
Effect of Contingency Factors on Risk Based Internal Audit Function among Deposit Money Banks in Nigeria

Mohammed Abdulkadir¹, Mohammed Bukar Kauji² and Fatie Ahmed Abdullahi³

^{1, 2 & 3} Department of Accountancy, Ramat Polytechnic Maiduguri
Corresponding E-Mail: mohammadabdulkadir114@gmail.com
Mobile: 08037336372

Abstract: *The study examine how contingency factors explain variations in risk based internal audit among Deposit Money Banks operating in Nigeria. It was restricted to only the selected contingency factors which were; organization size, structure, and environmental uncertainty as it affects deposit money banks in Nigeria. Data were obtained from primary sources through a structured questionnaire. Multiple Regression analysis and Analysis of Variance (ANOVA) were implored in testing the formulated hypotheses. Even though the study could not establish significant impact of organizational structure on risk based internal audit among DMBs in Nigeria, it concluded that only size (Number of branches) had considerable effect on RBIA and it was recommended that a comprehensive audit plan based on the risk needs of the bank should be developed to include spot checks on key areas at strategic intervals to ensure that branches are effectively covered and such areas were adequately reviewed so that size will not affect risk based internal audit function among DMBs in Nigeria.*

Key words: *Contingency, risk Based, Internal Audit, Deposit Money banks, Nigeria*

Introduction

Internal auditing has evolved remarkably over the years and has gained an increasingly important role within organizations including deposits taking organizations (Sridhar, 2003). The banking industry in Nigeria has received lot of attention over the years, particularly after the series of corporate failures. As part of measures to restore the credibility of banks, particularly of Deposit Money Banks, advanced corporate governance measures such as Risk Based Internal Audit was recommended by Basel Committee of Banking Supervision (BIS, 2012). Apart from the need to comply with this pronouncement, management in order to respond to fierce global competition tend to include improved quality and risk management initiatives, reengineered structures such as risk based internal audit to promote accountability.

As the banking industry evolved to meet the yearnings of good governance so has its internal control functions metamorphosed. In the view of (Chapman & Anderson, 2002) internal audit function not only secures good governance, as an independent, objective assurance and consulting task it seeks to add value, increase operational efficiency and help organizations accomplish predetermined objectives. Providing more support for this view Griffiths (2015) reiterated that the main function of internal auditing was to assist organisations to achieve its set objectives/goals.

Despite the relative importance of risk based internal auditing function, its success may vary among organisations in the same industry. Theorist in the field of management particularly theorist of contingency reasoning have attempted to explain why results of a common phenomenon may vary among business entities in the same industry.

Contingency theory postulates that there is no one best way of designing planning and control systems and management systems that are effective in one situation may not be successful in others. In other words, an optimal management system is contingent upon internal and external variables. In line with the propositions of the contingency theory therefore, there is no one best practice of achieving management objectives (Lawrence & Lorsch, 1967).

Researchers mostly gave emphasis on contingency factors as it relates to management and internal control system in organisations. This is evidenced in Fisher (1995) and Gerdin (2005) where it was noted that a control system may have to be tailored to multiple and sometimes conflicting contextual characteristics. Similarly, using the contingency approach researchers have attempted to explain the effectiveness of accounting and management control systems by examining designs that suit the nature of the environment, size, structure, technology, strategy, task environment, national culture, international competition and societal differences (Chapman, 1997; Reid & Smith, 2000; Chenhall, 2003). The relationship between internal control, management control systems and risk based internal audit was that of a dependent and independent variable. That is to say, risk based internal audit depends on the controls put in place by management in order to function. Control systems (Management or Internal) are those systems put in place by management of an organisation in order to safeguard assets and ensure the achievement of organisational objectives. While risk based internal audit validates that the internal control environment is functioning as planned, that assets are adequately safeguarded, and that the organization is operating in conformance with established policies.

Previous researches on contingency studies looked at effect of organization's size on control processes (Bruns and Waterhouse 1975; Ezzamel 1990; Libby and Waterhouse 1996; Hoque and James 2000; Duncan et al. 1999). These studies however, have not considered how organizational size may affect RBIA. Similarly, other researchers (Chenhall, 2003; Emmanuel et al., 1993 and Otley, 1980) noted that organizational structure remains an important factor in understanding the design of internal control. That, adopting particular structures affects control system as some relationships would be encouraged and others discouraged. These researches only explained how organisational structure influenced internal control system but not its effect on RBIA function. In the same vein, researchers such as (Merchant 1990; Hartmann 2000; Chenhall 2003) confirmed that environmental uncertainty is associated with a need for more open, externally focused, non-financial styles of Management Control System. It was clear that studies conducted on environmental uncertainty were related to management control system; hence the reason for the study on environmental uncertainty as it affects RBIA function.

From the forgoing it could be deduced that, the study on how contingency factors affects risk based internal audit function does not have much attention from researchers; hence the creation of gap in the area. Based on the position of contingency theory and internal control as highlighted in literatures (Jokpii, 2006), the study adopts contingency theory perspective as it relates to risk based internal audit among deposit money banks in Nigeria. To capture the complexities of risk-based internal audit structure design, this study examine three contingency characteristics, the impact of size, organization structure, and environmental uncertainty on a risk-based internal audit function.

Review of Literatures

Conceptual Issues

The conceptual issues discussed are: Internal auditing, risk based internal audit and the contingency factors (Organisational size, structure and environmental uncertainty).

Internal Auditing

Morgan (1979) viewed internal audit as a monitoring function which serves as organizational policeman and watchdog. According to Cook and Winkle (1976), the Internal Control System and consequently internal audit resembles the human nervous system which is spread throughout the business carrying orders and reactions to and from the management. Carmichael and Willingham (1987), and Grigorakou (1989) agree that internal auditing is the audit performed by employees of organizations functioning in a staff capacity and reporting to a higher level officer in the organization. Carmichael, Willingham, and Schaller (1996) argue that internal auditing is an important managerial control function which measures and evaluates the effectiveness of organizational controls.

Internal auditing is an independent appraisal function, established within an organization to examine and evaluate activities as a service to the organization. In addition it is designed to provide reasonable assurance regarding achieving organisation objectives (IIA, 1991).

The banking business management is responsible for drawing up procedures which identify measure, monitor and control the risk exposure of banks. The management is responsible for risk management, proposing suitable internal control mechanisms and monitoring their adequacy and efficiency. Internal audit function involves a repetitive monitoring of compliance with laws as well as prescribing measures and internal procedures for evaluating internal control.

The rapid growth in the balance sheet size of banks and the setting up of numerous branches, particularly as a result of the consolidation exercise, the need arises for administrative and operative authority to be delegated downwards. This is to ensure rapid and efficient services to the public. Since such delegations by the management are without abdication, the Executive Management, therefore, rely largely on the Chief Inspector of the bank to ensure effective monitoring of day to day activities of all units of the organisation. Information provided by the internal audit department will place management in a better position to consider necessary review of internal control measures and systems. Despite the benefits derivable from an internal audit function, the spate of corporate failures associated with poor corporate governance have paved way for a more robust internal audit function known as the Risk Based Internal Audit (RBIA).

Risk Based Internal Audit

Risk based internal audit (RBIA) is a term derived from the Institute of Internal Auditors (IIA) research foundation based in the USA (IIA, 2004) arising from a significant gap existing between available guidance and current practise of internal auditing, as well as the need to carry the auditing profession into the 21st century. Ideally, risk based internal audit is a paradigm shift from traditional approach of pre-auditing or transactional audit to systems audit and finally to risk based audit. In pre-audit, management abdicates its responsibilities to internal audits; under this system there were no audit reports and no review of the control system by management. On the other hand, systems audit was passive and reactive control based audit with no involvement of management in audit planning. Therefore, for internal audit to be effective and efficient, risk based internal audit was introduced in 2004 by the Institute of Internal Auditors (IIA). This new approach first determines organizational risks, thereby allowing for optimal use of rare audit

resources, higher agreement between internal audit and management goals, in order to facilitate organizational development, and reduce the potential for risks (Hematfar & Hemmati 2013). RBIA have shifted the focus of internal audit from systems-based to risk-based, internal auditors are also concern about the business risk. Thus, the work of internal auditors have moved from being control-driven to being business risk-driven (Castanheira, Rodrigues, & Craig, 2010).

Contingency Factors

Understanding the contingencies affecting the internal control structure is important when evaluating and restructuring the organization's control system. Modern management techniques have caused organizational downsizing, decentralization, fewer layers of middle management, delegation of responsibility and tendency to simplify processes in organizations (Jokipii 2006).

Fisher (1998) classified contingency characteristics examined in prior management control studies into five categories. The first category consists of variables related to uncertainty, which includes task and external environment uncertainty. The second category consists of firm technology and interdependence. The third contingency characteristics category includes industry, firm and business unit variables, such as size, diversification and structure. The fourth category consists of competitive strategy and mission. The last category examined in the control literature includes observability characteristics. Observability of behaviour or outcomes implies that control can only be exercised over variables that are observable by the evaluator.

Previous studies (Fisher 1995; Gerdin 2005) has noted that a control system may have to be tailored to multiple and sometimes conflicting contextual characteristics. To capture the complexities of risk-based internal control structure design, this study adopts three contingency variables namely; size, organization structure, and environmental uncertainty. There is evidence from earlier studies that these characteristics have some impact on the design of control structures and on performance (Castanheira, Rodrigues, & Craig, 2010; Henri, 2006; Chenhall 2003; Donaldson 2001; Hoque & James 2000; Macintosh 1994; Simons 1987; Drazin & Van de Ven 1985; Otley 1980).

Organizational Structure

Organizational structure refers to an internal pattern of roles, communication, authority and relationships. Chenhall (2003) noted that organizational structure remains an important factor in understanding the design of internal control. When adopting particular structures, certain kinds of contacts and relationships are encouraged and others discouraged (Emmanuel, Otley, & Merchant 1993). Otley (1980) suggested that different forms of organizational structure would require different types of accounting information to be provided to enable them to operate effectively. For example, a mechanistic structure (more centralized, vertically differentiated and formalized than an organic structure) may facilitate internal control by reducing the variability and increasing the predictability of work behaviour. However, a mechanistic structure may also reduce internal control effectiveness due to control loss in multiple hierarchies (Evans 1975) or alienation induced by centralization (Morris, Steers & Kock 1979). In a centralized organization the decision-making authority sits high up in the structure: the need for monitoring and control activities in the decision-making process is reduced. Vertically differentiated organizations may have problems with the information and communication component because information has to flow through different levels of the organization (Gosselin 1997). A highly formalized organization has control activities, but a low reliance on formal rules and procedures implies greater personal discretion and a tendency to take more features into account when monitoring and controlling (Whitley 1999).

Empirical Studies on Risk-Based Internal Auditing

Ayagre (2014) investigated the adoption of RBIA, factors influencing its adoption and the involvement of internal auditors in risk assessment based on ERM among Ghanaian companies. The study found that RBIA is popular amongst Ghana's club 100 companies and most pronounced in the financial services, telecoms and manufacturing companies. It also found that internal auditors are highly involved in risk management using the ERM. In a study to determine the impact of RBIA on financial performance using data from Kenyan commercial banks and adopting a survey method. Kasiva (2012) found that RBIA through risk assessment, risk management, annual risk based planning, internal auditing standards and internal auditing staffing when enhanced in these firms will assist in timely risk detection. This will allow the internal auditors to concentrate on high risk areas leading to increased transparency and accountability thus, enhancing financial performance.

Jokipii (2010) examined important contingency characteristics that should be taken into account when focusing on the internal control in an organisation, to determine which of the characteristics are helpful in explaining variations in an internal control system and its observed effectiveness. The study adopted a survey methodology with data collected through a web-based questionnaire. The study developed measurement models for internal control and its effectiveness and used them as latent variables in a quantitative analysis, using the SEM approach. The model was able to predict 9% of an internal control structure and 82% of observed internal control effectiveness. The results also showed that strategy and high perceived environmental uncertainty matter more in internal control than the other contingency characteristics examined.

Goodwin-Stewart and Kent (2006) use an agency framework to explore firm characteristics associated with the existence of internal audit function from risk management, control and governance perspectives influence, accountability and enhance provision of financial statement thereby influencing financial performance in financial institutions.

Theoretical Framework

Contingency Theory

Contingency theory emerged in the management literature in the late 1960s and the 1970s, as an alternative to the view of classical management theorists that there was a single 'best way' for managers to achieve efficient organizational operations. The roots of a contingency approach to management theory lay in the observation that in some cases the violation of classical management principles led to positive outcomes (Bartol et al. 1995). In its simplest form contingency theory contends that what constitutes effective management is situational, depending upon the unique characteristics of each circumstance.

While the roots of contingency theory are in the management and organizational theory literature, application of the theory to accounting, and in particular to the area of management accounting, followed quite quickly. The work of Hayes' (1977) on organizational sub-unit performance assessment, in which much of his model development is based on the work of Thompson (1967), represents one of the early efforts at applying a contingency approach to management accounting. The use of contingency theory in management accounting research has continued to advance.

Contingency theory is considered appropriate for the study because it fits the Committee of Sponsoring Organizations of the Treadway Commission (COSO, 1994) framework which suggests that two organizations should not have similar internal control systems unless the

organizations are completely identical. Contingency theory provides a widely approved research approach to study internal control and its effectiveness. Similarly, Chenhall (2003) observed that contingency-based management control research follows the conventional view that management control system as a passive tool designed to assist managers' decision-making.

Using the contingency approach researchers have attempted to explain the effectiveness of accounting and management control systems by using the nature of the environment, size, structure, technology, strategy, task environment, national culture, international competition and societal differences (Chapman 1997; Mitchell, Reid & Smith 2000; Chenhall 2003).

Methodology

Sources of Data and type of data

This study relied extensively on primary data gathered from primary sources. The study used primary source of data to generate responses on the effect of contingency factors on risk based internal audit function among Deposit Money Banks (DMBs) in Nigeria through web based questionnaire.

The Study Area

The study covered Deposit Money Banks (DMBs) in Nigeria focusing on branch supervision, compliance and control units of 21 DMBs. These units were saddled with the responsibility of assessing the implementation of the risk based internal audit function in the bank as such information relevant for the research was obtained from them.

The population for this study comprised of internal auditors in the twenty one (21) Deposit Money Banks in Nigeria. In these departments, persons designated as Unit Head in the Internal Audit and Control, Compliance or Risk Management department of DMBs were selected because their of job description. The individuals are usually involved in internal audit and control, compliance or risk management. As such they are more informed about risk based internal audit function.

Sample size and sampling technique

The sampling technique adopted in this study was purposive sampling. This sampling techniques was considered suitable for this study because the questionnaire responses can best be answered by them. As it will target respondents with particular characteristics or experience who will be more useful in providing the responses needed for the research (Etikan, Musa, & Alkassim, 2016).

According to Etikan *et al.* (2016) the purposive sampling technique, also called judgment sampling, is the deliberate choice of a participant due to the qualities the participant possesses. It is a nonrandom technique that does not need underlying theories or a set number of participants. Simply put, the researcher decides what needs to be known and sets out to find people who can and are willing to provide the information by virtue of knowledge or experience. This method was put to use by identifying internal audit and control, compliance and risk management departments in the selected deposit money banks. Consequently, three respondents were selected from each deposit money bank. A total of sixty-three respondents were sampled.

Method of Data Analysis

Both qualitative and quantitative techniques were deployed in data analysing for this study. After receiving questionnaires from the respondents, the responses were edited, classified, coded and tabulated to analyze quantitative data using Statistical Package for Social Science (SPSS version 20). Tables and charts were used to further represent the data for easy understanding and

analysis. The collected data was thoroughly examined and checked for completeness and comprehensibility. The data was then be summarized, coded and tabulated.

Presentation and Analysis of Data

Data reduction using Principal Component Analysis (PCA)

To examine the influence of contingency factors of size, organisational structure and environmental uncertainty we used the multiple regression function. Since the dependent variable is a categorical variable with ordered categories between 1 and 3 an ordinary least square regression will be inappropriate (Greene, 2000). The result of Ordinal Regression using SPSS is presented below. The hypothesis was tested using the sign of the coefficient and the p-value of size, organizational structure and environmental uncertainty.

**Table I
Model Fitting Information**

Model	-2 Log Likelihood	Chi-Square	df	Sig.
Intercept Only	118.487			
Final	.000	118.487	4	.000

Link function: Logit.

The Model Fitting Information in table I above obtained from the ordinal regression showed that, the significant chi-square statistic ($p < 0.05$) indicates that the final model gives a significant improvement over baseline intercept-only model. This implies that the model give better predictions than a guessed outcome based on the marginal probabilities for the outcome categories. This also mean that the model is fitted for our variables as sig ($p < 0.05$).

**Table II
Parameter Estimates**

	Estimate	Std. Error	Wald	df	Sig.	95% Confidence Interval		
						Lower Bound	Upper Bound	
Threshold	[RBIA = 1]	-40.881	13.155	9.658	1	.002	66.663	-15.098
	[RBIA = 2]	-15.775	6.024	6.859	1	.009	27.582	-3.969
Location	N_Branches	-.087	.032	7.283	1	.007	-.151	-.024
	RLin_CEO	1.006	1.271	.627	1	.429	-1.485	3.498
	RStaffstrength	-.087	.432	.040	1	.841	-.934	.761
	CusTastes	-.708	.802	.780	1	.377	-2.279	.863

Link function: Logit.

From table II above, the coefficient of RLin_CEO used as the study’s proxy for organization structure is positive while the sig. (p-value) is greater than 0.05. Thus, we fail to reject H_{01} . The result also showed that an increase in RLin_CEO by one point, the ordered log-odds of having a higher RBIA rating will increase by 1.006 while other variables in the model are held constant.

This implies that organisations with tall organizational structures are more likely to have higher RBIA rating.

From table II above, N_Branches has a negative coefficient and a sig (p-value) less than 0.05. Thus, we reject H₀₂. The result indicates that an increase in N_Branches by one point, the ordered log-odds of being in a higher RBIA reduce by 0.087 while other variables in the model are held constant. This indicates that the number of branches in a banks have negative impact on their RBIA.

Table II above showed that CusTastes has a negative coefficient and a sig (p-value) greater than 0.05. Thus, we fail to reject H₀₃. From the above results, the study also found that an increase in CusTastes by one point, the ordered log-odds of having a higher RBIA rating will decrease by 0.708. This indicates that CusTastes have a negative relationship with RBIA rating.

Discussions of findings

The results from data obtained and analysed showed that the size of DMBs measured by the number of branches range from a minimum of 2 branches to a maximum of 630 branches. The result also showed that majority of the banks has branches in the range of 201 – 300 branches. In the same line, Organizational structure measured by the reporting line from frontline officers to CEO indicates that majority of the banks have more than 3 reporting line between frontline officers and the CEO.

The study also found from the results that majority of the banks RBIA are at least moderately affected by frequency of change in customers' demand, tastes and preference, globalization and deregulation has effect on its operations and the intensity of competitors' action. The result also found that RBIA of the majority of the banks are affected by frequency of advancement in technology and regulations and government policies.

With regards to the application of RBIA function, majority of the respondents agreed that banks have written policies and such policies are made available to all employees. They also agreed that job descriptions are available and formal orientations are given to new staff. In examining the risk management practice of the banks, majority of the respondents agreed that board reviews management decisions, there is available and up to date risk registers, risk appetite are determined and regularly reviewed and that most banks use of recognized risk management framework

Conclusion and Recommendation

Risk based Internal audit function in deposit money banks in Nigeria is an important phenomenon which tends to aid such organisation to concentrate its limited audit resources to its identified key risk areas through the proper definition of risk appetite and development of a robust risk management framework by Management. However, researchers have paid little or no attention to how contingency factors affects risk based internal audit among deposit money banks in Nigeria, rather studies on as how contingency factors affects management and or internal control systems were conducted.

From the analyses, it was established that Number of branches have an inverse relationship with the risk based internal audit function, hence the larger the branch spread of a bank the less effective is its RBIA. This could be attributable to inadequate number of auditors which could be deployed round branches for effective monitoring of controls and risk management. This was in line with the usual practice of DMBs deploying auditors as residents to all locations, this had affected the effectiveness of audit function as most auditors were seen as part of the process as against the best practice of process independent.

The study could not establish significant impact of organizational structure on risk based internal audit among DMBs in Nigeria. Although most of the banks have vertical structures which is believed to have more supervisor and multi-level monitoring this was not found to impact significantly on RBIA. The study also established that environmental uncertainty has an insignificant relationship with the RBIA among DMBs in Nigeria. This can be explained by the internal nature of risk based internal audit function to the organization.

Recommendation

The importance of risk based internal audit function among deposit money banks in Nigeria cannot be over emphasized, risk management is key towards the achievement of organizational objectives. Based on the findings of this study, the following recommendations were presented;

- Branches should be categorized base on risk rating so that high risk, medium and low risk branches can be established and audit plan could be developed to suit each particular category for effective risk based internal audit function.
- A comprehensive audit plan based on the risk needs of the bank should be developed to include spot checks on key areas at strategic intervals to ensure that branches are effectively covered and such areas were adequately reviewed so that size will not affect risk based internal audit function among DMBs in Nigeria.
- There is need for DMBs to have a holistic review of perceived risk faced by each branch/location which is peculiar to its environment and incorporate into the organization's risk register.
- There is need for continuous monitoring solution or tools to review specific risks peculiar to each branch location; this will enable adequate response to changes in risk and business environment.

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