

An Empirical Study on the Effect of Internal Audit Function on Financial Performance of Commercial Banks in Sri Lanka

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Internal audit function is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. When banks' operations do not adequately consider internal audit function, they are unable to encounter its objectives as desired. The study aims to examine the effect of internal audit function on the financial performance of commercial Banks of Sri Lanka. Internal Audit Standards (IAS), Professional Competence (PC), Internal Controls (IC) and Independence of Internal Audit (IIA) were identified as independent variables, while financial performance was used as the dependent variable. The study administrated five-point Likert scale survey questionnaires to executives of both finance and internal audit departments of the selected commercial banks, to assess both primary and secondary variables under study, while secondary data were obtained from published annual financial statements to assure the financial performance. Among 26 commercial banks in Sri Lanka, 12 were selected for the sample based on market capitalization. The links between the variables were hypothesized and tested through multiple regression analysis using SPSS software. The study established that IAS, PC and IC have positive relationships with financial performance of commercial banks where as IIA had no significant effect on financial performance. Thus, it is recommended to utilize independent internal auditors and compensate them reasonably to guarantee that the administration is prompted appropriately through quality internal audit reports while adhering to frequent internal audit software upgrades.

Keywords: Internal audit, financial performance, commercial banks, internal controls