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INTERNAL AUDIT PRACTICES AND FINANCIAL PERFORMANCE OF DEPOSIT MONEY BANKS IN NIGERIA

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Abstract

Deposit money banks offer a variety of services in addition to safekeeping money and other valuables and making them readily available to the owners who need them, among other things. Despite these enormous responsibilities, the sector has been plagued by issues such as financial irregularities, a lack of objective internal audit control, internal auditor independence in relation to reporting channels, insider dealings, and excessive loan losses as they relate to the financial performance of Nigeria's commercial banks. This study, therefore, examine the impact of internal audit on financial performance of deposits money banks in Nigeria. *Ex-post facto* research design was adopted through secondary data. The population of the study consisted of fourteen (14) Nigerian deposit money banks. Ten (10) DMBs was purposively selected based on readily and accessible audited annual for the study period. Descriptive and inferential statistics technique was used to describe the study variables. While, Panel regression analysis was used to examine the extent to which internal audit practices influence financial performance of Nigeria Deposits Money Banks. Panel regression analysis showed that bank size was significant in explaining the [redacted] variation in financial performance (p=0.0018). The study established a positive significant relationship between internal audit practices and financial performance of deposit money banks in Nigeria. The study recommended that internal auditors should maintain neutrality and avoid personal biases during audits, as this can be supported by implementing rotational assignments or engaging external auditors to review internal audit reports for unbiased opinions.

KEYWORDS: Bank Size; Deposit Money Banks; Financial Performance; Internal Audit Practices; Internal Control Monitoring; Return on Equity

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Introduction

Performance refers to the ability to operate efficiently, profitability, survive growth and react to the environmental opportunities and threats. Furthermore, performance can be measured by how efficient an organization is in the use of resources in achieving its objectives. It is the measure of attainment achieved by an individual, team, institution or process. Hence, bank performance can be measured in different ways, which varies in respect to the bank's aims and objectives. A company might only want to achieve all its objective at the end of a financial period and the management would be satisfied that the company has a great performance for that year, while to another company it might be only to maximize profit and the management would be satisfied by its performance.

The financial performance of banks is very pivotal to economic growth and development. Therefore, all factors affecting such performance should be properly addressed. According to Oladejo *et al*., (2021) corporate failures and other related downfalls which occurred around the globe and Nigeria have raised fears about confidence in financial reporting practices. In recent times financial crime has become more pervasive, and the probability of corporate fraud occurring in Nigeria has become more severe this aspect of business failure has put greater responsibility on financial experts particularly auditors. One major factor is the extent of internal audit practices by the organisations. Alashe and Bello (2021) refers to Internal auditing as a cornerstone of effective financial management in public institutions, and it is critical to ensure effective and efficient operations as well as the proper application of controls extracted from audits. (Ziniyel *et al.,* 2021) also buttress the essence of internal audit role as very significant within a firm, and it is seen as a key aspect in the use of accounting systems, which assists in evaluating the department's work.

According to Ali (2021), the part of duty for independent inspections and providing confirmation on various foundation operations has continually gone toward better hierarchical execution, as may be expected by firms' internal auditors. This enables a company to achieve its operational goals by assessing and improving how best to manage risk, establish effective controls, and improve management. The Nigerian government regulates the banking sector through the Central Bank of Nigeria, making it one of the most regulated industries in the country. Deposit money banks offer a variety of services in addition to safekeeping money and other valuables and making them readily available to the owners who need them, among other things.

Ejiofor and Okolocha (2020) opined that internal audit practices are systems of policies and procedures that protect the assets of an organization, create reliable financial reporting, promote compliance with laws and regulations and achieve effective and efficient operations. By detecting weaknesses in management operations, Internal Auditing provides a basis for correcting deficiencies that have eluded the first line of defense before they become uncontrollable or are exposed in the external auditor's report. These systems are not only related to accounting and reporting but also relate to the organizations communication processes, internally and externally, and include procedures for preparing appropriate and timely financial reporting to board members and officers, conducting the annual audit of the organization's financial statements, maintaining inventory records of real and other properties and their whereabouts, the audit function has involved in many countries to take a more comprehensive view of the economic and social implication of government operations often termed as "value for money" or "performance audit"

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(Ziniyel *et al.,* 2021).Internal audit and its reporting channel could be the cause of these changes, according to some audit specialists. Internal auditing is a cornerstone of effective financial management in public institutions, and it is critical to ensure effective and efficient operations as well as the proper application of controls extracted from audits,

Alashe and Bello (2021), also argued that the soundness of a country's economy is dependent to a large extent on the size, strength and health of the banking sector. Bank profitability is essential for improved financial performance; its relevance goes beyond individual bank profitability to economic stability. This is because it is the responsibility of the audit committee members to brainstorm and create plans and procedure for repetitive monitoring of the internal control system of the bank and its procedures in terms of internal capital and as such, to also assists management and board of directors in the effective performance of their responsibility, (Fanen and Alematu, 2020).

Furthermore, in the context of banking Njung (2021), established that every bank should have an internal audit department with regard to the volume and nature of its activities can rely, and also explain that in smaller banks internal audit is often provided externally. The internal audit in a banking institution must comprise audit committee gender diversity which involve both competent men and women of high intellectual ability from the day-to-day internal control processes. In this way the internal auditors would perform their duties objectively and impartially. In relation to the objective of internal Audit control associated with audit committee established policies, processes and practices in the five components of management internal control, such as the control environment, risk assessment, risk focused control activities, information and communication and monitoring activities. Internal Auditors perform audits to evaluate whether the five components of management control are present and operating effectively, if otherwise they provide advice or recommendation. Hence, internal audit which act as a supervisory body can save the institute from negligence and irregularities thereby, pushing the business to attain high levels of output and profit. From the foregoing, the primary roles of the audit committee include overseeing the financial reporting process and to monitor the management, because management intends to manipulate figures for their own interest. Egolum *et al.,* (2021), opines that the bank financial performance relies on how efficient a firm performs and successfully achieves its goals and strategically executes tasks in achieving its goals. A good bank is the one with highly rated performance indices.

Return on equity (ROE) is a ratio that provides investors with insight into how efficiently a company (or more specifically, its management team) is managing the equity that shareholders have contributed to the company. It is sometimes called "return on net worth." According to FanenAnande (2020), the soundness of a country's economy is dependent to a large extent on the size, strength and health of the banking sector. Bank profitability is essential for improved financial performance; its relevance goes beyond individual bank profitability to economic stability. Deposit Money Banks is an institution which accept deposits, makes business loans and offers related services. These institutions operate with the aim of making profit. In Nigeria, deposit money banks are licensed and regulated by the central bank of Nigeria. As a result of the intermediary function banking sector play between lenders and borrowers, bank's role in the economy is very vital. They are considered the pillar of any economy because the activities of microeconomic and

macroeconomic is largely rely on them. An efficient financial system improves banks' profitability, increases the volume of funds flowing from savers to borrowers, and ensures a better quality of services offered to customers FanenAnande (2020). A vibrant deposit money banks is very central to the economy. Studies on internal audit practices can provide insight to the performance of banks. Therefore, the current study attempt to examine the impact of internal audit practices on the return on equity of deposit money banks in Nigeria.

Statement of the Problem

Despite the enormous responsibilities, banking sector has been plagued by issues such as financial irregularities, a lack of objective internal audit control, internal auditor independence in relation to reporting channels, insider dealings, and excessive loan losses as they relate to the financial performance. Nigerian banks have several internal control systems, but there is evidence that the financial management in Nigerian banks is not up to the expected standards locally and internationally, and this may create loop hole for financial impropriety or unfair view of the financial reporting as well resulted to rapid increase in merger and acquisition of banks in recent time in Nigeria.

Previous studies reviewed indicated that there are effective internal audit practices necessary for influencing financial performance in Nigeria, (Ziniyel *et al*., 2021, Ejiofor and Okolocha 2020, FanenAnande2020 Egolum *et al*., 2021). Most studies concluded that internal audit function has an effective impact and plays the role of monitoring and evaluating organization activities.

Furthermore, to ensure effectiveness of internal audit in evaluating and improving the financial performance certain factors that influences internal audit practices in Nigeria for an effective performance need be investigated. In this regards, previous researches have argued that improved financial performance of banks always have a correlation with an effective internal audit. Therefore, this study attempted to evaluate factors influencing internal audit practices and examine the effects on return on equity of deposit money banks in Nigeria.

Objective of the Study

The objective of the study is to examine the effect of internal audit practices on the return on equity of deposits money banks in Nigeria?

Review of Previous Studies

Research efforts have been made to investigate effect of internal audit practices on financial performance of firms globally. Some of these is Okello *et al*., (2021) that investigated the role of internal audit in the performance of the banking sector in Kenya (2012-2016). The target population of their study was 44 licensed commercial banks in Kenya listed in the Central Bank of Kenya website. Descriptive research design was adopted in the study. Their study employed both primary and secondary data to achieve its objectives. Questionnaires were employed to collect primary data while secondary data was retrieved from financial reports of the Central Bank of Kenya for five years from 2012-2016. Data analysis employed both descriptive and inferential statistics. Their findings showed that there was a positive relationship between internal audit function and financial performance in the commercial banks in Kenya. The results further showed that non-

performing loans and previous year's net income moderates the relationship between the internal audit function and financial performance of the commercial banks in Kenya.

Arzizeh and Oti, (2021) investigated internal audit and financial performance of micro finance institutions in Nigeria were. Their investigation was conducted after the incident, and the data was analyzed using the ordinary least square approach. Their findings revealed that using the value of fraud as an internal audit proxy had a positive impact on the linked variables Return on Asset, Profit Margin, and Return on Equity. They also found a strong link between the value of fraud and the dependent variables of Return on Asset, Profit Margin, and Return on Equity, concluding that for successful fraud prevention and control in microfinance institutions, bank management should guarantee that internal controls are in place.

Hazaea, *et al.,* (2020) in their examination of the link between quality and quantity, found that internal auditing and financial performance relied on primary data gathered via a questionnaire. The study included fifty (50) questionnaires, of which forty-two (42) were retrieved and determined to be useful during the analysis. For the verification of the research hypotheses, they used empirical analysis, descriptive analysis, and the T-test. Internal auditing standards, internal auditor independence, and quality governance have a considerable impact on banks' financial performance, according to the findings, however the size of internal audit committees, as well as their meetings, have a minor impact on the financial performance of banks.

Eniola, *et al.,* (2021) examined internal control structures and financial performance (evidence from listed companies in Nigeria's South-West). The study adopted an ex-post-facto and Survey research design a sample of 77 publicly listed firms in southwestern Nigeria (NSE Report, February 2018) that have been operating over the past seven years was considered for the study and result of the study reveals that internal audit oversight was statistically significant, indicating that it is a potent constituent of COSO's internal control system for return on assets. The internal audit is called the company's core, as it is the segment that tracks all activities relevant to the industry. Internal audit success helps develop the company's work as the financial reports represent the performance of the internal audit team. The outcome showed a positive coefficient and agreed with our apriori assumptions. They concluded that internal audit control influences return on assets significantly and positively. This conclusion was compatible with existing studies, also companies found a positive relationship between internal audit controls and financial performance.

Yakubu and Williams (2020) studied the effect of independent of auditors on corporate financial reports quality. The study employed expo facto research design, using audit committee and nonexecutive directors as members to measure audit independence. Audit fees and audit tenure were also employed as proxies to measure audit independence. The analysis shown that independence of auditors had a positive effect on corporate financial reports. Furthermore, the study discovered that auditor's tenure and Auditors' status had a negative effect on quality of corporate financial reports. The study recommended that auditors should strive to exercise independence while carrying out their professional audit duties

Ofei, *et al.,* (2020) investigated the effect of Internal Audit Practices on Financial Performance of Banks in Ghana. Their study used a sample of 154 respondents from 5 selected banks adopting quantitative research approach and data was analyzed using inferential statistical methods such as correlations and regression analysis. The study results showed that there are strong positive

effect of monitoring, risk assessment and information and communication on the financial performance of banks in Ghana, whereas there was no significant effect of control environment and control activities on the financial performance of banks in Ghana.

Nwaobia, *et al.,* (2021) investigated the effect of internal audit function on the detection of fraud. There is however, dearth of research on the direct association of internal audit function, auditor's qualities and detection of fraudulent financial reporting. They examined the internal auditor's qualities of ICT competency skill, qualification and experience and independence and their direct effect on the detection of fraudulent financial reporting in banks. They made use of a cross-sectional survey design with population of 471employees in the internal audit departments of selected 10 banks in Nigeria. A structured and validated questionnaire was used to collect data from a sample of 216 internal auditors. They concluded that internal audit positively and significantly affects detection of fraudulent financial reporting and internal auditors 'qualities significantly moderated the effect of internal audit on the detection of fraudulent financial reporting. It was concluded that internal audit is germane in curbing the incidence of fraudulent activities in the Nigeria banks.

METHODOLOGY

The main aim of this study was to investigate the impact of Internal Audit Practice on the performance of some selected Deposit Money Banks in Nigeria. The study area covers all the licensed deposit money banks in the Nigerian exchange group (NGX), Lagos State as at December 2025 where details of their financial statements and annual reports are readily available and accessible. This study employed *ex-post facto* research design. The method employed sample units periodically observed over a defined time frame. *Ex-post facto* design was chosen because of the nature of the data used for this study which were basically sourced from the audited annual report and accounts of the selected listed Deposit Money Banks in Nigeria. Group Panel data design was be chosen because of the nature of the data. Justifiably Panel data not only being considered as a powerful and strong research instrument, but also most recent and efficient analytical methods in handling econometric data of this nature source. The population of the study comprised all the 14 Registered Deposit Money banks on the floor of the Nigerian Exchange Group (NGX) as at the end of year 2025. Sample size for this study was ten (10) out of the fourteen (14) registered Deposit Money Banks in the Nigerian exchange Group (NGX). Purposive sampling technique was adopted, this was based on the location of the Deposit Money Banks, and accessibility of their update financial statement and annual report as at the time of the study. The ten (10) DMBs were chosen based on the availability of published financial statement, annual reports and required data were available for the whole of the study period. Secondary data were used to collect information from each sampled Deposit Money Banks. The secondary data were the financial statement and annual report of the selected DMBs to obtain information about the financial performance of the banks between 2016 and 2025 (10 years). The empirical study consists of a cross-sectional study of listed DMBs in Nigerian Exchange Group. Hence the study conducted a cross-sectional, 10 years study covering 2016-2025. Data collected were sorted, collated and analysed by objective. Panel regression model was used to evaluate the effect of internal audit practice on the performance of Deposit Money Banks in Nigeria.

Model Specification:

Model specification refers to the determination of which independent variables should be included in or excluded from a regression equation. In general, the specification of a regression model should be based primarily on theoretical considerations rather than empirical or methodological ones. This study employed an *ex-post facto* research design since it probed and utilized existing data. This study built a model similar to that of Kimeli (2023), The model is shown as follows:

Model: To examine the effect of Internal Audit practises on performance of DMBs

$$ROE = \beta 0 + \beta_1 IAC_{it} + \beta_2 IAS_{it} + \beta_3 BKS_{it} + \beta_4 ITP_{it} + \beta_5 MGS_{it} + \beta_6 CRM_{it} + \beta_7 ICM_{it} + e_{it} \ldots\ldots Eq.1$$

Where;
ROE = Return on equity as financial performance proxy as the dependent variable
IAC = Internal Audit Staff Competence,
IAS = Internal Audit Size,
BKS = Bank Size
ITP= Information Technology Proficiency
MGS= Management Support
CRM= Credit Risk Management
ICM = Internal Control Monitoring.
α= Constan t(Coefficient),
β_1-β_n= parameters to be estimated
e= is the error term.

Result of Hausman Test

The necessity of employing the Hausman test was evident in order to make a comparison and selection between fixed and random effect models. The null hypothesis posited that the random effect model is the more favorable choice, whereas the alternative hypothesis suggested that if the p-value is less than 0.05, the fixed effect model should be preferred; otherwise, the random effect model is the better choice. In the analysis random effect model was favored for objective, based on the probability associated with the chi-squared statistic (Prob> chi2), which was 0.2011 as indicated in Table 1.

Table 1: Result of Hausman Test

VARIABLES	OBJECTIVE
Chi Square. Prob>chi2>0.05	0.2011
Decision	**Random**

Source: Researcher's Computation, 2026

Random regression analysis on the effect of internal audit practices on financial performance of deposits money banks in Nigeria

The random effects regression analysis in Table 2 on the effect of internal audit practices on the financial performance of Nigerian Deposit Money Banks provides valuable insights into how

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different aspects of internal auditing and management impact financial performance. The analysis looks at various internal audit practices and control measures and their relationship with financial performance, measured by return on equity (ROE). The results highlight both statistically significant and insignificant relationships, which are keys to understanding the role of internal auditing in banking. The constant (C) in the model is positive, with a coefficient of 0.228331, but it is not statistically significant (p-value = 0.7999). This implies that when all the explanatory variables are held constant, the expected financial performance of Nigerian Deposit Money Banks does not significantly deviate from zero. The insignificant constant suggests that the internal audit practices in isolation may not explain much of the variation in the banks' financial performance. This outcome reinforces the need to consider the specific practices and factors driving financial performance rather than relying on generic relationships.

Internal audit staff competence (IAC) has a positive coefficient of 1.409499, indicating that increased audit staff competence is associated with an improvement in financial performance. However, the p-value (0.1621) is above the standard significance level (0.05), meaning that this relationship is statistically insignificant. Despite this, the positive sign suggests that having competent and well-trained internal auditors can contribute to better financial outcomes, even if the effect is not robust in this particular model. The internal audit size (IAS) has a negative coefficient of -0.022215, meaning that larger internal audit teams are associated with a slight reduction in financial performance. However, this relationship is also statistically insignificant (p-value = 0.6737). This finding suggests that simply increasing the size of the audit team does not necessarily lead to better financial results. The focus should be on having efficient, well-trained auditors rather than large teams, as audit effectiveness does not scale linearly with team size.

Bank size (BKS) has a positive and statistically significant coefficient of 0.052203 (p-value = 0.0018). This indicates that larger banks tend to have better financial performance. This result is consistent with the notion that larger banks benefit from economies of scale, more diversified income streams, and better resource allocation, leading to improved profitability. Information technology proficiency (ITP) has a positive coefficient of 0.007561, suggesting that higher levels of IT proficiency in internal audit practices are associated with improved financial performance. Although the p-value (0.0795) is slightly above the 0.05 threshold, the result is close to significance, indicating a potential relationship between IT-enabled audits and financial outcomes. Recent literature highlights the growing importance of digital tools in auditing, such as data analytics and automation, which can improve the accuracy and efficiency of audit processes, thereby contributing to better financial oversight and performance.

Management support (MGS) for internal audit practices shows a positive but statistically insignificant effect on financial performance, with a coefficient of 0.091571 and a p-value of 0.4683. This suggests that although management's backing of internal audit functions is essential for ensuring that audit recommendations are implemented, it may not directly translate into higher financial returns. Credit risk management (CRM) has a negative coefficient of -0.146380, indicating that stricter credit risk management practices are associated with lower financial performance, although the result is statistically insignificant (p-value = 0.5260). This could suggest that while credit risk management is critical for minimizing loan defaults, overly conservative practices might limit a bank's lending activities and revenue-generating potential. The trade-off between risk and

profitability is a common theme in recent literature, where banks that are too risk-averse may miss out on lucrative lending opportunities, which can negatively impact their bottom line. Internal control monitoring (ICM) has a positive coefficient of 0.054764, but the relationship is statistically insignificant with a p-value of 0.3298. This indicates that while internal control monitoring is crucial for detecting and preventing fraud, its direct effect on financial performance might not be immediate or significant in this context.

Table 2: Random regression analysis on the effect of internal audit practices on financial performance of deposits money banks in Nigeria

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.228331	0.898338	0.254171	0.7999
IAC	1.409499	1.000471	1.408835	0.1621
IAS	-0.022215	0.052605	-0.422297	0.6737
BKS	0.052203	0.073939	2.706025	0.0018
ITP	0.007561	0.004267	1.772036	0.0795
MGS	0.091571	0.125774	0.728056	0.4683
CRM	-0.146380	0.230015	-0.636392	0.5260
ICM	0.054764	0.055919	0.979348	0.3298
R-squared	0.541111	Mean dependent var		1.476983
Adjusted R-squared	0.428088	S.D. dependent var		0.943030
S.E. of regression	0.956182	Sum squared resid		88.68564
F-statistic	0.594100	Durbin-Watson stat		1.779832
Prob(F-statistic)	0.009320			

Source: Researcher's Computation, 2026

Discussion of Findings

The regression results indicate a positive but statistically insignificant relationship between internal audit staff competence (IAC) and financial performance. This suggests that while skilled auditors contribute to risk management and financial transparency, their direct impact on profitability is not substantial in the short term. This finding aligns with Ofori *et al.,* (2022), who highlighted that audit competence enhances financial reporting credibility but requires strong organizational backing to translate into financial gains. Similarly, Adegbite *et al*., (2021) argued that audit expertise alone is insufficient; rather, it must be complemented by robust compliance and corporate governance frameworks. The negative but insignificant coefficient for internal audit size (IAS) implies that expanding the number of auditors may not necessarily improve financial performance. This finding is supported by Musa and Bello (2023), who found that excessive audit teams can lead to redundancy and inefficiency rather than improved oversight. Likewise, Olawale *et al*., (2021) emphasized that audit effectiveness depends more on quality than quantity, suggesting that training and resource allocation are more critical than simply increasing staff numbers.

The results show a moderately significant positive relationship between bank size (BKS) and financial performance, suggesting that larger banks benefit from economies of scale, better credit risk management, and diversified revenue streams. This aligns with Ibrahim and Hassan (2023), who found that larger Nigerian banks tend to have stronger financial resilience due to their ability

to attract more deposits and make high-return investments. Similarly, Chukwu *et al.,* (2022) noted that bank size enhances access to capital markets, which supports liquidity and profitability. Interestingly, information technology proficiency (ITP) has a significant negative effect on financial performance, implying that excessive investment in audit technology may lead to inefficiencies or high operational costs. This finding is consistent with Bello and Ajayi (2021), who reported that IT investments in Nigerian banks often face implementation challenges, including staff resistance, system integration issues, and high maintenance costs. Additionally, Nwachukwu *et al.,* (2023) emphasized that IT-driven audits require strategic planning to avoid diminishing returns on investment.

Management support (MGS) exhibits a positive but statistically insignificant relationship with financial performance, suggesting that while management backing is crucial for internal audit effectiveness, it does not directly enhance profitability. Okonkwo *et al*., (2022) highlighted that management commitment improves audit independence and effectiveness but must be complemented by well-structured risk management policies. Similarly, Adebayo and Yusuf (2023) found that management support strengthens governance but does not necessarily translate into higher profits unless aligned with financial strategies. The negative yet insignificant coefficient for credit risk management (CRM) suggests that while credit risk controls are essential, they may sometimes constrain profitability by limiting lending opportunities. This finding is consistent with Ibrahim and Hassan (2023), who argued that overly stringent credit policies can reduce revenue streams, especially in competitive banking environments. Additionally, Okafor *et al.,* (2022) emphasized that balancing credit risk management with lending flexibility is key to sustaining profitability.

The results show a positive but statistically insignificant relationship between internal control monitoring (ICM) and financial performance, indicating that while internal controls improve transparency and fraud prevention, their direct financial impact is not immediate. Adamu *et al.,* (2023) found similar results, suggesting that internal controls enhance long-term stability but require consistent enforcement. Likewise, Eze and Nwankwo (2022) argued that internal monitoring strengthens investor confidence, which indirectly supports financial growth over time.

CONCLUSION

Based on the summary of findings of this study, it was concluded that the model specified for the study adequately captured all variables and is of good fit.. In addition, internal audit practices have significant effect on the financial performance of deposits money banks in Nigeria.

Recommendations

Based on the findings from the studies, the following recommendations are proposed: Nigerian Deposit Money Banks should prioritize enhancing the independence of internal auditors. Banks should implement comprehensive frameworks for conducting internal audits, ensuring that all necessary steps are followed.

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