

Impact of Internal Audit System on the Quality of Bank's Accounting Reports in Nigeria

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Abstract

Internal audit is seen as a powerful internal control mechanism that must be well established by an organization for effective control and enhanced checks and balances. However, extant literature has produced a multiplicity of findings on the effect of internal audit functions on financial reporting quality especially in the context of banks in Nigeria. To this end, this study was conducted to examine the effect of internal audit functions on the quality of bank's accounting reports. The specific objectives of the study were to investigate the impact of internal auditors' technical proficiency, internal audit procedures, and internal audit independence on financial reporting quality of Deposit Money Banks in Nigeria. The study anchored on the theory of inspired confidence, adopted the survey research design. A self-designed questionnaire was used as a tool for data collection for the study. Findings of the study indicate a significant positive effect of internal audit technical proficiency, internal audit procedures, and internal audit independence on the quality of accounting reports. The study concludes that internal audit functions influences the level of financial reporting quality of DMBs in Nigeria, and recommends amongst others that Banks should engage the services of qualified and competent internal auditors so as to enhance internal control system and promote better financial reporting quality.

Keywords: *Internal audit; Accounting Reports; Technical Proficiency; Auditor's Independence.*

1. INTRODUCTION

Internal audit practices are very central to the internal control system of any organization and play a vital role in promoting accountability, transparency, checks and balances and other ethical business principles. Internal audit is a powerful internal control mechanism that must be well established by an organization for a better financial reporting quality. According to Handoyo (2024) the external auditor should assess the quality of internal control, which includes evaluation of the quality of the internal audit function, as the internal control in its wider sense, including the internal audit function to be able to get a fair assessment of audit risk inherent in the engagement. The prominence and reliance on internal audit functions have increased due to greater emphasis on sound corporate governance as observed by Khan and Liu (2023). The internal audit functions provide stakeholders with information on a range of important issues and plays a vital role in monitoring the risk profile of an organization.

The internal audit functions and practices are expected to enhance the value relevance of any establishment's accounting information, which will eventually promote transparency, and accountability. Oladejo et al. (2018) view internal audit function from a global perspective stressing that internal audit is a necessity and adds value to the organization. Poltak et al. (2019) observed that the established effectiveness of internal audits is a control function for management in achieving the goals and targets of the organization.

The quality of financial and accounting reports has gained attention from researchers and stakeholders due to a number of factors, including economic downturns, the harmonization of accounting standards, the growth of disclosure mandates, and most importantly, a number of accounting scandals (Enofe et al., 2013; Herath & Albarqi, 2017). Accounting and financial reports provide information on the operational and financial performance of banks. According to this reasoning, audit processes used to produce accounting financial statements ought to adhere to the necessary criteria. Therefore, it's imperative to guarantee that bank audit procedures are carried out accurately in order to prevent theft and fraud incidents. While auditors bear the primary duty for audit quality, all stakeholders are essential in promoting high-caliber financial reporting.

The extent to which internal audit functions curb financial misconduct and promote better financial reporting quality has been a subject of debate by policy makers and researchers. For instance, Enofe et al. (2013) observed that audit failures of the early 2000s had raised concerns regarding the timeliness and reliability of accounting reports is a question for informed empirical research on financial reporting quality. Ejoh and Enom (2014) contended that the internal audit functions when diligently implemented can promote the quality of financial reports maintained by an organization to create confidence among shareholders.

However, there has been a notable lack of research especially in the context of developing nations regarding the direct association of internal audit functions and the quality of accounting reports in the banking sector. A few studies (Ejoh & Enom, 2014), Kayode & Oyeshola, 2021; Arzizeh & Oti, 2019) that have been conducted in the developing countries like Nigeria have placed emphasis its effect on performance or fraud detection instead of the overall financial reporting quality. Furthermore, empirical evidence of the impact of internal audit functions on quality of accounting reports have produced mixed results. This study aims to fill this gap by specifically investigating

internal audit attributes and their influence on the quality of accounting reports in selected DMBs in Nigeria. The primary objective is to determine the effectiveness of these systems in addressing the quality of financial reports of DMBs, focusing on key aspects such as auditor's technical proficiency, internal auditing procedures, and internal auditor's independence.

2. LITERATURE REVIEW

2.1 Theoretical Framework: Theory of Inspired Confidence

The auditors' theory of inspired confidence as developed by the Limperg Institute in the Netherlands in 1985 offers a linkage between the users' requirement for credible and reliable financial reports and the capacity of the audit processes to meet those needs. It sees through the development of these needs of the public (stakeholders) and the audit processes over time. The theory of inspired confidence states that the auditor, as a confidential agent, derives his broad function in society from the need for expert and independent examination as well as the need for an expert and independent judgment supported by the examinations.

The basic assumption of the theory of inspired confidence is that the duties and responsibilities of the auditors are a derivation from the confidence that is bestowed by the public on the success of the audit process and the assurance that the opinion of the accountant conveys. Since this confidence determines the existence of the process, a betrayal of the confidence logically means a termination of the process or function (Afolabi & Fawale, 2022; Boskou et al., 2019). Elvira (2018) in discussing the social significance of the audit stated that when the confidence that society has in the effectiveness of the audit process and the audit report is misplaced, the value relevance of that audit is destroyed. Therefore, auditors are expected to maintain reasonable quality assurance especially given that an audit failure is effectively a career-ending event. The theory suggests that the duties and responsibilities of the auditor are derived from the confidence which the public places on the success of the audit process and the assurance which the audit opinion provides. Auditors are therefore expected to maintain reasonable quality assurance in view of the fact that audit failure is a career-ending event.

2.2 Empirical Review

A number of empirical studies have been conducted on the link between internal auditing system and corporate financial reports. For example, Dije and Kabiru (2014) studied on the extent of internal audit functions outsourcing by Nigerian deposit money banks. The extent to which the banks outsource each of the 15 identified functions traditionally attached to the internal audit unit/department is tested, using a structured questionnaire to elicit responses from the top and middle level management staffs of the banks. The study found that all the 15 identified IAFs are being outsourced by the Nigerian DMBs at varying degree (completely, partially, occasionally or rarely). It also discovered that 6 IAFs stand out as those that are more outsourced than provided in-house by the Nigerian DMBs (going by the 50% and above scores they attracted from the respondents), and that the other 9 IAFs are more discharged in-house than outsourced to outside experts.

In a study, Abdalla (2024) sought to determine how much internal audit modifies the relationship between accounting information systems and the performance of Jordanian commercial banks.

This quantitative study used cross-sectional and descriptive methods to be at a declining trend of the survey mostly done on the accounting departments of 12 major Jordanian banks. Out of the 358 questionnaires distributed, 249 were returned; of those, only 243 were found to be valid following screening. As a statistical approach for data analysis, partial least square structural equation modelling (PLS-SEM) was employed, which is suitable when investigating complex relationships and evaluating hypotheses. The results show that the adoption of AIS systems and the enhancement of performance indicators at Jordanian banks are positively correlated. More importantly, the results imply that internal audit considerably amplifies the beneficial impact of AIS on bank performance. This twin realisation highlights the necessity for Jordanian banks to use modern AIS and for internal auditors to generally enhance the systems that guarantee they optimise performance gains. More importantly, the results highlight how crucial it is to include strong internal audit procedures and effective AIS in banking strategy, with significant ramifications for bank managers and sector officials.

The study conducted by Abdelrahim and Al-Malkawi (2024) investigated the impact of senior management support (SMS) on the variables that influence the efficacy of the internal audit (IA) function. Using a quantitative survey approach, information was gathered from 207 chief audit executives employed in Gulf Cooperation Council (GCC) nations. The partial least squares-structural equation modelling method (PLS-SEM) was used to analyse the data. Additionally, the moderating effect was investigated using a straightforward slope plots test. The findings indicate that SMS modifies the efficiency of IA in a mixed way. The relationship between the IA and the audit committee, the adoption of a quality assurance and improvement program, and the IA's role in leading the implementation of combined assurance are the areas where the interaction effect of SMS is negative and significant. In contrast, the effect is positive and significant when it comes to IA independence, IA staff competence, and adopting a risk-based audit approach. The findings also demonstrate that there is no moderating influence of IA size or external auditor collaboration. The impact of internal audit quality on the quality of financial statement information is the main topic of a paper by FuPing and Loang (2023). The dependent variable is chosen as a proxy for the quality of financial statements of enterprises whether financial restatement occurs. This study constructs an evaluation system for the quality of internal audit of enterprises by selecting five independent variables: the scale of internal audit, audit capability, scope of internal audit function, reliability of internal audit system, and independence of internal audit firms. Fifty listed Chinese SME financial services organisations made up the final sample data selected. It is ultimately determined that internal audit quality is favourably correlated with financial statements by developing a model, verifying the suggested hypothesis, and employing linear regression to assess the aforementioned variables. Put another way, a company's financial statements will generally be of higher quality if its internal audit is of a higher calibre.

Astuti (2023) research aimed to know the influence of assessment of internal audit performance to internal control system, influence of applying of internal audit to internal control system, and influence of assessment of performance and applying of internal audit both of internal control system. The research has been done by questionnaires internal auditor. Partially, internal audit performance and internal audit applying variable have influence significance of internal control system.

Oladejo et al. (2021) assessed the characteristics of internal auditing practices and how they affected the calibre of reports from particular companies. The financial reports of four food and

beverage companies that were purposefully chosen from among the twenty-three (23) listed on the Nigeria Stock Exchange as of December 2020 provided secondary data covering the nine (9) year period from 2010 to 2019. The three criteria that measure the internal audit practice—internal audit fee, internal auditor technical proficiency, and firm size—make up the independent variable in this study. The study found that internal auditing has a positive influence on quality of financial reports.

A case study was employed by Abdulai et al. (2021) in another study involving the University for Development Studies (UDS), Ghana. Examining the effectiveness and suitability of UDS's internal control framework, discovering new factors of high-quality financial reporting, and estimating the contribution of internal audit to high-quality financial reporting were the three primary objectives of the study. Seventy participants were selected for the study using stratified and purposive sampling methods, and a descriptive survey template was employed. Binary regression was employed in the analysis to meet objectives one and two, and the Best (2005) index was updated and used to meet objective three. The study determined that staff competence, computerised accounting system, and accuracy of financial reporting were factors of quality financial reporting. Due to improper implementation of two of the five essential elements of an effective internal control system—the control environment and information and communication—UDS's internal control system was found to be ineffective. Based on the analysis of remaining indicators, it was concluded that UDS's internal audit indicates an average degree of fraud prevention, with respect to the robustness of auditing processes and fraud prevention indicators. A high level of prevention is generally revealed by UDS's internal auditing. The University for Development Studies (UDS) ought to scrutinise, specify, and implement control setting, information, and communication elements of the internal control system that suit their work procedures, in addition to improving the current components, as per the study.

Based on the foregoing review, we propose the following hypotheses:

H0₁: Internal auditor's technical proficiency does not have a significant effect on quality of accounting reports of Deposit Money Banks in Nigeria

H0₂: Internal audit procedure does not have a significant effect on quality of accounting reports of Deposit Money Banks in Nigeria

H0₃: Internal auditor's independence does not have a significant effect on quality of accounting reports of Deposit Money Banks in Nigeria.

2.3 Conceptual Framework

Based on theoretical and empirical review, and the hypothesis developed, the following conceptual model can be proposed:

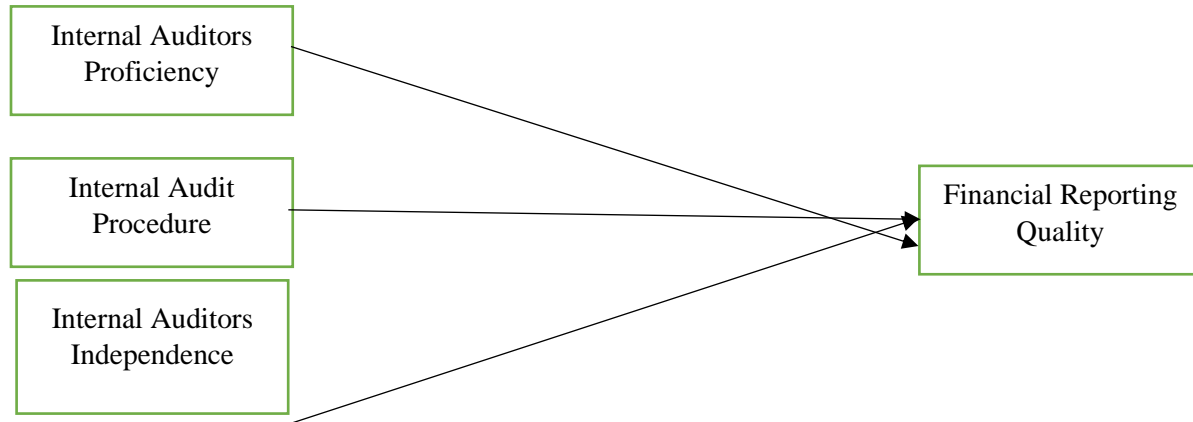


Figure 1: Conceptual Framework

Source: Author (2024)

The above framework conceptualizes graphically the interaction between variables studied in this work. The study adopts three measures of internal auditor technical proficiency, internal audit procedures, and internal auditor's independence as independent variables. Financial reporting quality is used as dependent variable for the study.

3. METHODOLOGY

A survey research design with a quantitative approach was used to investigate the links between internal audit system and quality of banks' accounting reports. The population of the study consisted of all Deposit Money Banks in Delta State. The study adopted a multi-stage sampling technique. First, 15 DMBs were randomly selected. Further, five (5) employees each from among fifteen (15) DMBs were chosen using a simple random sampling technique giving a total of seventy-five (75) target respondents for the study. Data were collected through structured questionnaires. Analysis involved descriptive statistics and linear regression using IBM SPSS software.

4. DATA ANALYSIS AND DISCUSSION

4.1 Descriptive Statistics

Auditors Technical Proficiency

Table 1 Responses on Auditors Technical Proficiency

No.	Item	Students' Mean	SD	Decision
1	My organization places emphasis on educational qualification	3.8623	1.06938	Agree
2	The selection for recruitment in this bank is based on work experience	3.3522	.79213	Agree
3	Qualification and discipline determine job placement in the audit unit	4.2753	.72493	Agree
4	Internal audit section of this bank is manned by qualified and competent staff	3.8583	.80152	Agree
5	There regular training and retraining of staff in our audit section	4.3036	.63830	Agree
6	Professional certification is a mandatory requirement for working in our accounting department	4.1903	.69275	Agree
Grand mean (\bar{x})		4.768		Agree

* The acceptance mean point for the items was 3.00, any mean (\bar{x}) that is 3.00 and above is agreed indicating a positive effect. Below 3.00 is disagreed which is regarded as a negative effect.

Source: Field Work (2024).

Table 1 above showed the distribution of the respondents based on their response to statements bordering on how auditors' technical proficiency influence financial reporting quality, with all of the responses being positive as they were above the mean cut off of 3.00. The most positive response had a mean score of 4.303 indicating that there is regular training and retraining of staff in our audit section. The least positive response was that the selection for recruitment in the bank is based on work experience with a mean score of 3.352. All of the respondents agreed and were positive with grand mean of 4.768 which further indicate that auditors' technical proficiency influences quality of accounting reports of banks in Nigeria.

Internal Audit Procedures

Table 2 Responses on Internal Audit Procedures

No.	Item	Students' Mean	SD	Decision
7	The internal control system is effective	3.5142	1.21926	Agree
8	The audit procedure enhances checks and balances	4.2955	.45721	Agree
9	Relevant authorisations are obtained before cash disbursements	3.8583	1.09700	Agree
10	Hierarchy of operations are consistently followed in approvals	3.3036	1.41454	Agree
11	There is a clear separation of duties among accounting and audit staff	2.4858	.93204	Disagree
12	Lodgements and payments are promptly verified by the Internal Control Unit of our organisation	3.4494	.91313	Agree
Grand mean (\bar{x})		4.181		Agree

* The acceptance mean point for the items was 3.00, any mean (\bar{x}) that is 3.00 and above is agreed indicating a positive effect. Below 3.00 is disagreed which is regarded as a negative effect.

Source: *Field Work (2024).*

Table 2 above showed the distribution of the respondents based on their response to effect that internal audit procedures have on accounting reporting quality with all the responses being positive as they were above the mean cut off of 3.00, except for item 11 that had a negative response as its mean score of 2.485 which was below 3.00. The most positive response had a mean score of 4.295 indicating that the audit procedure enhances checks and balances. The least positive response was that hierarchy of operations are consistently followed in approvals with a mean score of 3.303. Despite the one disagreed response, majority of the respondents agreed and were positive. Therefore, the result indicates that internal audit procedures have a significant positive effect on accounting reporting quality which is supported by the grand mean of 4.181.

Internal Audit Independence

Table 3 Responses on Internal Audit Independence

No.	Item	Students' Mean	SD	Decision
13	Audit department performs its functions without interference	2.6397	1.21463	Disagree
14	The internal auditors have no conflict of interest	3.6640	1.17063	Agree
15	Management does not interfere with internal auditors checks	3.4413	1.15628	Agree
16	The audit department verifies all transactions irrespective of status	4.0688	.56966	Agree
17	Internal auditors at the branch cannot be unilaterally appointed or removed by branch manager without approval from Head Office	4.2024	.40263	Agree
18	Internal auditors do not have direct interface with customers or clients	4.4049	.49186	Agree
Grand mean (\bar{x})		4.484		Agree

* The acceptance mean point for the items was 3.00, any mean (\bar{x}) that is 3.00 and above is agreed indicating a positive effect. Below 3.00 is disagreed which is regarded as a negative effect.

Source: Field Work (2024).

Table 3 above showed the distribution of the respondents based on their response to internal auditors independence. 5 items had agreed and positive responses with the mean responses above the 3.00 cut off while 1 had negative or disagreed response with the mean response less than the cut off mean. The most positive response had a mean score of 4.404 indicating that internal auditors do not have direct interface with customers or clients. The least positive response was that management does not interfere with internal auditors checks with a mean score of 3.441. The negative was item shows that audit department performs its functions without interference with a mean score of 2.639. The Despite the disagreed response, majority of the respondents agreed and were positive. Therefore, the result indicates that internal auditors' independence positively influence financial reporting quality of Deposit Money Banks in Nigeria which is supported by the grand mean of 4.484.

4.2 Test of Hypotheses and Discussion

Test of Hypothesis One

H₀₁: Internal auditor's technical proficiency does not have a significant effect on financial reporting quality of Deposit Money Banks in Nigeria

Table 4: Model Summary for Internal Auditor's Technical Proficiency

	Coeff.	Std.Err.	T	P value	Decision
ATP	0.096	0.052	17.575	0.000	Reject
_CONS	6.910	0.395	17.509	0.000	
Obs.	73				
F(2, 71)	17.575				
Prob > F	0.0000				
R-Squared (R ²)	0.552				
Adj. R ²	0.305				

Source: *Fieldwork, 2024.*

Hypothesis one of this study was tested by examining the effect of internal auditors' technical proficiency on quality of bank's accounting reports. As shown above, the co-efficient obtained for technical proficiency (ATP) is 0.096 with a corresponding p-value of 0.000. This result indicates clearly that internal auditor's technical proficiency has a significant positive effect on accounting reporting quality of the surveyed banks. With an R² of 0.552, it is evident that the model is able to explain 55.2% of changes in changes in accounting reporting quality due to technical proficiency of internal auditors. Given this result, the null hypothesis of no significant effect is thereby rejected. This establishes that there is a significant positive effect of internal auditor's technical proficiency on quality of accounting reporting of DMBs in Nigeria.

The result implies that the higher the internal auditor's technical proficiency, the higher the quality of financial reports of the banks. The result meets our *a priori* expectation. We anticipated that higher technical proficiency will improve performance of internal auditor's job and by extension accounting reporting quality. This result is consistent with prior studies in which higher educational qualification and professional experience of auditors is found to enhance financial reporting quality ((Khan & Liu, 2023; Oladejo et al., 2021).

Test of Null Hypothesis Two

H0₂: Internal audit procedure does not have a significant effect on financial reporting quality of Deposit Money Banks in Nigeria

Table 5: Model Summary for Internal Audit Procedures

	Coeff.	Std.Err.	T	P value	Decision
IAP	0.177	0.480	45319	0.000	Reject
_CONS	5.468	0.354	15.427	0.000	
Obs.	73				
F(2, 71)	45.319				
Prob > F	0.0000				
R-Squared (R ²)	0.729				
Adj. R ²	0.531				

Source: *Fieldwork, 2024.*

Table 5 presents the outcomes for the test of Hypothesis two for the effect of internal audit procedures on accounting reporting quality. As presented in the above table, co-efficient obtained for internal audit procedures (IAP) is 0.177 with a corresponding *p-value* of 0.000. With the

positive coefficient and probability value less than 0.05, we therefore have enough evidence to reject null hypothesis of no significant effect. This indicates that internal audit procedures have a significant positive effect on financial reporting quality of DMBs in Nigeria. The R^2 which is the coefficient of determination is 0.729 which shows that variations in accounting reporting quality are explained by internal audit processes. By implication, banks with clearly defined audit processes and procedures in the banking sector are expected to perform better in terms of the quality of their financial reporting. This result meets our *a priori* expectation because we envisaged that good internal audit procedure is key in banking. Prior studies such as Oladejo et al. (2021) and Abdulai et al. (2021) support this finding.

Test of Null Hypothesis Three

H_{03} : Internal auditor's independence does not have a significant effect on financial reporting quality of Deposit Money Banks in Nigeria.

Table 6: Model Summary for Internal Audit Independence

	Coeff.	Std.Err.	T	P value	Decision
IAI	3.637	0.418	3.042	0.007	Reject
_CONS	5.915	0.463	12.783	0.000	
Obs.	71				
F(2, 71)	3.042				
Prob	0.000				
R-Squared (R^2)	0.266				
Adj. R^2	0.071				

Source: *Fieldwork, 2024*

Hypothesis three examines the effect of internal audit independence on quality of bank's accounting reports. As observed, the regression estimates in reveal a positive coefficient and significant ($\beta_3 IAIit = 0.3.637$, $p=0.007<0.05$). We, therefore have enough evidence, based on the positive coefficient and the probability value less than 0.05, to reject the null hypothesis as the results suggest that there is a positive and significant effect of internal audit independence on quality of bank's accounting reports. This result implies that a bank that puts emphasis on the independence of its internal audit department is more likely to experience higher audit performance and by extension overall financial reporting quality. The finding meets our *a priori* expectation and is consistent with prior studies such as (Abbott et al., 2022; Kayode & Oyeshola, 2021; Arzizeh & Oti, 2019).

5. CONCLUSION AND RECOMMENDATIONS

The study was conducted to examine the effect of internal audit functions on the quality of accounting reports of Deposit Money Banks in Nigeria. In achieving this aim, the study obtained data through survey on variables which were believed to have relationship with internal auditing and accounting reporting quality. The factors this study focused on are internal auditor's technical proficiency, internal audit procedures, and internal auditors' independence. The study found that internal auditor's technical proficiency, internal auditing procedures, and internal auditors'

independence positively influence the quality of accounting and financial reporting of Deposit Money Banks in Nigeria. In conclusion, the study found that implementation of effective internal audit function is important to enhance better accounting reports in the Nigerian banking sector. In line with the findings of this study, it is recommended that Deposit Money Banks should engage the services of qualified and competent internal auditors so as to enhance internal control system and promote better accounting reporting quality. In addition, there is need to reinforce internal auditing procedures and processes to facilitate checks and balances in banking operations thereby enhancing accountability and transparency.

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