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RESEARCH ARTICLE

The Impact of Internal Audit Efficiency on Financial Performance

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ABSTRACT

The research objective was to examine the impact of internal audit efficiency on financial performance. A descriptive cross-sectional research design was used for this study to analyze data from respondents that were drawn from various firm's Human resource, Finance, Audit and Procurement departments. These data were evaluated with SPSS 28.0 using simple regression analysis. The study's findings demonstrated that internal audit and financial performance have significant relationship with each other. Therefore, the findings suggest that for rapid improvement of organization financial performance management of companies must discover new ways of strengthening the internal audit department.

Keywords: Internal Audit Efficiency, Financial Performance, Internal Control, Internal Audit Quality

Introduction

Internal audit is relevant in efficient utilization of resources, control misappropriation and combat fraud and misapplication of the resources of a company (Saidin, 2014). Internal Auditing applies principles in an organization to ensure efficiency in the growth and development of a company leading to sustainable financial conditions. Gwilliam (2014) believes that failure in an organization is the result of poor implementation of internal audit practices. The ultimate purpose of Internal Auditing is to achieve better returns for the organization in shape of improved firm performance Saud (2012) as cited in (Bouteina, 2021) . Internal Audit contributes more to achieving business objectives and putting strategies in place to attain them. In addition, the Internal Audit function is responsible for reinforcing management and Audit committee (Zain, 2009). Likewise, Internal Audit determines the reliability, reality, and integrity of financial and operational information that comes from different organizational units, on which appropriate business decisions at all levels of Management are based. Successful implementation of Internal tasks means that it must be independent, i.e., Company management should in no way be influenced by its work, information, conclusions, and evaluations. In this way the Internal Audit report becomes a means of communication between Internal Audit and Management, and an important guideline for the successful management of the company (Jovcmovi, 2011). Identification to improve firm's efficiency and help in reducing overhead can be possible by an effective internal audit, because an effective internal audit can also safeguard the firm by potential losses which can impact the financial performance of the firm (Stanisic, 2016). An effective and efficient internal audit function helps to achieve an increased level of shareholder's value (Awdat, 2015). Furthermore, a higher internal audit quality is able to better constrain earnings management, and in turn enhance the quality of financial reports (Hoe, 2015). According to Hassan (2014), audit quality acts as an essential element in maintaining the financial performance of companies, whereas (Ado, 2020) emphasizes that objective quality control forms the basis for confidence in the integrity and reliability of reports, which is extremely important for the efficient functioning of markets and also improves financial performance. Matoke (2016) also define the quality of auditing in two dimensions: first, the detection of anomalies and errors in the financial statements and second, the reporting of these anomalies and errors in the financial statements.

Adams (1994) confirms that the agency theory contributes to a rich and meaningful internal auditing research; explaining the existence of internal audit, its nature and the approach which is adopted; and predicting how internal auditors will be affected by organizational restructuring and rationalization. Mihret (2010) argued that there is a positive association between compliance with ISPPIA and organizational goal achievement that could serve to evaluate internal audit effectiveness. While the failure of businesses does not prove that the auditor's disclosures were not sufficient, investors may assert that such is the case. In answer to pleas from the public to provide them

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with more information, the role of the audit is a necessity expanding beyond a simple verification of transactions and accounts. Auditors are now attesting to qualitative assessments of the strategies outlined by the management of the firm.

This article aims to analyze the impact of internal audit efficiency on financial performance.

Theoretical Literature Review

Agency Theory

This study anchors on Agency theory which posits that corporations act as agents of its shareholders. Agency relationship could be defined as a contract among the organization owner(s) and its top management. Managers work with the organization as agents to perform some service on behalf of owners who delegate some decision-making authorities to managers. These authorities could be misused by managers to meet their own personal interests. Therefore, the existence of the audit committees, and the external and internal auditors will help the organization in enhancing their performance, and also will ensure that the management carries out its plans according to procedures (Adams, 1994). For a range of internal audit users, such as the board, audit committee, and senior management, internal auditors are viewed as agents and monitors. Agency problems could occur when the board or its audit committee is inefficient, and hence, the senior management is likely to be a powerful influence over the internal audit. This complex web creates an inherent dilemma for the internal audit: how can it carry out their monitoring role over management if it is ineffective itself?

Internal auditors often are employed by senior management, but at the same time, they are also agents of the board and audit committee who trust in the internal auditors' ability to evaluate senior management's works. However, internal auditors may have varying motives to act against the board of directors' interests and its audit committee and these motives include financial rewards from managers, personal relationships with them, and the power of senior management in shaping the future position of internal auditors and their salaries. In such a work environment, internal auditors as agents may have an incentive to be bias of information flows, which leads to new concerns of the board and audit committee about their trust on the internal auditors' objectivity and preventing such threats of objectivity becomes necessary for the board and its audit committee.

Internal Audit Function:

An internal auditor studies accounting records and prepares compliance reports to ensure that everything has been done correctly according to rules set by industry standards. Internal auditors need to have integrity and be fair in all their work. They also must show trust, independence and objectivity while being tough enough for difficult situations that can arise during an audit. It should be noted that the evaluation of inherent risks is the responsibility of management, not the internal auditor. The internal auditor provides assurance to management and audit committee (Zwaan, 2011) that the internal controls are effective and function as required, and also mathematically determines the importance of risk under the direction of management, while this process is still the responsibility of management. Today, Auditors are increasingly focusing on business processes and systems rather than transactions, as the case with traditional auditing (Soh, 2011). Bearing in mind that in addition to top management and the board of directors the users of an internal auditor's report are lower levels of management, shareholders, the chief
executive and financial directors, employees, and the external auditor, the internal auditor is expected to establish a relationship with management based on the fact that internal auditors are professionals whose activities are aimed at providing useful advice to achieve planned objectives (Sarens, 2011). In addition, the internal auditor is expected to be constantly improving and upgrading previously acquired knowledge. This means abandoning the understanding that the internal auditor's report is the final and only product of internal audit. Internal audit must increasingly direct its resources towards the future by providing advice in relation to anticipated future risks in certain business areas (Holt, 2009).

Financial Performance:
The concept of financial performance is an idiosyncratic measure of how well a company can leverage assets in key industries to generate revenue (Akram, 2017). Financial performance is an overview of the company's financial status report over a period of time to figure out how successful and profitable a company is in producing revenue. These indications include sales growth, profitability (reflected by ratios such as return on investment, return on sales, and return on equity). The financial performance report is prepared to show how well the company has performed financially. This is a summary of the company's financial performance that reports on the financial status of the company to help various investors and stakeholders make investment decisions. The main objective and purpose of a company is a topic of concern, it relates to profit, growth prospects, and goals, whether complementary or simultaneous, are often seen as the main goals of companies that are still controversial (Aregbeyen, 2004). From different perspective, not all companies have the same growth opportunities, but all companies strive to survive and grow. Corporate growth depends on both the demand for expansion and the availability of growth prospects. Firms' growth is therefore one of the central topics of interest to accountants, finance experts, business managers and economists. Research on business growth provides basic insights into one of the key indicators of performance and one of the fundamental factors of the economy. Due to its role in the economy, business growth is of great interest to policy makers because of its importance in job creation and productivity growth. In addition, firm growth is often seen as an indicator of business performance and is a top priority for executives (Hanson, 2007).

Internal Control:
The operational standard by the Institute of Chartered Accountants of England and Whales (ICAEW) define Internal Control as ''The whole system of control, financial and otherwise established by the management in order to carry on the business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible, the completeness and accuracy of the records'' (Olatunji, 2009). Hartcher (2009) as cited in ((Monday, 2014)) emphasized that internal controls are the methods or procedures adopted in a business to safeguard its assets, ensure whether financial information is accurate and reliable, ensure compliance with all financial and operational requirements, and generally assist in achieving the business's objectives. An effective internal control system lowers the risk of failing to meet a target in one of these three categories- operations, reporting, or compliance- to an acceptable level. Internal control is a management tool used to provide reasonable assurance that management objectives are being achieved.

Internal Audit Efficiency:
Based on the submission of Rezaee (1995) efficiency internal audit system entails the following components: Control Environment which are factors such as integrity, ethical values, competence of the workers and the philosophy of the management in the organization, it provide the premise needed for the other components to build on the internal audit system; Risk Assessment which involves careful scrutiny of factors that affect the possibility of achieving the organizational objectives by identifying and analyzing possible risks internally and externally; Control activities entails range of activities such as approval, authorization, verification, reconciliations and review of operating performance, security of assets and segregation of duties, which enables the identification, capturing and communication of pertinent information in a form and time frame in other to ensure effective and efficient discharge of individual responsibilities within an organization.

Internal Audit Quality Evaluation:
The market's estimation of the joint likelihood that an auditor will simultaneously find a major misstatement or irregularity in the client company's accounting system and will note and reveal that misstatement or irregularity is known as internal audit quality. Adeyemi (2010), agree that internal audit quality is the joint probability, as assessed by the market, that a given auditor will simultaneously discover a deficiency in the client's accounting system and report that deficiency, meaning that the auditor has both the technical competence to detect any material errors during the audit process and the independence to ensure that material errors and omissions are corrected or disclosed in the auditor's report. However, it would appear that the quality of internal auditing is enhanced when internal auditors are competent and independent.

Internal Audit Efficiency and Firm's Performance
The internal audit department is a very important department in a firm, it is regarded as the key element in the application of accounting systems and this in turn, helps in evaluating the work of the various departments in the company. When an efficient internal audit unit is in place in a company, it helps the organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes. It also provides assurance that internal controls in place are

adequate to mitigate the risks, governance processes are effective and efficient, and organizational goals and objectives are met. When the internal auditor competently carries out their duties, the company's financial performance will be enhanced. According to Alvin (2012), competency is knowledge and skills necessary to accomplish tasks that define one's job. In the internal audit area, competency consists of the development of specialized expertise that enhances the quality of internal auditing. It comprises internal audit experience, skills, knowledge, and professional proficiency (Mahzan, 2015). In addition to firm growth, the performance of companies constitutes another central topic of interest to a variety of interest groups. With respect to researchers, firm performance is considered as the most significant construct of strategic management research. For consultants, firm performance forms the top priority on their agenda. Some scholars even state the opinion that sustaining and increasing firm performance should be the final goal of a company.

Empirical Literature

Adegbola (2018) carried out research on the impact of internal auditing on the performance of Banks in Nigeria and it was executed by selecting four banks as case study. Secondary source of data collection was used through the administration of questionnaires and were analyzed using Statistical Packages for Social Sciences (SPSS). The research design used for the study was experimental research design (T-test). The result of the study revealed that the internal audit does influence bank performance. A series of recommendations were made of which points to the fact that qualified auditors should be appointed to carry out any audit activity so it can be done effectively, the banks in return should provide accurate information for the auditors and the legitimacy of the internal auditors' resume should be properly checked before appointment of auditors is made.

Aves (2011) conducted research on the effect of internal audit on profitability using cement listed firms in Pakistan as a case study. Secondary data collected from annual audited reports of firms were used as a basis for the study. The method of analysis used was regression method; SPSS & MS Excel were the tools for the analysis. In conclusion, there is a positive effect of an audit committee on firm's profitability ratio and on firm's performance.

Okolocha (2015) conducted a study to examine the extent internal control significantly improve the financial performance of commercial banks in Nigeria. The population of the study consists of seven (7) branches each from five (5) selected commercial banks in Enugu metropolis, Enugu state of Nigeria, which comprises of managers, internal control officers, funds transfer officers and cash officers. The study adopted research design and the data was analyzed using frequency counts, mean score, standard deviation. The hypothesis was tested using simple regression statistical tool with the aid of SPSS. The analysis revealed that internal audit control and procedures have positive effect on financial performance of commercial banks in Nigeria.

Joshi (2020) carried out an analysis on the determinants that affect the effectiveness of internal auditing for listed firms in India. The data for this study was gotten from secondary source through questionnaire administration to a sample of 300 listed companies. The result of this work was derived by applying multiple regression method and the determinants turned out to be significant. The three determinants are risk -based planning, usage of big data and analytics, and frequency of meetings of internal auditor with audit committee respectively.

Enekwe (2020) reviewed the effect of internal audit quality on the financial performance of companies in Nigeria. In this study, the authors examined the effect of internal auditor and audit committee independence on return on assets (ROA), The results of the study showed that internal audit quality influenced positively and significantly the financial performance.

Thanh (2022) discovered through study on the factors affecting internal audit effectiveness: Empirical evidence from Vietnam. The factors that were considered are, independence of internal auditors, the competence of internal auditors, management support for internal audit and quality of internal audit work. Regression model was used for this analysis through SPSS software. Secondary data sources were used through semi-structured in-depth interviews and an online survey, 144 responses were obtained from internal Vietnamese auditors of non-financial companies listed on the Vietnamese stock market in 2021. After processing the data, the results revealed two factors (independence of internal auditors and management support for internal audit) with a positive influence on internal audit effectiveness, whereas the competence of internal auditors and quality of internal audit work did not affect internal audit effectiveness.

Skender (2022) researched on the impact of internal audit quality on the financial performance of insurance companies: Evidence from Kosovo. The return on assets (ROA) ratio was used to measure financial performance. Data for this dependent variable were obtained from the six-month statements of insurance companies operating in Kosovo during the period 2015-2021. Secondary source of data collection was used through administration of questionnaires to each member of the target population consisting of members of the board of Directors, members of audit committee, managers of various departments, internal audit officers, legal officers, and finance officers. Also, three control variables (growth, size, and age of the company) were taken, as data analysis techniques are used, quantitative analysis and regression analysis. The study concluded that professional competence has significant positive impact, in contrast to the efficiency of internal audit, which had a negative impact on the financial performance of insurance companies.

Research Design and Methods

A descriptive cross-sectional research design was used for this study. The respondents were drawn from manufacturing firms' various departments, which included the human resource department, finance department, audit and procurement department. The study used purposive sampling to select these businesses organizations. The questionnaire results were analyzed in SPSS 28.0 using simple linear regression analysis. The study aimed to look into the impact of internal audit on financial performance.

Model Specification

The model specification used in this research work is simple linear regression analysis, which is defined as follows based on the relationship between predictors and dependent variables:

$$Y = \alpha_0 + \alpha_1 x_1 + \mu \dots\dots\dots\dots\dots\dots\dots\dots\dots (1)$$

$$Y = f(X)$$

Where Y=Dependent variable represented by financial performance
x_i= Predictors variable (Internal Audit)
α_0= Slope or intercept
α_1= Regression coefficients
μ= Error term

Data Analysis and Interpretation

The section contains the presentation, analysis, and interpretation of data gathered from respondents in the various firms studied. The responses were categorized by coding them in a Likert scale format so as to achieve our objective for this study. The analysis of the structured questionnaire was done using a statistical package for social science (SPSS version 28.0).

Table 1: Response Rate

	Frequency	Percentage	Cumulative Percent
Returned	152	87.86	87.86
Unreturned	21	12.14	100
Total	173	100	

Source: Field Work 2022

The above table 1 shows that one hundred and seventy (173) copies of questionnaire were distributed but only one hundred and fifty-two (152) were returned, while the remaining were not returned. The unreturned amounted to twenty-one (21). The reason for the unreturned includes the following:

I. A few respondents lost the questionnaire given to them.
II. A few respondents reluctantly did not respond to the questionnaire and lastly few others ticked two answers for a question, and this was recorded as a void to avoid incorrected interpretations.

Internal Audit

The study sort to find out about the internal audit found in the firms being studied

Table 2: Internal Audit

Statement	Strongly Agree	Agree	Neutral	Strongly Disagree
Accounts are regularly reconciled	47(30.9%)	69(45.4%)	24(15.8%)	12(7.2%)
Accuracy of information	55(36.2%)	63(41.4%)	14(14.5%)	10(6.6%)
Assets Register	53(34.9%)	64(42.1%)	23(15.1%)	12(7.8%)
Assets kept in custody	55(36.2%)	47(30.9%)	26(17.1%)	24(15.8%)
Records of assets	41(26.9%)	66(43.4%)	31(20.4%)	14(9.2%)
Proper monitoring	68(44.7%)	47(30.9%)	22(14.5%)	5(3.3%)
Staff adhere to control	75(49.3%)	58(38.2%)	12(7.9%)	13(8.6%)

Source: Field Work 2022

When it came to whether the firms under consideration regularly reconciled their accounts, the findings revealed that 31% strongly agreed and 45% agreed. Because 76% of respondents agreed, this implies that there is clear evidence that the firm's account is regularly reconciled.

Accuracy of information is critical in any organization when measuring internal audit; the study sought to determine whether accuracy of information was prioritized in the firm. According to table 2, 36% of employees strongly agreed that accuracy of information is emphasized in their company, 41% agreed, 15% neutral, and 7% strongly disagreed.

Furthermore, 35.0% of employees strongly agreed that the assets register is regularly updated. 42% agreed, 15% were neutral, and 8% strongly disagreed that the assets register is regularly updated.

The study went on to determine whether assets were kept in the custody of authorized personnel. According to table 1, the majority of respondents (36% strongly agreed, 31% agreed, 17& were neutral, and only 15% strongly disagreed).

Table 2 also shows that record of assets is maintained with 27% of the respondents strongly agreed, 43% agreeing while 20% were neutral and 9% strongly disagreed.

In response to the question of whether the firm's internal audit systems are properly monitored, 45% of respondents strongly agreed, 31% agreed, and 15% were neutral. The findings indicate that companies' internal audit systems are properly monitored.

Examining employee adherence control systems 49% of respondents agreed, 38% agreed strongly, 8% were neutral, and 9% strongly disagreed. According to the findings, 87% of respondents agreed that staff followed the controls in place.

Indicators of Financial Performance

The study sought to determine the indicators of financial performance of Rift Valley Bottlers.

Table 3: Financial Performance Indicators

Statement	Strongly Agree	Agree	Neutral	Strongly Disagree
Minimize financial error	73(48%)	62(40.8)	11(7.2%)	6(3.9%)
Increase of growth of shareholders wealth	55(36.2)	61(40.1)	16(10.5)	20(13.2%)
Enhanced company expansion	66(43.3%)	60(39.5)	17(11.2%)	9(5.9%)
Reduced occurrence of liquidation	55(36.2%)	32(21.1%)	26(17.1%)	39(25.7%)
Enhanced profit level	53(36.2%)	51(33.6%)	31(20.4%)	17(11.2%)

Source: Field Work 2022

According to the findings, 48% of respondents strongly agreed, 41% agreed, 7% were neutral, and 4% strongly disagreed that using proper internal audit systems aids in the reduction of financial errors, thereby promoting financial accountability.

The results indicate 36% of the participants strongly agreed, 40% agreed, 11% were neutral and 13% strongly disagreed that the management makes sure the shareholder value is increased in terms of the share returns.

Table 3 shows 43% of the respondents strongly agreed, 40% agreed, 11% were neutral and 6% strongly disagreed that the financial management of the firms studied makes sure it reduces its operations cost in order to increase its financial growth through opening other branches in the country.

From the study 36% of the participants strongly agreed, 21% agreed, 17% were neutral and 26% strongly disagreed that the company makes sure its funds are used efficiently in order to reduce occurrence of liquidation.

From the findings 36% of the respondents strongly agreed, 34% agreed, 20% were neutral and 11% strongly disagreed that financial performance is measured in terms of profit value where the company is evaluated on the returns gained after sales of goods.

Hypotheses Testing

Decision Rule: Accept the null hypothesis if the if the probability value >0.05 otherwise accept the alternative hypothesis.

Hypothesis One

H_{01}: There is no significant effect of internal audit on financial performance among the manufacturing firms.

Table 4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.867[a]	.822	.056	5.08124
a. Predictors: (Constant), Internal Audit				

Model Testing and Interpretation

The model summary above explains the percentage of the dependent variable (financial performance), that can be determined by the independent variable (Internal audit). According to this Table, the dependent variables account for 82.2% (R Square, 0.822) of the independent variable. While the remaining 17.8% can be explained by other factors outside the scope of this model. This implies that internal audit and financial performance have significant relationship with each other. This Pearson correlation coefficient (R) result also showed a positive value of 0.867, which also lends credence to the fact that internal audit has direct influence on financial performance.

Table 5: ANOVA Table

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	129.014	1	129.014	4.860	.004[a]
	Residual	3982.249	151	26.548		
	Total	4111.263	152			
a. Dependent Variable: Financial performance						
b. Predictors: (Constant), Internal Audit						

The study also conducted analysis of variance to determine the extent to which the Independent and dependent variable relates with each other, and the result showed that P- value Obtained (0.004) was lower than the 5% level of significance specified in SPSS software for this analysis, therefore, according to the decision rule, the Alternate hypothesis will be accepted, while the Null hypothesis will be rejected. This implies that internal audit has significant influence on financial performance of the selected firm.

Table 6: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	18.968	2.415		7.855	.000
	Internal Audit	.318	.104	.177	3.057	.019
a. Dependent Variable: Financial Performance						

Simple linear regression analysis was also conducted to determine if the result established by ANOVA Statistic are similar to that of the regression coefficient. The result shows that the P-value obtained (i.e., 0.019) for the regression coefficient was also lower than the alpha level of significance of 5% specified in SPSS for this analysis therefore, thus, it can be inferred from this result, that the ANOVA Statistic is similar to that of the regression coefficient. Thus, the Alternate Hypothesis will be accepted while the Null Hypothesis will be rejected, which means that there is significant relationship between internal audit and financial performance of the firms.

Discussion of Result

The result of this study indicates that internal audit will significantly improve financial performance of the manufacturing firms. This was confirmed by the result of the statistical analysis which shows that that the P-value obtained (0.019) was lower than significance value of 5% specified in SPSS for this analysis. This means that for rapid improvement of organization financial performance, management of the manufacturing firms must discover new way of strengthening the internal audit department. From table 2 it can be observed that, the response on accuracy of information in which majority of the respondents strongly agreed to its effect on internal audit efficiency is consistent with the findings from Skender (2022) that professional competence has significant positive impact on the internal audit function of companies. This means that, for reliable financial information to be provided in the financial reports of a company, competent internal audit personnel have to be employed. The response on proper monitoring which were mostly strongly agreed by the respondents suggest that the conclusion in Okolocha (2015) which revealed that internal audit control and procedures have positive effect on financial performance of commercial banks in Nigeria is valid. This means that, an effective internal audit function allows for proper monitoring of a company's internal controls and organizational activities.

Conclusion

This study's purpose was to investigate the impact of internal audit efficiency on financial performance. Making use of data from different company's departments, ranging from human resource department, finance department, audit and procurement department. There was a test on the percentage of the dependent variable (financial performance) that can be determined by the independent variable internal audit, the null hypothesis was rejected after this test. This implies that internal audit has significant influence in financial performance of selected firms. The results demonstrate that implementing effective internal Audit functions is predicted to enhance company performance and should be encouraged. As a result, the report recommends that professionals should be employed to take up internal audit functions. Partners and staff to audit engagements should have strong understanding of the entity's business, appropriate industry knowledge, appropriate experience and a sound understanding of financial reporting requirements.

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