly reliable measure gives the same result every time it is applied.
239 The reliability of the measures used in this study was assessed by computing the Cronbach alpha which is a
240 function of the mean correlation of all the study items with one another and is synonymous with correlation
241 coefficient. It actually assesses the degree to which responses to the items on a measure are similar thus serving
242 as an indicator of internal consistency of a measure. An eighteen (18)-item questionnaire was constructed. Of this
243 number, thirteen (13) items were found to have Cronbach alpha exceeding 0.7(as suggested by Nunally (1978).
244 Five (5) items could not meet this cut-off criteria and were accordingly expunged (see Copy of questionnaire in
245 the appendix). The actual Cronbach alpha deemed significant relating to the reliability estimates for each of the
246 constituent elements of the study are highlighted in table 1 below:

247 **12 e) Methods of Data Analysis**

248 Our statistical analysis of data using the SPSS involved the following: frequency tables, percentages, Pearson's
249 Product Moment Correlation Coefficient, (r) and Stepwise regression analysis. Thus our interpretation of r and
250 the level of statistical significance was strictly based on the SPSS output. Thus, the study used both descriptive
251 and inferential analyses. Descriptive analysis was used to determine the extent of internal audit practices in the
252 GOCs studied while the inferential analyses (Pearson's r and the Stepwise Regression Analysis) were used to test
253 the hypotheses.

254 IV.

255 **13 DATA ANALYSES AND RESULTS**

256 **14 a) Describing Internal Auditing Practices in GOCs - 257 Preliminary Analyses**

258 Tables 2, 3, 4, and 5 summarised the questionnaire results of the internal auditing practices of GOCs using
259 simple percentages and frequency tables. The table shows that a majority of the surveyed companies, 36 (or
260 80 Percent) indicated the existence of an internal audit department while 9 (or 20 percent) said their company
261 has no internal audit department. For the other companies having internal audit departments, the table shows
262 that the departments are not adequately staffed in terms of numbers. None of the surveyed companies has more
263 than 10 internal audit staff. Interestingly a majority of the GOCs (47 Percent) indicated that the department is
264 headed by people with accountancy background that have several years of experience.

265 We also made an attempt to determine the degree of freedom of internal auditors to carry out their monitoring
266 activities. Table 3 summarises the results on the extent of independence of internal auditors in GOCs. 3 shows
267 that 66.6 percent of companies with internal audit departments disagree that their internal auditors have the
268 freedom to plan and carry out the audit work. 11.2 percent were undecided while 22.2 percent agreed that internal
269 auditors have that freedom. Also 77.8 percent disagree that the department enjoys free access by way of making
270 reports to the highest level of management. On the issue of the freedom to control affairs of the department
271 by way of determining the appointment, removal, promotion and remuneration of all internal audit staff, the
272 majority view (63.9 percent) was that such freedom was absent. We also attempted to examine the question of
273 whether internal auditors have clearly defined authority to carry out the work. That is, whether there existed any
274 delegated authority to enter premises to interview staff, to examine documents and observe processes in order to
275 collect audit evidence. As shown in table 4, the majority view was that internal auditors have restricted access to
276 obtain information which they considered necessary for the audit (a 75 percent disagreement rating). 75 percent
277 of the respondents also affirmed that internal auditors have limited right of access to examine documents. 19

278 Scale: Ranging from 1 = Strongly Disagree; 2 = Disagree 3 = Undecided; 4 = Agree to 5 = Strongly Agree
279 Matters relating to scope and objectives of internal audits, management action on audit reports and staffing in
280 terms of number, qualification and experience also engaged our attention. The result is presented in table ??.

281 15 Table 5 : Internal Audit staffing, Management Action on 282 Reports and Scope

283 Source: Survey Data, 2011 Scale: Ranging from 1 = Strongly Disagree; 2 = Disagree; 3 = Undecided; 4 =
284 Agree to 5 = Strongly Agree As revealed in table 5, the majority view (63.8 percent) was that there exist a
285 well-defined scope and objectives of the internal audit function while 30.6 percent have a contrary view. As to
286 whether company management do take the necessary action on internal audit reports and recommendations, the
287 majority view (77.7 percent) was that this was not the case. On the issue of staffing of the department in terms
288 of number, qualification and experience, 64 percent of the respondents disagreed that the function is well-staffed.
289 27.7 percent however, maintained that the department is adequately staffed while 8.3 percent were undecided.
290 Having established the nature of audit practices in the surveyed GOCs, we now proceed to test the hypotheses
291 of the study.

292 16 b) Hypotheses Testing

293 The system of hypotheses previously presented postulates relationships between corporate financial performance
294 and internal audit practices and between the internal audit practice/performance relationship and the moderating
295 variable-political influence. While the 2variable hypotheses (H o1 -H o3) are tested using the parametric Pearson
296 Product Moment Correlation, r, the hypothesis involving moderator variable (H o4) is tested using Stepwise
297 Regression Analysis. The acceptance or rejection of each hypothesis is then determined by the significance of the
298 regression coefficients.

299 17 March

300 Internal Auditing and Performance of Government Enterprises: A Nigerian Study H o1 : There is no significant
301 relationship between the existence of an internal audit function and profit level in GOCs.

302 The test result is as shown in table 6. From the results there is a weak positive relationship between internal
303 auditing practices and profit level in GOCs. The r value is 0.208 which is not significant (0.170) at the 0.05
304 level. The results support H o1 that there is no significant relationship between the existence of an internal audit
305 function and profit level in GOCs. : There is no significant relationship between the existence of an internal
306 audit function and returns on Investment in GOCS.

307 Table 7 contains the test results. The table shows an r value of 0.091 which is not significant (0.208) at the 0.05
308 level. There is a negligible positive association between internal audit practices and Return on Investment. The
309 result support H o2 that there is no significant relationship between the existence of an internal audit function and
310 Return on Investment in GOCs. Thus, internal audit practices of GOCs do not significantly influence companies'
311 return on investment. Source: SPSS Window Output Version 13.0 H o3 : There is no significant relationship
312 between the existence of an internal audit function and levels of Return on equity in GOCs.

313 The test result is presented in table 8. From the table, the r value shows a negligible negative association
314 (-0.081) which is not significant (0.598) at the 0.05 level. This offers support to Ho3 that there is no significant
315 relationship between the existence of an internal audit function and levels of return on equity in GOCs. Thus,
316 internal audit practices of GOCs do not significantly influence companies' return on equity. H o4 : Political
317 influence on the management of a GOC does not significantly influence the internal audit practices/performance
318 relationship.

319 The Stepwise Regression Method was used for testing hypothesis 4. Using the method, data relating to the
320 surveyed companies' internal audit practices were entered into the SPSS programme that ran the test. On the
321 choice of "entry" and "stay" values of the Stepwise selection criteria we adopted the value of .05 and .10 for
322 "entry" and "stay" respectively. Thus only variables that met the set criteria are entered into the model while
323 those that failed to meet the criteria are eliminated. Variables are, thus, entered according to the magnitude of
324 their contribution to R 2 .

325 We tested for the effect of political influence (measured by government's appointment of board members)
326 on the internal audit practices/ performance relationship. For this purpose, respondents were put into two
327 categories. In the first category were respondents who 'disagreed' (through their rating) that Board appointment
328 by government had an effect on the relationship. The second group were those who, also by their ratings, "agreed"
329 that government's appointment of Board members had an effect on the relationship. Table 9 summarized the
330 SPSS output.

331 Using the Stepwise Regression Method, we tested the rating of respondents regarding whether appointment
332 by government of GOCs' board members had an effect on the predictor variable's relationship with profits. With
333 respect to those who agreed that Board members appointment by government influenced the relationship, table
334 9 reveals that internal audit having an r value of 0.176 with a p-value of 0.164 does not significantly correlate
335 with profit at the 0.05 level. Thus respondents are agreed that political influences measured by government

336 appointment of Board members does not mediate on the influences of internal audit practices on profit levels of
337 GOCs. Similarly, for respondents that disagreed with government appointment of board members as having an
338 effect on the internal audit practices/performance relationship the Stepwise procedure revealed that there was
339 no effect as the predictor variable failed to meet the method's criteria at the 95 percent level of confidence. that
340 government appointment of board members as suggested by the respondents' ratings has no moderating effect on
341 the influences of internal audit practices on return on investment and return on equity of GOCs -the predictor
342 variable was not entered and retained at the entry and stay values of .05 and .10 respectively. Thus, the test
343 results offer support to Ho4 that political influence on the management of a GOC does not significantly influence
344 the relationship between internal auditing practices and financial performance.

345 **18 DISCUSSION OF FINDINGS a) Internal Auditing and 346 Financial Performance of GOCs**

347 It is widely believed that internal auditing, where it exists, contributes to improved financial performance
348 of the organization. According to Bejide (2006) "an effective internal audit service can, in particular, help
349 reduce overhead, identify ways to improve efficiency and maximize exposure to possible losses from inadequately
350 safeguarded company assets all of which can have a significant effect on the bottom-line". Venables and Impey
351 (1991) opined that internal audit is an "invaluable tool of management for improving performance".

352 To Hermanson and Rittenberg (2003) the existence of an effective internal audit function is associated with
353 superior organizational performance. Prasad and Rao (1989) expressed similar sentiments when they observed
354 that the internal auditor by acting as a watchdog saves the organization from malpractices and irregularities thus
355 enabling the organization to achieve its objectives of ensuring high level of productivity and profit.

356 Our findings in this study, however, contradicts the above positions. We found that there was no significant
357 relationship between the existence of an internal audit function and financial performance of GOCs. That
358 is, internal auditing, where it exists, does not influence the profit levels, return on investment and return on
359 equity of GOCs. This findings is at odds with that of KPMG (1999) which identified a positive association
360 between an internal audit function and financial performance. In a survey of some 201 senior company executives
361 in the United States, the KPMG study found that the internal audit function in organizations, where it exists,
362 contributes substantially to performance improvement and assist in identifying profit improvement opportunities.
363 Our findings in this study also contradicts that of Fadzil, et al (2005) which found that internal auditors assist in
364 running a company more efficiently and effectively to increase shareholders' value. On the other hand, the findings
365 is similar to that of ??riffiths (1999) which found no relationship between internal audits and performance. That
366 study found widespread "lukewarm" or negative attitudes to internal audit (in the privately.-owned organizations
367 studied) and that the function was lacking in skills and appropriately trained staff.

368 The absence of a significant relationship found between internal auditing practices and financial performance
369 may be attributed to the size of GOCs involved in this survey. Internal auditing is believed to be associated more
370 with large than with small companies.

371 **19 March**

372 Internal Auditing and Performance of Government Enterprises: A Nigerian Study Prior studies (for example,
373 Carcello et al 2005; Stewart and Kent, 2006) found a strong association between internal audit and the size of
374 the firm. These findings suggest that smaller firms do not regard internal audit as cost effective. In the present
375 study, a majority of the GOCs fall within the "small" category, (using the classification criteria adopted earlier
376 stated in the methodology section). Even among some of the large ones having internal audit departments, the
377 actual practices suggests a possible underemphasis on internal auditing. Therefore, the seemingly de-emphasis on
378 internal auditing by the majority small GOCS may have contributed to the absence of a significant relationship
379 between internal auditing practices and financial performance. Where internal auditing is It is a matter of
380 concern that some of the GOCS do not have internal audit Departments. Interestingly, however, some of the
381 companies (qualifying as large going by this study's criteria) had been making substantial profits for so many
382 years now. This goes to affirm the fact that superior financial performance may not come about just from an
383 internal audit function. Even in those cases where an internal audit department (or unit) exists, the departments
384 were functioning with skeleton staff not adequate in relation to the size of the company. Majority of the companies
385 have internal audit staff numbering between one and five. None has more than ten irrespective of the size (see
386 Table 2). A majority of the internal audit Departments are headed by college graduates with years of experience
387 or by graduate accountants. A negligible few are under the headship of a chief internal auditor with professional
388 accountancy qualification.

389 The internal audit Departments of the surveyed enterprises could not have been effective as internal auditors in
390 these companies lacked professional independence in the discharge of their duties. In order to serve a constructive
391 purpose internal audit judgments have to be unbiased and therefore can only be made by taking an objective view
392 from an impartial viewpoint. As we saw in Table 3, the internal audit Departments of these companies, where
393 they exist, lacked the freedom to plan and carry out the work thus limiting the scope of the audit conducted by
394 the Department. They also lacked the freedom of access to the highest level of management and to determine
395 the appointment or removal, promotion and remuneration of internal audit staff all of which make for internal

22 B) PRACTICAL IMPLICATIONS

396 auditor's independence. In these situations, the watch dog's job of saving the undertaking from malpractices
397 and irregularities which in turn leads to improved performance is greatly undermined. Moreover, where company
398 management fails or it is reluctant to take actions on internal audit reports and recommendations, internal
399 auditing suffers. This is the case of our surveyed companies as we saw in Table ???. The above discussion leads
400 to a very significant conclusion: the internal audit function, where it exists, does not significantly influence
401 financial performance of a GOC. The absence of a relationship may be attributed to a possible underemphasis
402 on internal auditing by GOCs. Where internal auditing is not accorded any serious attention, clearly it cannot
403 impact positively on financial performance. Financial performance of a GOC may improve not as a result
404 of just an internal audit function (especially when proper attention is not accorded it) but also from some
405 other variables. The foregoing clearly shows that the functioning of the internal audit system in the surveyed
406 GOCs had not been effective. Had it been effective, it would have benefited the enterprises in several ways by
407 plugging out loopholes present in their various activities thereby improving financial performance. b) Effect of
408 Political Influence on the Internal Auditing Practice/Performance Relationship Political influence (which we used
409 in this study as synonymous with the external environment) was hypothesized to have a moderating effect on the
410 internal audit practices/performance relationship. Political influence was measured by government's appointment
411 of Board members. Prasad and Rao (1989) had alleged that political influence is generally seen in the matter
412 of appointment of Board members and other executives to GOCs. The variable -political influence -was found
413 to have no moderating effect on the relationship between internal auditing practices and financial performance
414 of GOCs. This finding is consistent with William's (2005) study of small and medium sized Singaporean firms
415 which found no direct relationship between accounting control practices and the overall firm performance when
416 the environmental influences of uncertainty was added. Government's appointment of Board members which
417 may include politicians may not afterall be bad per se so long as it is done on merit and not on political grounds.
418 Akinsanya (1992) had observed that in the United Kingdom, the Minister is required to make appointments
419 from among persons "appearing to him to be qualified as having had experience of and having shown capacity in
420 industrial, commercial or financial matters, applied science and administration or the organization of workers".

421 In concluding our discussion, it may be necessary to point out that the absence of a significant relationship
422 between internal auditing practices and the measure of financial performance adopted could mean that internal
423 auditing practices have become a necessary but not sufficient condition for financial performance in GOCs in
424 Nigeria.

425 20 VI.

426 21 IMPLICATIONS OF THE STUDY

427 The present study has made some contributions to theory building and provide guidance to operators of GOCs
428 in Nigeria in the following ways: a) Theoretical Implications An unexpected result and indeed a more interesting
429 contribution to the literature, is the findings in this study of the absence of a significant relationship between
430 internal auditing practices and financial performance. The auditing literature widely concede that internal
431 auditing, where it is practiced, should result in superior organizational financial performance (see for example,
432 Vanasco, et al, 1995; Hermanson and Rittenberg, 2003; Fadzil, et al, 2005, Bejide, 2006). The findings of this
433 study suggests that GOCs lacked an effective monitoring system provided by internal auditing which ultimately
434 resulted in the absence of a significant relationship between this control practices and financial performance. This
435 is an important contribution to the literature since as this finding imply, the mere creation of an internal audit
436 department in an organization does not automatically result in superior financial performance.

437 The department must receive the necessary adequate management support for it to function effectively.

438 Moreover, the present study extends previous research by providing useful insights into the internal auditing
439 practices of GOCs in Nigeria. Prior accounting control practices research involving, particularly the budgeting
440 aspect have largely been confined to privately-owned companies in the developed countries such as the U.S.A, the
441 U.K. and New Zealand. Thus, the present study made a contribution given that there had been no prior research
442 (to the best of our knowledge) dealing with the performance consequences of internal auditing practices in GOCs
443 in Nigeria. The present study had filled this gap. Thus, the present study, has provided fresh empirical evidence
444 relevant to theorytesting of the relationship between internal auditing practices and financial performance of
445 GOCs. Thus, to researchers interested in this area, the present study had provided fresh empirical evidence
446 relevant to theory-testing of the relationship between internal auditing practices and financial performance of
447 GOCs. This study, hopefully, should rekindle their interest in this seemingly under-researched area in Nigeria
448 especially when the bulk of the auditing literature suggests that internal auditing as a control mechanism should
449 lead to improved financial performance of organizations. Evidence provided by the present study will provide a
450 ready source of materials for such future studies.

451 22 b) Practical Implications

452 An important finding of this research pertains to the extent of the internal auditing practices in GOCs. The
453 study had brought to the fore, the need for adequate staffing in terms of numbers, qualification and experience
454 in the Internal Audit Departments of these companies as, well as the establishment of the Department where it
455 is non-existent. There is no doubt that Internal auditing benefits managers in providing bases for judgment and

456 action, helping managers by reporting weaknesses in control and performance, providing counsel to managers and
457 board of directors on the solutions of business problems and supplying information that is timely, reliable and
458 useful to all levels of management. If properly implemented, internal auditing, should contribute meaningfully
459 to financial performance of GOCs.

460 To policy makers in GOCs in Nigeria, this study had also brought to the fore the significance of internal
461 auditing and how it could assist the organization to achieve its profitability goals. It is noteworthy that at the
462 time of this study some of the GOCs (falling within the scope of the study) have remained closed for many
463 years with some "only merely alive" as they were owing arrears of workers' salaries. The present study is, thus,
464 significant as it provides fresh evidence as to whether or not the "poor" performance state of these enterprises was
465 due to the non-existence and/or inadequacy of the control structure such as that provided by internal auditing.
466 Consequently, policy makers will be assisted to know the state of these enterprises for appropriate measures to
467 be taken so that the scarce resources of the government are not misutilized and does not lead to demoralization
468 of the concept of public enterprise system in Nigeria.

469 **23 VII.**

470 **24 CONCLUSION AND RECOMMENDATIONS**

471 From our discussion of findings, we can conclude that the present study provides some evidence on the performance
472 consequences of internal auditing practices in GOCs in Nigeria. Specifically, the internal audit function, where
473 it exists, in a GOC does not significantly influence financial performance and that political interferences by
474 way of government's appointment of board members does not significantly impact these enterprises' financial
475 performance. The absence of a relationship arose from possible underemphasis on internal auditing by these
476 enterprises. Where the internal audit function is de-emphasised (as the present study shows), clearly, it cannot
477 impact positively on financial performance. Consequently, we strongly recommend the creation of an Internal
478 Audit Department in those enterprises where there is none. Existing Departments then should be strengthened
479 by according them the necessary professional independence and employing adequate number of experienced and
480 qualified staff to enable the Department extend coverage of the audit to all

481 **25 March**

482 Internal Auditing and Performance of Government Enterprises: A Nigerian Study significant activities of these
483 enterprises. Had that function been effective, it would have benefited the enterprises in plugging out loopholes
484 that may be present in the enterprises' activities with resultant positive effects on financial performance.

485 Although, the present study offered some contributions to our understanding of the relationship between
486 internal auditing practices and corporate financial performance, future research should incorporate non-financial
487 measures such as quality, employee satisfaction in addition to financial measures in order to further enrich our
488 understanding of the internal auditing/performance relationship. It is also suggested that future research should
489 examine companies with "mixed ownership", that is, those partly owned by government and partly by private
490 investors so as to see what impact the elements of private and government ownership together would have in an
internal auditing practices/performance study. ^{1 2}



o37

Figure 1: H o3 : 7 Global

Source: Survey Data, 2011

Figure 2: Table 1 :

¹MarchInternal Auditing and Performance of Government Enterprises: A Nigerian Study © 2012 Global Journals Inc. (US)

²Global Journal of Management and Business Research Volume XII Issue VI Version I © 2012 Global Journals Inc. (US)

S/N	Scale Particulars	Correlation	Alpha
A	Internal Auditing		
	Coefficient alpha for scale 0.7762		
1	The objective and scope of the internal audit function are clearly defined by company management	- 0.7544 0.2828	
2	In my company the internal auditor enjoys some degree of independence as manifested in his freedom to plan and carry out the work.	0.1182	0.7386
3	In my company, the internal auditor enjoys some degree of independence as manifested in his freedom to access the highest level of management	0.2444	0.7325
4	In my company, the internal auditor enjoys some degree of independence as manifested in his freedom to determine the appointment or removal, promotion and remuneration of all internal audit staff.	0.2924	0.7315
5	The internal auditor in my company has a clearly defined authority which empowers him to ask for any information which he considers necessary from any officer of the company.	0.3554	0.7281
6	The internal auditor in my company has a clearly defined authority which empowers him to the right of access to any part of the company property and to any document.	0.0525	0.7412
7	Our company management do take the necessary action on internal audit reports and recommendations.	0.6494	0.7126
8	The internal audit department of my company is adequately staffed in terms of number, qualification and experience.	0.6494	0.7133
9	In my company internal audit reports go to top management and this is considered better than taking such reports to the finance manager.	0.3491	0.7283
S/N	Scale particulars	Correlation	Alpha
B	Financial Performance		
	Coefficient Alpha = 0.7739		
10	Our company's profit levels are compared with those of major competitors	0.0527	0.7406
11	Our company's return on investment is compared with those of major competitors	0.1119	0.7482
12	Our company's return on equity is compared with major competitors	0.0959	0.7398
C	Contextual (Moderating) Factor		
13	Government's appointment of our company's Board members affect financial performance	0.0075	0.7427

Figure 3: Table 2 :

3

3 = Undecided; 4 = Agree to 5 = Strongly Agree
Table

Scale	Manifestation of Independence		Departments		to
	Freedom to plan and carry out work	Frequency %	Free access to highest level of management	Frequency %	
1	3	8.3	10	27.8	11
2	21	58.3	18	50.0	12
3	4	11.2	3	8.3	4
4	5	13.9	3	8.3	4
5	3	8.3	2	5.6	5
Total	36	100.00	36	100.00	30.6

Figure 4: Table 3 :

4

S/No	Item	Frequency	Percent
1	Existence of internal audit department:		
	Separate Internal Audit Dept	36	80
	No. Internal Audit Dept.	9	20
	Total	45	100
2	Number of Staff in Department:		
	Between 1 to 5	30	83.3
	Between 6 to 10	6	16.7
	More than 10	Nil	Nil
	Total	36*	100.0
3	Headship of Internal Audit Department:		
?	A Chief Internal Auditor with a Professional Accountancy Qualification	6	16.7
?	A Graduate Accountant		
?	A University Graduate without an Accountancy Background	13	36.1
?	A College Graduate with several years of experience	Nil	Nil
	Total	17	47.2
		36*	100.0

Figure 5: Table 4 :

6

Pearson's r (Internal Audit (I.A) and Profit Level (PL))

Source: SPSS Window Output Version 13.0

Figure 6: Table 6 :

7

Investment)

Figure 7: Table 7 :

8

Equity)

Source: SPSS Window Output Version 13.0

Test of mediator variable (political influence) on the internal audit practices/performance relationship.

Figure 8: Table 8 :

9

also show

[Note: © 2012 Global Journals Inc. (US)]

Figure 9: Table 9

Internal Auditing and Performance of Government Enterprises: A Nigerian Study

APPENDIX

March

1.	a) Survey Questionnaire			
2.	i. Identification of Respondent			
1.	Name of company (optional)			
2.	What percentage of the equity share is government-owned?			
	100%	50% and above	less than	
			50%	
3.	Your functional position in the company? Please tick			
	Internal auditor	Chief Internal Auditor		
	Accountant	Chief Accountant		
	Finance Manager			
4.	Your level of schooling/professional qualification? Please tick			
	Bachelors degree	Masters degree	De-	Diploma
	Post Graduate Diploma	College	Cer-	
	ACA	ificate		
		Other (please specify)		
5.	The number of workers in my company is:			
	Below 300	Over 300		

[Note: 2. Akinsanya, A. (1992) "Evaluating the performance of Public Enterprises in a Changing Environment". *Nigerian Management Review* Vol. 7 Nos. 1 & 2]

Figure 10:

491 .1 A)

492 Please tick (?) as appropriate in the spaces provided: i) In my company:
 493 -there is a separate internal audit unit/department -there is no internal audit unit/department (ii)
 494 The number of staff in the internal audit department is Free access to the highest level of management 4
 495 Freedom to determine the appointment or removal, promotion and remuneration of all internal audit staff.
 496 The internal auditor has a clearly defined authority which empowers him to: 5
 497 Ask for any information which he considers necessary from any officer of the company. 6
 498 The right of access to any part of the company and to any document. 7
 499 Company management do take the necessary action on internal audit reports and recommendations 8
 500 The internal audit department of my company is adequately staffed in terms of number, qualification and
 501 experience. 9
 502 The internal audit reports go to top management and this is considered better than taking such reports to the
 503 finance manager.
 504 iii.

505 Financial Performance 10

506 . Please rate by a tick (?), company's profit levels over the past five years relative to your major competitors
 507 using the following scale:

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