



**S.T MARY'S UNIVERSITY**  
**SCHOOL OF GRADUATE STUDIES**

**THE EFFECTS OF INTERNAL AUDIT CONTROL ON  
FINANCIAL REPORTING QUALITY: A STUDY ON SELECTED  
MICROFINANCE INSTITUTES IN ADDIS ABABA**

**BY**  
**HIWOT MENGESHA**

**DECEMBER 2024**

**ADDIS ABABA**

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**APPROVAL SHEET**

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## DECLARATION

I, the undersigned, declare that this thesis proposal is my original work, prepared under the guidance of Mohammed S. (Asst. Professor). All sources of materials used for the thesis proposal have been duly acknowledged. I further confirm that the proposal has not been submitted either in part or in full to any other higher learning institution for the purpose of earning any degree.

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## ENDORSEMENT

This thesis has been submitted to St. Mary's University, School of Graduate Studies for examination with my approval as a university advisor.

MOHAMMED SEID (Asst. Professor)

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Advisor

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Signature

December 2024

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The Researcher.

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## **ACRONYMS AND ABBREVIATIONS**

<b>COSO</b>	Committee of Sponsoring Organizations of the Treadway Commission
<b>FAS</b>	Financial accounting standards
<b>FVA</b>	Fair value accounting
<b>GAAP</b>	Generally accepted accounting principles
<b>IAS</b>	International standards on auditing
<b>IASB</b>	International Accounting Standards Board
<b>IFRS</b>	International financial reporting system
<b>SFAS</b>	Statement of financial accounting standards
<b>SPSS</b>	Software Package for Social Sciences

## ABSTRACT

*This study aimed to investigate the influence of internal audit control practices on the quality of financial reporting within microfinance institutions located in Addis Ababa. The study was conducted using an explanatory research design to attain this study. The study employs a quantitative research methodology to gather and estimate primary data sources. The sample population consisted of directors, managers, internal auditors, and senior accountants, from which 181 active staff members of microfinance institutions were chosen using a convenient sampling technique to participate in the survey. Primary data were gathered via self-administered standardized questionnaires directed at the selected respondents. Data analysis was performed using a multiple linear regression model to explore the relationship between internal audit control practices and financial reporting quality, specifically focusing on aspects such as audit standard compliance, auditor autonomy, staff competency, the effectiveness of the internal control system, and risk mitigation. Both descriptive and inferential statistical methods were utilized for analysis, facilitated by SPSS version 22.0. The results indicated that all five internal audit practices exerted a positive and statistically significant impact on financial reporting quality. Notably, risk mitigation emerged as having the most substantial effect, followed by auditor independence. The internal control system and audit standard compliance demonstrated a moderate influence, while the impact of professional competency was comparatively minimal. In summary, strict adherence to established audit standards plays a crucial role in enhancing financial reporting quality. The independence of auditors not only facilitates unbiased assessments but also bolsters the integrity of financial statements. Although professional competence contributes positively to financial reporting quality, its impact is less pronounced than that of other factors. The presence of robust risk mitigation strategies and internal control systems within the institutions mitigates the likelihood of inaccuracies and fraudulent activities, leading to more reliable financial statements. Ultimately, the effectiveness of audit systems is essential for sustaining auditor independence and ensuring compliance with relevant standards*

**Keywords:** Audit Standards, Internal Audit Control, Financial Reporting, Microfinance Institutions, Professional Competency



# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1. Background of the Study**

The integrity of financial reporting is fundamental to the operational success and sustainability of microfinance institutions. Internal audit controls serve as a mechanism to reduce risk, improve compliance with regulatory standards, and enhance the overall quality of financial reporting. However, many microfinance institutions in Ethiopia have inadequate internal control systems, resulting in financial distortions and lack of stakeholder trust (Abraham and Sulaiman, 2020). This problem is further exacerbated by a lack of qualified personnel, poor compliance with audit standards, auditor independence, and lack of internal controls, which can hamper the effectiveness of the internal audit function (Beneish, 2018).

The concept of internal audit has changed significantly over the past several decades. Historically, internal audit has focused primarily on compliance and fraud detection. However, as financial transactions have become more complex and corporate governance has become more important, the internal audit function has evolved into a strategic tool for organizational improvement and risk management (Institute of Internal Auditors, 2019). In Ethiopia, the microfinance sector has grown significantly since the first microfinance institution was established in 1996 with the goal of reducing poverty and increasing financial inclusion (World Bank, 2021). However, the rapid expansion of the industry has outpaced the development of robust internal audit systems, raising concerns about the quality of financial reporting.

The importance of studying the impact of internal audit controls on financial reporting quality cannot be overemphasized. Microfinance institutions are tasked with managing savings and credit for vulnerable populations, so the accuracy and reliability of their financial reports are critical to maintaining public trust and ensuring continued support from donors and investors (Meyer, 2018). Financial reporting is also essential for effective decision-making by both management and stakeholders. Zikmund (2020) explains that inadequate internal controls can lead to financial mismanagement, regulatory penalties, and even institutional failure, which can have serious consequences for the communities they serve.

Previous studies have established a positive relationship between internal audit effectiveness and financial reporting quality. For example, a study by Alzeban and Gwilliam (2014) found that the internal audit function significantly contributes to improving the reliability and transparency of an organization's financial reporting. Similarly, a study by Robert (2020) found that organizations with strong internal audit controls experienced reduced financial discrepancies and increased stakeholder trust. However, the paucity of empirical research specifically focused on microfinance institutions in Ethiopia highlights an important area for further research.

Despite the existing literature on internal audit controls and financial reporting quality, there remains a notable knowledge gap regarding their interaction in the context of Ethiopian microfinance institutions. Most studies have focused primarily on larger organizations or developed countries, leaving a gap in understanding how internal audit practices can be adapted to address the unique challenges faced by microfinance institutions in developing countries (Baker and Hayes, 2021). Furthermore, current trends indicate a growing awareness of the importance of corporate governance and risk management in the microfinance sector, and further investigation into the role of internal audit in improving the quality of financial reporting is warranted (Microfinance Gateway, 2022).

While this recognition, there is still a gap in our comprehensive understanding of the specific mechanisms through which internal audit control influences financial reporting quality, highlighting the need for this study. By investigating these dynamics, organizations can improve the transparency and accountability of their financial disclosures, ultimately benefiting investors and the economy as a whole (Abbott, Parker, and Peters, 2004). Therefore, it is worth considering the impact of internal audit control on financial reporting quality, which is an important area of research, particularly in the microfinance industry in Ethiopia. The fact that improved financial reporting quality is a manifestation of a strong internal audit function (Cohen, Holder-Webb, and Pant, 2008) suggests a relationship that warrants further investigation.

## **1.2. Statement of the Problem**

Strong internal audit controls play a critical role in this framework, ensuring the accuracy and reliability of reported financial data. By carefully assessing financial transactions, this internal audit function is designed to enhance compliance with existing regulatory frameworks by identifying inconsistencies and mitigating potential risks. Furthermore, this rigorous oversight contributes to the continuous improvement of the quality of financial reporting, as confirmed by Cohen and Sayag



(2010) and Mihret and Yismau (2007). Ultimately, strengthening internal audit practices serves as a cornerstone of effective governance and accountability in microfinance institutions, ensuring informed decision-making that can deliver broader socio-economic benefits to the society they serve.

However, the current situation in Ethiopia highlights serious deficiencies in the internal audit practices of various microfinance institutions (MFIs). Many microfinance organizations face challenges due to inadequate internal controls to safeguard assets and ensure the reliability of financial reporting. In addition, auditors often lack sufficient training and experience, which hinders their ability to effectively evaluate financial transactions. These deficiencies are further exacerbated by widespread disregard for established auditing standards and lack of auditor independence, as highlighted by Abraham (2020). As a result, the financial statements prepared by these organizations often contain inconsistencies and inaccuracies that not only undermine the credibility of the organization, but also pose serious risks to stakeholders, including investors, customers, and regulators. The consequences of these shortcomings can be serious, potentially resulting in financial losses and diminishing confidence in the microfinance sector as a whole.

The consequences of inadequate internal audit controls go beyond simple financial discrepancies and can have ripple effects that can significantly undermine the viability of an organization. A study by Khan and Jabeen (2016) highlights that impaired financial reporting integrity not only raises concerns among investors but also acts as a deterrent to potential capital inflows as stakeholders increasingly prioritize transparency in their investment decisions. Furthermore, institutions that do not have a strong audit structure are often subject to regulatory scrutiny, which can result in significant fines and reputational damage. This environment of uncertainty often limits the efficient allocation of resources as decision makers struggle to rely on unreliable financial data. As a result, MFIs, which typically operate within limited resources, may experience stagnant growth, which negatively impacts their ability to promote economic development in the communities they serve. Therefore, it is important for organizations to prioritize internal audit as a fundamental component of their governance structure to ensure not only compliance but also sustainable development of their mission.

In this regard, in line with the country's commitment to increase private investment in the economy to achieve development and growth goals, an initiative was taken in 2011 to develop a Statement on Financial Reporting (Yitayew, 2016). Much attention has been paid to various issues related to the development and implementation of reliable, transparent and understandable financial reporting by

companies: a unified financial reporting law to enhance transparency in decentralized financial reporting structures; and to support the economy and reduce the risk of financial crises; corporate bankruptcies and their associated negative economic impacts; and the creation of an agency responsible for the regulation of financial reporting. As a result, financial institutions, especially microfinance and semi-formal microfinance, have been trying to implement international financial accounting standards. However, the extent to which internal control plays a significant role in financial statement quality remains questionable.

Extant research has been conducted in the specific area of the relationship between internal audit control and financial reporting quality (Katrodia, 2012; Hambrick, 2018; Sawyer, 2021). However, there remain gaps in the literature that need to be addressed. First, as financial and accounting reporting systems move from historical (traditional) data to fair value accounting standards, further research is needed on the impact of internal audit control on financial reporting quality (Robert, 2021). Second, this issue is even more pronounced in the context of developing countries that have not yet fully implemented the new standards (Hambrick, 2018). Third, microfinance is also developing and growing, especially in Ethiopia. The need to study their relationship cannot be denied, as reliable and trustworthy financial information is a requirement of members and stakeholders.

Therefore, the objective of this study is to investigate the impact of internal audit control on the quality of financial reporting in selected microfinance institutions in Addis Ababa. By identifying the existing gaps in internal audit practices and their impact on financial reporting, this study aims to provide actionable insights that can improve the effectiveness of internal audit and consequently improve the overall quality of financial reporting in the microfinance sector.

### **1.3. Research Questions**

1. How does adherence to accounting and auditing standards affect quality of financial reporting of microfinance institutes in Addis Ababa?
2. To what extent does auditor independence influence the quality of financial statements of microfinance institutes in Addis Ababa?
3. What effect does the competence or expertise of internal audit staff have on financial reporting quality of microfinance institutes in Addis Ababa?

4. How does effective risk management contribute to financial reporting quality of microfinance institutes in Addis Ababa?
5. What role does an organization's internal control system play in ensuring accurate financial reporting of microfinance institutes in Addis Ababa?

## **1.4. Objectives of the Study**

### **1.4.1. General Objective**

To examine the effect of internal audit control on financial performance of microfinance institutes: the case of saving and credit cooperatives in Addis Ababa.

### **1.4.2. Specific Objectives**

1. To investigate the effect of strict compliance with accounting standards on the quality of financial reports produced by microfinance institutes in Addis Ababa.
2. To examine the effect of auditor independence on the quality of financial statements in microfinance institutions in Addis Ababa.
3. To evaluate the effect of internal audit staff competency on financial reporting quality of microfinance institutions in Addis Ababa.
4. To analyze how effective risk management practices enhance the quality of financial reports provided by microfinance institutions in Addis Ababa.
5. To investigate the role of an organization's internal control system in ensuring quality financial reporting quality of microfinance institutions in Addis Ababa.

## **1.5. Significance of the Study**

The study's significance lies in its potential to drive positive change, promote inclusive growth, and enhance the resilience and competitiveness of the financial sector in Ethiopia and beyond. This research holds significance for various stakeholders to realize the role of internal auditors as a significant managerial control system in the organization since it safeguards their interests, it will assist the microfinance members and other including policymakers, regulators, microfinance institutions, and investors, who contribute to economic development and the broader community.

For the fact that the internal audit in microfinances will be made effective and professional through such investigations. As this study views internal audit control as independent function, through

practical implementation of the recommended given through internal audit reports, the management of microfinance institutes will be able to enhance the quality of their financial reporting and the overall performance of the institutes at large. The results of the findings will contribute to the existing theory by expanding knowledge on internal audit control practices that comply with professional standards such as International Standards on Audit and also serve as a springboard for future study.

### **1.6. Scope of the Study**

The study will specifically examine the Ethiopian context, considering the country's several crucial implications. The research might help microfinance members and other stakeholders to understand the vital role internal auditors play as a key managerial control mechanism within the organization. Internal auditors are instrumental in protecting stakeholders' interests by ensuring that the financial operations and reporting of the organization are conducted with integrity and transparency. Through this study, the effectiveness and professionalism of internal audits in microfinance institutions would be enhanced. By delving into how internal audits function and identifying areas for improvement, it also paves the way for more robust and effective audit practices. It may underscore the importance of internal audit control as an independent function. By implementing the recommendations provided through internal audit reports, the management of microfinance institutions can significantly improve the quality of their financial reporting and overall performance. This independent scrutiny ensures that the organization's financial practices adhere to high standards of accuracy and reliability. The study would expand the existing body of knowledge on internal audit control practices. By exploring practices that comply with professional standards, such as the International Standards on Auditing, it may contribute valuable insights and serve as a foundation for future studies in this field. By highlighting these key points, the study underscores the importance of internal audits in safeguarding interests, enhancing audit effectiveness, maintaining independence, and contributing to the broader theoretical framework of internal audit control

### **1.7. Limitations of the Study**

In light of the significant findings from the study, it is important to formulate a series of recommendations to address the limitations identified in the study and suggest avenues for further scientific research. First, it is recommended that future research efforts include a more diverse sample population to increase the generalizability of the results. This suggestion stems from the observation that the current study primarily recruited participants from a specific demographic group, potentially

limiting the applicability of the conclusions drawn. Additionally, adopting a longitudinal methodology is recommended as it allows for observing changes over time, thereby providing a deeper understanding of the phenomenon under study. These recommendations can be made by researchers in the field, particularly those specializing in social and behavioral sciences, who have the expertise necessary to conduct a comprehensive analysis that addresses the identified gaps. Finally, interdisciplinary collaboration is encouraged to foster innovative perspectives and methodologies, allowing the research community to gain a more holistic understanding of the topic. Therefore, the interaction of different methodologies and increased sample diversity are important to foster robust discourse and generate more nuanced insights in future research.

## **1.8. Definitions of Key Terms**

The definitions of key words are presented as:

**Internal Audit Standard:** The professional practice of internal auditing is principle-focused and provide a framework for performing and promoting internal auditing. (Institute of Internal Auditors, 2017, p. 105).

**Independence of Internal Audit:** It refers to the freedom from conditions that threaten the ability of the internal audit activity to carry out responsibilities in an unbiased manner. (Hung, 2019, p. 118).

**Professional Competence:** refers to the ability to effectively complete tasks using relevant skills and attitudes necessary for the job. It encompasses a range of skills and competencies that contribute to a workplace's productivity and are essential for managing employees toward achieving set organizational goals. (Kontz, 2020, p. 53).

**Internal Controls:** Internal controls are accounting and auditing processes used in a company's finance department to ensure the integrity of financial reporting and regulatory compliance. (Reeve, 2018, p. 221).

**Risk Mitigation:** In the context of internal audit control, risk mitigation involves specific actions taken to address risks related to control design, execution, and effectiveness. (Hung, 2019, p. 67).

**Financial Reporting Quality:** Quality financial reporting provides information that is useful to analysts in assessing a company's performance and prospects. (Sawyer, 2021, p. 222).

## **1.9. Organization of the Study**

The final thesis was organized into five chapters, each playing a crucial role in the overall structure and flow of the study. The first chapter, Introduction, will provide a comprehensive overview of the research by discussing the Background of the Study, the Statement of the Problem, the Objectives of the Study, the Significance of the Study, the Scope of the Study, and the Organization of the Study. This chapter sets the stage for the research, giving readers a clear understanding of its context and purpose. The second chapter, Review of Related Literature, examined existing literature pertinent to the study, exploring various theories, models, and empirical studies that relate to the research topic. This review helps to establish a solid theoretical foundation and identifies gaps that the current study aims to fill. The third chapter, Methodology, detailed the research design, the steps followed for data collection, the analytical techniques employed, and the processes used for interpreting the data, ensuring that the study's objectives are met through rigorous and systematic research methods. The fourth chapter, Data Analysis and Discussion, presented a detailed analysis and interpretation of the collected data, discussing significant patterns, trends, and insights in relation to the study's objectives and literature review. This chapter provides a comprehensive understanding of the research outcomes. Finally, the fifth chapter, Conclusion and Recommendations, synthesized the study's findings into meaningful conclusions and offer practical recommendations based on the research results. This chapter reflects on the overall contributions of the study and its implications for further research, providing valuable insights for practitioners, policymakers, and future researchers

## **CHAPTER TWO**

### **REVIEW OF THE RELATED LITERATURE**

This chapter explores the theoretical framework that forms the basis of the research argument. It covers a comprehensive review of the literature relevant to the research objectives. The literature sources include scientific journals, books, and articles relevant to the nature of the study. This chapter introduces the conceptual model developed to guide the empirical research and concludes.

#### **2.1. Theoretical Literature**

##### **2.1.1. Internal Audit and Control Concepts**

In the dynamic microfinance environment where organizations provide financial services to underserved sectors, the importance of strong internal control and internal audit systems cannot be overemphasized. These mechanisms are critical to ensuring operational efficiency, asset protection, and enhancing the credibility of microfinance institutions (MFIs). This review examines the definitions of internal control and internal audit, explains their meaning, and examines their role in microfinance organizations.

##### **2.1.1.1. Internal Control**

Internal control is a fundamental concept of organizational management that underlies the mechanisms, processes, and systems in place to protect organizational assets, improve operational efficiency, and ensure compliance with applicable laws and regulations. As organizations continue to navigate an increasingly complex environment, the relevance of internal control systems is becoming increasingly apparent, requiring a comprehensive understanding of the components, purpose, and overarching structures that govern them. According to (Institute of Internal Auditors, 2021), internal control can be understood as a process designed and implemented by an organization's management and governing bodies. It aims to provide reasonable assurance regarding the achievement of

objectives in three major categories: operational efficiency and effectiveness, reliable financial reporting, and compliance with applicable laws and regulations.

Internal control systems vary greatly depending on the specific nature, size, complexity, and risk environment in which an organization operates (Awasthi, Kumar, and Tripathi, 2018). However, in this study, internal control refers to the processes designed and implemented by an organization's management and those charged with governance to provide reasonable assurance regarding the achievement of objectives in the areas of operational efficiency, reliable financial reporting, and compliance with applicable laws and regulations (Committee of Sponsoring Organizations of the Treadway Commission [COSO], 2013).

COSO provides one of the most widely accepted frameworks for understanding internal control. Internal control is defined as “the processes performed by an organization's board of directors, management, and other personnel to provide reasonable assurance regarding the achievement of objectives such as the efficiency and effectiveness of operations, the reliability of financial reporting, and the reliability and effectiveness of management and compliance with applicable laws and regulations.” (Robert, 2020). The COSO framework defines five key components of internal control: control environment, risk assessment, control activities, communication capabilities, and monitoring activities.

The primary objectives of internal control can be divided into three key areas: optimizing operational efficiency, providing reliable financial reporting, and complying with regulatory requirements (Cohen, Holder-Webb, and Pant, 2008). Organizations strive to optimize their operations by using resources efficiently and achieving objectives in a timely manner. Effective internal control helps reduce the risks associated with operational failures, inefficiencies, and mismanagement, ultimately contributing to the success of the organization. Cohen and Sayag (2010) explain that high-quality financial reporting is necessary for stakeholders, including management, investors, and regulators, to make informed decisions based on accurate and reliable financial information. Internal control plays a critical role in protecting financial data and preventing distortions, fraud, and errors that could compromise the integrity of financial statements. Finally, organizations must comply with various laws, regulations, and industry standards that apply to their activities (Khan and Jabeen, 2016). A strong internal control framework helps identify and manage compliance risks, thereby preventing legal penalties, reputational damage, and business disruption.



Implementing an effective internal control system can significantly improve an organization's ability to achieve its goals and aspirations. Strengthened internal controls can reduce the risks associated with fraud, operational failures, and regulatory violations. Transparency and accountability also build stakeholder trust, bringing the organization closer to its goals. Organizations that prioritize internal controls are also better prepared to adapt to changes and challenges in their operating environment (Abraham (2020)). Agility is enhanced through a clearly defined risk management strategy that enables timely response to new threats. On the other hand, organizations with weak or ineffective internal controls can face financial losses, reputational risks, and operational failures that hinder growth and stability.

Overall, internal control is a critical framework for organizations seeking to manage accountability and risk. By establishing a robust internal control system that encompasses key components such as control, risk assessment, communication capabilities, and monitoring activities, organizations can effectively navigate the complexity of today's operating environment. Additionally, aligning internal control with the organization's goals optimizes productivity, ensures financial reporting, and achieves regulatory compliance. Ultimately, effective internal control is not simply a regulatory necessity; it is essential to an organization's success and sustainability in a constantly changing world.

#### **2.1.1.2. Internal Audit Control**

**Internal Audit Controls** Internal audit control refers to the systematic process established by an organization's management and governance structure to evaluate and improve the effectiveness of risk management, control, and governance processes (Institute of Internal Auditors [IIA], 2017). It covers a set of procedures and practices designed to ensure the integrity of financial statements, compliance with laws and regulations, and operational efficiency. The purpose of internal audit control is to provide stakeholders with assurance that the organization's risk management strategy is sufficient and effective and that the organization's operations are conducted in an ethical and transparent manner.

Internal audit control frameworks typically follow established standards, such as the International Standards for Professional Practice in Internal Auditing (IIA, 2021). These standards provide guidance that internal auditors must adhere to when planning and performing audits, thereby promoting consistency and reliability in the audit process. Components of internal audit control can

be included in several key areas, such as risk assessment, internal control, compliance monitoring, reporting and communication, and continuous improvement.

Effective internal audit control begins with a robust risk assessment process. Organizations must identify, analyze, and manage risks that could impede the achievement of their objectives. This includes a thorough assessment of internal and external risks, including operational inefficiencies, fraud, regulatory changes, and market volatility (COSO, 2017). Internal audit control should be complemented by an internal control system that protects assets, ensures the accuracy of financial reporting, and improves operational efficiency. According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO), these controls are divided into five components: control environment, risk assessment, control activities, information and communication, and monitoring activities (COSO, 2017). Compliance with applicable laws and regulations is critical in today's business environment. Internal audit controls serve to monitor compliance through regular audits and assessments, helping organizations avoid legal pitfalls and related reputational damage (Arens, 2019). Effectively communicating audit results is paramount to establishing a culture of accountability within the organization. Internal audit controls require the development of clear reporting mechanisms to communicate risks and audit results to management and the board (IIA, 2021). Internal audit control should be viewed as a continuous process that evolves with the changing environment of the organization. Continuous monitoring and improvement of audit strategies and practices are required to adapt to new challenges and ensure that internal control remains effective (Bourne & Walker, 2018).

In terms of the importance of internal audit control, it serves as a fundamental mechanism for achieving effective management and operational excellence. Key benefits include improved risk management, improved operational efficiency, stakeholder confidence, regulatory compliance, and informing strategic decisions. Internal audit control promotes a proactive approach to risk management, enabling organizations to identify and mitigate potential risks before they escalate. This in turn fosters a culture of risk awareness and reinforces the organization's strategic objectives (IIA, 2017). Internal audit helps streamline operations and promote best practices by assessing processes and identifying inefficiencies. These improvements can lead to cost savings and increased productivity, which can enhance market competitiveness (Mautz & Neff, 2019). A transparent and robust internal audit process instills trust in stakeholders, including investors, customers, and

regulators. This trust is critical to maintaining an organization's reputation and providing a strong foundation for long-term sustainability (COSO, 2017).

In a similar vein, increasingly stringent regulations and standards across various industries are putting pressure on organizations to comply with ever-increasing legal requirements. Internal audit controls help ensure compliance with these rules, thereby reducing fine risk and encouraging ethical behavior in organizations (Arens et al., 2019). Internal audit reports provide valuable information about an organization's performance and risk profile. This information is necessary for management to make informed decisions, allowing the organization to align its strategies with its risk tolerance and overall objectives (Bourne & Walker, 2018).

#### **2.1.1.3. Internal Audit Controls for Organizational Functions**

The effective implementation of internal audit controls has a wide-ranging impact on the functioning of an organization. Improved risk management, improved operational efficiency, and improved compliance allow organizations to navigate uncertainty and focus on achieving strategic objectives. In addition, the internal audit function acts as a catalyst to encourage accountability and ethical behavior within the organization. Additionally, organizations that effectively use internal audit controls tend to be more resilient in the face of disruption. In an era characterized by rapid technological advancements and changing market dynamics, the ability to adapt and respond to new risks is more important than ever. Internal audit controls provide a foundation for organizations to remain flexible and responsive to change. Moreover, the value of internal audit controls goes beyond simple compliance and operational efficiency. It promotes an organizational culture that prioritizes honesty and transparency. By reinforcing ethical standards and accountability, organizations can attract and retain top talent, ultimately creating an environment that drives productivity and innovation (Mautz & Neff, 2019).

In conclusion, internal audit controls can be considered an essential element of modern organizational management. It addresses a comprehensive framework that integrates risk management, compliance monitoring, and operational efficiency. The importance of internal audit control is emphasized by its ability to increase stakeholder trust, improve decision-making, and promote a culture of accountability within the organization. As the business environment continues to change, the relevance and necessity of internal audit control are becoming more evident, and it will become the cornerstone of sustainable organizational success.

### **2.1.2. Financial Reports**

According to Samrin (2018), financial statements generally include a summary that describes the financial position, operating results, cash flows, and changes in capital of an organization over a period of time. Each summary is presented separately in its own format. The summary of financial position is presented in a financial statement called the balance sheet. This report summarizes the status or position of resources at a particular point in time. The results of operations are reflected in the income statement, and the cash flow statement shows the sources and uses of cash.

The quality of financial reporting is the end result of a series of accounting activities performed during the financial reporting period (Ali, 2019; Fouadi, 2022). Financial statements must provide information that meets several important criteria. First, the information must be understandable. That is, it must be presented in a format and technical language appropriate to the level of understanding of the user. Second, the information must be consistent with the purpose for which it is to be used. If it is not relevant, it is meaningless. Third, the information must be reliable and free of misleading interpretations or material errors, so that it can be relied on for decision-making. Fourth, the information must be comparable to previous information within the same company and to previous information from similar companies during the same period. Fifth, the information must be neutral and intended for the general purpose of users without biasing any particular party. Sixth, the financial statements must be presented in a timely manner so that they can be used as a basis for corporate decision-making. Seventh, the information must be complete and present all material financial facts without misleading the reader. By meeting these criteria, financial statements can be considered high quality and can contribute positively to the decision-making process of the company.

#### **2.1.2.1. Qualitative characteristics of financial statements**

Recently, the International Financial Reporting System (IFRS) in 2010 recognized the qualitative characteristics of accounting information (IFRS, 2018). The purpose of this framework is to evaluate the quality of financial statements in terms of providing useful information to users of financial statements. Hermann (2021) found that fair value improved the quality characteristics in terms of providing useful information to users of financial statements. He added that fair value accounting was better than historical cost accounting in terms of improving the quality characteristics of accounting information. Similarly, Tan (2015) found that users and preparers of financial statements in Australia and Singapore tended to have similar perceptions that fair value accounting had qualitative

characteristics of accounting information. On the other hand, Hann, Heflin, and Subramanayam (2017) found no information benefits from adopting fair value accounting.

To construct the measurement tool, we draw on prior literature that defines financial reporting quality in terms of fundamental, qualitative characteristics that support decision-making usefulness. Fundamental qualitative characteristics (e.g., relevance and fair presentation) are the most important and determine the content of financial statement information. Improving the quality characteristics (i.e., understandability, comparability, verifiability, and timeliness) can enhance the usefulness of the solution when the fundamental quality characteristics are established. However, they cannot determine the quality of financial reporting on their own (International Auditing Standards Board - IASB, 2018). The basic (relevance and truthful representation) and enhancing (comparability, verifiability, and understandability) qualities are presented as follows:

#### **2.1.2.1.1. Relevance of information**

Information is relevant if it can change the decisions users make as capital providers. Information has predictive value and can be changed if confirmed. Information has predictive value if it is valuable as an input to the forecasting process used by capital providers to form expectations about the future. The FASB defines predictive value as “the quality of information that helps users increase the likelihood that they will accurately predict the outcome of past or present events” (FASB, 2016). IFRS adds that information has confirmatory value if it confirms or modifies past (or current) expectations based on prior estimates. He notes that while predictions and confirmation are interrelated, information with predictive value generally also has confirmatory value.

#### **2.1.2.1.2. Reliable Representation**

Financial information that fairly represents economic phenomena reflects the economic substance of the underlying transactions, events, or conditions, which is not always identical to its legal form. Fair representation is achieved when the description of an economic phenomenon is complete, neutral, and free from material error. According to FASB, representational validity is “the agreement or conformity between a scale or description and the phenomenon it purports to represent” (Tan, 2015).

A complete specification is achieved when financial statements include all the information necessary to fairly represent the economic phenomena they purport to represent. Omissions may be false or misleading and therefore not useful to users of financial statements. Another sub-characteristic of reliable representation is neutrality. Peason (2018) defines it as a state of being free from bias in order

to achieve a predetermined outcome or induce a specific action. Neutral information is free from bias and therefore faithfully represents the economic phenomenon it purports to represent. IFRS (2018) states that fair presentation does not imply complete freedom from error, as economic phenomena are measured under conditions of uncertainty. However, IFRS assumes that measurements should be based on appropriate inputs that reflect the best information available. It also states that a minimum level of precision is required for the estimate to be an accurate representation.

#### **2.1.2.1.3. Comparability**

Comparability can be defined as the quality of information that enables users to identify similarities and differences between two economic phenomena. Users should be able to compare a company's financial statements over time to identify trends in the financial statements and to compare different companies to assess relative financial position, performance, and changes in financial condition. IFRS considers comparability to include consistency. "Comparability is the goal. Consistency is the means to achieve this goal." (IFRS, 2018). Consistency, on the other hand, is defined as adherence to consistent policies and procedures from period to period. Davis (2017) argues that the fair value hierarchy makes consistency and comparability clearer than historical cost. Verifiability is the quality of information that helps assure users that the information faithfully represents the economic phenomena it purports to represent.

#### **2.1.2.1.4. Verifiability**

Verifiability Auditability of financial reporting quality is the extent to which a range of knowledgeable and independent observers can agree that the information in the financial statements fairly represents the economic phenomena it purports to represent. An audit implies that a range of knowledgeable and independent observers can reach a general, if not necessarily complete, agreement." IFRS (2018). He defines verifiability as the ability of measurers to establish through agreement that information represents what it purports to represent. It is one of the quality characteristics of financial reporting, along with understandability, comparability, and timeliness. This helps to assure users that the information is free from material errors and biases and can be relied upon to represent the economic reality of the organization (Lan, 2020). This can be achieved by using appropriate accounting practices, policies, valuations, and disclosures that are consistent with financial reporting standards

and conceptual frameworks. This can also be enhanced by external audits, internal controls, and governance mechanisms that provide checks and balances in the reporting process.

Verifiability is not a single, absolute concept, but rather a matter of degree. Some information is more verifiable than others, depending on the nature and complexity of the underlying transactions and events. Verifiability does not necessarily mean complete certainty or accuracy, but rather a reasonable level of agreement among different observers. It is important to users of financial statements because it increases confidence and trust in the information and reduces the risk of manipulation or distortion by the preparers or managers of the organization (Vitolla, 2020). It also facilitates comparison and analysis of financial information across different organizations and periods, which is important for economic decision making.

#### **2.1.2.1.5. Understandability**

Understandability is the quality of information that allows users to understand its meaning. It is enhanced when information is clearly and concisely categorized, characterized, and presented. Comparability can also improve understandability (Hermann, 2021). Understandability is improved when information is categorized, characterized, and presented clearly and concisely. Understandability refers to the quality of information that enables users to understand its meaning.

It is measured using five items that emphasize the transparency and clarity of the information presented in the annual report. First, categorized and characterized information refers to how well the information contained in the annual report is organized. A well-organized annual report makes it easier to know where to find specific information. Disclosures, especially notes to the balance sheet and income statement, can also be useful in explaining and providing greater insight into earnings performance (Beretta and Bozzolan, 2022). Narrative descriptions, in particular, help to increase the comprehension of information. Additionally, the use of tables and graphic formats can help clarify relationships and ensure conciseness, thereby increasing comprehension. Furthermore, when annual report writers combine easy-to-understand words and sentences, readers are more likely to understand the content (Courtis, 2018). When technical jargon, such as industry jargon, cannot be avoided, adding explanations to the glossary can improve the comprehension of the information.

#### **2.1.3. Theoretical Framework**

The theories relevant to internal audit and financial reporting quality examined in this study include agency theory, stakeholder theory, and contingency theory.

#### **2.1.3.1. Agency Theory**

Agency theory examines the dynamics between the separation of ownership and control in modern corporations, with particular attention to the agent-principal relationship and the resulting conflicts of interest. Managers acting as agents are expected to control the operations of the corporation to maximize shareholder value and protect the interests of all stakeholders (Lan, 2020). They are responsible for both operating the business profitably and preparing the financial statements of the organization. However, agency problems often arise because of managers' self-interest and discretionary incentives. Conflicts between management's goals and those of owners can negatively affect firm performance. In addition, managers may be motivated to manipulate earnings through accounting practices to achieve earnings targets and secure performance-related bonuses, which can further contribute to information asymmetry between managers and owners. Therefore, for the quality of internal audit control to be effective, top management support is as important as stakeholder independence. Otherwise, problems in the agency relationship between management and shareholders can arise.

#### **2.1.3.2. Stakeholder Theory**

According to stakeholder theory, managers should make decisions in a way that considers the interests of all stakeholders in the company, including not only financial stakeholders but also employees, customers, communities, and government officials (Freeman, 2017). From a stakeholder perspective, companies should strive to achieve various goals from various stakeholders, not just the goals of shareholders. Freeman (2017) argues that business organizations should pay more attention to the interests of other stakeholders when making strategic decisions. Stakeholder theory is related to the term "responsibility," which Parnell (2018) defines as the responsibility of one party to another party in a relationship where one party delegates certain responsibilities to another party.

Therefore, it can be argued that the quality of financial reporting can reduce information asymmetry between an organization and its stakeholders in a timely manner and consequently improve the relationship between them. If a company has good corporate governance practices and a high-quality internal audit function, it can provide high-quality financial information to various stakeholders. According to stakeholder theory (Pearson, 2019), managers should always provide reliable information to various stakeholders. According to stakeholder theory, a company with internal audit quality and a board of directors who are independent from management and have expertise in financial matters and can perform their roles can meet the needs of various stakeholders.



When evaluating the most applicable theoretical framework for research focusing on the impact of internal audit control on financial reporting quality, both agency theory and resource-based view (RBV) tone should be considered. Agency theory, which clarifies the relationship between principal and agent, emphasizes the need for strong internal control to enhance the transparency and reliability of financial reporting by mitigating information asymmetry and conflicts of interest that may occur within an organization. This theory posits that an effective internal audit function serves as an important mechanism for aligning the interests of management and stakeholders, ultimately fostering a culture of accountability and trust.

In contrast, the resource-based approach suggests that firms can directly contribute to superior financial reporting outcomes by leveraging the internal audit function as a unique organizational resource that not only protects assets but also improves operational efficiency. While both theories provide valuable insights, agency theory may provide a more complete framework for understanding the specific dynamics at play in the relationship between internal audit control and financial reporting quality, especially in a context where stakeholder interests are paramount and the need for accountability is increasingly apparent. Therefore, rigorous research based on agency theory may provide greater insight into how the internal audit function contributes to improving an organization's financial reporting standards.

## **2.2. Empirical Studies Review**

The empirical literature review focuses on the relationship between internal audit control and financial reporting quality. In these regards, several studies were conducted on different industries in different countries' context. Some of the empirical studies are presented.

### **2.2.1. Standards compliance and financial reporting quality**

In a comprehensive study of the impact of internal audit and quality on financial reporting standards, Ahrens, Elder, and Beasley (2019) analyzed data from 156 publicly traded companies in the United States from 2014 to 2018. Their findings highlight a significant correlation between the quality of the internal audit function and operational effectiveness. The authors emphasize that failure to adhere to established auditing standards can seriously compromise the integrity and timeliness of financial statements. The authors advocate that management implement sound audit policies and procedures that ensure effective communication with employees and close monitoring of these standards. He

suggests that organizations consider outsourcing their financial audit function in cases where internal capacity is lacking to maintain the standards expected in financial reporting.

Similarly, Bourne and Walker (2018) investigated the impact of internal audit control on financial reporting quality by focusing on the corporate governance of selected Armenian construction companies. Using a stratified random sample, they conducted a survey of 330 respondents and found that strict adherence to internal audit standards and maintaining auditor independence were important factors affecting financial reporting quality. They argued that if the internal audit team does not have the necessary competencies to meet professional standards, the reliability and consistency of financial statements can be significantly compromised.

In addition, Internal Auditor. (2019) used a quantitative approach to investigate the role of internal audit control on financial reporting quality in Ugandan statutory companies, targeting 300 participants including finance and audit managers of Indonesian multinational manufacturing companies. The results of this study confirmed a significant relationship between the effectiveness of the internal audit function and management's commitment to both international and internal audit standards.

These comprehensive findings suggest that strict adherence to auditing standards is fundamental to achieving high-quality financial reporting. By providing a comprehensive overview of operating practices, the importance of a well-executed internal audit process as a means of achieving an organization's financial reporting objectives is highlighted. As a result, internal audit improves financial reporting that is more verifiable, comparable, and understandable. Based on these results, it can be argued that compliance with auditing standards has a positive and significant impact on the quality of financial reporting, which leads to the proposed hypothesis:

*H1 – Standards compliance has a positive and significant effect on financial reporting quality.*

### **2.2.2. Auditor autonomy and financial reporting quality**

Abraham and Suleiman (2020) conducted an empirical analysis focusing on the relationship between financial reporting quality and internal control systems of companies listed on the Lotus Islamic Index of the Nigerian Stock Exchange. Using a post-hoc survey design, which is recognized as a non-experimental research methodology, they relied on secondary data sources to collect information related to financial reporting and internal control mechanisms of 15 companies included in the Lotus Islamic Index during the period 2012 to 2016. The findings indicated that there is a significant

correlation between auditor professional competence and the effectiveness of internal audit control systems, which in turn has a positive effect on the auditability of financial reporting quality.

Mautz and Neff (2019) investigated the impact of internal control activities on financial reporting quality in Nigerian higher education institutions. Their study included a survey of 225 participants and found that all institutional activities are primarily initiated by senior management. They found that the roles of finance and accounting departments were clearly separated and that senior management regularly monitored the work of their subordinates. The study concluded that the independence of internal auditors is important because there is a risk that one employee may have access to confidential financial information without the supervision or consent of another employee.

Meyer (2018) also investigated whether the internal audit function can improve the quality of financial reporting and mitigate reporting fraud in Indian construction companies. Using multiple regression analysis, the study conducted a survey of 360 randomly selected respondents from 10 construction companies in Bombay and found a significant relationship between internal audit independence and financial reporting quality. The results show importance of establishing effective checks and balances in financial transactions to protect against theft and other security threats.

Collectively, these studies highlight the critical role that audit independence plays in ensuring high-quality financial reporting by detecting fraud in internal audit. This independence not only helps organizations comply with regulatory requirements and prevent fraud, but also improves operational efficiency by enhancing the accuracy and timeliness of financial disclosures. Thus, the effectiveness of internal control systems, which are affected by auditor independence, is directly related to the quality of financial statements. In essence, a high level of auditor independence is associated with improved financial reporting quality, characterized by characteristics such as relevance, verifiability, comparability, and understandability. Therefore, the following hypothesis is proposed:

*H2 – Auditor autonomy has a positive and significant effect on financial reporting quality.*

### **2.2.3. Staff Competence and Financial Reporting Quality**

In a comprehensive study, Kirubel (2016) investigated the role of the audit function in improving the quality of financial reporting through the lens of corporate governance, particularly in private commercial banks located in Addis Ababa, Ethiopia. This study used a quantitative methodology and distributed questionnaires to a diverse group of 216 stakeholders, including bank staff, board

members, auditors, executives, and audit committees. The results showed a significant positive correlation between the professionalism of the internal audit committee and the overall quality of financial reporting. Kiragu suggested that improving the corporate governance structure requires a strategic allocation of responsibilities between the internal audit organization and the external audit organization, and that these roles should be filled by individuals with the necessary skills and competencies.

Based on this framework, Kiragu (2016) investigated the mechanisms underlying the relationship between the quality of financial reporting and internal audit control in companies listed on the Athens Stock Exchange. Using a well-structured survey of 300 respondents, the study highlighted the evolving nature of the internal auditor and highlighted the management orientation and value-adding potential of the internal auditor by assessing their role in both the advisory and traditional audit functions. Analysis using regression models confirmed a positive relationship between auditor competence and the effectiveness of the internal audit function, which in turn improved the overall quality and clarity of financial reporting.

Continuing the conversation on internal audit quality, Kallunki (2016) investigated how internal audit committee members and external auditors conceptualize internal audit quality. A survey of 385 employees from 15 insurance companies in Qatar found that external auditors primarily evaluate internal audit quality through the lens of auditor competence and independence, in line with international auditing standards.

The results of the study showed that the competence of internal auditors and audit committee members plays a significant role in determining the integrity and clarity of financial statements prepared by a company. Accordingly, this study proposed the following hypotheses:

*H3 – Staff competence has a positive and significant effect on financial reporting quality.*

#### **2.2.4. Risk Mitigation and Financial Reporting Quality**

A study by Alali and Waal (2014) investigated the impact of a comprehensive risk management framework on the accuracy and reliability of financial reporting in listed companies. The results showed that organizations that use robust risk assessment mechanisms are better able to anticipate and resolve potential mismatches, thus experiencing higher quality financial reporting, which in turn increases stakeholder trust. In addition, a study by Kallunka (2016) provides evidence that effective

risk mitigation strategies, particularly those that integrate advanced information technology systems, help reduce earnings management practices, thereby increasing the transparency of financial disclosures. This is consistent with Kothari (2016) who argues that companies that prioritize risk control are more likely to produce financial statements that more accurately reflect economic performance, ultimately increasing investor confidence and reducing the cost of capital. In addition, another empirical study by Wang and Zhang (2021) examines the relationship between corporate governance, risk mitigation mechanisms, and financial reporting quality in a rapidly changing emerging market context. Research has shown that companies with strong governance practices and up-front risk assessment processes tend to produce higher quality financial statements, which in turn promotes greater investor confidence and market stability. A study by Elgammal and Ishak (2022) examines the long-term impact of integrated risk management systems on financial reporting quality, highlighting the importance of ongoing monitoring and adaptive strategies in achieving sustainable reporting practices. Longitudinal studies have shown that organizations that prioritize risk reduction not only improve their compliance with financial reporting standards, but also improve their financial performance over time. Effective internal audit controls begin with a strong risk assessment process. Organizations must identify, analyze, and manage risks that could impede the achievement of their objectives. This includes a thorough assessment of internal and external risks, including operational inefficiencies, fraud, regulatory changes, and market volatility (COSO, 2017). Taken together, these studies therefore highlight that implementing strategic risk mitigation measures plays a key role in not only protecting organizational assets, but also improving the integrity and quality of financial reporting. Based on these arguments, the hypothesis is proposed:

*H4 – Risk mitigation has a positive and significant effect on financial reporting quality.*

#### **2.2.5. Control System and Financial Reporting Quality**

A study by Alali and Waal (2014) investigated the interaction between strong internal control systems and improved financial reporting quality in private commercial banks in Bombay, India. Using a descriptive research design, their study analyzed the responses of 220 participants from 10 banks. The results obtained through multiple linear regression analysis showed that internal audit process had the most significant impact on the quality of financial reporting, suggesting that having an effective and competent internal audit system can significantly improve the integrity, clarity, understandability, and comparability of financial reporting. Financial reporting.

Kiragu (2016) also conducted a study on 218 publicly traded companies in the United States between 2000 and 2005, which showed that the quality of the internal audit function was a constraint on earnings management. The study demonstrates a strong relationship between internal audit effectiveness and financial reporting quality, and particularly highlights that a weak internal audit system is closely related to abnormal accruals. The results indicate that if internal audit is not performing its function effectively, it can jeopardize the reliability of financial statements. This highlights the need for organizations to adopt a robust audit framework that ensures auditor independence and adherence to established standards.

Similarly, Alzeban and Gwilliam (2014) investigated the relationship between internal audit control and financial reporting quality in some multinational companies in the United Arab Emirates. The results of a multiple linear regression analysis conducted on a random sample of 225 respondents from 35 food and confectionery companies showed that weaknesses in the company's internal control system can have a negative impact on accounting quality. The study emphasizes that the internal audit function plays a key role in assessing the adequacy, effectiveness, and overall effectiveness of internal controls, thus facilitating continuous improvement of these systems. It was concluded that a strong internal audit function can significantly enhance management practices by implementing effective control systems in organizations. Based on these thoughts, we can propose a hypothesis:

*H5 – The control system positively and significantly influences the quality of financial reporting.*

### **2.3. Conceptual Framework**

The conceptual framework serves as a visual representation of the relationship between the independent and dependent variables in the study. The objective of this assessment is to analyze the impact of internal audit control on the quality attributes of financial statements. In this context, internal audit control is assessed on several parameters including compliance with standards, auditor independence, staff competency, risk management practices, and the effectiveness of control systems. It is classified as an independent variable.

Financial reporting quality is described as a basic and enhanced quality characteristic that supports decision-making, which is considered the dependent variable of the study (Institute of Internal Auditors, 2019). Internal audit control includes various processes and practices designed to ensure that an organization's financial reporting is accurate, reliable, and compliant with relevant standards. Auditor autonomy is another important aspect that affects the effectiveness of internal audit. When

auditors are given the independence necessary to perform their evaluation without undue influence from management, they are more likely to provide an objective assessment of financial practices and controls. Staff competency also plays an important role in internal audit controls. The skills and experience of the audit team can determine the completeness of the audit process. Competent staff are better equipped to identify issues and areas that require improvement within financial reporting. Risk mitigation is an essential part of the internal audit process that involves identifying and managing financial reporting risks. By effectively assessing potential risks, companies can implement appropriate controls to prevent fraud and inaccuracy in their financial statements (Microfinance Gateway, 2022).

The relationship between internal audit controls and financial reporting quality highlights the importance of effective internal audit preparation to promote transparency and accountability in an organization. Studies have shown that implementing a sound internal control system can improve the fundamental qualitative characteristics of financial reporting, thereby enhancing its overall usefulness (Kewo and Afiah, 2017). Based on the theoretical literature and empirical reviews, the relationship is presented schematically as:

*Independent Variables (Internal Audit Control)*

*Dependent Variable*

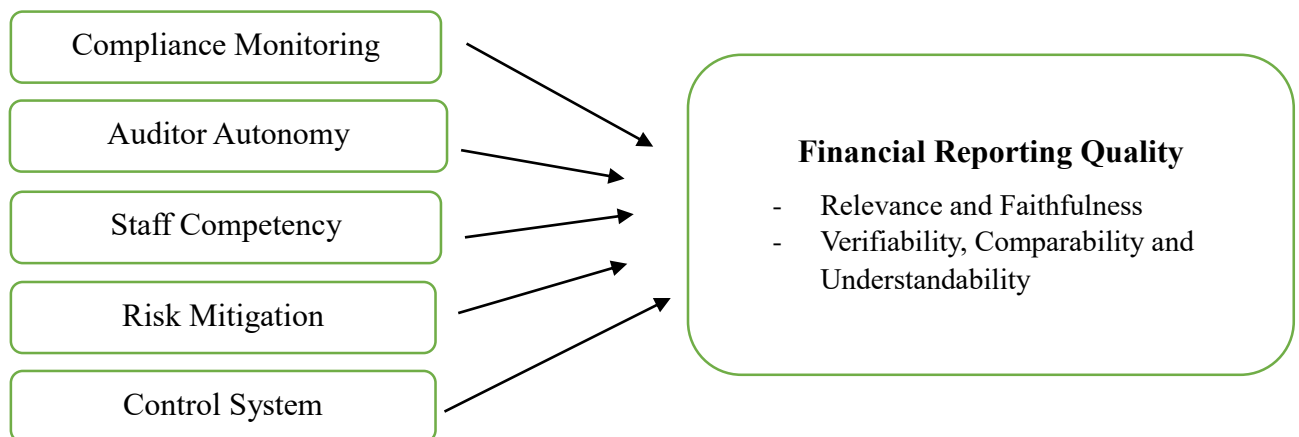


Figure 1. Conceptual Framework of the Study

(Source: Kewo and Afiah, 2017)

## **CHAPTER THREE**

### **RESEARCH DESIGN AND METHODOLOGY**

The quality of financial reporting is critical for stakeholders across all sectors, particularly in the context of microfinance institutions (MFIs) where transparency and accountability are essential for sustaining trust and attracting investments. This study explores the relationship between internal audit control mechanisms and the quality of financial reporting within MFIs in Addis Ababa, Ethiopia. A comprehensive research methodology is essential to achieve this objective, ensuring the collection of valid and reliable data that inform the findings and conclusions of the study.

#### **3.1. Research Approach**

Research approaches point out the methods of data collection, data analysis, and interpretation, communicating findings, validation and the questions to be responded to, the chosen approach of inquiry equally determines the study techniques. In keeping with Leedy and Ormrod (2013) a research approach may be regarded as a blueprint, a grasp plan that specifies the methods. Therefore, every study requires a research design that is carefully tailored to the exact needs of the problem under investigation (Creswell, 2009). As mentioned in Kothari (2004) and Creswell (2003) research approach can be classified into three approaches and a researcher can use one tactic in conducting a given research. Those are quantitative, qualitative, and mixed research approaches. In this paper, the researcher used a quantitative method. The rationale behind this choice was that quantitative data would be utilized to scrutinize the correlation between internal audit control and the quality of financial reporting. This method entailed the creation of data in a quantitative format, which could then be subjected to a stringent quantitative or inferential analysis. This analysis was conducted formally and strictly, by Hair (2019). This approach allowed for a precise and objective examination of the relationship under study. Thus, the quantitative research approach was suitable for examining the relationship between internal audit control and financial reporting quality.



### **3.2. Research Design**

Refers to the general plan that integrates the distinctive mechanisms of the study logically, ensuring that the studies effectively address the research problem (De Vaus, 2011). Different researcher Mathoko (2007) additionally argued that a research design is a procedural plan adopted by the researcher to answer research questions in an objectively, precisely, valid, and economic way; therefore, research designs the arrangement of conditions for data collection and analysis of in a way that seeks to combine relevance with the purpose of the research. It constitutes the blueprint for the collection, measurement, and analysis of data and guides the researcher to know what to do throughout the research process Saunders, Lewis & Thornhill (2009) argued that research questions like what, how, and why answers using an explanatory research design method. Therefore in this study, the researcher applied Explanatory research design was applied as it was deemed appropriate to realize the objectives of this study, given that explanatory research was utilized to establish cause-and-effect relationships between variables. It represented a causal analysis concerned with the examination of how two or more variables affected changes in another variable (Saunders, 2015). Both descriptive and inferential statistics were employed to describe the demographic profiles of the respondents and study variables based on their responses, while also inferring meaningful predictions from the causal relationships between dependent and independent variables.

### **3.3. Population**

In research, the study population refers to the group of interest that is considered for statistical analysis (Hair, 2019). This study targets the permanent and professional employees of selected MFIs, specifically, including directors, managers, auditors, and accountants. Professional staff are taken as a unit of measure for the reason that they are in a position to have detailed information and understanding regarding the practices of internal audit control and financial reporting quality of their respective organizations. By studying this group, aimed to gain valuable insights into the practices and their interrelationship in these critical areas. According to the NBE database, there are a total of 48 MFIs, of which 4 institutes have turned to commercial banks. Among them, 29 companies are located in Addis Ababa city.

For this study, the survey focuses on all the MFIs located in the city, the largest metropolitan area in the country (as reported by the Addis Ababa City Administration in 2022). However, the institutes that have sustained in the market over decades counted only 14 in number, are specifically considered

as their internal audit practices' impact are often noticed in their respective institution over time. Strong internal control and governance can lead to better firm financial outcomes and are influenced by factors such as investor protection, board composition, and management practices (Robert, 2022). It can manifest in improved organizational performance, including enhanced operational efficiency, increased transparency, and better risk management. These changes can be gradual and become more evident as the institution adapts and aligns its practices with good governance principles. Therefore, the professional staff in these 14 MFIs (Ref. Appendix III) which accounted for 486, served as the target population of the study

### **3.4. Sample Size**

Sampling involves choosing a subset of individuals from a larger population for research purposes. It's a practical approach when a full census is not feasible. With a known population size of 486, the sample size can be calculated using the Slovin formula, a simplified formula proposed by Yamane (1967), which provides a representative sample for the study. This formula helps in determining an appropriate sample size that represents the population, ensuring that the study findings are reliable and valid within the specified error margin. The formula is as follows:

$$n = \frac{N}{1+N(e^2)} = \frac{486}{1+(486*0.05^2)} = 219$$

Where:

N -Designates total number of customers;

e - Designates maximum variability or margin of error 5% (0.05); and

n- designates computed sample size.

### **3.5. Sampling Technique**

Sampling procedures were methodologies employed to select a subset of individuals or entities from a larger population for research purposes (Saunders, 2015). There were primarily two categories of sampling methods: probability and non-probability. Given that the precise count of intended respondents was known, in this study, a probability sampling method was deployed to select them proportionally from their respective stratum. Consequently, a stratified random sampling technique was utilized to select target respondents from a specific group of professionals, predominantly accountants, auditors, managers, and directors (board members) who were presumed to possess in-depth knowledge pertinent to enhancing the quality of financial reporting directly through internal

audit control practices; thus, the generalizability of the results of the findings to the entire population was not in question.

### **3.6. Sources of Data**

Referring to the survey conducted among professional staff within selected Microfinance Institutions (MFIs) in Addis Ababa, the research aimed to delve deeper into the perceptions and attitudes of these professionals regarding key operational aspects. The survey specifically targeted their understanding and evaluation of internal audit controls, corporate governance standards, and the overall quality of financial reporting within their institutions. The rationale for focusing on primary data collection stemmed from its inherent benefits. Primary data provided up-to-date, specific, and detailed information directly from the source, ensuring that the data was highly relevant and tailored to the research objectives. This firsthand information proved invaluable as it captured the current realities and nuanced perspectives of those working within the MFIs, offering a rich, in-depth understanding of the internal mechanisms and their effectiveness. By directly engaging with the professional staff, the research uncovered insights into how internal audit controls were implemented and the perceived integrity and accuracy of financial reporting. These insights were crucial for identifying strengths and areas for improvement within the MFIs' operational practices.

Moreover, the absence of secondary data necessitated a primary data-driven approach. Secondary data, which included previously collected and readily available information, may not have existed for the specific context of MFIs in Addis Ababa or may not have been as current or relevant as needed for this study. Therefore, the research relied on surveys, interviews, or other data-gathering techniques to obtain the necessary information directly from the professionals involved.

### **3.7. Data Collection Instrument**

A survey questionnaire was utilized to collect the primary data. As suggested by Creswell (2009), administering questionnaires allowed the researcher to gather data at a low cost, even when the universe was large and geographically widespread. Respondents who were not easily approachable were also reached conveniently, enabling the collection of large samples. Consequently, the results were made more dependable. The questionnaire consisted of three sections. The first section covered the demographic profile of the participants; the second section was structured on a 5-point Likert scale (1 - Strongly disagreed, 2 - Disagreed, 3 - Neutral, 4 - Agreed, and 5 - Strongly agreed) to indicate their degree of agreement with the statements regarding the constructs under study, namely

Financial Reporting Quality and Internal Audit Control. The internal audit control encompassed five dimensions: standard compliance, auditor autonomy, staff competence, risk mitigation, and control system. This framework was adopted from a previous study by Kewo and Afiah (2017) regarding the same constructs but modified for the financial industry without altering the fundamental concepts.

### **3.8. Data Collection Procedure**

The research was conducted in person to fulfill academic requirements. A total of 30 questionnaires were distributed at randomly selected microfinance institutions in Addis Ababa, from which the pilot test participants were not included in the main survey, to test the validity and reliability of the scaling instrument. Regarding the validity, the content of the questionnaire was reviewed and edited by professionals, including advisors, senior auditors, and managers. Once the validity and reliability were confirmed, the questionnaires were distributed to the targeted respondents at their respective head offices and branches until the required sample size was attained. Respondents filled out the questionnaires accordingly after having provided their full consent and being briefed on the purpose of the study by the student researcher.

### **3.9. Data Analysis and Presentations**

Both descriptive and inferential statistics were applied to analyze the quantitative data to be collected through a structured questionnaire. All the variables are coded and entered into the SPSS 22.0 to analyze the data obtained through questionnaires. Descriptive statistics was used to describe the usefulness of the data set and examine relationships between variables. To view the internal consistency of the scale items, Cronbach coefficients (alpha) are also computed.

The study applied a multi-regression analysis model for testing the hypotheses drawn from the conceptual framework. Linear regression estimates the coefficients of the linear equation, involving one or more independent variables that best predict the value of the dependent variable. Multiple linear regressions are conducted to identify the relationship between internal audit control and financial information quality dimensions. Regarding the model specification, the basic aim was to see the extent to which the financial reporting information quality is affected by the internal audit control. Thus, in this study:

- The independent variables are Standard Compliance, Auditor Autonomy, Staff Competency, Risk Mitigation, and Control System.

- The dependent variable is: Financial reporting quality is considered.

To evaluate the relation, the multiple linear regression model for testing the formulated hypotheses is designed as:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + e$$

Substituted the model with this expression is presented as:

$$FRQ = \beta_0 + \beta_1 STND + \beta_2 AUTO + \beta_3 COMP + \beta_4 CONT + \beta_5 RISK + e$$

Where:

$Y = FRQ$  = Overall Financial Information Quality;  $X_1 = STND$  = Standard compliance;  
 $X_2 = AUTO$  = Auditor autonomy;  $X_3 = COMP$  = Staff Competence;  $X_4 = CONT$  = Internal Control System;  
 $X_5 RISK$  = Risk Mitigation;  $e$  = error term;  $\beta_0$  = constant, term;  $\beta_1, 2, 3, 4,$  and  $5$  = coefficient terms

The regression output would have the coefficient of determination ( $R^2$  value), the regression coefficient (Beta coefficient), and the P-values for the significance of the model (ANOVA Test). Correlation coefficients were used to quantitatively describe the strength of the association between the variables.

### 3.10. Validity Test

Validity is the most critical criterion and indicates the degree to which an instrument measures what it is supposed to measure (Creswell, 2009). Different steps were taken to ensure the validity of the study. Data were collected from reliable sources (from respondents who have experiences in internal audit control and financial performance of the institutes). Survey questions were made based on the literature review and frame of reference to ensure result validity. In selecting a relevant measure for an outcome variable, logical inferences must be made from the operation upon which the measure is based on the theoretical constructs relevant to the study. The content and construct validity were also checked to ensure the quality of the research design. The student researcher customized the adopted questionnaire in its final version, after highlighting some of the comments and suggestions provided by the participants of the pilot test.

Then it was subjected to be reviewed by corporate managers, thesis advisors, and respondents from selected MFIs. Their comments and suggestions were considered to clarify the jargon and technical words for ease of understanding.

### 3.11. Reliability Test

Reliability is essentially all about internal consistency. That is, if something is measured many times and the result is always the same, then we can say that the measurement instrument is reliable (John, 2007). Cronbach's Alpha is a commonly used test of internal consistency. It essentially calculates the average of all the possible split-half reliability coefficients. The alpha coefficient ranges in value from 0 (denoting no internal reliability) to 1 (perfect internal reliability). Higher results ( $>.07$ ) are typically employed as a rule of thumb to denote an acceptable level of internal consistency.

In this study, Cronbach's alpha test is used to test the internal liability of the study variables. Cronbach's alpha ( $\alpha$ ) is a coefficient of reliability that is used to measure the internal consistency of the scale; it represents a number between 0 and 1. Scales with coefficient alpha between 0.6 and 0.7 indicate fair reliability (Zikmund, 2010).

Table 1. Reliability Test Results

	N	Cronbach's Alpha
Audit Standards Compliance	6	.797
Auditor Independence	6	.729
Professional Competency	5	.701
Internal Control System	5	.739
Risk Management	5	.709
Financial Reporting Quality	5	.796
Total	28	.887

Source: Own Survey 2024

A standardized questionnaire/ scale measurement was adopted from Kewo and Afiah (2017) that contains closed-ended questions along with different literature reviews related to the objectives of the study. The scale, in the previous study, was found valid and reliable as its overall Cronbach's alpha test was found .901. However, since some of the questions were customized in the context of the MFI industry, the reliability test was also conducted for check-and-balance.

The pilot test results, as shown in Table 1., the results were found within the acceptable range of alpha above 0.7. Thus, as an indicator of acceptability of the scale for further study, all five internal audit control dimensional (audit standards, auditor's independence, professional competence, internal control system, and risk management) and the overall financial reporting quality were above 0.7. The

alpha score of all the constructs yielded the Cronbach alpha of  $r = 0.887$  on average. Based on the alpha score within the range, the data collection instrument was considered a reliable tool to carry out data analysis as it enabled to yield of stable and consistent results.

### **3.1. Ethical Considerations**

When conducting business research, it is crucial to consider ethical principles. These principles were categorized into four different types: harm to participants, lack of informed consent, invasion of privacy, and deception. It recognized the potential harm that research could cause to participants. Therefore, it took precautions to minimize any adverse effects. The survey ensured that participants were fully informed about the study's purpose, procedures, and potential risks. Their voluntary participation was essential and obtained their consent. While collecting data, the student researcher respected participants' privacy. Descriptive questions about age and gender were included but took care not to reveal any personally identifiable information. Moreover, transparent with participants, the study did not mislead them or lead them to believe that the research was about something other than its actual purpose. In summary, the research adhered to ethical standards as it considered these principles carefully, ensuring that the study was conducted ethically and by the requirements.

## **CHAPTER FOUR**

### **DATA ANALYSIS AND INTERPRETATIONS**

This chapter comprises the data presentation, analysis, and interpretation of the primary data collected through a self-administered standard questionnaire. Mainly both descriptive and inferential analysis were carried out to address the specific objectives of the study.

#### **4.1. Response Rate**

The response rate describes the methodology used to collect data through a self-administered questionnaire, which included personal information of the respondents, four dimensions of internal audit control (namely audit standard compliance, auditor independence, professional competence, and internal control system), corporate governance and a financial reporting quality attribute.

Table 2. Response Rate

Questionnaires	Frequency	Percentage (%)
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Total distributed	219	100.0
Unreturned questionnaires	27	12.3
Returned questionnaires	192	87.7
Response errors	11	5.0
Total valid and usable	181	82.6

Source: Own Survey 2024

In examining the response rate of the distributed questionnaire, the data presented in Table 2 offers insights into the effectiveness of the survey dissemination process. Out of a total of 219 questionnaires that were distributed, 192 were successfully returned, constituting a response rate of 87.7%. This indicates a significant level of engagement from the surveyed individuals. However, it is worth noting that 27 questionnaires went unreturned, representing a 12.3% rate of non-response. While it is common to encounter non-responses in research studies, minimizing the number of unreturned questionnaires is essential to enhance the overall data quality and representativeness of the sample. Furthermore, among the returned questionnaires, only 11 (5.0%) were found to contain response errors, highlighting the overall quality of the collected data. Ultimately, a total of 181 valid and usable responses were obtained, accounting for 82.6% of the distributed questionnaires. In conclusion, the analysis of the response rate in the distributed questionnaire provides valuable insights into the effectiveness of the data collection process. The high response rate, coupled with a low percentage of response errors, underlines the success of the study in eliciting participant engagement.

## 4.2. Demographic Characteristics of the Respondents

The first part of the questionnaire consists of the demographic characteristics of respondents. It requested a limited amount of information related to the personal and demographic status of the respondents including gender, age, education, section, position, and work experience.

Table 3. Demographic Characteristics of Respondents

Category		N	(%)
Sex	Male	107	59.1
	Female	74	40.9
	<b>Total</b>	<b>181</b>	
Age	< 30	34	19.1
	31 – 45	81	45.5
	46 – 60	52	29.2
	> 60	11	6.2



	<b>Total</b>	<b>181</b>	
<b>Education</b>	Diploma	9	5.0
	Degree	109	60.2
	Masters	63	34.8
	Others	0	0.0
	<b>Total</b>	<b>181</b>	
<b>Department</b>	Audit	56	30.9
	Finance	93	51.4
	Board Member	32	17.7
	<b>Total</b>	<b>181</b>	
<b>Position</b>	Senior	103	56.9
	Supervisor	48	26.5
	Manager	16	8.8
	Director	5	2.8
	Others	9	5.0
	<b>Total</b>	<b>181</b>	
<b>Service Year</b>	1 – 5 years	96	53.0
	6 - 10 Years	61	33.7
	Above 10 Years	24	13.3
	<b>Total</b>	<b>181</b>	

Source: Own Survey, 2024

Referring to Table -3, the results show that:

**Gender:** A higher number of male respondents (107) compared to female respondents (74), with males making up 59.1% and females 40.9% of the total (181 respondents). This indicates a gender imbalance in the survey participation. Nonetheless, with the scope and sample size of this study, it would be premature to make conclusive statements about what this gender disparity means, other than the sampling diversity. Possibly future endeavors with a gender-specific focus could investigate this venue from a gender perspective.

**Age Range:** The respondents are predominantly in the 31-45 years age group, with 85 individuals (47.0%), followed by the 46-60 years age group with 51 individuals (28.2%). The respondents aged less than 30 years age group have 34 individuals (18.8%), and those who were over 60 years age group have the least share with 11 individuals (6.1%). This suggests that the survey mainly captured the views of middle-aged individuals.

**Educational Attainment:** A majority of the respondents have a degree with 109 individuals (60.2%), followed by those with a Masters at 63 individuals (34.8%). Only 9 individuals (5.0%) hold a Diploma, and no respondents fall into the ‘others’ category. This indicates a highly educated sample of respondents and is capable of grasping the contents of the questionnaire which helps to get reliable or credible data, emphasizing the importance of this educational level in the respondent pool.

**Department:** The majority of the staff 93 (51.4%) are in the Finance department, followed by Audit 56 (30.9%), and Board Members 32 (17.7%). This suggests that the company has a significant focus on financial operations. This data provides insights into the composition of the workforce across different departments. It highlights the prominence of Senior Accountants and Auditors, while also acknowledging the contributions of Managers, Directors, and other staff members. The distribution reflects the firm structure and the importance of each role in achieving the company’s objectives.

**Position:** Over half of the staff 103 individuals are senior representing 56.9% of the total, indicating a large accounting function in the survey. Supervisors make up 48 (26.5%) of the staff, while 16 managers, 5 directors, and 9 other staff constitute a smaller portion that represents 8.8%, 2.8%, and 5.0% respectively). This distribution might reflect a typical corporate hierarchy with fewer staff in higher-ranking positions.

**Service year:** Regarding employees’ work experience with their respective companies, the results reveal that the respondents who have been working for 1 – 5 years took relatively the highest share 96 (53.0%), followed by 61 (33.7%), and 24 (13.3%) with the tenure ranging from 6 – 10 years, or above 10 years respectively. Nearly half of the respondents were employed relatively for a longer period (more than five years), implying that they would have more information/experience regarding the organizations’ internal audit controls and quality of financial reporting.

#### **4.3. Description of Study Variables**

In this descriptive analysis, the study variables are presented and analyzed using descriptive statistics. The study variables are audit standards, auditor’s independence, professional competence, internal control system, risk management, and financial reporting quality. To compare the respondents’ perception of the study variables, descriptive statistics of mean and standard deviation were used. The mean indicates to what extent the sample group averagely agrees or disagrees with the different statements. As designed by Best (2005), the scale is set in such a way that respondents strongly disagreed if the mean scored value is in the range of 1.00 – 1.80; disagreed within 1.81 – 2.60; neither

agreed nor disagreed within 2.61 - 3.41; agreed if it is in the range of 3.41 – 4.20; while strongly agreed when it falls within 4.20 – 5.00. In addition, standard deviation shows the variability of an observed response. If the deviation is greater than the threshold (Std. 1.000), there is a high variation among the group.

#### 4.3.1. Audit Standard Compliance

Table 4. Description of Audit Standard Compliance (n = 181)

Statements	Mean	Std.
The firm consistently adheres to standards in its internal audit processes.	4.28	1.447
Internal controls are aligned with established financial reporting guidelines.	4.22	1.473
A clear procedure is set to ensure compliance with accounting standards	3.73	1.642
The management regularly reviews compliance with laws and regulations.	3.61	1.769
Audit findings are effectively communicated based on these standards.	3.86	1.712
Compliance with standards is prioritized by management in the audit process.	4.00	1.546
<b>Average</b>	<b>3.95</b>	<b>1.129</b>

(Source: Own Survey, 2024)

The responses gathered from a sample size of 181 participants, as outlined in Table 4, provide valuable insights into the perceptions of audit standard compliance within the firm. With an overall average of 3.95 (Std. 1.129), these responses suggest that while there is a recognition of the importance of compliance and communication, there may be a gap in the perceived effectiveness of current practices. The higher standard deviations indicate a broader range of opinions, hinting at inconsistent experiences across the organization. More specifically:

The first statement, which asserts that "the firm consistently adheres to standards in its internal audit processes," garnered the highest mean score of 4.28 (Std. 1.447). This indicates a strong perception among respondents that the firm prioritizes and successfully implements internal audit standards. Similarly, the second statement, indicating that "internal controls are aligned with established financial reporting guidelines," also received a commendable mean score of 4.22 (Std. 1.473), further consolidating the positive outlook regarding the firm's internal controls and echoing the sentiment that there is a solid foundation ensuring compliance with financial reporting standards.

In contrast, the statement regarding the clarity of procedures designed to ensure compliance with accounting standards received a significantly lower mean score of 3.73, accompanied by a higher standard deviation of 1.642. This divergence signals potential ambiguity or inconsistency in the procedural framework aimed at ensuring compliance. The next two statements, addressing the regularity of management reviews on compliance with laws and regulations (mean = 3.61, std. = 1.769) and the effectiveness of communication regarding audit findings based on these standards (mean = 3.86, std. = 1.712), reveal further areas for improvement.

Finally, the statement reflecting that "compliance with standards is prioritized by management in the audit process" received a mean score of 4.00 (Std. 1.546). This positive indication reinforces the notion that management's prioritization of compliance plays a crucial role in shaping the internal audit culture. However, the score's proximity to the average alongside a significant standard deviation suggests that while some employees may feel confident in management's commitment, others may perceive a lack of proactive measures.

#### 4.3.2. Auditor Independence

Table 5. Description of Auditor's Professional Independence (n = 181)

Statements	Mean	Std.
Auditors in the organization operate with a significant degree of independence from management.	3.94	1.634
The internal audit function has unrestricted access to all necessary financial records and personnel.	3.29	1.628
There are no undue pressures on auditors to overlook or alter findings in internal audit reports.	3.86	1.687
The reporting structure allows auditors to communicate openly with the board without interference from management.	3.30	1.823
Auditors feel empowered to perform their roles without fear of retaliation for unfavorable findings.	3.47	1.628

Statements	Mean	Std.
Independence issues are promptly addressed and mitigated.	3.23	1.709
<b>Average Mean</b>	<b>3.51</b>	<b>1.098</b>

(Source: Own Survey, 2024)

Auditor independence is a cornerstone of effective internal auditing, essential for ensuring reliable financial reporting and organizational integrity. Table 5 presents a summary of respondents' perceptions regarding various dimensions of auditors' professional independence. The average mean score across all statements stands at 3.51 (Std. 1.098), indicating an overall positive but cautious view of auditor independence within the organization. The fact that the majority of the respondents believe that auditors in the organization operate with a significant degree of independence from management (mean score of 3.94 with Std. 1.634), suggests a generally positive perception of auditors' autonomy. This level of perceived independence is critical, as it underpins auditors' ability to provide objective assessments without undue influence from management. Furthermore, the absence of undue pressures on auditors to overlook or alter findings (mean score 3.86), reflects a better-than-average assurance against coercive influences. However, the relatively high standard deviation of 1.687 suggests differing opinions on this matter, highlighting a potential area of concern regarding the internal audit culture.

Nonetheless, the statement regarding unrestricted access to financial records garnered a mean score of 3.29 (Std. 1.628), which is notably lower. This indicates potential barriers to auditors' full access to necessary information, which could compromise their effectiveness. The mean score of 3.30 for the reporting structure suggests that while there is some level of openness in communication with the board, challenges may still exist regarding management interference. Additionally, the score of 3.47 on auditors' empowerment indicates a moderate level of assurance that auditors can report unfavorable findings without fear of retaliation, yet this is coupled with a standard deviation of 1.628, implying variability in individual experiences. Lastly, The prompt addressing of independence issues scored the lowest mean at 3.23, underscoring a need for more robust mechanisms to mitigate potential threats to independence.

In general, while there are encouraging signs of auditor independence, several areas require attention. Specifically, unrestricted access to information and the proactive management of independence issues are critical for fostering an environment in which auditors can operate effectively. Addressing these concerns will enhance the integrity and reliability of the internal audit function, ultimately supporting the organization's governance framework.

#### 4.3.3. Auditor's Professional Competency

Table 6. Description of Description of Professional Competence (n = 181)

Statements	Mean	Std.
The internal audit staff members possess the necessary qualifications and expertise to conduct rigorous audits.	4.48	1.272
Ongoing training programs are in place to enhance the skills and knowledge of the internal audit team.	3.58	1.535
The firm actively recruits skilled professionals for its internal audit function.	3.34	1.874
There is a culture of continuous improvement among the internal audit staff, fostering professional development.	3.78	1.824
The competency of the internal audit team is regularly assessed and addressed through performance evaluations.	3.05	1.854
<b>Average</b>	<b>3.64</b>	<b>1.139</b>

(Source: Own Survey, 2024)

In examining the responses presented in Table 6, which assesses various aspects of professional competence within an internal audit team, several noteworthy trends emerge. The data provides insights into perceptions of qualifications, ongoing training, recruitment practices, and the culture surrounding professional development within the internal audit function. Overall, the average score of 3.64 (Std. Dev. = 1.139) reflects a mixed perception of professional competence among internal audit staff. While there are strengths in qualifications and a moderate focus on continuous improvement, significant opportunities exist to enhance ongoing training, recruitment, and performance evaluation practices.

In this regard, the highest-rated statement indicates that internal audit staff members possess the necessary qualifications and expertise to conduct rigorous audits, with a mean score of 4.48 (Std. = 1.272). This suggests a strong confidence among respondents regarding the foundational competencies of the auditing team, reflecting positively on the team's ability to fulfil its essential role in organizational oversight. The perceptions of a culture of continuous improvement within the internal audit team scored moderately at 3.78 (Std. = 1.824). This indicates that there is a general acknowledgment of efforts to promote professional development; however, it may not be perceived as strongly embedded within the team culture compared to other aspects. Similarly, the statement regarding ongoing training programs received a mean score of 3.58 (Std. = 1.535), indicating a moderate level of satisfaction with the current training initiatives available for skill enhancement. This implies that while some training exists, respondents perceive a potential gap in the robustness or accessibility of these programs.

On the other hand, the firm's recruitment practices for skilled professionals in the internal audit function received a lower mean score of 3.34 (Std. = 1.874), signaling concern about whether the current approach sufficiently attracts qualified candidates. This finding could point to the need for a more strategic recruitment effort to ensure that the team is equipped with top-tier talent. The lowest score pertains to the regular assessment of competency through performance evaluations (mean of 3.05, Std. = 1.854). This suggests that respondents are less confident in the mechanisms in place for evaluating and addressing the competencies of the internal audit staff, raising questions about the effectiveness of feedback systems and their impact on professional growth within the team.

#### 4.3.4. Internal Control System

Table 7. Description of MFIs Internal Control System (n = 181)

Statements	Mean	Std.
The internal control system is comprehensive and effectively supports accurate financial reporting.	4.25	1.395
There are documented procedures for the execution of financial transactions that enhance transparency.	3.81	1.689

Statements	Mean	Std.
Regular assessments are conducted to evaluate the effectiveness of the internal control system.	2.98	1.813
The organization prioritizes the improvement of its internal control mechanisms based on audit outcomes.	4.26	1.404
Management actively supports and enhances the internal control framework to ensure financial integrity.	3.72	1.644
<b>Average Mean</b>	<b>3.80</b>	<b>1.118</b>

(Source: Own Survey, 2024)

The internal control system within Microfinance Institutions (MFIs) plays a pivotal role in ensuring the accuracy of financial reporting and maintaining organizational integrity. Table 7 reveals various dimensions of these control systems, categorizing key statements regarding the efficacy and robustness of the internal control frameworks in place.

The statement regarding the comprehensiveness of the internal control system, which received a mean score of 4.25 (Std. 1.395), underscores a strong belief in the capability of these systems to facilitate accurate financial reporting. It indicates a significant portion of respondents perceive the internal controls as thorough and supportive of financial accuracy, reflecting a foundational aspect of effective governance in MFIs. Besides, the high mean score of 4.26 (Std. 1.404) concerning the prioritization of internal control improvements, based on audit findings, suggests that MFIs are responsive to audit outcomes. Such adaptability is essential for the evolution of internal controls, ensuring they adequately address emerging risks and operational challenges.

Same vein, the mean score of 3.81 (Std. 1.689) for the existence of documented procedures for executing financial transactions indicates a moderate level of confidence in transparency. Although a majority recognizes the presence of formalized processes, the relatively lower score points to potential gaps in the systematic documentation and dissemination of these procedures that warrant further exploration. The score of 3.72 (Std. 1.644) pertaining to the active support provided by management for enhancing the internal control framework also reveals a positive yet moderate affirmation of leadership engagement. Strong management support is crucial for fostering a culture of accountability and integrity within financial operations.



In contrast, the assessment of regular evaluations of internal control effectiveness yielded a mean score of 2.98 (Std. 1.813), indicating a weaker perception of the proactive measures taken to scrutinize the internal control systems. This score reflects an area ripe for improvement, as continuous evaluations are critical for adapting to dynamic challenges and ensuring ongoing efficacy.

Overall, the average mean score of 3.80 (Std. 1.118) indicates an overall favorable perception of the internal control systems in MFIs, though several specific areas exhibit opportunities for enhancement. Addressing the identified weaknesses, particularly in evaluating effectiveness and ensuring comprehensive documentation, will be vital for strengthening the operational resilience and financial integrity of these institutions.

#### 4.3.5. Risk Mitigation

Table 8. Description of MFIs Risk Mitigation Practices (n = 181)

Statement	Mean	Std.
The internal audit function effectively assesses potential risks that could affect financial reporting.	3.85	1.698
There are clear procedures in place for mitigating identified risks within financial operations.	3.90	1.592
Internal audits are conducted with a strong focus on evaluating risk management processes in financial reporting.	3.73	1.615
The organization regularly updates its risk management strategies based on findings from internal audits.	3.46	1.678
Employees are encouraged to report potential risks without fear, contributing to proactive risk management.	3.51	1.669
<b>Average Mean</b>	<b>3.69</b>	<b>1.122</b>

(Source: Own Survey, 2024)

Table 8 presents a comprehensive overview of the risk mitigation practices employed by microfinance institutions (MFIs). The data reveals an overall average mean score of 3.69 (Std. 1.122), indicating a moderate perception of the effectiveness and implementation of risk management strategies within these organizations.

Notably, the statement regarding the existence of clear procedures for mitigating identified risks within financial operations garnered the highest mean score of 3.90 (Std. 1.592), suggesting a relatively strong recognition of structured risk mitigation processes. Conversely, the regular updating of risk management strategies, based on internal audit findings, received the lowest mean score of 3.46 (std. 1.678), highlighting a potential area for improvement in the adaptability of these strategies to emerging risks. Furthermore, the emphasis placed on internal audits as a mechanism for assessing potential risks in financial reporting is underscored by a mean score of 3.73 (Std. 1.615), reflecting a commitment to integrating risk management within financial oversight. The encouragement for employees to report risks without fear (mean = 3.51 with Std. 1.669) points to an organizational culture aimed at fostering proactive risk management. Collectively, these findings suggest that while MFIs recognize the importance of risk mitigation practices, there remains a critical need to enhance the dynamism of their risk management strategies in response to audit insights.

#### 4.3.6. Financial Reporting Quality

Table 9. Description of financial reporting quality (n = 181)

Attributes	Mean	Std.
Financial statements are prepared accurately/ transparently.	3.53	1.379
Adequate disclosures are made in financial statements.	4.18	1.184
Financial reporting complies with relevant accounting standards.	4.19	1.157
Internal controls support reliable financial reporting.	3.50	1.375
Financial reporting undergoes independent review or audit.	3.47	.845
<b>Average Mean</b>	<b>3.77</b>	<b>.894</b>

(Source: Own Survey, 2024)

In Table 9, the focus is on evaluating the quality of financial reporting, based on certain key attributes. The first attribute pertains to the accuracy and transparency in preparing financial statements, with a mean score of 3.53 and a standard deviation of 1.379. Moving on to the adequacy of disclosures within financial statements, the mean score stands at 4.18, with a standard deviation of 1.184. Additionally, the adherence to relevant accounting standards in financial reporting yields a mean score of 4.19, with a standard deviation of 1.157. The effectiveness of internal controls supporting reliable financial reporting is reflected in a mean score of 3.50 and a standard deviation of 1.375.

Furthermore, the practice of subjecting financial reporting to independent review or audit receives a mean score of 3.47 with a standard deviation of 0.845. When considering the overall average mean across all attributes, it amounts to 3.77, with a standard deviation of 0.894, indicative of the overall quality of financial reporting is viewed positively, although the standard deviation points to some variability in the responses. This comprehensive assessment suggests that while there are areas of strength in financial reporting practices, particularly in compliance and independent review, there is also a need for ongoing focus on timeliness and the continuous strengthening of internal controls to support the reliability of financial reporting.

#### **4.4. Inferential Analysis**

Inferential statistics uses sample measurements of the subject and make generalization about the larger population. It comprises different test such as correlation test among variables and assumption of data test for their suitability or fitness to the intended regression analysis model namely normality, collinearity, linearity and homoscedasticity. Finally, the multiple regression analysis in terms of model summary, ANOVA test and beta coefficients are conducted to address the objectives of this study.

##### **4.4.1. Correlation Analysis**

This study employs correlation analysis, which investigates the strength of the relationships between the studied variables. Pearson correlation analysis was used to provide evidence of convergent validity. Pearson correlation coefficients reveal magnitude and direction of relationships (either positive or negative) and the intensity of the relationship (-1.0 + 1.0). Correlation is perhaps the most basic and most useful measure of association between two or more variables (Festinger, 2005). To interpret the direction and strengths of relationships between variables, the guidelines suggested by Field (2005) were followed. His classification of the correlation coefficient (r) refers 0.1– 0.29 is weak; 0.3 – 0.49 is moderate; and  $\geq 0.5$  is strong.

Table 10. Pearson Correlation Matrix

	STND	AUTO	COMP	CONT	RISK	FRQ
Audit Standard Compliance – STND	1					

Auditor Independence – AUTO	.313**	1				
Auditor Professional Competency – COMP	.175*	.227**	1			
Internal Control System – CONT	.332**	.396**	.367**	1		
Risk Mitigation - RISK	.308**	.329**	.355**	.353**	1	
Financial Reporting Quality – FRQ	.469**	.564**	.417**	.535**	.602**	1
**. Correlation is significant at the 0.01 level (2-tailed).						
*. Correlation is significant at the 0.05 level (2-tailed).						

(Source, Own Survey, 2024)

Table 10 indicate indicates the relationship between financial reporting quality and internal audit control dimensions. The internal audit control dimensions are auditing standard compliance, auditor independence, auditor professional competency, internal control system and risk mitigation. The results show that overall internal audit control dimensions have positive and significant relationship with financial reporting quality. Specifically,

- Audit standard compliance has a positive and moderate relationship with financial reporting quality ( $r = .469$ ) at  $p < 0.01$ .
- Auditor independence had positive strong relationship ( $r = .564$ ) with financial reporting quality at  $p < .01$ .
- Auditor professional competency had positive and moderate relationship with financial reporting quality ( $r = .417$ ) at  $p > .01$ .
- Internal control system has positive strong ( $r = .535$ ,  $p < 0.01$ ) with financial reporting quality.
- Finally, the relationship between risk mitigation and financial reporting quality is found to be positive and strong as  $r = .602$  at  $p < .01$ .

The correlation matrix provides valuable insights into how these factors interact and influence each other in the context of auditing and financial reporting. An increase in internal audit control increases the financial reporting quality of the institutions implying that internal audit control activities are good predictors of financial reporting quality.

#### 4.4.2. Multiple Regression Assumption Tests

Linear regression (Ordinary Least Square) is an analysis that assesses whether one or more predictive variables explain the dependent (criterion) variable. The assumption test is the underlying assumption that the accuracy of a specified model predicts the outcome variable with minimum possible error

induced. For a given multiple regression model, to take it as a credible model, it shouldn't violate the following assumptions. These assumptions are Multicollinearity (highly relatedness of predictor variables), Normality (symmetric distribution of data based on given mean and variation), and Homoscedasticity (uniform/ random distribution of error terms).

#### 4.4.2.1. Multicollinearity

Multicollinearity refers to the situation in which the independent/predictor variables are highly correlated. Tolerance and variance inflation factors (VIF) values for each predictor are means of checking for violation of collinearity assumption. Tolerance value below 0.1 and VIF above 10% indicate a multicollinearity problem (Robert, 2016).

Table 11. Collinearity Diagnostics

Coefficients <sup>a</sup>			
Model	Collinearity Statistics		
	Tolerance	VIF	
1	Audit Standard Compliance	.824	1.214
	Auditor Independence	.778	1.285
	Auditor Professional Competency	.806	1.241
	Internal Control System	.712	1.404
	Risk Mitigation	.759	1.317

i. Dependent Variable: Financial reporting quality

Source, Own Survey, 2023

In this study, the results in Table 11, shows that the collinearity statistics analysis of variance inflation factors (VIF) value ranges from 1.214 to 1.404 and Tolerance value ranging with 0.712 to 0.824 indicated that there was no collinearity problem. This could be taken as a confirmation that there are no multi-collinearity problems to proceed for regression analysis. That means, when independent and the mediator variables are highly related ( $r > .80$  in most cases), there is the possibility of variables' "overlap" or sharing of predictive power or they would have been basically measuring the same thing or they both convey essentially the same information (Robert, 2016).

#### 4.4.2.2. Homoscedasticity –

Testing for Homoscedasticity lies with an assumption in regression analysis that the residuals at each level of the predictor variable(s) have similar variances. Using the plots of ZRESID against ZPRED,

the distribution is checked whether the graph looks like a random array of dots evenly dispersed around zero. This is to mean that at each point along with any predictor variable, the spread of residuals should be fairly constant.

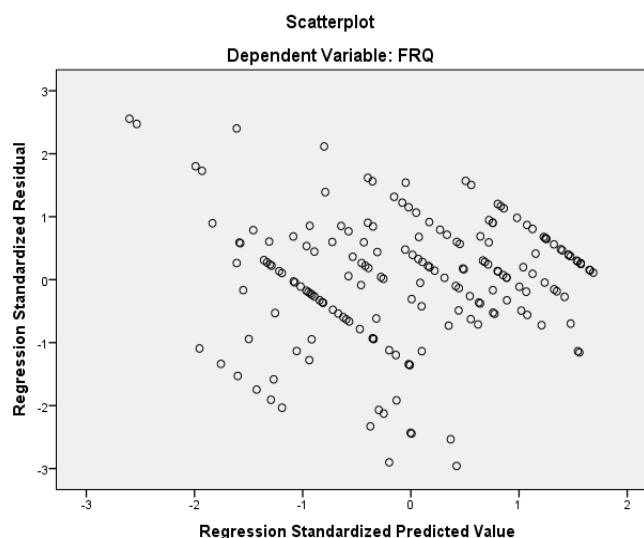


Figure 2. Homoscedasticity Test

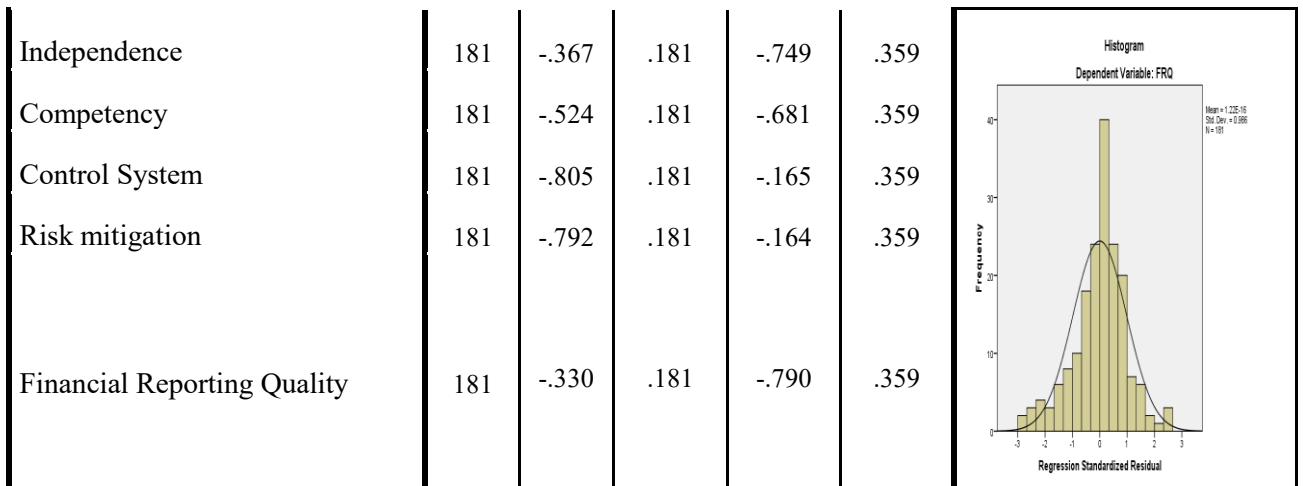
Figure - 2, shows each of the predictor variables against the standard residual values. The plot depicts how the points are randomly and evenly dispersed throughout the plot. And, these patterns are indicatives of a situation in which the assumption of homoscedasticity has been met.

#### 4.4.2.3. Multivariate Normality –

To check that distribution of scores is normal, it needs to look at the values of Kurtosis and Skewness. The values of skewness and kurtosis should be zero in a normal distribution. Positive values of skewness indicate a pile-up of scores on the left of the distribution, whereas a negative value indicates a flat distribution. The further the value is from zero, the more likely it is that the data are not normally distributed. Both of which have an associated standard error.

Table 12. Normality Test

	N	SKEWNESS		KURTOSIS		
	STAT	STAT	STD.	STAT	STD.	
	181	-1.131	.181	.355	.359	
Compliance						



Source, Own Survey, 2023

As shown in Table 12, all the four internal audit control and risk mitigation dimensions' z-scores skewed to the right side and were found to be within an acceptable range (skewness within -2.0 to 2.0; and Kurtosis within -2.0 to 2.0). Therefore, it is pretty clear then that the numeracy scores are negatively skewed, indicating a pile-up of scores on the right of the distribution.

#### 4.4.2.4. Linearity –

The linearity assumption can easily be checked using scatterplots or residual plots: plots of the residuals vs. either the predicted values of the dependent variable or against (one of) the independent variables. The scatter plots of standardized residuals versus the fitted values for the regression models were visually inspected from figure 3.

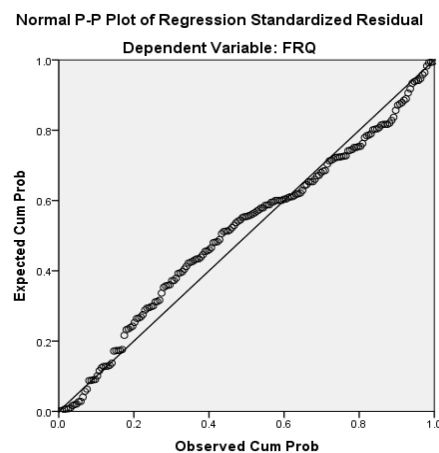


Figure 3. Linearity Test

#### 4.4.3. Regression Analysis

Multiple regression analysis in this research was used to model the value of the construct variable (financial reporting quality) based on its linear relationship to two or more predictors (audit standard compliance, auditor independence, auditor professional competency, internal control system and risk mitigation). In order to indicate the impact that each predictor has on the construct variable, the unstandardized coefficients are checked. In this regard, to address the objectives of this study, three regression analyses are conducted. These analyses are:

*The effect of internal audit control practices on financial reporting quality (Direct Relationship)*

Table 13. Model Summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.781 <sup>a</sup>	.611	.600	.56148

a. Predictors: (Constant), RISK, CONT, COMP, AUTO, STND

As indicated in the model summary of the analysis on Table 13, the value of  $R^2 = .611$  indicated relations of the four independent variables with the dependent one which are accounted for approximately 61.1% ( $R^2$ ) of the variation in financial reporting quality. However, the remaining percent (38.9%) was explained by other variables not included in this study.

Table 14. ANOVA Analysis

ANOVA <sup>a</sup>						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	86.524	5	17.305	54.890	.000 <sup>b</sup>
	Residual	55.171	175	.315		
	Total	141.694	180			

a. Dependent Variable: Financial Reporting Quality

b. Predictors: (Constant), RISK, CONT, COMP, AUTO, STND

As indicated in Table -14 of ANOVA test, F value of 54.890 is significant at  $p < 0.001$ . Therefore, it can be inferred that with 61.1% ( $R^2$ ) of variance, internal audit control is significant and the model appropriately measured the dependent variables – Financial reporting quality. In short, the regression



model predicts financial reporting quality, and has been significantly explained by the four independent variables of internal audit control.

Table 15. Estimated Regression Coefficients

Coefficients <sup>a</sup>					
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	.435	.212		2.051	.042
Audit Standard Compliance	.149	.041	.189	3.644	.000
Auditor Independence	.234	.043	.290	5.420	.000
Auditor Professional Competency	.101	.041	.129	2.461	.015
Internal Control System	.152	.044	.192	3.428	.001
Risk Mitigation	.265	.043	.335	6.188	.000

a. Dependent Variable: Financial Reporting Quality

The regression analysis show that all internal audit control dimensions have positive and significant effect on financial reporting quality. Referring Table 15, the aggregate effect of the internal audit control on financial reporting quality is explained as:

$$FRQ = .435 + .189 STND + .290 AUTO + .129 COMP + .192 CONT + .335 RISK$$

Where:

FRQ = Overall Financial Information Quality;      STND = Standard compliance;  
 AUTO = Auditor autonomy;      COMP = Staff Competence;  
 CONT = Internal Control System;      RISK = Risk Mitigation

Table 15 presents the estimated regression coefficients derived from an analysis aimed at exploring the relationship between internal audit control and financial reporting quality. The table elucidates both unstandardized and standardized coefficients, alongside their respective standard errors, t-values, and significance levels (Sig.), signifying the effect of various factors on the dependent variable of interest, which is financial reporting quality. More specifically:

- Notably, the constant term is estimated at 0.435 with a p-value of 0.042, indicating its statistical significance at the 5% level.
- Among the independent variables, 'Risk Mitigation' exhibits the highest unstandardized coefficient of 0.265, accompanied by a striking t-value of 6.188 and a p-value of 0.000, thus suggesting that effective risk mitigation strategies substantially enhance the quality of financial reporting. Furthermore,
- 'Auditor Independence' (B = 0.234, Sig. = 0.000) and 'Audit Standard Compliance' (B = 0.149, Sig. = 0.000) also emerge as statistically significant contributors, highlighting the importance of auditor autonomy and adherence to established auditing standards.
- Other significant factors include 'Internal Control System' (B = 0.152, Sig. = 0.001) and 'Auditor Professional Competency' (B = 0.101, Sig. = 0.015), which, though less influential than risk mitigation and auditor independence, still represent critical components in enhancing financial reporting quality.
- The standardized beta coefficients further enlighten this analysis, with 'Risk Mitigation' (Beta = 0.335) and 'Auditor Independence' (Beta = 0.290) revealing robust relationships, thus reinforcing the assertion that focus on these areas is imperative for improving financial reporting standards in practice.

Overall, the findings underscore the multifaceted internal audit control practices influencing financial reporting quality, advocating for a strategic emphasis on auditor independence, compliance with audit standards, and the establishment of effective internal control systems as key drivers of enhanced financial disclosure practices.

## 4.5. Discussion

In recent years, the quality of financial reporting has gained increasing attention from both academics and practitioners, highlighting its pivotal role in ensuring the transparency and reliability of financial information. The results illustrate the findings from a regression analysis purposed to identify the relationship between internal audit control and financial reporting quality. Central to this discussion are the estimated regression coefficients, their statistical significance, and the implications they bear for further research and practice in the field of accounting and auditing. Regarding the key findings from the regression analysis, the study identifies several critical factors related to internal audit control influencing financial reporting quality, with a particular emphasis on risk mitigation, auditor independence, audit standard compliance, internal control systems, and auditor professional competency.

Among the independent variables of internal audit control practices at the MFIs in Addis Ababa, risk mitigation emerges as the most influential factor, reflected by an unstandardized coefficient of 0.265 and a remarkable t-value of 6.188 (p-value = 0.000). This suggests that organizations employing effective risk mitigation strategies can substantially enhance the quality of their financial reports. The findings underscore the relevance of risk management frameworks that not only address potential financial misstatements but also enhance stakeholders' confidence. Moreover, the emphasis on risk mitigation strategies aligns with the works of Mikes (2009) and the risk management literature which suggests that organizations that proactively adopt risk management practices tend to exhibit higher levels of performance and reporting quality. This interrelationship underscores the growing necessity for organizations to integrate risk management into their financial reporting processes.

Auditor independence trails closely with a coefficient of 0.234 and a significance level of  $p = 0.000$ . This result aligns with established literature that posits auditor independence as a crucial component of credible financial reporting (DeAngelo, 2018; Beasley, 2019). This study's findings resonate with prior research that emphasizes the interrelatedness of auditor independence and financial reporting quality. For instance, Abbott (2023) conducted a study demonstrating that strong auditor independence improves the credibility of earnings reports, thereby enhancing the relevance and reliability of financial information. Their findings bolster the argument that auditor independence is not merely a regulatory requirement but a fundamental requisite for high-quality financial reporting.

The assertion that independent auditors are less likely to succumb to conflicts of interest reinforces the necessity of maintaining autonomy as a means of preserving the integrity of financial statements. Similarly, audit standard compliance demonstrates significant impact with a coefficient of 0.149 and  $p = 0.000$ , emphasizing the vital role of adherence to the established standards in enhancing financial reporting quality. This finding coincides with prior research indicating that compliance with auditing standards fosters a disciplined approach to auditing that directly correlates to the reliability of financial disclosures (Carcello, 2022). Additionally, research by Knechel (2023) highlights how adherence to auditing standards leads to improved audit quality and subsequently higher integrity in financial reporting. The relevance of audit standard compliance as delineated in this analysis aligns with their assertions about the necessity of structured audit frameworks for delivering superior financial statement assurance.

Other noteworthy factors include internal control systems ( $B = 0.152$ ,  $\text{Sig.} = 0.001$ ) and auditor professional competency ( $B = 0.101$ ,  $\text{Sig.} = 0.015$ ), indicating their contribution, albeit to a lesser extent compared to risk mitigation and auditor independence. The internal control system's role has been widely documented, with studies showcasing that robust internal controls not only help in accurate financial reporting but also mitigate risks of error and fraud (COSO, 2013). In examining the role of internal controls, the findings of the presented study correlate with the work of Cohen (2018), who argue that effective internal control systems are essential for managing risks associated with financial reporting. Their findings emphasize that the probabilistic identification of control weaknesses can lead to significant lapses in financial report integrity. This perspective aligns seamlessly with the presented results that underscore the internal control system's significance.

In conclusion, the results of the findings shed light on the multifaceted determinants of financial reporting quality, advocating for a strategic emphasis on critical areas related to internal audit control practices such as auditor independence, compliance with auditing standards, staff competency, risk mitigation and the establishment of effective internal control systems. By situating these findings within the broader context of existing research, it becomes clear that enhancing financial reporting quality is not merely a matter of regulatory compliance but a multidimensional approach involving various stakeholders. Future studies should continue to explore these relationships to ensure the ongoing improvement of financial reporting practices and integrity, thereby fostering greater stakeholder trust and market stability.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

This chapter presents a summary of the major findings, conclusions based on the findings, and recommendations based on the conclusions. It ends with suggested areas for further improvement.

#### **5.1. Summary of Major Findings**

Based on the results of the analysis, the findings of this research have been summarized as follows:

- Inefficiencies related to regularity of management reviews on compliance with laws and regulations (mean = 3.61) and effectiveness of communication regarding audit findings based on the standards (mean = 3.86) are evidenced.
- The results indicate that there is restricted access to financial records (mean 3.29) and potential threats to auditor's independence (mean 3.23).
- Besides, management interference (mean 3.30) and auditors' report of unfavorable findings without fear of retaliation (mean 3.47) are also evidence.
- Lack of regular assessment on employee competency through performance evaluations (mean of 3.05). Moreover, current recruitment approach couldn't sufficiently attract qualified candidates (mean 3.34).
- The assessment of periodic and continuous evaluations on the effectiveness of the internal control system are perceived weak (mean 2.98).
- Lack of regular updating of risk management strategies based on internal audit findings (mean 3.46) highlights a potential area for improvement in the adaptability of the strategies to emerging risks.
- Lack of employee encouragement for reporting financial related risks without fear (mean = 3.51) is also evidenced.

## **5.2. Conclusion**

The effectiveness of internal audit control practices plays a pivotal role in enhancing the quality of financial reporting, particularly within the context of Microfinance Institutions (MFIs) in Ethiopia. As this analysis illustrates, several key components like compliance with established standards, the autonomy of auditors, the competency of staff, the effectiveness of internal control systems, and the implementation of risk mitigation strategies, are interdependent elements that collectively contribute to improved financial reporting outcomes.

Compliance with standards is foundational; it ensures that MFIs operate within a framework that enhances accountability and transparency. When these organizations adhere to international and local regulatory requirements, the credibility of their financial statements is significantly bolstered. Moreover, auditor autonomy is critical, as it empowers internal auditors to act without undue influence, allowing them to objectively assess the financial reporting processes and highlight any inaccuracies or risks that may threaten the integrity of the financial information.

Equally important is staff competency, which directly influences the quality of the audit function. Well-trained personnel are better equipped to identify potential discrepancies and implement effective controls, leading to more reliable financial reporting. Furthermore, a robust internal control system serves as a structural backbone, ensuring processes are in place to detect and rectify errors promptly. This results in a greater level of assurance regarding the accuracy of financial information provided to stakeholders. Moreover, the adoption of risk mitigation strategies aids MFIs in navigating uncertainties and challenges that may arise in their operations. By proactively addressing potential risks, these institutions can safeguard their financial reporting processes from anomalies that could misinform stakeholders and compromise the institution's reputation.

In conclusion, the relationship between internal audit control practices and financial reporting quality among MFIs in Ethiopia is both substantial and multifaceted. Strengthening these practices will not only reinforce the reliability of financial reports but also fortify the overall governance framework of MFIs. As these institutions continue to evolve and respond to the dynamic economic landscape, prioritizing robust internal audit mechanisms will be essential in fostering trust and stability in the microfinance sector. Emphasizing these areas will ultimately contribute to the enhanced sustainability of MFIs and the development of a more inclusive financial ecosystem in Ethiopia.

### **5.3. Recommendations**

Based on the identified inefficiencies and concerns within the organizational framework, several recommendations are proposed to enhance compliance, communication, and overall effectiveness.

- First, it is advisable for upper management to establish a structured schedule for regular management reviews focused on compliance with laws and regulations. This should coincide with strategies to improve communication regarding audit findings, addressing the effectiveness.
- Furthermore, the finance department should ensure that access to financial records is improved, as restricted access may jeopardize transparency and accountability.
- To preserve auditor independence, an independent oversight committee should be established to mitigate management interference and to encourage auditors to report unfavorable findings without fear of retaliation.
- Additionally, human resources should implement regular performance evaluations to assess employee competency and enhance recruitment strategies to attract qualified candidates.
- Revising the assessment criteria for the internal control system, which currently appears weak, alongside establishing more dynamic risk management strategies based on internal audit findings, could significantly improve adaptability to emerging risks.
- Lastly, fostering an organizational culture that encourages employees to report financial risks without fear should be prioritized, ensuring robust mechanisms are in place to support whistleblowing and enhance overall risk management.

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## Appendices

### STAINT MARY’S UNIVERSITY SCHOOL OF POSTGRADUATE STUDIES

#### *Survey Questionnaire to be filled by staff selected microfinance institutes*

**Dear Respondent,**

My name is Hiwot Mengesha, a graduating class of St. Mary’s University. I am currently conducting my research entitled “The effect of internal audit control on financial reporting quality: the case of selected microfinance enterprises in Addis Ababa” for partial fulfillment of the requirements for the master’s degree in finance and accounting.

The purpose of the study is to investigate how internal audit control mechanisms influences the quality of financial reporting within microfinance institutions in Addis Ababa. The study aims to assess the effectiveness of internal audit controls in ensuring accurate and reliable financial reporting. Identify best practices and potential areas for improvement in the internal audit processes of microfinance enterprises helps prepare reliable, credible, verifiable, understandable and comparability of the financial statements prepared by the microfinance institutions. It also provides empirical evidence to support the development of policies and strategies that can improve financial reporting standards and transparency in the microfinance sector.

Please, you are kindly requested to be honest in filling out this questionnaire as the results of this study can be used as a basis for further study. Your confidentiality will be protected and any information collected in this study will be granted full confidentiality. Please don’t hesitate to contact me if you have any doubts or suggestions regarding the content and the subject matter as well.

***Thank you for your valuable time in advance!***

***My good contact no. is:***

***Name- Hiwot Mengesha; Mobile- 0911371841***

## General Information

Your Participation is Voluntary.

Do not write your name on the Questionnaire.

### I. Demographic Profile of Respondents

Direction: The following statements are about your personal information. Please write the necessary information on the blank space provided and, in the optional items, indicate your answer by putting a tick mark (x) in the box.

1. Sex ☐ Female ☐ Male
2. Age (years old) ☐ 21 - 30 ☐ 31 – 40 ☐ 41 - 50 ☐ 51 - 60
3. Education ☐ Diploma ☐ Degree ☐ Masters & above  
☐ Other, please specify\_\_\_\_\_
4. Department ☐ Finance ☐ Board Member ☐ Audit
5. Position ☐ Director ☐ Manager ☐ Auditor ☐ Accountant  
☐ Other, please specify\_\_\_\_\_
6. Experience ☐ 1 – 5 years ☐ 6 – 10 years ☐ over 10 years

### Part II. Study Questions related to Internal Audit Control and Financial Reporting Quality

Please read each statement carefully and show your level of agreement on the statements by putting the “X” mark in the boxes using the following Key:

Strongly Disagree (1)	Disagree (2)	Neutral (3)	Agree (4)	Strongly Agree (5)
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Aspect	Statement	(1)	(2)	(3)	(4)	(5)
Standard Compliance	The organization consistently adheres to regulatory standards in its internal audit processes.					
	Internal audit controls are aligned with established financial reporting guidelines and frameworks.					

	There is a clear procedure in place for ensuring compliance with accounting standards during financial reporting.					
	The internal audit department regularly reviews compliance with laws and regulations governing financial practices.					
	Audit findings are effectively communicated based on these standards.					
	Compliance with internal or external standards is prioritized by management in the audit process.					
<b>Auditor Autonomy</b>	Auditors in the organization operate with a significant degree of independence from management.					
	The internal audit function has unrestricted access to all necessary financial records and personnel.					
	There are no undue pressures on auditors to overlook or alter findings in internal audit reports.					
	The reporting structure allows auditors to communicate openly with the board without interference from management.					
	Auditors feel empowered to perform their roles without fear of retaliation for unfavorable findings.					
	Independence issues are promptly addressed and mitigated.					
<b>Staff Competence</b>	The internal audit staff members possess the necessary qualifications and expertise to conduct rigorous audits.					
	Ongoing training programs are in place to enhance the skills and knowledge of the internal audit team.					
	The organization actively recruits skilled professionals for its internal audit function.					
	There is a culture of continuous improvement among the internal audit staff, fostering professional development.					
	The competency of the internal audit team is regularly assessed and addressed through performance evaluations.					



<b>Risk Mitigation</b>	The internal audit function effectively identifies and assesses potential risks that could impact financial reporting.					
	There are clear procedures in place for addressing and mitigating identified risks within financial operations.					
	Internal audits are conducted with a strong focus on evaluating risk management processes in financial reporting.					
	The organization regularly updates its risk management strategies based on findings from internal audits.					
	Employees are encouraged to report potential risks without fear, contributing to proactive risk management.					
<b>Control System</b>	The internal control system is comprehensive and effectively supports accurate financial reporting.					
	There are documented procedures for the execution of financial transactions that enhance transparency.					
	Regular assessments are conducted to evaluate the effectiveness of the internal control system.					
	The organization prioritizes the improvement of its internal control mechanisms based on audit outcomes.					
	Management actively supports and enhances the internal control framework to ensure financial integrity.					
<b>Financial Reporting Quality</b>	The financial statements are prepared accurately/transparently.					
	Adequate disclosures are made in financial statements.					
	Financial reporting complies with relevant accounting standards.					
	Internal controls support reliable financial reporting.					
	Financial reporting undergoes independent review or audit.					