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Effect of Internal Audit Attributes on the Quality of Financial Reporting in Musanze District.

A Case Study of Non-Budget Agencies.

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Abstract: The paper's purpose is to evaluate the effectiveness of internal auditor's independence on the quality of financial reporting of non-budget Agencies in Musanze District. The research employed a survey research design. The study administered 100 questionnaires randomly to respondents, 97 questionnaires were returned and analyzed. Data conducted by taking 50 non-budget agencies from sectors, schools, and health centers in Musanze District. The data collected were analyzed using descriptive and inferential statistics. The results of the findings revealed that auditors' independence has a statistically significant positive effect on quality of financial reporting of non-budget agencies in Musanze District. The study concluded that effective and efficient internal audit attributes can affect the quality of financial reports of non-budget agencies in Musanze District based on factors analyzed in the study such as auditors' independence. Thus, the quality of financial reporting depends strongly on the attributes internal audit.

Keywords: Internal Audit Attributes, Financial reporting, Auditor's independence.

I. Introduction

An important condition for the corporation management during the period of crisis in the global economy is the efficient use of available resources and provision of relevant information for management optimal decision-making. Among the activities that allow improving the current practice of resources use is the implementation and the use of internal financial control system. It should be noted that internal financial control should be used in conjunction with the accounting and managerial accounting systems including budgeting system which integrated into the company's management process, providing management of necessary, timely and reliable information, providing reliable estimates and analysis of key performance indicators as well as the need to control forecast data (Henkland*et al.*, 2014; Ling,2015; Ronzhina, 2016).

Internal audit control encompasses an established of rules, policies, procedure implemented by an institution to offer assurance on the reliability of its reports, effectiveness and efficiency of its operation and the compliance and compatibility of their activities with laws and regulation. Based on the information from report of the audit general (2017) showed that financial statements for 82 entities (50% of 165 report) received unqualified audit opinion, these financial were free from any material misstatement and reflected true and fair view and balances reported by these budget agencies.

1.1 Problem statement

The Government of Rwanda (GoR) has remarkably improved its PFM systems through the implementation of the five years PFMSSP (2013-2018). The progress in PFM is particularly manifest in Strengthened capacities in PFM across government agencies both at central and local level; the implementation of the Integrated Financial Management Information System (IFMIS) in almost all budget agencies. The IFMIS is now implemented at the level of Sectors and is planned to be rolled out in other subsidiary entities of the Districts, i.e. Health centers and schools, in the near future. In a bid to enhance professionalization and capacity building across all PFM disciplines, the GoR is currently implementing a PFM Learning and Development Strategy which was adopted. In this context, all Government officials involved in PFM such as Directors of Finance, accountants, internal auditors, and budget officers will be facilitated to attend professional courses that lead to certification. Despite the efforts and investments made by the GoRin order to improve the level of compliance, serious issues in PFM persist in Rwandan institutions.

One of the necessities of auditing case is the presence of effective attributes of internal audit on the good quality of financial reporting. Thus, the problem is that if effective internal audit attributes can lead to reduction of time, costs, and incidental auditing in audit process, and if effective internal controls influence increasing audit quality, detection of significant errors and distortions, and validating financial statements and reporting.

1.2 Specific objectives

i. To determine the effect of auditor's independence on financial reporting of non-budget agencies in Musanze District

ii. To examine the effect of auditor's financial expertise on financial reporting of non-budget agencies in Musanze District

iii. To establish the impact of management support and risk management on the quality of financial reporting of non-budget agencies in Musanze District

iv. To determine the roles of government policies and regulations on internal audit attributes for a good financial reporting of non-budget agencies in Musanze District.

II. Literature Review

2.1 Concept of quality of financial reporting

The objective of financial reporting is to provide the users of the report information about the economic resources, claims and changes in resources. According to IASB, the essential principle of assessing the financial reporting quality is related to the faithfulness of the objectives and quality of disclosed information in a company's financial reports. These qualitative characteristics enhance the facilitation of assessing the usefulness of financial reports, which will also lead to a high level of quality. To achieve this level, financial reports must be faithfully represented, comparable, verifiable, timely, and understandable. Thus, the emphasis is on having transparent financial reports, and not having misleading financial reports to users; not to mention the importance of preciseness and predictability as indicators of a high financial reporting quality (Gajevszky, 2015).

2.2 Concept of Internal audit attributes

Internal Audit has become an indispensable management tool for achieving effective control in both public and private organizations. Control mechanisms are those processes set up to monitor and to direct, promote or restrain the various activities of an enterprise for the purpose of seeing that enterprise objectives are met. Internal audit is an internal mechanism the members of the organization use in effective discharge of their responsibilities. It's also an independent appraisal function established within an organization to examine and evaluate the effectiveness, efficiency and economy of managements control system (Subramaniam, 2006). The aim is to provide

management with re-assurance that their internal control systems are adequate for the need of the organization and are operating satisfactorily (Reid &Ashelby, 2002).Badara&Saidin (2014) state that internal audit effectiveness has become a fruitful topic over the decade. This is because of the important roles play by the internal auditors in organizational survival and achievement. They averred that most of the organizations, whether public or private, have established internal audit department with the mind of enjoying the benefit behind the internal audit service.

Increased audit quality works to reduce information asymmetry and conflict of interest between managers and shareholders (Arens*et al*., 2010). Hence, the process of auditing is seen to work as a monitoring mechanism which assists in enhancing the quality of disclosure (Agyei-Mensah, 2018). Internal auditing is developing as a substantial element of management in both the public and the private sectors. Because of its importance and because of its continuous escalation into the management process, it is essential this action be taken to ensure that the performance of internal auditing conforms to high quality standard (TheofanisKaragiorgos,2006).

Mustika (2015) tested the factors that influence the internal audit effectiveness, including internal auditor competencies, internal auditor independence, auditee support to internal audit activity, and the internal and external auditor relationship. Using the internal auditor inspectorate in Java Province, Indonesia, the researcher found that the internal audit effectiveness can be attained through increase internal audit competence, independence, and strong relationship between internal and external auditor. However, this study found that auditee support has no effect on internal audit effectiveness.Rudhani, Vokshi&Hashani (2017) asserted that since audit has a great importance in preventing, consulting, and finding cases of funds misuse, it was thought of analyzing the factors that contribute to increasing the efficiency of internal audit in the public sector which would help to set proper and more transparent governance of public financial resources. They therefore undertook a study that investigated the relationship between effectiveness and contributing factors. The data for the study were collected through an online questionnaire and direct hand-outs of such. The results of the empirical analysis proved that effectiveness has a positive relationship with internal audit quality, the competence of the internal audit team, the independence of internal audit, as well as with the support of internal audit from the management.

III. Methodology

The researcher used correlational design about a group of people (one or more), who are asked several questions with their answers being recorded in a summarized questionnaire and in putted into spreadsheet tables then analyzed into SPSS. The questions may be about their opinions, attitudes, characteristics, orexperiences.The population targeted is 195 persons, from sectors, Health centers and schools. Five pointsLikert scale close ended structured questionnaire were used as a data collection instrument while inferential statistics were used to draw inferences from the data.

IV. Findings

4.1 Descriptive Statistics

The findings in Table 1 indicated that, many of the respondents agree with the statements in establishment that, the internal auditors carry out the audit exercise in independent way from the management.

Table 1: Auditors 'independence on the quality of financial reporting

Nº	Statement	Mean	Standard Deviation
1	Internal Auditors perform their duties with a greater degree of autonomy and independence from Management	4.237	1.14358
2	Internal auditors work independently and conduct their work without interference of any official	4.471	0.95
3	Independence is necessary for the effective achievement of the internal audit functions?	4.309	1.0243
4	Does it really matter that your agency be audited by an internal auditor?	4.196	1.1332
5	After auditing exercise, does Internal Auditors sit down writing their auditing reports?	4.155	1.24449
6	How fully do you consider you were consulted on matters which were included within the audit report?	4.052	0.88236
7	Internal auditors may not have conflict of interests while auditing?	4	1.09924
8	No undue delays in the presentation of financial reports?	4.381	0.80936
9	Financial reports are presented annually as required by regulatory bodies of public financial management?	4.381	1.03525
10	Does the internal audit reports being regularly submitted to Sector/School/ Health Center?	4.103	1.28683

Source: (Field data, 2021)

4.2 Inferential Statistics

Table 2 indicates an assessment of statistical significance of the result. This is a test of the null hypothesis to enable the determination of whether the null hypothesis should be accepted or rejected. From the coefficient table, the significance value in this study is 0.000, which is lower than the cut-off of $p < 0.05$. This therefore signifies that there is statistically significant relationship between auditors' independence and quality of financial reporting.

From Table 2 the R value is 0.907 and R^2 is 0.823 when expressed in percentage terms; it shows that this model explains 90.7% of the variance in the dependent variable being quality of financial reporting. That is to say, the remaining 9.3% variation in the dependent variable can be explained outside the independent variable by other factors.

An affirmative and positive relationship exists linking auditors' independence and financial reporting of the NBAs (Pearson correlation coefficient r=0.847 Sig = 0.015) and that for financial reporting to increase, auditors' independence is a vital and necessary part. This is in line with Ljubisavljević and Jovanovi (2011)who proposed that organizational independence of the internal audit department helps it output reliable financial reporting to all stakeholders of the company which meets the requirements they may have regarding the financialreporting.

Table 2.Auditors' independence and Quality of Financial Reporting.

Model Summary

Model		R	R Square	Adjusted R Square	Std. Error of the Estimate
1		.907[a]	.823	.821	.40920

a. Predictors: (Constant), Auditors' independence

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	73.979	1	73.979	441.801	.000[b]
	Residual	15.908	95	.167		
	Total	89.887	96			

a. Dependent Variable: Quality of financial reporting

b. Predictors: (Constant), Auditors' independence

Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.966	.160		6.029	.000
	Auditors' independence	.768	.037	.907	21.019	.000

a. Dependent Variable: Quality of financial reporting

Source: (Field Data, 2021).

V. Conclusion and Recommendation

The internal audit attributes are important to the growth of firms as it provides essential services for the management of the firms. It is helpful in bringing a "methodical disciplined way to gauge and refine the control and governance procedures, effectiveness of risk management" Institute of Internal Auditors. It is a vital characteristic and as evidenced by the increasing demand for this service in several organizations. The financial reports express the work and quality of an internal audit department and its efficiency will help in enhancing the quality of activities of the company. The financial reports express the work and quality of an internal audit department and its efficiency will help in enhancing the quality of activities of thecompany.

The role of this research was to establish if there is a connection between the internal audit attributes and financial reporting of non-budget agencies in Musanze District. From the analysis the research confirmed that the independence of internal auditors affects the financial reporting of non-budget agencies to a greatextent. Independence is a vital component of auditing; the truthfulness of the auditor's opinions, conclusions and recommendations should be respected as such. Internal auditorsmustnothaveaconflictofinterestswiththeagency;andfinally,independence in carrying out an internal auditor's duties is essential for the achievement of the function and objective of internal audit.

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