

**INTERNAL AUDIT FUNCTION AND FINANCIAL PERFORMANCE OF
MICROFINANCE INSTITUTIONS IN MAKINDYE DIVISION: A CASE
OF PRIDE MICROFINANCE KABALAGALA BRANCH**

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**A RESEARCH REPORT SUBMITTED TO COLLEGE OF ECONOMICS AND
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DECLARATION

I declare that this research is my original work and it has not been presented for a degree or any other academic award in any university or institution of learning.



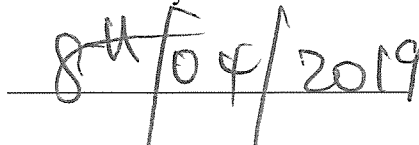


Signature

Date

APPROVAL

This is to confirm that the work in this research report is carried out under my supervision and is now ready for submission to Kampala International University.


Signature
Date

Name: Mrs. Irau Florence

DEDICATION

I dedicate my research report to my parents especially father Wasambakho Patrick and mother Mrs Nabafu Sarah for their effort and struggle that has been important towards my life especially education and completion of my study.

ACKNOWLEDGEMENT

During the process of carrying out my research and through the production of this report, many people have assisted me. I therefore wish to express my sincere gratitude to all those who helped me materially and morally.

I start by thanking the students in my class of BBA of Kampala International University for organizing this exercise that has exposed me to the practical part of my course.

I again would like to thank my supervisor Mrs. Irau Florence who invested much of their valuable time in doing this noble exercise of supervision, may the almighty God bless you.

I will not forget the different people including my brothers Nicolas Matsukuni, Moses Mukwana and my sisters Justine Wanyetse, Evelyne Nambuya and friends Primah Tumuhimbisa, Ivan Winobusingye, Andrew Ssemwanga, Patrick, Deo, and Emmanuel who offered me assistance in different ways. I cannot forget my family which offered the greatest support financially during the process of carrying out my research.

ABSTRACT

The purpose of the study was to find out the effect of internal auditing on financial performance of pride microfinance institutions. The study objectives were to establish the effect of internal audit Standards on the financial performance, to examine the effect of professional audit competency on financial performance and to determine the effect of internal controls audits on financial performance of Microfinance Institutions. The data was collected from 30 respondents who were employees of Pride Microfinance. The study employed a cross section research design based on the questionnaire data that was closed ended. The findings reveal that internal audit function has an effect on financial performance of Pride Microfinance, supported by the significant positive perceptions and the literature support on the internal audit Standards, professional audit competency and Internal controls audits seen supporting the financial performance. Based on the findings, the study concludes that internal audit Standards affect the financial performance of Pride Microfinance, The study concludes that effective audit standards implementations can derive financial performance for the organization. On the second research objective, Professional audit competency contributes to financial performance of Pride Microfinance authority. Present findings on the relationship with financial performance of Pride Microfinance Limited. On the third objective, Internal controls audits on financial performance of Pride Microfinance through increase effectiveness in credit control, Improves marketing activities of the organization, enhanced control over organizational activities, mechanism for simulating risk management, there is realization of value for money in the operations, effective internal control lead to proper credit control, auditing of financial books lead to increased profitability and proper financial management leads to effective debt collection. The study recommends that Pride Microfinance should maintain the existing control environment, information and communication, assurance services as per results of the findings which showed a positive significant effect on these attributes to performance. On the second objective, professional audit competency can be improved through in-house audit training programs and control self-assessment questionnaires to create more awareness to staff of the roles and duties of internal auditors to enable audit services such as advisory services to run smoothly. On the third objective, the study also recommends that Management should establish and implement periodic

view of internal audit performance to ensure that its performance and value to the Institution is maximized and to ensure compliance with appropriate standards and guidance.

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CHAPTER ONE

INTRODUCTION

0 Introduction

This chapter of the study explains the background, statement of the problem, purpose of the study, research objectives, research questions, scope as well as significant of the study and operational definitions of key terms.

1 Background of the Study

1.1 Historical Perspective

For most of its history audit has served as a simple administrative procedure comprised mainly of checking documents, counting assets, and reporting to Board of Directors, management or external Auditors. In recent times, however, a combination of different forces has led to a quiet revolution of the profession. Organizations have to demonstrate accountability in the use of shareholders money and efficiency in the delivery of services. Organizations now demand great competency and professionalism from internal audit, and scarce resources must be deployed more efficiently to minimize and manage risks. Technological advancement makes it possible to track and analyze data with continually increasing speed thus making it essential for organizations to be well advised by the internal audit department. Internal audit varies from one organization to another, and making change to modern internal audit can be a substantial undertaking. The transition from merely ensuring compliance with rules and regulations to truly delivering added value requires more than just organizational changes. In many bank institutions staff is poorly paid and unmotivated, ethical standards are weak, and governance practices are ineffective leading to asset mismanagement (Ramamoorti, 2003).

Over the world there is a realization that the Internal Audit activity has the potential to provide hitherto unparalleled services to management in the conduct of their duties. This potential has been turned into a challenge and embodied in the new definition of Internal Auditing from the Institute of Internal Auditors (the IIA). Commercial banks have come to the realization that internal audits essential in improving management of assets in the organizations improved financial performance of banks (Basel Committee, 2002).

On the African continent the need for objectivity and impartiality is of particular importance for the internal audit department in organizations across Africa. It is not well emphasized, this does not include the possibility that this department, too, may contribute to advisory and consultancy activity, if the independence of analyses and evaluations is ensured. Some banks have also introduced a system of evaluating their activities, which does not replace, but supplements the function of the bank's internal audit. This is a formal and documented process whereby management and employees analyze their activities and evaluate the effectiveness of the related internal control procedures (Otieno, 2012). Internal audit has several aims and principles which it is necessary to adhere to. It is the board of directors of the bank, however, which bears final responsibility that the bank's management applies an appropriate and effective system of internal audit, a system of evaluating banking activity risk and risks concerning bank capital, appropriate methods of monitoring compliance with laws, measures and internal procedures. Likewise, the bank's management is responsible for drawing up procedures which identify, measure, monitor and control the risks that the bank faces.

Kawanda (2008) in Uganda most internal audit professionals argue that an effective internal audit function correlates with improved financial performance. An effective internal audit service, in particular, helped reduce overhead, identify ways to improve efficiency and maximize exposure to possible losses from inadequately safeguarded company assets all of which can have a significant effect on the financial performance. He also stated that internal audit is an invaluable tool of management for improving performance. Internal auditors help run company more efficiently and effectively to increase shareholders value. Finally Aguola (2012) argued that the existence of an effective internal audit function is associated with superior organizational performance.

At the empirical level, a survey conducted by Chepkorir (2010) found that the internal audit function in organizations where it exists, contributes substantially to performance improvement and assist in identifying profit evidence in corporate disasters, particularly financial fraud. It consistently documents an association between weak governance. Thus internal audit by acting as a watchdog could save the organization from malpractices and irregularities thus enabling the organization to achieve its objectives of ensuring high level of productivity and profit.

1.1.2 Theoretical Perspective

The study was guided by the Agency theory and internal audit. This theory was developed by Stephen Ross in the mid-1970s and he states this theory is a useful economic theory of accountability and it helps to explain the development of the audit. Agency theory also provides a useful theoretical framework for the study of internal auditing function and he proposes that agency theory not only helps to explain and predict the existence of internal audit but that it also helps to explain the role and responsibilities assigned to internal auditors by the organisation (Adams, 1994).

1.3 Conceptual Perspective

The independent variable of the study is internal audit, Pickett (1976) stated that internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes. The Board of Directors of the Institute of Internal Auditors in June 1999 described internal audit as an independent, material and consultancy activity, which adds value and improves the functioning of an organization. Internal audit is a part of the repetitive monitoring of the internal control systems of the bank and its procedures for evaluating internal capital. As such, it assists management and the board of directors in the effective performance of their responsibility as outlined above (Gramling, 2007).

The dependent variable of the study is financial performance is taken to be the function of an organizational ability to meet its objectives by exploiting the available resources in an effective and efficient way Power, Michael. (2009) adds that, performance entails effectiveness which refers to a firm's ability to serve and produce what the market requires at a particular time and efficiency which means meeting objectives at the lowest possible cost with the highest. Financial performance of organization can be gauged via the degree of attainment of their organizational objectives like meeting both short-term and long-term objectives as and whenever they fall due. Optimal resource utilization should ensure maximum output in the projects named in the organizational objectives. Organizations cannot afford to waste their limited financial and skilled human power resources on unproductive ventures Upadhaya & Blount (2014). Performance in this study was gauged by profitability/surplus, cost per unit and degree of goal attainment.

profit/Surplus, this is a control dimension that ensures that users of financial information, who include all the stake holders, get an accurate and reliable summary which communicates the firm's financial affairs (Pandey 2012).

1.4 Contextual Perspective

Wide microfinance institution is a microfinance institution located in Kampala Uganda. It is a registered Microfinance institution providing Loans, supporting savings and other financial transactions that are almost done in banks (Kalu 2011). The framework also points out that controls are most effective when they are "built into" the entity's infrastructure and further states that "built in controls support quality and empowerment initiatives, avoid unnecessary costs and enable a quick response to changing conditions (COSO 2012).

The microfinance institution has many branches operating in the country. The microfinance institution has many branches operating across the country as so need the auditing function to be highly developed to enable it function to its best.

This particular study focuses on Kabalagala branch that is among the central branches operating in the heart of Kampala and therefore serving many people in their work environment hence auditing is essential. A country wide report of Microfinance institutions by Bank of Uganda in 2015 reveal that Wide Microfinance cites Kabalagala branch among the challenging on in operations as regards to auditing, these presents the branch as an avenue necessary for the study (BOU, 2014).

2 Statement of the problem

Financial institutions in Uganda though of good reputation and a profitable is faced by many challenges among them is financial performance occasioned by poor financial performance. Despite being key in providing the requirements of citizens of Uganda, this is coupled with increased operational costs that has seen a company's activities slow down resulting in a shrunken market share, low sales volumes, customers dissatisfaction, and inability to pay suppliers Sayag (2010). Despite the above, internal audit being an indispensable management tool for achieving effective control in both public and private organizations. By detecting weaknesses in management operations and providing a basis for correcting deficiencies that have eluded the first line of defense before these deficiencies become uncontrollable. The issues

However, are to what extent financial performance be improved through internal auditing. It was based on this that the research set to examine the effect of internal auditing function on financial performance of Pride microfinance.

3 Purpose of the study

The purpose of the study was to find out the effect of internal auditing on financial performance of pride microfinance institutions.

4 Research Objectives

- 1) To establish the effect of internal audit Standards on the financial performance of Microfinance Institutions
- 2) To examine the effect of professional audit competency on financial performance of Microfinance Institutions
- 3) To determine the effect of internal controls audits on financial performance of Microfinance Institutions.

5 Research questions

- 1) What is the effect of Internal Audit Standards on the financial performance of Microfinance Institutions?
- 2) What is the effect of professional audit Competency on financial performance of Microfinance Institutions?
- 3) What is the effect of internal controls audits on financial performance of Microfinance Institutions?

6. Scope of the study

6.1 Subject Scope

The study was conducted on the internal auditing function and how they affect financial performance of organization. The study will be internal audit standards, professional audit competency and internal controls audits and their effect on financial performance.

6.2 Geographical Scope

The study was carried out in Pride microfinance limited. The place was chosen because the researcher has access to it and because the company holds substantial information necessary for the study.

6.3 Time Scope

The research was carried out for the period of three months that is to say from October to December 2018. This period is chosen to help the researcher obtain enough information on the topic under investigation

7 Significance of the study

This study will help in increasing the role and image of internal audit in commercial banks to make it more effective and professional. It will help the shareholders appreciate the role of the internal audit as one of the most important managerial control systems in an organization required to safeguard their interests.

Management of organizations will be able to look for ways of making Internal audit a completely dependent function from the management thus making it more effective. By implementing commendations given on the internal audit reports management will be able to enhance performance of the organizations.

For scholars it will help them to appreciate and enhance their knowledge of internal audit so as to adhere to the professional ethics as required by the IAS.

Researchers and academicians will benefit from the study as it will add knowledge to the existing body of literature in the subject area. The study will stimulate further research and it's expected to be used as reference material under literature review in future research.

8 Definition of key terms

Internal audit standards: Internal audit Standards are principles-focused, mandatory requirements consisting of statements of basic requirements for the professional practice of internal auditing and for evaluating the effectiveness of performance, which are internationally applicable at organizational and individual levels. Internal controls audits are a process for assuring achievement of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting, and compliance with laws, regulations and policies.

Financial Performance in this study was gauged by profitability, sales, and market share. Profit/Surplus, this is a control dimension that ensures that users of financial information, who

clude all the stake holders, get an accurate and reliable summary which communicates the firm's financial affairs (Pandey, 2012) define the concepts of profitability, sales growth and market share. Market share growth: this is the increase in the amount of customer's bases that the business or banks serve.

CHAPTER TWO

LITERATURE REVIEW

0 Introduction

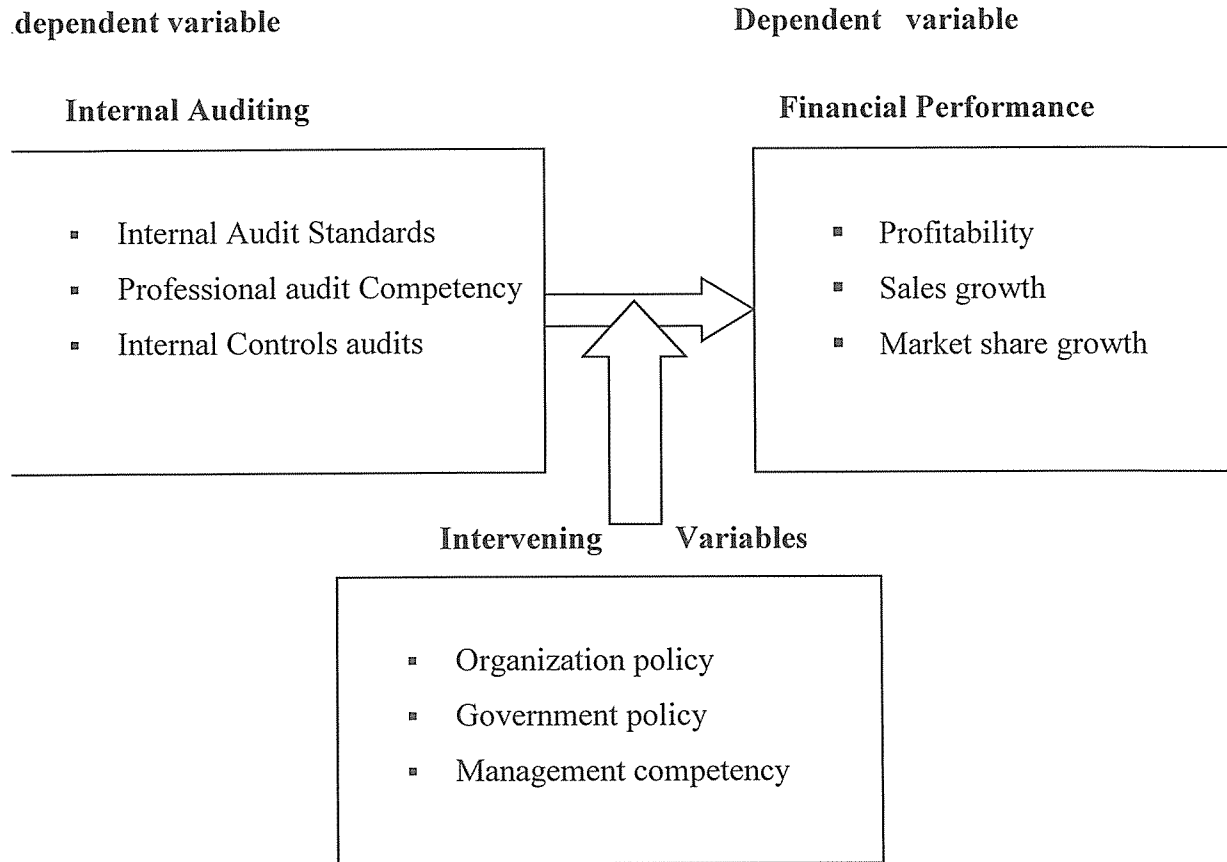
review of literature is crucial as it shows a picture of the state of knowledge in the area of study. This chapter reviews various literatures in the fields of internal audit and its effect on financial performance of organizations. The review of literature is based on objectives set out in chapter one of this study. The chapter is organized based on theoretical review, conceptual framework, related literature review based on objectives and related studies based on the independent and dependent variables.

1 Theoretical Review

The study was guided by the Agency theory and internal audit which was developed by Stephen Ross in the mid-1970s and he states this theory is a useful economic theory of accountability and helps to explain the development of the audit. Agency theory also provided a useful theoretical framework for the study of internal auditing function and he proposes that agency theory not only helps to explain and predict the existence of internal audit but that it also helps to explain the role and responsibilities assigned to internal auditors by the organisation (Adams, 1994). He further states that the agency theory provides a basis for rich research which can benefit both the academic community and the internal auditing profession.

Furthermore, The Agency theory is concerned with the conflicting interests of principals and agents (Jensen and Meckling, 1976). However, as the theory abstracts from all other frictions away except the one between managers and owners, the empirical model we will build later on is significantly different. The theory, nevertheless, demonstrates well the fundamental conflict of interest between managers and owners.

2.2 Conceptual Review



The conceptual framework shows the linkage between internal auditing and financial performance of organizations. The basis of internal auditing is internal audit standards, professional competency and internal control audits. These have an effect with financial performance of the organizations. The concept of internal auditing is as it is done has an effect on financial performance of the organizations.

3 Review of related literature

The review of the literature is being done based on the objectives of the study.

3.1 Role of Internal Audit Standards on the financial performance of organizations.

Internal audit Standards are principles-focused, mandatory requirements consisting of: statements of basic requirements for the professional practice of internal auditing and for evaluating the effectiveness of performance, which are internationally applicable at organizational and individual levels.

gr Lon Bogdan Dumitrescu in his article of internal audit in organizations (2004) knowledges that every bank should have an internal audit department on which with regard to the volume and nature of its activities it can rely. In smaller banks internal audit is often provided externally. The internal audit department in a banking institution must be independent from the activities which it controls and must likewise be independent from the day to day internal control processes. In this way it is guaranteed that this department performs its activities objectively and impartially. Internal auditors may not have a conflict of interests with the bank.

Standards for audits and audit related services are published by the IIA (2008) and include tribute, performance and implementation standards. In general, formal auditing standards recognize that internal auditors also provide services regarding information other than financial reports. They require auditors to carry out their role objectively and in compliance with accepted criteria for professional practice, such that internal audit activity will evaluate and contribute to the improvement of risk management, control and governance using a systematic and disciplined approach. This is important not only for compliance with legal requirements, but because the scope of an auditor's duties could involve the evaluation of areas in which a high level of judgment is involved, and audit reports may have a direct impact on the decisions or the course of action adopted by management (Bou Raad 2000). It can thus be argued that greater quality of a work understood in terms of compliance with formal standards, as well as a high level of efficiency in the audit's planning and execution will improve the audit's effectiveness.

Members of the internal audit team may not participate in the organization's operations or in the selection and implementation of internal control systems. The professional competence, as well as internal motivation and systematic professional development of each internal auditor are essential factors for the correct functioning of the whole internal audit department of the bank. It is also recommended to rotate individual auditors in the framework of the department, so that the routine performance of work activities is avoided. The internal audit department manager should be responsible that the department performs its activities in accordance with the due principles of internal audit. Especial care should be taken that the audit plan is drawn up formally and procedures for all members of the team are in writing. The professional competence of the department's employees must always be ensured, as must their regular training. The internal

dit department is responsible to the bank's management and its board of directors, possibly so to the audit committee, if the bank has one. These bodies of the bank should primarily be formed as to the progress of the audit plan and the attainment of the internal audit department's objectives.

3.2 Effect of professional audit Competency on financial performance of organizations

Detecting fraud is a challenging task. Perpetrators actively engage in deception in an attempt to conceal their behavior, auditors may have limited experience in fraud detection, and fraudulent activities are inherently unpredictable and difficult to detect (Herz and Schultz, 1999; Kaplan et al., 2010; Nieschwietz et al., 2000). Hence, the organization would be optimally served by identifying and utilizing those individuals who, because they appear to share certain unique personality traits or characteristics, may be best suited to the fraud detection task. For example, Becker et al. (1981) used perceptions of relative aggressiveness between internal and external auditors to investigate the detection of corporate irregularities. Internal auditors play an important role in fraud detection with most frauds identified by the internal audit function (CPMG, 2003, Norman et al., 2010). Due to the importance of effective fraud detection, any measures that can enhance the efficacy of auditors should be of value. While experience and ability are undeniably important in the detection process, certain individual characteristics may be predictive of the capacity to detect fraud (Ashton, 1999). Understanding how auditors are perceived, and how these perceptions lead to beliefs regarding their detection abilities, is an important first step in relating personality traits to the efficacy of auditors.

A review of the research reveals a general acknowledgment that the five factor model can be used as a descriptive mechanism for the most salient elements of an individual's personality (Judge et al., 2002). Conscientiousness is the personality dimension primarily responsible for organizing and directing individual behavior and conscientious individuals may be characterized as responsible, diligent, persevering and thorough (Digman and Takemoto-Chock, 1981)

In fact, some studies have demonstrated that conscientiousness correlates with task performance almost as strongly as cognitive ability (Alonso, 2000). Previous research has demonstrated a linkage between conscientiousness and task performance, and the linkage has been shown to be stable across time (Barrick et al., 1993). Conscientiousness can affect job performance in a number of

ays. Conscientious employees are generally more reliable, more motivated, and harder working; they are also likely to devote more energy to the task at hand and spend less time daydreaming (Viswesvaran, 2006)

Wells (2003) conducted a series of interviews with successful fraud examiners and found that these individuals exhibited a cluster of common traits including perseverance, diligence and integrity each of which is an attribute of the conscientiousness dimension. Within the context of the five factor model, only conscientiousness has been found to reliably predict job performance across all occupational groups (Robertson et al., 2000).

This results in greater assimilation of task related knowledge, leading to greater productivity (Jones and Viswesvaran, 2006). Conscientious individuals would be expected to pay more attention to detail and profit more from vicarious learning, thus gaining enhanced job knowledge and being more productive (Bandura, 1977; Viswesvaran, 2006). These assertions were confirmed by Colquitt et al. (2000) who showed that conscientiousness was highly correlated with motivation to learn and by Borman et al. (1991) who demonstrated a positive association with job knowledge.

3.3 Effect of internal controls audits on financial performance of organizations

Controls audits are designed to ensure that appropriate controls over systems and software are in place to ensure that internal controls and internal checks are functioning as designed, (Haylas and Ashton, 1982). Controls audits can have features built into them to ensure that fraudulent transactions are flagged or made difficult, if not impossible, to transact. Controls audits provide assurance that controls are working, but they do not necessarily detect fraud or corruption. Internal controls audit objectives relate to management's plans, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal control includes planning, organizing, directing, and controlling program operations and the systems put in place to measure, report, and monitor program performance, (Esmailjee, 1993).

Haylas and Ashton (1982) in their effort to provide evidence on the effectiveness of particular audit techniques in detecting errors that affect the financial statements suggested that all intentional errors are concentrated in relatively few audits and these are fairly predictable by

dustry. The great majority of such errors affect income but the direction of effect may either be understatement or over statement. Regarding the signaling of an error, they found that the large portion of financial statements errors are initially signaled by less rigorous audit procedures such as analytical review and discussions with the client. Client personnel problems such as experience, incompetence and insufficient knowledge and inadequate control follow up or views were found instrumental in causing the errors.

Idih (1983) evaluated the internal controls of Ethiopian Airlines in Nairobi branch and concluded that the lack of segregation of accounting and custodian functions was the greatest weakness of the branch office. He argued that there is need to centralize cash receipts, establish an audit unit, separate accounting unit from sales section, separate duties of purchase activities and establish a perpetual inventory system for the tickets. He further emphasized that the existence of control is very crucial especially under today's condition with severe competition which place premium on reliable customers' services, on consideration of cash, on realization of capital assets and manpower and on other reduction costs.

Smaljee (1993) studied the internal controls of Nyayo Bus Service Corporation a state corporation. He observed that cash receipts as well as cash disbursements bear fairly strong controls attributed to the fact that the government accounting system is still in operation. However, the payroll and the stores accounting systems had a lot to be desired. Regarding the organizational chart, a lot of information was missing. The internal auditor was being underutilized as he was charged with the responsibility of performing routine control checks which were also performed by the examination section. This led to duplication of efforts and down playing of the internal auditor's effective role.

Meitany (2000) in a study of internal audit control functions and its implications for risk assessment by the internal auditor: A case of quoted companies concluded that even though the extent of reliance on internal control is not sensitive to the strengths of audit departments, companies should not do away with it. This is because as a management tool it should assist management in its day to day operations and not necessarily of any relevance to the external auditor. This may be attributed to the fact that external auditor may have specific considerations

which may be beyond the strength of internal controls. However, though the system of internal control was ranked as the most important factor in obtaining audit evidence other indicators followed. It therefore implies that once the auditor establishes the strength of the audit department, other risk indicators come into play notwithstanding the strength of internal control

a study investigating the effects of internal control deficiencies on firms risk and cost of equity capital, Ashbaugh, Collins, and Kinney (2006) concluded that firms that disclose an internal control problem experience a significant increase in market adjusted cost of capital and firms that subsequently improve their internal control systems exhibit a decrease in their market adjusted capital. This study provides evidence that internal control risk matters to investors and those firms reporting strong internal controls or firms that correct prior internal control problems benefit from lower costs of equity capital beyond that predicted by other internal control risk factors.

findings by Schneider and Church (2008) on the effect of auditor's internal controls opinion on loan decisions suggested that an adverse internal control opinion can underpin the assurance provided by unqualified opinion on financial statements taken as a whole and have a negative effect on lenders assessment. Adverse internal control opinion weakens the importance assigned to the balance sheet and income statement in lending decisions and that it reduces lenders confidence that financial statements are presented fairly in conformance with the generally accepted accounting principles. Khandawalla (1972) carried out a research on the relationship between the degree of competition and control. He concluded that the greater the degree of competition, the greater would be the need to control costs and evaluate whether actual performance meets the target performance expectations

4 Review of related studies on internal auditing and financial performance of organizations

According to Cooper and Craig (1983), on his study on the role of internal audit in the Asia Pacific region. This seminal research on internal audit in Australia found a number of issues that were of concern to the profession. It was found that there were a number of misconceptions about what internal auditors were doing and what their chief executive officers (CEO) perceived was being done and in fact there were expectations by the CEO's that internal audit could do

more than the traditional financial auditing work mainly being done at the time. There was nevertheless strong support for internal audit by CEO's and at the time it was seen as offering long-term career prospects. However, the profession in Australia in the early 1980's suffered from an image problem, it did not have a strong professional body to represent its interests as it has now, and there were no generally accepted professional qualifications recognized as necessary to practice as an internal auditor. The study was undertaken before the development of modern internal auditing, as we know it now. It did, however, set the scene for a number of subsequent studies in Australia, Hong Kong and Malaysia.

According to Peursem (2004), a major study was been undertaken in New Zealand on internal auditor's role and authority. In this study, internal auditors were asked to come to a view on whether functions they perform in connection with audit engagements are essential, and to what degree they feel they enjoy the authority over, and independence from, management that we might expect of a professional. The research constituted a survey of New Zealand auditors, all of whom were members of the New Zealand branch of the IIA. A very high percent (73%) response rate was achieved over the original and follow-up survey. The study found that characteristics of a 'true' profession exist but do not dominate. Significantly, and as subgroups, Peursem also observed that public practice and experienced auditors may enjoy greater influence over management, and accountancy-trained auditors may enjoy greater status owing to the mystique of the activities emanating from their membership of well-known accountancy professional bodies. The research supports prior studies by Coopers and Craig (1983), Cooper et al. (1966) and Gramling (1997) which all expressed serious reservations about the effectiveness of the internal auditor's role. In a follow up study in New Zealand, Peursem examined the role of the New Zealand internal auditor and conceptualizes on the auditor's influence over that role. The fundamental questions how an effective internal auditor can overcome the tension of working with management to improve performance, while also remaining sufficiently distant from management in order to report on their performance. The research found that there are three concepts characteristic of those who best balanced their role: the internal auditor's external professional status; the presence of a formal and an informal communication network; and the internal auditor's place in determining their own role

Mawanda (2008) conducted a research on effects of internal control systems on financial performance in institution of higher learning Uganda. In his study he investigated and sought to establish the relationship between internal control systems and financial performance in an Institution of higher learning in Uganda. Internal controls were looked at from the perspective of Control Environment, Internal Audit and Control Activities whereas Financial performance focused on Liquidity, Accountability and Reporting as the measures of Financial performance. The Researcher set out to establish the causes of persistent poor financial performance from the perspective of internal controls.

A survey, by Ernst & Young, polled 695 chief audit executives and C-suite executives and found that 80 per cent of them admitted that their organization's internal audit function has room for improvement. The report found that 75 per cent of the survey respondents believe strong risk management has a positive impact on their long-term earnings performance. An equal percentage of the respondents believe that their internal audit function has a positive impact on their overall risk management efforts. As the role of the internal auditor evolves and stakeholder expectations rise, internal audit functions increasingly require competencies that exceed the more traditional technical skills, such as the ability to team with management and business units on relevant business issues.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter consists of the methodology in terms of research design, the description of the population, the sample and sampling procedures, data collection procedures, data quality control measurements and data analysis procedures.

3.1 Research Design

The study employed a cross sectional design. This design was selected because the researcher intended to establish facts that already existed as opposed to creating new information that was necessitated experimental research. Cross sectional design deal with information that already exists. The findings established can be used to confirm validity of theories and examine relationships between variables encompassed by the study. The study was cross-sectional because data was gathered from the respondents at one point and there were repeat sessions. It was carried out using both qualitative and quantitative methods to generate information by use of questionnaires. The study therefore was based on the views of the respondents to draw conclusions and also make recommendations.

3.2 Population of the study

The population of the study employed of Pride microfinance. The employees were in three categories namely management accountants and operational employees with the population of 32. The population of these is courtesy of the human resource manual of the 2017/2018 for the respective employees.

3.3 Sample size and Sample size determination

3.1 Sample size

Out of the total population of the study, the researcher selected a sample of respondents who were identified from the total population of 32. This number was arrived at by use of the Slovene's formula as illustrated below.

: Slovene's Formular
$$n = \frac{N}{1+N(e)^2}$$

$$n = 32$$

$$n = \frac{32}{1+32(0.05)^2}$$

$$n = \frac{32}{1.08}$$

$$= 30$$

Table 3.1: Showing Breakdown of Population and Sample of Respondents

Category of Respondents	Population	Sample	Sampling Technique
Management	4	4	Purposive
Accountants	8	7	Simple Random
Operational employees	20	19	Simple Random
Total	32	30	

Source: Human resource Manual, 2018

3.3.2 Sample size determination

The researcher used both purposive and random sampling techniques to gather data. The Management was purposively selected since they head different departments of the selected companies and thus had sufficient knowledge concerning the study. Accountants and operational employees were randomly selected so as to get equal representation of the respondents. In that way, every member got an equal chance to be selected.

3.4 Research Instruments

3.4.1 Questionnaires

The questionnaires were used to obtain quantitative data for the research because it has been observed that in considering the various research options for systematically gathering information, the questionnaire has earned the right to be a perennial favourite, a frequent choice of researchers because of its being versatile, time efficiency and cost efficiency including the ability to get the job done. Here, self-administered questionnaires were employed containing close-ended questions.

3.5 Validity and Reliability of the instrument

3.5.1 Validity

The tool validity was checked and confirmed using retest method, three weeks later between the first and second application and using Cronbach Alpha for the internal coordination, the value for retest is to be a content validity index (CVI.) judges were used to establish a validity for each item. The inter judge coefficient validity was computed to be $CVI = \frac{\text{number of judges declared item valid}}{\text{total no of judges to arrive at an average acceptable for the study using the research instrument}}$.

According to Amin (2005) Validity of instrument is determined by the formula:

$$CVI = \frac{RQ}{TQ}$$

Legends: CVI = Content Validity Index

RQ = Relevant Questionnaires

TQ = Total Number of Questions

Total number of questions for the instrument accepted as valid was based on the average index which was computed. A value of 0.7 and above implied that the instrument is valid.

3.5.2 Reliability of the instrument

The reliability of the questionnaires were improved through pre-testing of pilot samples. This enabled the amendment of some questions. Furthermore, reliability of the scales was carried out with the application of the Cronbach Coefficient Alpha for the computations so as to check for the internal consistency of the scales. The Cronbach Coefficient Alpha on internal consistency test was with the results to be presented in a table. The reliability indices/coefficients for all constructs used in the study. All alpha reliabilities (α) for all scales were computed and be above 0.5, ranging from meet acceptance standards for research (Nunnally, 1978).

3.6 Sources of data

Both primary and secondary data was used

3.6.1 Primary Data

The researcher gathered data by means of key format interviews, and questionnaires which was given to the respondents in order to capture the information about internal auditing and financial performance. This was used to compare the status quo in terms of previous and current information on internal auditing.

3.6.2 Secondary data

Secondary data is information which has been already collected by someone else for other purposes and can be used to compile data or raw data. Secondary data was obtained through notes, correspondences and minutes of meetings from and reports of the organizations of the study.

3.7 Data collection procedure

The data collection procedures were undertaken three phases that included pre data gathering, actual data gathering and post data gathering

Pre data gathering

- i. An introductory letter was secured from the college of higher degree and research to conduct the study after which permission from the organizations was sought to distribute questionnaire to their respondents.
- ii. The researcher oriented and brief his research assistants on the sampling and data gathering procedures.
- iii. The questionnaires for actual distribution were prepared and code accordingly.
- iv. The non-standardized instruments were tested for validity and reliability.

Actual data gathering

- The respondents were requested to answer the questionnaires as objectively as possible and not to leave any option unanswered.

Post Data Gathering

- The data was collected, organized and entered into excel for data processing and analysis in order to prepare the final report for submission to the college of economics and management

CHAPTER FOUR

DATA PRESENTATION, INTERPRETATION AND ANALYSIS OF FINDINGS

4.0 Introduction

The data is presented and interpreted in view of the topic establishing the impact of internal auditing function on financial performance of Pride Microfinance. The focus was on 30 respondents who included the selected respondents of Pride Microfinance. The interpretation also sought to answer the research questions that were raised in chapter one. Presentation and interpretation of data in this chapter has been done with the aid of quantitative and qualitative methods. Quantitative methods involved the use of tables, graphs, percentages and personal analysis and interpretation presented in essay form. The data analysis and interpretation was based on the research questions as well as research objectives, the presentation is divided into two parts. The first part presents the respondents profile or demographic information, while the second part deals with presentation, interpretation, and analysis of the research objectives.

4.1 Demographic information of respondents

This part presents the background information of the respondents who participated in the study. The purpose of this background information was to find out the characteristics of the respondents in terms of gender, age, level of education, time of stay in the organization and position in organization as per the study.

4.1.1 Gender of respondents

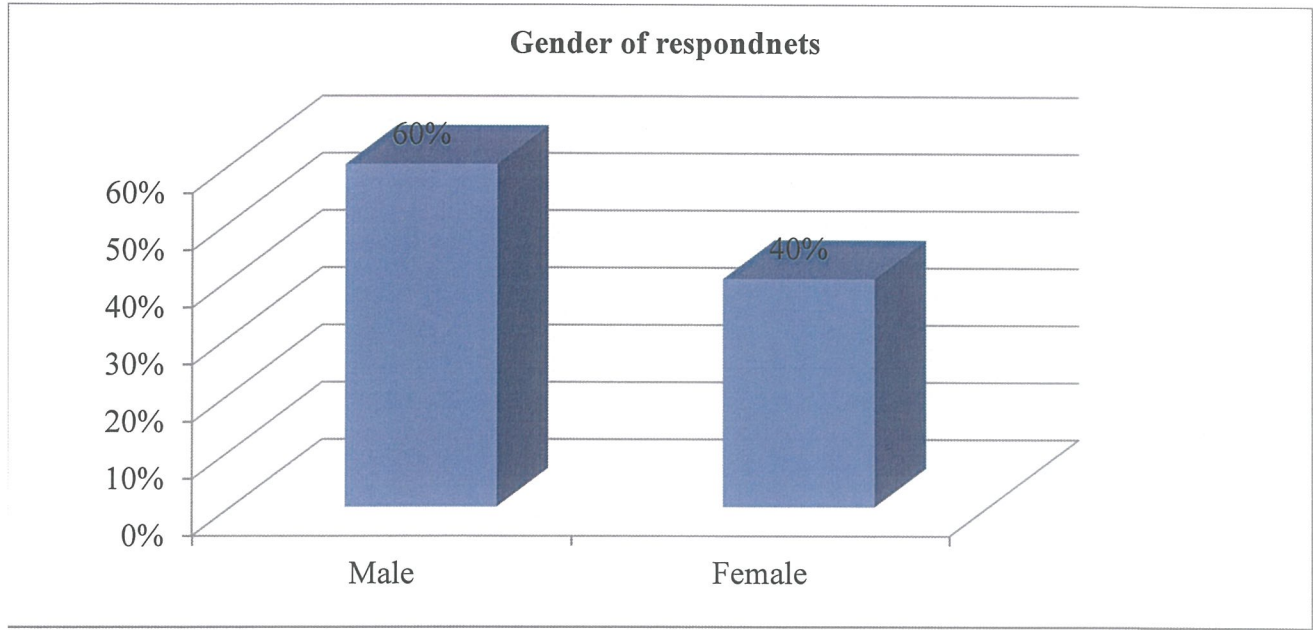
Here the researcher was interested in gathering information on the gender of respondents and information got was presented in the table below.

Table 1: Showing Gender respondents

Gender	Frequency	Percentage
Male	18	60
Female	12	40
Total	30	100

Source: Primary data, 2019

Figure 1: Shows the gender of the respondents



Source: Primary data, 2019

From table 1, it can be seen that the majority of respondents are male that is (18) representing 60% of the total number of respondents, 12 respondents are female representing 40% of the respondents. This is an indication that gender sensitivity was taken care off so the findings therefore cannot be doubted on gender grounds; they can be relied for decision making. It further indicates that the researcher sought for information from both genders.

4.1.2 Findings on age distribution of respondents

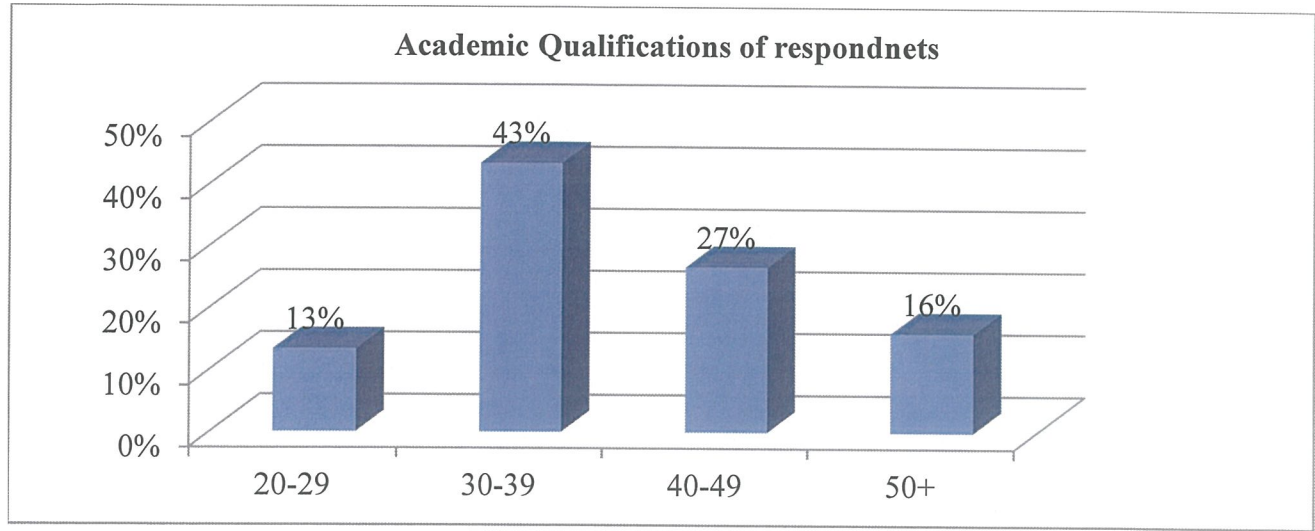
Here the researcher was interested in gathering information on the age of respondents and information got was presented in the table below.

Table 2: Show the age distribution of respondents

Age	Frequency	Percentage
20 –29	4	13.3
30 – 39	13	43.3
40 – 49	8	26.6
50+	5	16.7
Total	30	100

Source: Primary data, 2019

Figure 2: Shows the age of respondents



Source: Primary data, 2019

Table 2 above shows that, majority of respondents were aged between 30–40 years 13(43.3%) respondents followed, by 40–50 years represented by 8(26.6) respondents, followed by 51+ represented by 5(16.7%) respondents and 20–29 represented by 4(13.3%). From the above analysis, it can be construed that majority of the respondents are mature hence the information obtained from them can be trusted and looked at as true and good representation of the information the researcher was looking.

4.1.3 Findings on education of respondents

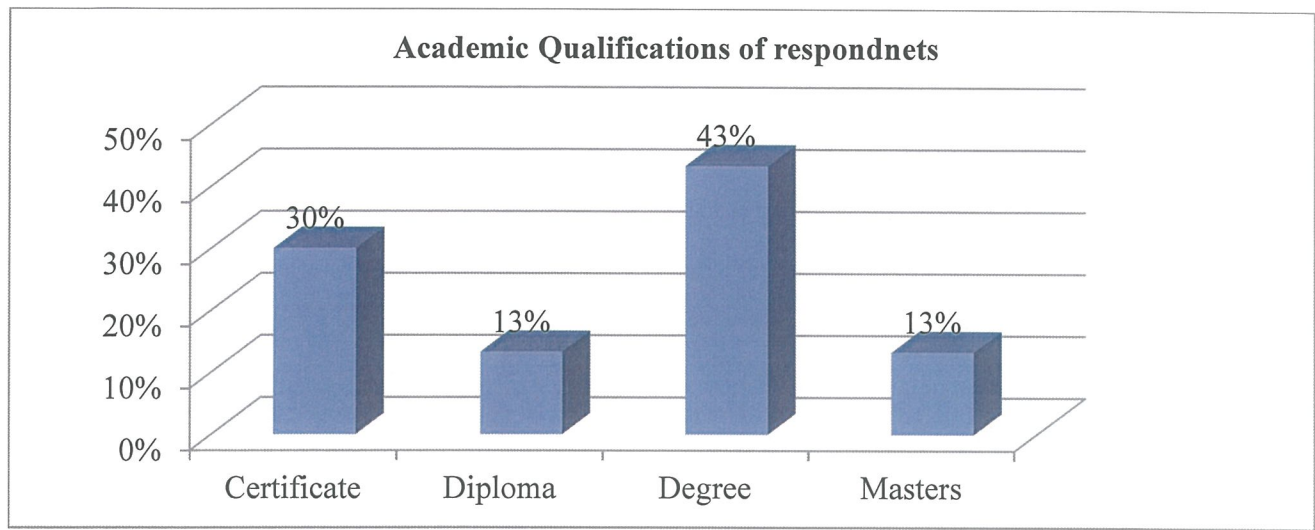
Here the researcher was interested in gathering information on the education of respondents and information got was presented in the table below.

Table 3: Show education of the respondents

Academic qualifications	Frequency	Percentage
Certificate	9	30.0
Diploma	4	13.3
Degree	13	43.3
Others	4	13.3
Total	30	100

Source: Primary data, 2019

Figure 3: Bar Graph shows academic qualifications of the respondents



Source: Primary data, 2019

Results in table 3 indicate that majority of the respondents were 13 for degree holders representing 43.3% followed by certificate level with 9 respondents representing 30% , diploma followed with 4 respondents representing 13.3% and others with the same with 13.3%. This implies that the respondents are well educated and therefore the information obtained from them can be relied on for the purpose of this study. It is of no doubt therefore that information is attained from highly educated respondents. Information can therefore be relied on for decision making in this topic.

4.1.4 Time of work in this organization

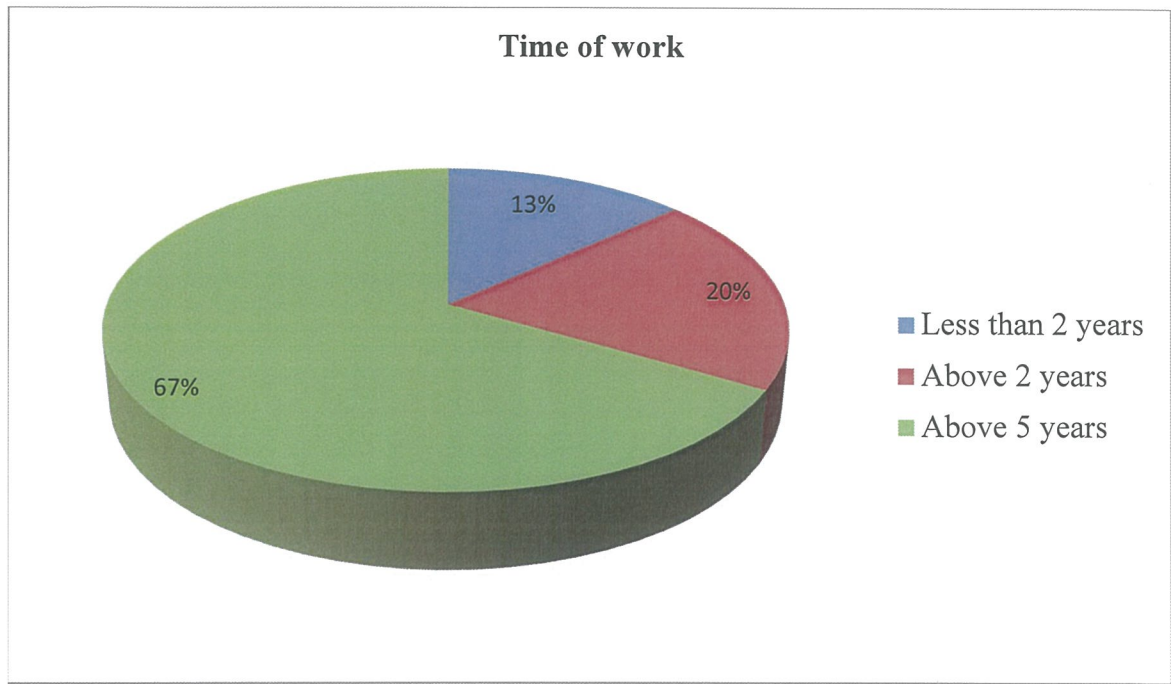
Here the researcher was interested in gathering information on the time of work in the organization by respondents and information got was presented in the table below.

Table 4: Show Time of work in this organization

Time of work	Frequency	Percentage
Less than 2 years	4	13.3
Above 2 years	6	20.0
Above 5 years	20	66.7
Total	30	100

Source: Primary data, 2019

Figure 4: Pie chart shows the marital status of respondents



Source: Primary data, 2019.

Results on the time respondents have worked in Pride microfinance were that majority of the respondents had worked there for above 5 years (66.7%) of the respondents, above 2 years had 20% of the respondents, Less than 2 years had 13.3% of the respondents. This implies that many respondents had worked in the organization for a long period of time.

4.2 Effect of internal audit Standards on the financial performance of Microfinance Institutions

The first objective of the study was to establish effect of internal audit Standards on the financial performance of organizations. The study findings are presented and interpreted as showed below.

Table 6: Show the responses on effect of internal audit Standards on the financial performance of Microfinance Institutions.

Weight	Strongly Agree		Agree		Not Sure		Disagree		Strongly Disagree		Total	
	f	%	f	%	F	%	f	%	F	%	F	%
Internal audit Standards and financial performance												
Provide guidance in the auditing	16	53.3	6	21.6	2	6.7	2	6.7	4	13.3	30	100
IAS provide measures for audit evaluation	14	46.7	9	30	7	23.4	0	0	0	0	30	100
The IAS provide means and direction to auditing	20	66.7	3	10	1	3.3	2	6.7	4	13.3	30	100
Provide areas of the guidance on audits	19	63.3	2	6.7	3	10	2	6.7	4	13.3	30	100
Provide aspects of auditable areas	10	33.3	9	30	3	10	5	16.7	3	10	30	100
Provision of utmost organizational state identification	15	50	2	6.7	7	23.3	4	13.3	2	6.7	30	100
The IAS provide aid to the auditors detection of fraud	9	30	10	30	7	23.3	2	6.7	2	6.7	30	100
The IAS is fundamental for effective auditing	8	26.7	6	20	7	23.3	5	16.7	4	13.3	30	100
Totals	95	370	47	155	37	123.3	22	73.5	23	76.6	30	100

Source: Primary Data, 2019

The table 6 illustrates field data collected on role of internal audit Standards on the financial performance of Pride Microfinance Limited, the responses were captured in form of those who strongly agree, agree, not sure, disagree and strongly disagree. The following was collected.

Provide guidance in the auditing according to 16(53.3) strongly agreed respondents, 6(21.6%) agreed while 6.7% were not sure, 6.7% disagreed while 13.3% strongly disagreed.

IAS provide measures for audit evaluation had (14) 46.7% of the respondents who strongly agreed, (9) 30% agreed, (7) 23.4% were not sure, none of the respondents strongly disagreed and none of the respondents disagreed.

The IAS provide means and direction to auditing had (20) 66.7 % of the respondents who strongly agreed, (3) 10% agreed, (1) 3.3% were not sure and (2) 6.7% and (4) 13.3% strongly disagreed and disagreed respectively on this cause.

Provide areas of the guidance on audits had (19) 63.3% of the respondents who strongly agreed, (2) 6.7% agreed, (3) 10% were not sure, (2) 6.7% disagreed and (4) 13.3% strongly disagreed.

Provide aspects of auditable areas (10) 33.3% of the respondents who strongly agreed, (9) 30% agreed, (3) 10% were not sure, (5) 16.7% disagreed and (3) 16.7% strongly disagreed.

Provision of utmost organizational state identification had (15) 50% of the respondents who strongly agreed, (2) 6.7% agreed, (7) 23.3% were not sure, (4) 13.3% disagreed and (2) 6.7% strongly disagreed. This was the cause that had the largest number of respondents who strongly agreed and agreed.

The findings were also that there is the IAS provide aid to the auditors detection of fraud the responses were that 30% of the respondents strongly agreed, 30% agreed, while 23.3% were not sure , 6.7% of the respondents disagreed while 6.7% of the respondents strongly disagreed.

Finally the IAS is fundamental for effective auditing was that the respondents had 26.7% of the respondents who strongly agreed, 20% agreed, 23.3% of the respondents were not sure while 16.7% of the respondents disagreed and 13.3% of the respondents strongly disagreed.

The information from above reveals that the level of agreement on role of internal audit Standards on the financial performance of Pride Microfinance (Those who strongly agreed and agreed) this is because the overall agreement presents above 66 percent average on the responses presented on internal audit Standards with respect to provide guidance in the auditing 77%, IAS provide measures for audit evaluation had 76%, provision of utmost organizational state identification 79%, provide aspects of auditable areas 68%, providing auditable areas had 65% and Provision of utmost organizational state identification 79%. The IAS is fundamental for effective auditing 46%, The IAS provide aid to the auditors detection of fraud60%.These findings imply that internal audit Standards contribute to the financial performance of Pride Microfinance.

4.3 Effect of professional audit Competency on financial performance of Pride Microfinance

The second objective of the study was to establish the effect of professional audit Competency on financial performance of Pride Microfinance. The data collected was presented and interpreted as shown below.

Table 7: Show responses on effect of professional audit Competency on financial performance of Pride Microfinance

Statement	Strongly Agree		Agree		Not Sure		Disagree		Strongly Disagree		Total	
	f	%	F	%	F	%	F	%	f	%	F	%
Attaining competency in audits	6	20	18	60	3	10	3	10	0	0	30	100
Establishing the gaps in the organizational audits	15	50	6	20	3	10	3	10	3	10	30	100

Provision of standards for audits	14	46.7	6	20	5	16.7	2	6.7	0	0	30	100
Enhancing the authenticity of the audit	16	53.3	5	16.7	1	3.3	4	13.3	4	13.3	30	100
Provision of means to effective evaluation	7	23.3	12	40	4	13.3	3	10	4	13.3	30	100
Provision of an audit competent requirements	9	30	10	30	7	23.3	2	6.7	2	6.7	30	100
Effective detection of the audit errors	19	63.3	1	3.3	2	6.7	6	20	2	13.3	30	100
Provision of the audit security and trust	9	30	10	30	4	13.3	5	16.7	3	10	30	100
Totals	95	316.6	68	220	29	96.6	28	93.4	18	66.6	30	100

Source: Primary Data, 2019

The data collected above shows that in relation to the effect of professional audit Competency on financial performance of pride Microfinance. The research was based on the agreement parameters of strongly agreed, agreed, not sure, disagree and strongly disagreed.

Attaining competency in audits had 6(20%) of the respondents who strongly agreed, 18(60%) agreed, 3(1%) of the respondents were not sure and 3(10%) disagreed and none strongly disagreed.

Establishing the gaps in the organizational audits had 15(50%) of the respondents strongly agreed, 6(20%) agreed, 3(10%) of the respondents were not sure, 3(10%) disagreed and 3(10%) strongly disagreed.

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SECTION B: Effect of internal audit Standards on the financial performance of organizations.

The use of likert scale were 1= strongly disagree, 2= Disagree, 3= Neutral, 4= Agree, 5= Strongly Agree.

		Rankings				
	Internal audit standards and financial performance	1	2	3	4	5
a)	Provide guidance in the auditing					
b)	IAS provide measures for audit evaluation					
c)	The IAS provide means and direction to auditing					
d)	Provide areas of the guidance on audits					
e)	Provide aspects of auditable areas					
f)	Provision of utmost organizational state identification					
g)	The IAS provide aid to the auditors detection of fraud					
h)	The IAS is fundamental for effective auditing					

**COLLEGE OF ECONOMICS AND MANAGEMENT
DEPARTMENT OF ACCOUNTING AND FINANCE**

MARCH, 11TH 2019

To whom it may concern

Dear Sir/Madam,

RE: INTRODUCTORY LETTER FOR MAKONA SHEDRACK 1161-05014-04209

This is to introduce to you the above named student, who is a bonafide student of Kampala International University pursuing a Bachelor's Degree in Business Administration, Third year Second semester.

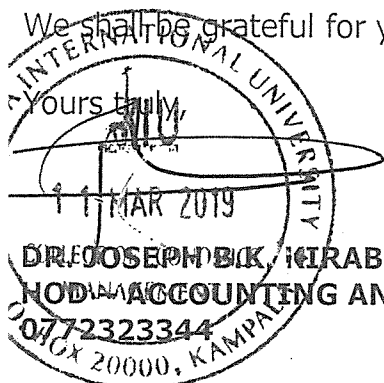
The purpose of this letter is to request you avail him with all the necessary assistance regarding his research.

**Topic: - INTERNAL AUDIT FUNCTION AND FINANCIAL
PERFORMANCE OF MICRO FINANCE INSTITUTIONS**

CASE STUDY: - PRIDE MICRO FINANCE KABALAGALA BRANCH

Any information shared with him from your organization shall be treated with utmost confidentiality.

We shall be grateful for your positive response.



**DR. JOSEPH BIKIRABO
HOD. ACCOUNTING AND FINANCE**

0772323344

PRIDE MICRO FINANCE

P.O BOX 31817
KABALAGALA BRANCH

DE MICRO FINANCE

14th March, 2019

BOX 31817,

Kabalagala Branch

Ref: CR /204/1

Ref:

Head of Accounting & Finance,

Kampala International University,

P.O BOX 20000,

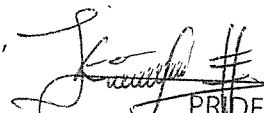
Kampala, UGANDA

ACCEPTANCE OF Mr. MAKONA SHEDRACK FOR FIELD RESEARCH PRIDE MICRO FINANCE.

to acknowledge receipt of your letter dated 11th March, 2019 regarding the research information
of the above mentioned student.

The purpose of this letter therefore, is to inform you that we have accepted him to carry out his research
in **PRIDE microfinance**.

We have also advised to avail the evaluation criteria to the work based supervisor to guide
the student appropriately.


PRIDE
MICRO FINANCE
LIDAWISI 4 MAR 2019 ★
PO BOX 31817
KABALAGALA BRANCH
RESOURCE MANAGER

PRIDE MICRO FINANCE

KABALAGALA BRANCH