

Internal Audit Practices And Financial Performance Of Selected Commercial Banks In Arua City, Uganda

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Abstract: *The purpose of this study was to investigate the effect of internal audit practices on financial performance of selected commercial banks in Arua City Uganda. It was guided by three objectives that included to establish the effect of professional competency, Internal Control and independence of Internal audit practices on the financial performance of commercial banks in Arua City Uganda. It also adopted Contingency, Agency and Lending Credibility Theories to guide the study that comprised of a population of 187 respondents from which a sample size of 127 respondents were selected, and a descriptive research design was used to collect data using self-administered questionnaires as the main data collection instrument and interviews and analyzed using SPSS (descriptive statistics, Pearson correlation coefficients as well as regression analysis). Qualitative data was analyzed by thematic analysis. The findings of this study found out that there was a significant positive effect of professional competency, Internal Control and independence of internal audit practices on the financial performance of selected commercial banks in Arua City. Recommendations based on findings were that; in order to improve professional competency, commercial banks should carry out continuous professional development such as training workshops, seminars, conferences, and certifications, to stay updated with the latest industry trends, best practices and regulatory requirements.*

Keywords— (Internal audit practices; Financial performance; Commercial banks)

1. INTRODUCTION

In 2021, the global banking industry experienced a rebound in profitability after a challenging 2020 due to the COVID-19 pandemic. The ROE of global banks increased from 7.9% in 2020 to 10.3% in 2021. The report attributed this increase to a combination of factors, including cost-cutting measures and increased revenue from trading and investment banking activities (McKinsey & Company, 2021). Worldwide, it is widely acknowledged that internal audit practicing can offer unparalleled services to management in carrying out their duties. The Institute of Internal auditors (IIA) has recognized this potential and incorporated it into the new definition of internal audit practices, presenting a challenge to internal auditors. Commercial banks have also realized that internal audit practicing is crucial in enhancing asset management within banks, which, in turn, leads to better financial performance of banks (Basel Committee, 2002).

In Uganda, the financial sector, like many others, had recovered from the economic decadence that resulted from a 15-year turmoil (1971 to 1986) and by the end of 2007, the BoU regulated financial institutions consisted of 16 commercial banks, 4 credit institutions, 4 MDIs, 2 leasing firms, 19 insurance companies, and 84 forex bureaus. This saw an increase in commercial bank branches up to 290 where Clients increased from below 300,000 to over 3.5 million by 2007 (Association of Microfinance Institutions in Uganda, 2008) and to 658 branches in 2015 (Association of

Microfinance Institutions in Uganda, 2015). This trend has continued to explode till date as worsened by the Covid-19 Pandemic. According to the Bank of Uganda (2022), which is the central bank of Uganda, there were 25 licensed commercial banks operating in Uganda as of September 2022.

Commercial Banks in Uganda during the past two decades 1990-1999 and 2000-2009, Uganda commercial banking industry underwent significant restructuring. In the early 1990s, Uganda embarked on banking sector reforms, focusing on improving bank performance, through liberalization and strengthening prudential regulations (Bategeka & Okumu, 2010). The reforms restructured the banking industry with regard to advances in computer technology, that led to electronic and internet-based banking. Consequently, there are changes in internal bank operations; relationships with customers and inter-bank interactions. In 2018, the Central Bank of Uganda penalized several commercial banks, including Diamond Trust Bank and Stanbic Bank, for failure to comply with anti-money laundering regulations, which were attributed to inadequate internal controls and weak internal audit practices. In 2019, DFCU Bank, one of the largest commercial banks in Uganda, faced scrutiny over its internal audit practices, following revelations that a former employee had embezzled funds worth UGX 10 billion (\$2.7 million) over a period of several years, which went undetected by the bank's internal audit practices function. In 2020-21, the Bank of Uganda issued a warning to commercial banks over the increasing incidence of cyber-attacks and fraud, which were attributed to weak internal controls and inadequate internal audit practices (BOU Report, 2021). These cases

illustrate the financial loss suffered by different commercial banks and at times it has led to solvency and winding up of these banks, there this study intended to examine the potential impact of weak internal audit practices on the financial performance of commercial banks in Uganda, including loss of customer trust, reputational damage, and financial losses

Research Objective

The overall objective of this study was to establish the relationship between internal audit practices and financial performance of Selected Commercial Banks in Arua City.

Specific Objectives

- To establish the relationship between professional competence of internal auditors and financial performance of selected commercial banks in Arua City.
- To assess the relationship between Internal Controls and financial performance of Selected Commercial Banks in Arua City.
- To examine the relationship between internal audit practices independence on financial performance of Selected Commercial Banks in Arua City.

2. METHODOLOGY

Research Design

The study adopted a descriptive cross-sectional research design, which according to Kothari (2004), is used when the problem has been defined specifically and where the researcher had certain issues to be described by the respondents about the problem, Olufemi et al. (2021). Survey designs were found to be accurate in descriptive studies and generalizations of result according to Shaikh et al. (2020).

Target Population Sample Size and Sampling Techniques

The target population for this study comprised of 187 respondents that included staff members of the selected commercial banks in Arua City that were selected to constitute the respondents of the study basing on their rankings. The study selected 127 respondents from a targeted population. Respondents were selected in terms of their rankings as follows: Group Heads, Relationship Managers, Account Officers and Financial Managers and Accountants from each of the selected Banks which are six banks in total. The Slovene's formula was used to determine the sample size.

The sample was selected using simple random and purposive sampling.

Questionnaires

A questionnaire was the major method to be used for data collection. The questionnaires was preferred for this study because it enabled the researcher gather views, opinions, perceptions and feelings, such information was only converted through the use of questionnaires, thus made it easier to collect relevant information. The first section in the questionnaire was the face sheet to collect data on profile of respondents. The second section in the questionnaire was Internal audit practices. The third section of the questionnaire had questions on Financial performance. All the questions are Likert Scaled on four points ranging from 1= strongly disagree, 2 = disagree, 3 = agree, and 4 = strongly agree. The questionnaires contained close-ended questions to collect quantifiable data relevant for precise and effective correlation of research variables. They were also preferred to save time, enable respondents to easily fill out the questions and keep them on the subject and relatively objective.

Interview

An interview guide was used as a method of data collection that involved asking questions to gather information from a respondents. Interviews were conducted in-person, over the phone, or online, depending on the research needs and goals. The researcher used this instrument to collect information from middle management levels of commercial banks like Financial Managers, Segment Managers, risk managers and Internal auditors because Interviews are a powerful data collection tool that provided rich, detailed information about participants' perspectives, experiences, and behaviors.

3. PRESENTATION, ANALYSIS AND INTERPRETATION OF RESULTS

The independent variable in this study was internal audit practices, this variable (IV) was broken into three constructs and these were; professional competency (with six questions), internal control (with six questions) and Independence of Internal audit practices (with six items/questions). Each of these questions was based on a four-point Likert scale whereby respondents were asked to rate the Internal audit practices by indicating the extent to which they agree or disagree with each question.

Multi-Correlation between internal audit practices and financial performance of commercial banks

		Internal audit practices	Financial Performance
Internal audit practices (Professional Competence, Internal Controls and Internal audit practices Independence)	Pearson Correlation	1	.755**
	Sig. (2-tailed)		.005
	N	108	108
Financial Performance	Pearson Correlation	.755**	1
	Sig. (2-tailed)	.005	

	N	108	108
**. Correlation is significant at the 0.05 level (2-tailed).			

Source: Primary Data

The table above shows the relationship between internal audit practices (independents variable) and Financial performance (dependent variable). It shows that the correlation between the combination of all the three constructs of (Professional Competence, internal controls and independence of Internal audit practices) and financial performance gives a multiple correlation coefficient $P=0.000$ $N=108$, $r= 0.755^{**}$. The relationship is statistically significant at 95% confidence level since p-value (Sig.) is less 0.050 ($=0.000$). This implied that there exists a strong positive relationship between internal audit practices and the financial performance of commercial banks.

Regression Analysis showing the effect of professional competency on financial Performance of commercial banks in Arua City Uganda

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.435 ^a	.287	.180	.41125

a. Predictors: (Constant), Professional competency

ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	22.842	1	11.953	32.677	.000 ^a
	Residual	39.226	107	.384		
	Total	50.157	108			

a. Predictors: (Constant), Professional competency

b. Dependent Variable: Financial Performance of commercial banks

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.643	.329		3.291	.002
	Professional competency	.651	.228	.435	6.617	.000

a. Dependent Variable: Financial Performance of commercial banks

Source: Primary Data

Regression analysis results in the Model Summary table indicated that variation of professional competency accounted for 28.7% on financial Performance of commercial banks in Arua City Uganda and this was indicated by r-squared of 0.287, implying that professional competency significantly contributes ($\beta=0.651$) as beta coefficient on the financial performance of commercial banks in Arua City Uganda. Professional competency in banking operations includes understanding the various products and services offered by commercial banks, such as deposit accounts, loans, trade finance, and payment systems. Employees need to be knowledgeable about the processes, regulations and compliance requirements related to these operations.

The ANOVA table indicated that professional competency significantly affects financial Performance of commercial banks and this was indicated by the F-value =32.677 and Sig-value=.000, since the sig. value (0.000) was less than 0.05 and which is the maximum level of significance required to declare a significant effect. This implies that professional competency as highly affects financial performance of commercial banks in Arua City Uganda. The coefficients

table indicated that considering the standard error, professional competency significantly affects financial Performance of commercial banks ($\beta=0.651$, Sig=0. 000). This still shows that during customer servicing, employees in a bank need to have competencies in understanding customer needs, building relationships, resolving issues, and maintaining a high level of professionalism in their interactions with customers. This competency is relevant for roles such as customer service representatives, relationship managers and branch managers. From table above, the significance level of 0.000 indicates with no discontentment that we can reject the null hypothesis that professional competency do not predict financial performance when professional competency (X) is zero it is the value of financial performance(Y). In this case the intercept is .643, so $X=0$, Y will equal to .643, following the linear regression equation of $Y=\beta X+C$, where (Y) is the dependent variable, (X) is the independent variable, Beta (β) is the slope of the regression line and (C) is a constant/Intercept. Hence the model Financial Performance = 0.435 Professional competency + C.

Regression Analysis for the effect of internal control on financial performance of commercial banks in Arua City Uganda

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.794 ^a	.570	.565	.33660

a. Predictors: (Constant), Internal control

ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	15.448	1	15.448	136.347	.000 ^a
	Residual	11.670	107	.113		
	Total	27.117	108			

a. Predictors: (Constant), Internal control

Dependent Variable: Financial Performance of commercial banks

Coefficients^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	.307	.212		1.448	.001
	Internal control	.884	.076	.794	11.677	.000

a. Dependent Variable: Financial Performance of commercial banks

Source: Primary Data

Regression analysis results in the model Summary table indicated that variation of internal control on financial performance of commercial banks in Arua City Uganda at a rate of 57% and this was indicated by r-squared of 0.57, hence implying that internal control significantly influences the financial performance of commercial banks in Arua City Uganda. Still this indicated that internal auditors have always assessed the control environment to ensure that it promotes a strong control consciousness and supports the establishment of effective internal controls.

The ANOVA table indicated a positive significant effect internal control has on financial performance of commercial banks and this was indicated by the positive F-value=136.347 and Sig- value=0.000. This implies that internal control highly affects the financial performance of commercial banks in Arua City Uganda since it has evaluated the design and operating effectiveness of control activities, which are the specific policies and procedures implemented by the bank to mitigate identified risks. Still this implied that high level of internal control improves the level of financial performance of commercial banks and poor internal control system reduces

it. The coefficients table indicated that considering the standard error, internal control significantly affects the financial performance of commercial banks beta coefficient ($\beta=0.884$, Sig=0.000). Hence indicating that internal control has helped in the assessing of adequacy of controls over financial transactions, accessing controls to systems and data, segregation of duties, approval processes, and other controls relevant to the bank's operations.

Table above indicates that the intercept is 0.307, so $X=0$, Y will equal to 0.307, following the linear regression equation of $Y=\beta X+C$, where (Y) is the dependent variable, (X) is the independent variable, Beta (β) is the slope of the regression line and (C) is a constant/Intercept effect between internal control and the financial performance in Commercial banks. Where y = financial performance, $\beta=0.794$, x = internal control and C= constant.

This shows that: financial performance = 0.794 x Internal control + constant.

Regression Analysis showing the effect of Independence of Internal audit practices on financial Performance of commercial banks in Arua City Uganda

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.623 ^a	.421	.364	.50465

a. Predictors: (Constant), Independence of Internal audit practices

ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	1.670	1	1.670	28.889	.003 ^a
	Residual	24.050	107	.188		
	Total	25.720	108			

a. Predictors: (Constant), Independence of Internal audit practices

Coefficients^a

b. Dependent Variable: Financial Performance of commercial banks

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.839	.432		4.257	.000
	Independence of Internal audit practices	.773	.159	.623	2.981	.000

a. Dependent Variable: Financial Performance of commercial banks

Source: Primary Data

Regression analysis results in the Model Summary table revealed that variation of Independence of Internal audit practices accounted for 42.1% on financial Performance of commercial banks in Arua City Uganda and this was indicated by r-squared of 0.421, implying that Independence of Internal audit practices contributes to the financial performance of commercial banks in Arua City Uganda. The ANOVA table indicated that Independence of Internal audit practices significantly affects the financial performance of commercial banks and this was indicated by the F-value=28.889 and Sig-value=.003, since the sig. value (0.000) was less than 0.05 and which is the maximum level of significance required to

declare a significant effect. This implies that independence of Internal audit practices has helped the internal auditors to exercise professional judgment in their audit work, basing on their expertise, experience and professional standards. The coefficients table indicated that considering the standard error, independence of internal audit practices significantly influences the financial performance of commercial banks in Arua City Uganda ($\beta=0.623$, Sig=0.000). Hence indicating that the internal auditors have had the freedom to form their own opinions and conclusions based on their audit work, without any undue influence or pressure from management or other stakeholders. From table above, the significance level of 0.000 indicates totality to reject the null hypothesis that Independence of Internal audit practices do not predict

financial performance when Independence of Internal audit practices (X) is zero it is the value of financial performance (Y). In this case the intercept is 1.839, so $X=0$, Y will equal to 1.839, following the linear regression equation of $Y=\beta X+C$, where (Y) is the dependent variable, (X) is the independent variable, Beta (β) is the slope of the regression

line and (C) is a constant/Intercept. This indicates that: Financial performance = 0.623 Independence of Internal audit practices + C

Multiple Linear Regression analysis between the Dependent and Independent Variables

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.755 ^a	.520	.650	.38568

a. Predictors: (Constant) Independence of Internal audit practices, Professional competency, Internal control

b. Dependent variable; Financial Performance of commercial banks

ANOVA^b

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	6.648	3	2.216	25.538	.000 ^a
	Residual	3.905	107	.087		
	Total	10.553	108			

a. Predictors: (Constant), Independence of Internal audit practices, Professional competency, internal control

Coefficient^a

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)					
	Internal audit practices	3.062	.239		6.232	.001
	Professional competency	.651	.228	.435	6.617	.000
	Internal control	.884	.076	.794	11.677	.000
	Independence of Internal audit practices	.773	.159	.623	2.981	.000

a. Dependent Variable: Financial Performance of commercial banks

Source: Primary Data

Regression analysis results in table 4.7 revealed that internal audit practices variation accounted for 52% on financial performance of commercial banks in Arua City Uganda and this was indicated by adjusted r squared of 0.520, this implied that internal audit practices significantly affects financial performance of commercial banks in Arua City Uganda, and this is indicated by the F-value=25.538, and Sig=0.001. The coefficients table indicated that of all the aspects of internal audit practices, internal control accounted for the biggest influence on financial performance of commercial banks in Arua City Uganda ($\beta=0.421$, Sig=0.001).

Table above shows that all dimensions of ICs (Professional Competence, Internal Controls and Independence of Internal audit practices) were significant influential factors of

financial performance. All the R-values were greater than 0.000 indicating that all variables were statistical in influencing financial performance within Commercial Banks.

4. DISCUSSIONS, CONCLUSIONS AND RECOMMENDATIONS

Discussions of the findings

The results on findings revealed that there is a significant effect professional competency has on financial Performance of commercial banks in Arua City Uganda, as the ANOVA indicated that professional competency significantly affects financial Performance of commercial banks and this also implied that competent bank employees can optimize operational processes, use technology effectively and ensure compliance with regulatory requirements. This can result in

improved operational efficiency, reduced operational costs, and enhanced productivity, leading to better financial performance for the bank. This finding is in line with Uecker et al. (2015) who utilized view of relative forcefulness among inward and outside evaluators to examine the discovery of corporate anomalies. Inside inspectors assume an essential job in extortion location with most cheats recognized by the interior review work. While experience and capacity are verifiably critical in the location procedure, certain individual attributes might be prescient of the ability to identify misrepresentation. Seeing how reviewers are seen, and how these observations lead to convictions in regards to their recognition capacities, is an imperative initial phase in relating identity qualities to the adequacy of evaluators. Because of the significance of powerful misrepresentation discovery, any estimates that can improve the viability of reviewers ought to be of esteem (Norman et al., 2016).

Asare (2009) argued that the professional competency function can be recognized as concerning three major basics, that is to say the assessment and development of internal audit practicing, control and authority processes in a business. However, this study was different from Asare (2009) since it focused on professional competency in relation to internal audit practicing to establish how each of these relates with performance of selected commercial banks in Arua City Uganda. Internal audit practicing, control and governance encompasses the policies and procedures recognized to ensure the accomplishment of goals and comprise the suitable appraisal of risk, the professional competency provides the administration reports and truthful information to that the administration they come to a decision the behavioral and principled standards set for business value and workers.

The results proved a positive significant of effect internal control on financial Performance of commercial banks in Arua City Uganda; The ANOVA indicated a positive significant effect internal control has on financial performance of commercial banks and this therefore implies that effective internal controls ensure that banks comply with laws, regulations, and industry standards. Yet non-compliance can result in financial penalties, reputational damage, and operational disruptions, which can adversely affect a bank's financial performance. Strong internal controls help banks stay compliant, reducing the risk of penalties and reputational damage. This finding agrees with Whittington and Pany (2013) who argued that internal control places the quality of the business by influencing the control conscious of organization. They further declare the internal control is viewed as; honesty and principled standards of staff accountable for creating, administering, and monitoring the controls, commitment and capability of persons performing assigned obligations, or internal audit practices committee, administration viewpoint and working style and business arrangement, which may be a well-organized. Jenny and Pamela (2016) noted that a principal panel and organization improve an organization's internal control when they set up and efficiency correspond printed policies and measures, a

system of beliefs, and values of behavior. They also enhance the internal control when they behave in an ethical manner creating a positive tone at the top and when they require that same standard of conduct from everyone in the organization.

Okwach (2014) observed that under effective internal control environment, the organizational members utilize the available resources efficiently and effectively hence, achieving the expected organizational performance. Okwach (2014) further views internal control as an empowering agent of execution of undertakings by association individuals as set by the board individuals and departmental directors through frames of mind and activities that support the most elevated amount of respectability, fitting authority theory, working style and individual and expert gauges, along these lines prompting sensible consistence and operational proficiency levels. Internal control helps toward reducing the level fraudulent activities within organizational operation also the quality of an entity's internal controls system depends on the function and quality of their internal control (Amudo & Inanga, 2009).

The results indicated that Independence of Internal audit practices significantly affects financial performance of commercial banks in Arua City Uganda; The ANOVA indicated that Independence of Internal audit practices significantly affects the financial performance of commercial banks and the effect therefore implies that an effective independent internal audit practices function can critically evaluate the effectiveness of internal controls in place within the bank. This includes evaluating the design and operating effectiveness of controls, identifying control gaps, and recommending improvements. This finding is in line with Seguya (2015) who noted that all components of Internal audit practices standard Function including internal control, internal audit practicing processes and corporate governance processes have a significant positive effect on management of public funds. However, Seguya (2015) left a content gap that was filled by the current study since his study focused on internal audit practicing and Management of public Funds in a public sector yet the current study focused on internal audit practices and financial performance of commercial banks which are private companies in Uganda. Ljubisavljevic & Jovanovi (2015) observed that internal audit practices standard makes a great involvement to the accomplishment of business goals, and the execution of strategies for their accomplishment.

5.2 Conclusions

Professional competency, internal control and Independence of Internal audit practices have a significant effect on financial performance of commercial banks in Arua City Uganda, hence concluding that the professional competency, internal control and Independence of Internal audit practices within commercial banks are a crucial factors that can impact financial performance whereby competent internal auditors contribute to efficient operations, effective risk management, innovation, enhanced customer service and accurate financial

reporting, all of which collectively contribute to improved financial performance for the bank. Investing in building and maintaining a competent workforce including internal auditors is essential for commercial banks to achieve their financial goals and succeed in today's competitive banking environment.

Recommendation

- Commercial banks should carry out continuous professional development (CPD) such as training workshops, seminars, conferences, and certifications, to stay updated with the latest industry trends, best practices and regulatory requirements.
- Commercial banks' owners should establish written policies and procedures that provide clear guidance on the bank's operations, financial reporting and risk management processes.
- Commercial banks' owners should establish a separate and an independent internal audit practices department that operates independently from other functions within the bank, such as risk management, compliance and operations.

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