Impact of Quality Control on Risk Assessment of Internal Auditors of Selected Deposit Money Banks in Nigeria

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Abstract

After the successful implementation of risk assessment in internal audit unit of manufacturing sector, it is now being extensively applied in service sectors which include banks, to improve business performance. The purpose of this study is to examine of the impact of quality control on risk assessment of internal audit. The identification, assessment, and prioritization of risks followed by coordinated and economical application of the scarce resources to monitor, minimize, and control the impact and/or probability of unfortunate events is what is usually known as risk assessment. It introduces the idea that the likelihood of an event happening can be reduced, or its consequences minimized. If risk are not properly assessed and prioritized, time can be wasted in dealing with it. At the same time, spending too much time assessing and managing unlikely risks can divert resources that could be used more profitably. This study uses purposive sampling technique and judgmental method of sampling, primary data collection was used and one way ANOVA techniques was used in data analysis. The result of this study shows that, with Risk based approach to internal audit's perspective on risk and audits changed, internal auditors have been offered an opportunity to create more value.

Introduction

In any business organizational environment, emphases are placed on risk most of the time, referring to its management, prevention, effects among others. Risk management must be part of the organization's strategy in order to achieve the goals and objective of the organisation. Risk is a possibility of loss or injury, (Njogo, 2012).

Perception of organisations to the risk in today's dynamic competitive environment have changed with globalization and now, taking advantage of the returns of risky activities has become one of the priorities of organisations. However, the global economic crisis required that risks be managed by the organisations. These developments revealed the auditing of risky activities incurred by organisations, in particular banks, in other words, the Risk-Based Internal Auditing (RBIA) approach. This approach is separated from the other internal audit approaches with its features such as focusing on fields exposed to high risk rather than the financial field and creating much value. RBIA selects the high-risk fields determined by risk assessment as a focal point and provides time and cost saving in the audit. Now, internal auditors do not only supervise the control activities, but also contribute to the development of the risk management processes by defining the universe of risks and continuously monitor the risk status of business, (Ameen Al-basheer, 2015). RBIA orientation to the future's risks is the main difference between this new model of audit and the traditional one that looks backwards, presenting to the entity's management only the past risks. RBIA improves the economic activities providing the maximum of efficiency.

On the other hand, Quality Control is the maintenance of the actual performance as compared to the standard, (Priya, 2015). It provides the necessary framework for continuous improvement of service quality, increase customer satisfaction and strengthen confidence of all stakeholders, (Priya, 2015). Risks have become important of which all level of manager must be aware. Risks are not just a problem of perception but are real. The threat, failure, liquidation or bankrupt of the enterprises, the loss of customers are real phenomenon in banking services, evolving under uncertainty circumstances, (Thaddeus, 2012). That is why risk assessment has been an increasingly important topic in the processes of decision-making in many areas such as business, finance and banking, and other field of endevour.

Risk analysis should be carried out in the early stages of the processes within the quality management system, thus contributing to the systematic identification of threats ahead. The analysis of the frequency and severity of these risks, in order to prevent, reduce or the total elimination of these risks strengthen the role of total quality control, because quality risk assessment is one of the most important components of the quality control and assurance.

The objective of the risk assessment was to identify the departments, offices, areas, units, or processes that pose the greatest risk to an Institution and then to align internal audit resources, where appropriate, to best help the Institution achieve its objectives, (Kirogo, 2014). The study also indicate that internal audit plan usually contains key information on the planned audit activity for any fiscal year which was based on the results of the annual risk assessment process and the management on the other hand make sure that appropriate quality control is put in place, so that the combine effort of the risk based internal auditing and the quality control put in place by the management, will lead to the achievement of the general objective, which was clearly spelled out in the blue print of the organisation. According to (Chornous, 2013), maintaining the acceptable profitability ratios of the safety and liquidity parameters in the management of assets and liabilities is another important objective of risk assessment.

Statement of problem

Many previous studies such as (Kirogo, 2014), (Celayir, 2014) and (Chornous, 2013)have been conducted within the context of risk assessment, but most of these study, if not all, relates risk assessment to either information support, management or banking system. None of which is considering the impact of quality control in Deposit Money Banks on risk assessment of internal auditor, because quality control is mostly used in construction and manufacturing companies which are vulnerable to various risk. The objective of the study is to examine the impact of quality control on risk assessment of internal auditors in money deposit banks and purposely to discuss how the risks are identified and measured and how the risk based internal auditing plan is affected by quality control, by examining risk assessment study which is the most important stage of this scenario

Conceptual issues

Quality Control (QC) is an important element in the overall performance of any entity. It is essential in all service providing sectors, (Mangino, 2001). Money deposit banks like other organizations should be interested on how to use quality control to reduce the work of the audit unit (risk-based auditing) performance. The importance of this is based on the assertion that auditing based on risk assessment is bound to militate against risks. QC is an activities which include general methods such as accuracy checks on data acquisition and frequent comparing of actual performance with standards and the use of approved standardized procedures in the discharge of duties. QC is defined as the operational techniques and activities used to fulfill requirements for quality, (Danescu, 2010). The study also indicate that controlled environment, controlled activities, and risk management are some of the component of effective quality control

Control Environment

(Sherman, 2010), (Inanga, 2009), as well as (porter, 2007), described Control environment as the attitude toward internal control and control consciousness established and maintained by the management and the employees of an organization. It may be viewed as the foundation for other components of internal control providing discipline and structure.

Control Activities

Control activities are tools both manual and automated that help prevent or reduce the risks that can impede accomplishment of the organization's objectives and mission. According to (Messier, 1997), control activities are the policies and procedures that help ensure that necessary actions are taken to address the risks involved in the achievement of the entity’s objectives.

Risk Management

Risk management in the words of (Oluchukwu, 2012), is the process of identifying risks, assessing their implications, deciding on a course of action, and evaluating the results. Risk Management can be seen as, the identification, assessment, and prioritization of risks followed by coordinated and economical application of resources to minimize, monitor, and control the probability and/or impact of unfortunate events. Risks can come from uncertainty in financial markets, project failures, legal liabilities, credit risk, accidents, natural causes and disasters as well as deliberate attacks from an adversary. Risk management ensures that an organization identifies and understands the risks to which it is exposed.

Elements of quality control

(Aqeeli, 2001), refers to the quality control as a modern management philosophy or approach takes the form of a comprehensive management system, based on making positive changes radically for everything within the organization. These include changes in thought, behavior, values, beliefs, regulation, administrative concepts, administrative leadership style, work and performance measures systems, in order to improve and develop each institution components to reach the highest quality in the output of goods and services at the lowest cost in order to achieve the highest degree of satisfaction among its customers by satisfying their needs and desires according to what they expect.

Risk Management in Deposit Money Banks

The banking industry is a highly regulated industry with detailed and focused regulators. While banks struggle to keep up with the changes in the regulatory environment, regulators struggle to manage their workload and effectively regulate their banks. The impact of these changes is that banks are receiving less hands on assessment by the regulators, less time spent with each institution, and the potential for more problems slipping through the cracks, potentially resulting in an overall increase in bank failures. According to (Jaiye, 2009), business of Banking is to manage risks associated with accepting deposits, granting loans and trading portfolios. The changing economic environment has a significant impact on banks and thrifts as they struggle to effectively manage their interest rate spread in the face of low rates on loans, competition for deposits and the general market changes, industry trends and economic fluctuations.

(Andrea, 2010) argued that, Management failure can be easily recognized in losses resulting from over aggressive lending practices and risk tolerances that were too high. However, as one digs deeper, more failures can be recognized in operational inefficiencies, weak internal control environments, and lack of management attention to detail. Also the management of the banks' asset portfolios also remains a challenge in today's economic environment. Loans are a bank's primary asset category and when loan quality becomes suspect, the foundation of a bank is shaken to the core.

Risk assessment

In the words of (porter, 2007), Risk Assessment is a systematic process of organizing information to support a risk decision to be made within a Risk Management process. The process consists of the identification of hazards and the analysis and evaluation of risks associated with exposure to those Hazards. This is basically a cause and effect analysis. The "cause" is the event that might occur, while the "effect" is the potential impact to the subject in question, should the event occur.

The Process of Risk Assessment

The process of risk assessment is the most important stage of the RBIA. The point that must be take into account is that it is important to have an effectively functioning risk management system in business in order to both obtain the required effect from RBIA and do the risk assessment activities more consistently, (porter, 2007). The data obtained from the risk management system will be used in the RBIA and so that more reliable information will be possible. Because the risk assessment constitutes the foundation of the RBIA. This process consists of the below stages, (Griffiths, 2005), establish goals and context, identification and classification of risks, analyze the risk, risk measurement, arranging and prioritization of risks, creating the risk matrix, preparation of risk assessment report and monitoring the risk.

Establish goals and context

The purpose of this stage of planning enables to understand the environment in which the respective organization operates, that means to thoroughly understand the external environment and the internal culture of the organization.

The Identification and Classification of Risks

In order to identify the risk in the organisation, firstly a pro-risk scanning system should be created. The setting of scanning system makes the identification of risk process more concrete. At this stage, danger and opportunities which are exposed to the business and auditable unit should be determined. When the risks are identified in any process, firstly the goal clearly should be presented. After setting the goal, the situation and danger should be determined that prevent the achievement of this goal, and then the risk should be identified. At this point, another central point of focal is the classification of risks.

Risk classification systems are important because they enable an organisation to identify accumulations of similar risks. A risk classification system will also enable an organisation to identify which strategies, tactics and operations are most vulnerable. Risk classification systems are usually based on the division of risks into those related to financial control, operational efficiency, reputational exposure and commercial activities. However, there is no risk classification system that is universally applicable to all types of organizations

Analyze the risk

Risk analysis involves the consideration of the source of risk, the consequence and likelihood to estimate the inherent or unprotected risk without controls in place. It also involves identification of the controls, an estimation of their effectiveness and the resultant level of risk with controls in place. Qualitative, semi-quantitative and quantitative techniques are all acceptable analysis techniques depending on the risk, the purpose of the analysis and the information and data available. Often qualitative or semi-quantitative techniques can be used for screening risks whereas higher risks are being subjected to more expensive quantitative techniques as required. Risks can be estimated qualitatively and semi-quantitatively using tools such as hazard matrices, risk graphs, risk matrices or monographs but noting that the risk matrix is the most common. Applying the risk matrix, it is required to define for each risk its profile using likelihood and consequences criteria.

Risk Measurement

The risks should be measured after the risks are competed at the level of business and activity. The risks should be measured generally according to the possibility of occurring and when they occurred how much they affected the organisation. In measuring risk, the following are considered:

i. Estimate the importance of a risk,

ii. Evaluate the possibility of occurring risk,

iii. Pay attention to how manage the risk.

Arranging and Prioritization of Risks

The final stage of risk assessment is to determine the priority or classification of risk. Generally the unit component which are audited are ranged as low, medium and high risky. This arrangement is called risk level CBN, (2010). These levels are:

High risk Level: High risk level states is where there is a high risk activities, risk status, which is big according to business sources, where a large number of transactions and / or activities which the structure of activities are the complex. At this risk level, the changes which occur in the risk measure, the possibility to affect the operation capital and income negatively is high.

Medium risk Level: Medium risk level states risk situations, depending on the state of enterprise resources at a reasonable level, with reasonable volume of transactions, the quality of the activities with regard to the normal activities is normal.

Low risk Level; occurring damage will be small and limited.

After determining the level of risk, each auditable area is rated based on risk criteria. According to the results of rating, the audit areas expressed as of high, medium or low risk area according to the rating scale:

Detailed risk assessment continues with the measurement and prioritized of risk in terms of likelihood and impact and finally ends with the preparation of a risk matrix.

Creating the Risk Matrix

Assessment of each area of risk level is placed in a risk matrix. While higher levels risk are in the unacceptable risk group, lower risks are located in the acceptable risk group.

Risk Matrix

Likehood

Very likely	Acceptable risk medium 2	Unacceptable risk High 3	Unacceptable risk Extreme 4
Likely	Acceptable risk Low 1	Acceptable risk medium 2	Unacceptable risk High 3
unlikely	Acceptable risk Low 1	Acceptable risk Low 1	Acceptable risk medium 2
	Minor	Moderate	Major

Impact

Figure: 1. Risk Matrix according to internal audit

Risk Matrix is a flexible and dynamic analysis tool showing enterprise's risk status on the basis of each activity, the effectiveness of risk management systems, net risk level and changes in the risk level. While risks having a low level of risk (acceptable risk) are not evaluated in risk based internal audit. The risks with high level risk (unacceptable risk) is subjected to detailed examination. After detailed examination of the processes belonging to risks above, the limit of acceptable risk to reduce or to terminate is decided. Remaining risks between these two risk groups are included in the closest risk group. The aim here is to decide which risk treated as a priority depending on the results of risk measurement. Top priority risk is the most urgent and important risk and needed to be resolved first. The highest degree risk is required to be addressed as a top priority in reduction activities, (Danescu, 2010).

Preparation of Risk Assessment Report

Risk Assessment Report is prepared based on risk matrix in order to be explanative and guiding. Issues to be included in the report are:

i. Explanation of all of the risk elements in the risk matrix, the most important is business activities, activity areas and business units, business strategies and other factors that may affect the risk profile of the enterprise,
ii. The deviation from the risk matrix and risk assessment reports prepared in prior periods, and the reasons
iii. The existing risk management approach of the enterprise, the tools used, the techniques used in risk measurement and assessment of the effectiveness of the risk management center,
iv. The assessment of the adequacy of the internal control environment in relation to risk exposure,
v. The relationship between probability and impact of the risks identified using various assay methods,

Monitoring the risk

It is important to understand that the concept of risk is dynamic and needs periodic and formal review. The currency of identified risks needs to be regularly monitored. New risks and their impact on the organization may be taken into account. Milestones or benchmarks for success and warning signs for failure need to be identified. The review period is determined by the operating environment, but as a general rule, a comprehensive review for every five years is an accepted industry norm, (Danescu, 2010). This is on the basis that all plan changes are subject to an appropriate change process including risk assessment. The review needs to validate that the risk management process and the documentation is still valid.

Empirical review

Relevant studies on quality control in Deposit Money Banks and risk assessment of internal auditors is not really much in the literature. Most of the literature if not all, did not really combine the two, but instead, contain either of the variable (Risk assessment and Quality control) and another variable outside the subject matter.

(Kirogo F. K., 2014) examine the Effect of risk based audit on financial performance of Insurance Companies in Nakuru Town, Kenya. The study focused on effect of risk assessment on financial performance. Agency theory was used as guide to the research, Descriptive survey was employed and data were analyzed using Pearson correlation analysis and the results presented in tables which is adequate in coming up with a conclusion. Thus the study found a positive relationship between risk based auditing and financial performance of insurance companies. The study recommends that management of insurance companies should adopt effective risk based audit practices such as risk assessment to enhance effective and efficient financial performance. The findings are expected to provide useful insights and fresh empirical evidence of the relationship between risks based audit practices and financial performance in organisation, and concludes that risk based auditing through risk assessment positively affected the financial performance of organisations

(Celayir V. F., 2014), conducted a study Enron, Worldcom in the U.S.A. on risk based internal auditing and risk assessment process. The study examine how risk management can be used through risk assessment to mitigate future risk in order to reach the stated targets raised by the management which is done through the risk based internal auditing. It is a qualitative research, the methodology used was more of descriptive but no theory was used to guide the study but concluded that the auditors who are supposed to be an independent unit should collaborate with the management to be able to identify future risk, so that it can be mange properly.

(Jawaher A. B., 2012), in their study carried out in Hong Kong on the Exploration of Quality Control in Banking and Finance, discussed the use of quality control techniques in the improvement of the banking and service industries. The study also showed that a record number of loans are defaulting, mortgage foreclosures, loss of investments are causing failure of and sometimes even collapse of financial and banking institutions. The concepts of quality control is seen to have mitigated some of the risk associated with banks in Hon Kong, Which as a result reduces the rigor risk assessment of the internal auditors of the banks. And it was recommended that Quality control techniques will eventually improve the competitiveness of banking and service industries worldwide, with the fact that the study has no theoretical frame work that guides it but it is a descriptive survey research.

(Oluchukwu, 2012), conducted a research on Risk management in the Nigerian banking industry. The study concentrate on Risk Management, that is how risk can be identified, assessed and prioritized, followed by coordination and economical application of resources to minimize, monitor, and control the probability and or impact of unfortunate events. The study is qualitative in nature and conceptual issues are discussed with descriptive survey method employed, and Deming's theory was used as a guide, but there were no recommendation.

This study hypothesized that proper quality control has no significant effect on risk assessment of internal auditors of banks.

Theoretical framework

Some theories have been formulated to explain the pertinent issues with regard to the function of auditor in organizations in terms of quality control. This study was based on two theories namely the agency theory and Deming's Theory as some of the previous studies have also used them as a guide.

Agency Theory

Agency theory was propounded by Jensen and Meckling (1976). An agency relationship is one in which one or more persons (the principal) engage another person (the agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent. Perhaps the most recognizable form of agency relationship is that of employer and employee. The central idea behind the Principal/Agent model is that the Principal is too busy to do a given job and so hires the Agent. As (kook, 1989) noted, the theory of agency seeks to resolve problems in a relationship with conflict of interest and risk sharing when attitudes towards risk diverge. It is further observed that, while a beneficial agency cost is one that increases a shareholder’s value, an unwanted agency cost may occur when the management actions conflict with the shareholder’s interests. In the context of auditing, (Berg, 2010) asserts that agency theory holds that the auditor is appointed in the interests of both the third parties and the management.

Deming's Theory

Deming in 1928 propounded that all stakeholders and all departments in an organization should be considered as a part of one whole system. The stakeholders and departments should work together towards a common goal to optimize the performance of system. Deming's profound knowledge system consists of Understanding how the firms’ processes work, Understanding the variations that do occur and why they do, and understanding what can be known and human nature understanding. The Deming's theory of total quality management points are: Creation of a purpose of constancy, new philosophy adoption, halting the dependency on mass inspections, newer award business courtesy of price, ensure there is a production system that is continuous and improvement of service, enhanced performance courtesy of the job training, infusing quality in leadership, dismantle fear aspects from the firm, do away with departmental barriers, eliminate work goals that are based on quantity achieved, eliminate use of quotas and standards, encourage pride in craftsmanship, facilitate the training and education process of everyone in the firm and ensure that the firm’s top management structure facilitates the other points.

This study is guided by Deming's theory, because it portray most of the assumption that are used in quality control, and was also used in the work of (Oluchukwu, 2012). If carefully followed, quality control will be enhanced which will lead to minimization of risk, as a result risk assessment of internal auditors.

Methodology

This study used a survey research. The population used in this study comprises of workers in some selected Deposit Money Banks (First Bank Nig. PLC, Guarantee Trust Bank PLC and Unity Bank PLC) within Borno, Gombe and Yobe state. In order to have a reasonable number for this study. Purposive sampling technique and judgmental method of sampling is used, as the only people with in-depth knowledge and experience in the area under this study were selected. Data considered for the study were obtained from primary source using questionnaire to obtain the data from relevant personnel of the selected banks. Sixty questionnaire were distributed, filled and returned. One way ANOVA techniques was used in data analysis.

Demography of the respondents

Gender	No of Respondent	Percentage
Male	48	80
Female	12	20
Age grouping	No of Respondent	Percentage
20 – 30 years	9	15
31 – 40 years	41	68.33
41 and above	10	16.67
Academic qualification	No of Respondent	Percentage
Diploma	11	18.34
NCE	15	25
B.Sc	31	51.67
Post graduate	3	5
Duration in service	No of Respondent	Percentage
0 – 10 years	45	75
11 – 15 years	11	18.33
16 and above	4	6.67

Testing of Hypothesis using One Way Analysis of Variance (Anova)

The study hypothesized that proper quality control has no significant effect on risk assessment of internal auditors of banks.

Table 2

ORGANISATIONS	YES	NO	TOTAL
First Bank Nig. PLC	3	17	20
Guarantee Trust Bank PLC	0	20	20
Unity Bank PLC	2	18	20
TOTAL	5	55	60

The study used ANOVA at $\alpha = 0.05$ to test its hypothesis that proper quality control has significant effect on risk assessment of internal auditors of banks

$N = 6$; $Q = 60$; & $t = 3$

$SST = \sum X^2 - Q^2/N$

⇨ $3^2 + 0^2 + 2^2 + 17^2 + 20^2 + 18^2 - 60^2/6 = 426$

$SSB = \sum S^2/n - Q^2/N$

⇨ $5^2/3 + 55^2/3 - 60^2/6 = 416.6$

$SSw = SST – SSB$

⇨ $426 – 416.6 = 9.4$

TABLE 3 ANOVA summary table

Source	SS	df	MS	F-ratio
Between	416.6	2	208.3	$208.3 / 3.13$ = 66.55
Within	9.6	3	3.13	
Total	426	5		

Looking at the F-distribution table, the research found that at 0.05 $F_{2,3}$ = 30.82. The calculated F-value is 66.55 while the critical value at 0.05 level of significance is 30.82. Therefore H_0 is rejected because the calculated value (66.55) is greater than the table value of 30.82 at 0.05 level of significance that is proper quality control has significant effect on risk assessment of internal auditors of banks. Thus, this analysis shows that most of the respondent in question have the opinion that there is a strong positive relationship between quality control and risk management

The findings of the current study may assist the management of all the money deposit banks in reducing foreseeable risk. It may also assist them in decision making and formulating key strategies, which can aid in mitigation of risks. The study may also be significant in that it may be a reference for other researchers interested in the field of bank, audit, organizational quality control, organizational risk assessment and related areas. The study was conducted in some selected Deposit Money Banks (DMBs, considering their management staff and internal auditors.

Summary

As the developments of economic in the world increases, there is also an increase in work intensity and work rate of businesses that means the volume of business has expanded significantly. Furthermore, to control each process in terms of both time and resources becomes more difficult, and this has raised the cost of the audit unit. These changes led to the risky activities become inevitable. Foreseeable, detection and mitigation of risks that may occur has become a necessity. Organisations are becoming more vulnerable to risks that made the various methods of measuring and managing risks necessary. The traditional internal audit approaches used are becoming inadequate to satisfy the needs of organisations, as a result, modifying the structure of internal audit towards internal auditing systems that focus on risk management through risk assessment becomes apparent for most economic sectors especially the banking sector. Risk assessment is a systematic process comprising the steps of identification of risks, measurement in terms of impact and likelihood and then creation of a risk matrix by prioritizing.

Conclusions

The internal audit and risk management activities which were the two concepts that are considered independently of each other in the past, are now entering into interaction with each other and use each other's outcomes to attain the set objectives of the organisation in question. For this reason, in many organisations, the internal audit adopts a risk based approach in internal audit plans development. With quality control in place by the management will also form part of internal control, the internal auditing can determine the risk status of the enterprise, by allocating the scarce audit resources accordingly and efficiency. With Risk based approach to internal audit's perspective on risk and audits changed and internal auditors have been offered an opportunity to create more value.

Recommendations

In this context, risk status will be discovered primarily in the risk based internal auditing and issues such as scope of audit activities, content, timing and the allocation of resources is shaped according to the risk. The most important step in risk based internal auditing approach is risk assessment. Risk assessment is a work that should be seriously considered as component of internal control and at the same time as part of the internal audit planning stage on internal audit standards. It is not correct to qualify risk assessment as a single activity.

In order for an enterprise's risk based internal audit approach to benefit a high level from the risk based internal auditing, a high level of risk maturity is required. Internal audit should provide assurance to existing risk management framework, that is, there should be an existence of an efficiently functioning risk management system. If the risk management system is inadequate in the enterprise, quality control should provide support in encouraging this system in this aspect. Quality control and risk management systems must work in an interactive format. Thus, in the light of the risk results obtained in both studies, a healthier audit is conducted and cost benefit balance is achieved.

Suggestion for further study

The limitation of study was the inability to include more Deposit Money Banks (DMBs) as this study concentrated only on three (3) banks. The study would have covered more financial institutions so as to provide a more broad based analysis

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