

# Dimensions of Internal Audit Quality and Performance of Local Governments in Nigeria

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## Abstract

The study examined the influence of the dimensions of internal audit quality on the performance of local governments in Nigeria. A total of 301 heads of internal audit unit of Nigeria local governments responded to the survey. Robust regression analysis was conducted using the Stata software and the results show that internal audit competence, training and development, organizational independence, and management support for internal audit had significant positive relationship with local government performance while internal audit quality of work performed, though positive, had no significant relationship with local government performance in Nigeria. Furthermore, management support towards internal audit had more influence on local government performance. Therefore a commitment on the part of local government administrators towards strengthening the quality of internal audit will contribute more towards remedying some performance failures currently being faced.

**Keywords:** internal audit, internal audit quality dimensions, local government, local government performance

## 1. Introduction

Local governments are the closest tier of government to the people and are important for the development of society. Local governments are recognized as structures through which leadership delivers on its mandate for community and social development (Schoburgh, 2012). Local governments serve to ease the conduct of government activities and ensure adequate representation of communities by reducing emphasis on central government. An estimated 53 percent of the Nigeria's population of 177.5 million lives in rural areas (World Bank, 2014). This indeed saddles the local government with an enormous task of ensuring resources are judiciously managed to maximize value for the citizens. In Nigeria, local governments occupy the third tier of government established for speedy development of communities through providing essential services that other tiers of government may not undertake effectively (Lawal & Oladunjoye, 2010). Local governments provide services such as sanitation, education, community health care, security and other basic amenities that impact the lives of the community. Reported issues on account of the 2008 recession include political and financial pressures, fiscal stress, budget cuts, increasing challenges at providing services, rising demand for services, changes in local government employment relationships, negative perception of government and its employees, including insider threats (Hilvert & Swindell, 2013; Levine & Scorsone, 2011; Perlman, 2014). At the country level, Nigerian local governments face a wide range of issues as reported by academics and the media: severe poverty in rural areas as 80 percent live below poverty line, social services and infrastructure are limited (International Fund for Agricultural Development [IFAD], 2016), seemingly inadequate resources (Oviasuyi, Idada, & Isiraojie, 2010), mismanagement, reckless spending, corruption (Lawal & Oladunjoye, 2010), and are far from producing their intended outcome for community wellbeing. Olusola's (2011) study of some local government councils reported a worsening dependence on upper tier government for funding as these councils were unable to generate up to 10 percent of their budgeted revenue. Given these performance failures, provision of basic services by local governments in Nigeria is a challenge. Consequently, the present administration of local government is regarded as ineffective and inefficient and limited in delivering on its mandate to communities (Oviasuyi et al., 2010).

Successive political administrators have had their turns, each promising bogus policies and project implementation, yet citizens barely experience even the basic amenities needed as rural poverty is on the rise. Local governments fortunes keep dwindling and majority depend heavily on federally allocated revenue for

survival. Little wonder the fall in the country's revenue arising from the drop in crude oil price and sales saw a widespread inability of local governments to meet recurrent expenditure. It is important to note that local government administration is guided by mechanisms of controls expected to ensure citizens get the most out of government programmes. One of such control mechanisms is the setting up of internal audit unit in all local governments as a statutory requirement. Internal audit serves as the first line of defense against opportunistic behaviours of administrators. However, local governments in Nigeria are still regarded as inefficient in meeting the needs of communities due to widespread governance failures (Oviasuyi et al., 2010). Given these widespread governance failures, we question the effectiveness of existing mechanisms of control in the local government particularly, the internal audit. What impact do the dimensions of internal audit quality have on local government performance?

The internal audit function has been acknowledged as a value-adding function to an organization because of its unique role in governance, control, and risk management (Soh & Martinov-Bennie, 2011). Specifically, the internal audit functions has been acknowledged to reduce risks, improve control risks, minimize external monitoring cost, minimize earnings management, moderate fraud risks, reduce opportunistic behaviours and perform other non-financial statement related task within an organization (Ege, 2015; Prawitt, Smith, & Wood, 2009). Also, the quality of the internal audit is capable of ensuring sound governance and accountability in the public sector (Lapointe, 2008). Internal audit, working under the right conditions and supported by top management who is committed, can help the local government achieve goals that impact the lives of communities. The internal audit quality includes competence, independence, quality of work, training and development, and management support for internal audit. These quality dimensions include specific characteristics the external auditor seeks in placing a reliance on the work of the internal auditor (Reinstein, Lander, & Gavin, 1994). From the resource base view, internal audit is a valuable resource to an organization and its contribution to organizational processes can enhance overall performance. However, evidence of this value-adding role is yet to impact on the performance of local governments in Nigeria. This study aims at examining the various dimensions of internal audit quality and their influence on the performance of local government in Nigeria. Also, the study seeks to answer the question on which of the dimensions of internal audit quality is most critical to internal audit contribution to local government performance in Nigeria. The remaining part of the article includes literature review, methodology and results, discussion of findings and conclusion.

## **2. Literature Review and Hypotheses Development**

### *2.1 Local Government Performance*

Public sector performance has attracted diverse attention especially in the wake of the new public management paradigm. Increasingly, public sector organizations are encouraged to improve and publish information about their performance by imbibing management practices in the private sector (Hoque, 2008). Several indicators have been developed to assess performance in the public sector as reported in the literature (Pilcher, 2005). Assessing public sector performance is complex because goals and objectives are geared towards providing benefits citizens and stakeholders as against profits for a few shareholders as found in the private sector. Also, making a comparison in the public sector is difficult as goals are often ambiguous and meant to serve multiple stakeholders who make varying demands for services (Boschken, 1994). However, in evaluating performance in the public sector, institutional context is equally important. For example, public sector organizations are influenced by rules and regulations which vary according to context and must be adhered to. These have far reaching influences on how they perform. Given the diverse group of stakeholders with divergent interests, multiple goals and objectives which could be sometimes ambiguous and conflicting, assessing organizational performance in the local government would depend on which goals, whose perspective is being studied and what dimensions to focused on (Walker, Damanpour, & Devece, 2010). Organizational performance in the public sector is often associated with concepts of accountability, efficiency, effectiveness, fiscal health, revenue autonomy, consumer satisfaction, fiscal strength, responsiveness, quality of service, and financial performance (Carmeli & Tishler, 2004; Walker & Boyne, 2006). Given the diverse concept of performance, authors operationalized the concept based on their focus. Performance reflects an organization's ability to achieve set goals (Rainey & Steinbauer, 1999). These goals could relate to financial or non-financial aspects of the organization where improvement is needed. Furthermore, several factors have been documented as critical to public sector performance. Boyne (2003) identified resources, management, regulation, markets, and organization as factors influencing public sector performance. In terms of resources, internal audit quality is a valuable factor for organizational health and progress. In view of the above, internal audit has been acknowledged as a value-adding factor to an organization with potentials of providing the needed platform for enhanced organizational performance. Also, the quality of the internal audit function is more critical to

organizational performance than its mere existence as a department. This is particularly important in the Nigerian local government where the financial regulations require the setting up of the internal audit function in every government agency across the three tiers of government. However, local governments in Nigeria are yet to benefit from the value-adding role of internal audit which should translate to improved organization processes. Hence, the quality of internal audit is a necessity and what dimensions of internal audit quality are most critical to its contribution to organizational improvement is important.

## *2.2 Internal Audit Quality and Performance*

The internal audit quality minimizes risks, improves control issues, reduces external monitoring cost, reduces earnings management, mitigates fraud risks and minimizes other opportunistic behaviours within an organization (Ege, 2015; Prawitt et al., 2009). However, Davidson, Goodwin-Stewart, and Kent (2005) found no evidence that the presence of internal audit could be associated with lower earnings management. Also, Ege (2015) suggest that if managers have control over internal audit quality, opportunistic behaviours can go on unabated. This implies that an organization may have an internal audit function, yet opportunistic behaviours may not be curtailed especially where aspects of the function can be contained by management. Most studies on the internal audit quality focused on the various aspect of an organization and were done in the private sector and few have delved into the subject in the Nigerian context. For example, Onatuyeh and Aniefor (2013) examined the role of effective internal audit in the management and accountability of the public sector using 245 respondents from audit departments of ministries and government agencies in Edo state in Nigeria. Although their study found some evidence that effective internal audit promotes accountability, their measure of effective internal audit leaves much to be desired as no reliability or previous test of their instrument was reported. Also, the analysis was merely descriptive as no relationship was tested. Similarly, a study by Ebimobowei and Kereotu (2011) in two southern states of Nigeria using 96 internal auditors in state ministries found widespread governance failures resulting from internal audit not performing its role. Their study ignored the quality of internal audit in arriving at their conclusion as the quality of internal audit is important both for role performance and contribution to organizational performance. Baltaci and Yilmaz (2006) acknowledged the limited number of studies on internal audit in the public sector especially at the local government level and called for more research. Furthermore, a close look at internal audit quality shows the similarity of the concept with that of internal audit effectiveness. Internal audit quality has been defined variously by researchers (Reinstein et al., 1994; Prawitt et al., 2009). According to the Institute of Internal Auditors (2012), measures of internal audit quality includes competence, objectivity, independence and integrity, and work performance. These measures are important factors in internal audit playing a significant role in governance, control, and risk management. In addition to these, internal audit training and development and management support towards internal audit are important factors in the quality of the function. Thus, these factors can have far-reaching influence on the performance of local governments in Nigeria.

### *2.2.1 Competence and Quality of Work Performed*

A study of an organization's most influential factors on the quality of information system ranked the competence of the internal auditor as paramount while independence was least (Wright & Capps III, 2012). In another study, internal audit quality was found to be significantly related to negative abnormal accruals, indicating that internal audit quality may help minimize opportunistic behaviour and reduce earnings management within an organization (Prawitt et al., 2009). Competence indicates the educational qualifications, professional certification and professional experience of internal audit staff (Zain, Subramaniam, & Stewart, 2006). It also indicates possession of the required knowledge and experience for the job. The knowledge includes a thorough grab of the operations of an organization. The more competent the internal audit, the more likely the function can assess factors which indicate management bias or risks of opportunism and serve as safeguards to mitigate the threat (Prawitt et al., 2009). Competence affects the quality of work of internal auditors. Hence, the quality of output of internal auditors affects organizational processes and how the function is perceived within the organization. Thus, the following hypotheses are put forward:

Hypothesis 1: Internal audit competence is positively related to local government performance

Hypothesis 2: Internal audit quality of work performed is positively related to local government performance

### *2.2.2 Organizational Independence*

Independence relates to internal auditors ability to undertake audits without any form of impediments and in a manner that is free of all forms of bias (Institute of Internal Auditors, 2012). This can be achieved through unrestricted access to all areas of review selected by internal audit. Objectivity describes internal audit maintaining an attitude devoid of any form of bias. Internal auditor's independence and objectivity are crucial

elements in portraying the function as effective and allow the execution of their roles in a manner that enables the organization to achieve its objectives (Christopher, Sarens, & Leung, 2009). Stewart and Subramaniam (2010) summarized independence as "state of affairs" and objectivity as "state of mind" which enables the internal auditor act in an unbiased attitude in the discharge of duties (p. 330). Internal auditors in Nigerian local governments face some potential threats to their independence and objectivity especially because they are employees and their recruitment and subsequent deployment are done in line with civil service rules. The Civil Service Commission is responsible for employment and transfers and this has a potential impact on internal audit status within the organization. Arena, Arnaboldi, and Azzone (2006), in a multiple case study of six companies in Italy, found two of the six companies studied used the internal audit as training ground and management sees nothing wrong. Similar findings were reported by Sarens and De Beelde (2006). In terms of transfers, a study of 34 chief audit executives in Australia found that internal audit staff was frequently transferred out to higher positions of management and in most of the reported cases staff spent less than a year in internal audit (Christopher et al., 2009). A similar situation applies to internal auditors in the of local government as local government civil service commission in Nigeria often transferred internal auditors out to occupy other functions outside audit. This has severe implications on the objectivity and independence of the internal audit function as Chadwick (1995) suggest that the internal auditor may not take a firm stand on critical issues in a bid to maintain relationships that can be rewarding to his future career. Although the Financial Memoranda (1999) for local governments in Nigeria provides for the chief internal auditor's reporting directly to the local government Chair, yet reservations have been expressed regarding internal audit independence and objectivity. Onatuyeh and Aniefor (2013) argue that internal auditors in the Nigerian public sector may not always be objective and independent because of the prescribed reporting relationship to council chairmen who are elected persons with varying interest and are subject to a wide range of interference. However, internal audit organizational independence is important to enable the function to contribute to the performance of an organization. Therefore, we posit that:

Hypothesis 3: Internal audit organizational independence is positively related to local government performance.

### 2.2.3 Training and Development

Effective organizations regularly invest on the training of employees while others see such an effort as costly with no value added (Ubeda-Garcia, Marco-Lajara, Sabater-Sempere, & Garcia-Lillo, 2010). However, the importance of training employees is echoed by researchers and practitioners and has been acknowledged as helping employees perform better in their jobs. For example, regular training enables employees to keep abreast with new developments and further translates to better performance on the job (Pickett, 2000). The Institute of Internal Auditors (2009) recognizes the hours spent on training of internal audit staff as an important index of internal audit quality. By implication, training and retraining internal auditors can improve their skills and enhance their quality of work which in turn contributes to organizational performance. One main study to have examined the relationship between internal audit training and development and internal audit effectiveness were those of Cohen and Sayag (2010). They sampled internal auditors and general managers of 108 Israeli private and public sector organizations. Their result showed no significant relations between internal audit training and development and internal audit effectiveness. This finding was surprising as training can impact positively on work performance. However, they concluded that management factors were more critical in internal audit training and development. This implies that management commitment is imperative in training and developing internal auditors for maximum contribution to performance. Ege (2015) asserts that managers may commit more misconduct where they can restrain the quality of internal audit. Internal audit quality can be controlled by restricting the exposure of the function to important trainings that strengthen their skills and abilities to curb opportunistic behaviours. Thus, training and avenues for self-development of internal auditors can help minimize opportunistic behaviours and help the local government perform better through minimizing waste and leakages. Therefore, training and development can enable internal audit function to contribute meaningfully to the performance of an organization. From the above discussion, we posit that:

Hypothesis 4: Internal audit training and development is positively related to local government performance.

### 2.2.4 Management Support for Internal Audit

Management support is important for internal audit's role in governance, control and risk management as these impacts organizational processes. Low support for internal audit in the public sector was reported in a study of internal audit function in South African public sector (Schyf, 2000). The study suggests that the perception of internal audit function in an organization depends on the support the function receives from top management, appreciation of internal audit role by other organizational participants, funding, understanding regulations

governing internal audit activities, and level of overlap between internal and external audit. In summary, the organizational context where an internal auditor operates determines how effective internal audit activities would contribute to the performance of the Organization (Okike, 2004). An organizational context represents an atmosphere created by top management to portray the internal audit function as an important activity whose recommendations and suggestions are treated promptly in the overall interest of the organization. Top management support of internal audit positions the function for better effectiveness (Cohen & Sayag, 2010). Also, top management support sets the ethical tone in an organization and sets the stage for internal audit function to contribute to the performance of the organization (Schwartz, Dunfee, & Kline, 2005). Top management support is pervasive as it includes funding, training and development, staffing and implementation of internal audit findings and recommendations (Cohen & Sayag, 2010; Mihret & Yismaw, 2007). Therefore, we posit that:

Hypothesis 5: Management support for internal audit is positively related to local government performance

### 3. Methods

#### 3.1 Instruments

All variables of this research were derived from previous studies. Questionnaire items measuring local government performance, internal audit competence, quality of work performed, organizational independence, training and development, and management support towards internal audit were derived from previous studies. Items measuring the dimensions of internal audit quality were adapted from the works of Ahmad (2013) and Cohen and Sayag (2010). Items measuring local government performance were adapted from Brewer (2006) and Maher and Deller (2011). Responses were based on a five-point Likert scale ranging from "strongly disagree" (1) to "strongly agree" (5). All the variables had reliability ranging between .679 and .838 which falls within the acceptable range (Hair, Black, Babin, & Anderson, 2010). Out of the 600 questionnaires mailed to internal auditors of local governments in Nigeria, 323 were returned while 301 were retained for further analysis. Demographic characteristics of the respondents and the descriptive statistics for the variables on the questionnaire are presented on Table 1 and Table 2 respectively.

Table 1. Descriptive statistics

Variables	Mean	SD	Skewness	Kurtosis
Competence	4.054	.886	-1.575	2.659
Training and Development	2.708	.968	.206	-.821
Management support towards internal audit	3.491	.913	-.693	-.098
Organizational independence	3.579	1.028	-.650	-.444
Quality of work performed	3.64	.814	-.920	.522
Performance	2.752	.747	.457	-.138

Table 2. Demographic characteristics of respondents

Item	Details	Frequency	Percentage (%)
Reporting level of internal auditor	Chairman of Council	297	98.7
	Others	4	1.3
	Total	301	100
Work experience in internal audit	1-5 years	142	47.2
	5-10 years	108	35.9
	Over 10 years	40	13.3
	Missing	11	3.6
	Total	301	100
Academic major	Accounting/ Auditing	223	74.09
	Finance/Economics	65	21.59
	Others	12	3.99
	Missing	1	.33
	Total	301	100

Professional qualification	Certified Accountant	189	62.8
	None	82	27.2
	Missing	30	10
	Total	301	100

#### 4. Results

Given that the distributions of the data for this study were heavily skewed, the robust regression analysis was used for further analysis. Robust regression addresses issues bordering on non-normality of data due to highly skewed distributions which affect the assumption of homogeneity of variance (Erceg-Hurn & Mirosevich, 2008). According to Hair et al. (2010), violations of normality assumption can have serious effects on sample sizes 50 or less but the effect is diminished for samples above 200. Furthermore, Hair et al. (2010) suggest that remedying normality is required for equality of variance especially with large sample sizes above 200. Furthermore, correlation analysis was performed and the results show that all variables are positively correlated with local government performance. Multicollinearity was not a problem as the correlation results showed that none of the variables had a correlation up to .80 (Hair et al., 2010). The correlation result is presented on Table 3.

Table 3. Correlation analysis

Variable	LG PERF	COMP	TRADEV	MSIA	ORGIND	IAQWK
LG PERF	1					
COMP	.135*	1				
TRADEV	.232*	.080	1			
MSIA	.428*	.443*	.295*	1		
ORGIND	.293*	.438*	.158*	.528*	1	
IAQWK	.271*	.574*	.237*	.586*	.465*	1

Note: LG PERF = local government performance, COMP = competence, TRADEV = training and development, MSIA = management support towards internal audit, ORGIND = organizational independence, IAQWK = internal audit quality of work. Correlation is significant at  $p < .05$

Furthermore, the robust regression result shows that internal audit competence, training and development, management support towards internal audit, and organizational independence were positively and significantly related to local government performance. However, internal audit quality of work, though positive was not significantly related to performance. Also, the results show that the most critical aspect of internal audit quality dimension to local government performance is management support towards internal audit. Thus, hypothesis H1, H3, H4, and H5 were supported while H2 was not supported. The robust regression results are shown on Table 4.

Table 4. Robust regression results

Hypothesis	Variables	Beta Coefficient	Standard Error	t-statistics	p-value	Remarks
H1	COMP	.358	.053	1.72	.086*	Supported
H2	IAQWK	.045	.059	.690	.488	Not supported
H3	ORGIND	.106	.047	1.77	.078*	Supported
H4	TRADEV	.113	.048	1.71	.088*	Supported
H5	MSIA	.108	.059	4.95	.000**	Supported
	R <sup>2</sup>					.209
	F					17.62**
	n					301

Note: LG PERF = local government performance, COMP = competence, TRADEV = training and development, MSIA = management support towards internal audit, ORGIND = organizational independence, IAQWK = internal audit quality of work. \*  $P < .10$ ; \*\*  $P < .001$ .

## 5. Discussion and Conclusion

From the results of the analysis, it can be concluded that the dimensions of internal audit quality have an impact on the performance of local governments. Although, this is the first to test the dimensions of internal audit quality against performance in the public sector, the results are consistent with similar researches in both private sector and public sector (Aikins, 2011; Ali et al., 2012; Ege, 2015; Prawitt et al., 2009). Similar findings were acknowledged that internal audit competence, organizational independence, and management support towards internal audit were regarded as critical to the effectiveness of internal audit in the public sector (Baharud-din, Shokiyah, & Ibrahim, 2014; Cohen & Sayag, 2010). The results of this study not only affirms this, but shows that the more internal audit is competent, organizationally independent, exposed to training and development, the more likely the function can help improve the performance of an organization. Also, the results demonstrate that management support towards internal audit is central to the quality of the function and its contribution to performance. These findings are consistent with those of Ali et al. (2012) who assert that the more support internal audit receives from management; the more the function can undertake procedures that affect organizational progress. However, internal audit quality of work though positive was not significantly related local government performance. This finding is unexpected as internal audit quality of work is regarded as an important aspect in its value-adding role. However, the result agrees with those of Cohen and Sayag (2010) who found no significant relations between internal audit's quality of work performed and added contribution of internal audit in the public sector but significant in the private sector. This could be due to the nature of the public sector where according to Ali et al. (2012) political administrators resist attempts at exposing their activities to control mechanisms such as internal audit through containment and restricting of their work.

On the whole, the study shows that the dimensions of internal audit quality have a positive impact on performance. A commitment on the part of local government administrators towards strengthening the quality of internal audit will contribute more towards remedying some performance failures currently being faced.

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