



# The Impact of Internal Audit Practices on Financial Management of Local Government Authorities: The Case of Morogoro Municipality in Tanzania

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## Authors' contributions

*This work was carried out in collaboration between both authors. Both authors read and approved the final manuscript.*

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## ABSTRACT

This study intended to explore the impact of internal audit practices on financial management of the Tanzanian LGAs, mainly at Morogoro Municipal. Descriptive and multiple regression analysis were applied on the collected data through survey instrument. Our findings indicate internal audit independence and quality of internal audit work significantly affect financial management in the stated LGAs. On the other hand, internal audit proficiency has no negative insignificant impact on financial management. It is recommended that LGAs should ensure that internal auditors are always equipped with relevant audit experience to enable them carry out their activities with confidence. Also, independence of internal auditors in Tanzanian LGAs must be significantly emphasized in order to ensure effective operations and management of public resources. Since our study concentrated only in one Municipal Council (Morogoro Municipality), it is recommended that future studies should consider the remaining Municipals in Tanzania. Moreover, consideration of qualitative research approach will add more in-depth understanding on how internal audit practices explain effective financial management principles in Tanzania. This can be achieved by applying focus group discussion, interview and other relevant means of data collection apart from survey instrument which is constrained by biasness.

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## 1. INTRODUCTION

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations” [1]. “It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes” (Institute of Internal Auditors, 2018). “Auditing practice is categorized into either internal or external auditing based on circumstances into which it is undertaken” [1]. “In terms of government institutions, internal audit practices helps government organizations to ensure accountability and integrity, improves the execution of government programs and develops a sense of trust and confidence among citizens and various stakeholders in the public interest” [2]. “The core purpose of internal auditing practices is to monitor government revenue collection and expenditure as appropriated by the parliament in order to bring about greater transparency and accountability in the management of public finances” [3]. “Internal audit practice is, therefore, the use and application of knowledge, skills, tools, and mathematic techniques to audit activities to meet audit requirements” [4].

“The current auditing practice started developing from the 19<sup>th</sup> century when auditing came into existence as a separate legal entity” [4]. “The demand of internal audit unit in most African countries increased since its early inception 1930” [5]. “Recently, in Tanzania the importance of internal audit has seen a rapid growth in public sectors to promote good governance by providing objective assessment of whether the public resources are adequately utilized in order to achieve favorable results” [6]. “With a commitment to integrity and accountability, internal auditing practice provides value to governing bodies and senior management as an objective source of independent advice” [4]. “In keeping with these assertions, to accomplish this, internal auditing practices in most local government authorities (LGAs) must function in a manner that is in accordance with applicable professional auditing standards” [1]. “That is, internal auditing practices enhance prudent use of resources, accountability and improve institutional efficiency. Besides, internal audit practice has been recognized as a tool for

ensuring effective working of the internal control system” [5].

Studies have been undertaken on how internal audit practices affect financial management and performance in various organisations. Ondieki [7] in his study focusing on “the effect of internal audit on financial performance of commercial banks in Kenya found out that internal audit standards, independence of internal audit, professional competency and internal control had a positive relationship with financial performance and management of commercial banks”. According to Dogani [1] “the inability to complete the established internal audit effectively is an area of overwhelming concern audit management. From the above studies undertaken no studies have been done on the assessment of internal audit practice in improving financial management in local government authorities (LGAs)”.

The internal auditors must function in a manner that is in accordance with applicable professional standards and the quality of the internal control systems [8]. Internal audit practice is an essential part of the control of public organizations (LGAs being among them) as the main complaint in the sector is that internal audit departments are too understaffed and under resourced to be fully managing and effectively improving finance (Dozie et al., 2018). Yet, the importance of internal audit practice and internal controls are only recognised and emphasized after irregularities are discovered [2]. As the LGAs implement an accrual accounting system and has a good quality financial report, it will have an impact on the quality of public services [5].

Moreover, the concept of internal audit practice in Morogoro municipality has not been fully tapped with regard to human resources, budgetary control, financial accountability and risk management. This could be seen in the numerous cases of misuses of public fund, frauds, errors, loses and poor handling of public funds and poor governance [9]. Despite these observations, little research has been done to assess the internal auditing practices in improving financial management with reference to Morogoro municipality into perspective and how they contribute towards prudent financial management of the municipality [10-13].

Despite the fact that, numbers of studies have been undertaken in the area of internal auditing, most of them have been focusing on internal control system and internal audit standards and not on the impact of internal audit practices on financial management. Studies on the impact of internal auditing practices on the financial management of the LGAs are in scarce, mainly in Tanzanian LGAs [14-16]. Understanding this, our current study focuses on the impact of internal audit practices on financial management in the Tanzanian LGAs. Specifically, it examines the influence of professional proficiency, internal audit independence and quality of audit works on financial management. After presenting introductory part of the study, the next sections deal with discussion of theoretical and empirical literature review and research methodology. Presentation of findings and its discussion are also shown. Finally, conclusion and recommendations as well as areas for further studies are also presented.

## 2. LITERATURE REVIEW

For the aim of examining the impact of internal audit practices namely professional proficiency, internal audit independence and quality of audit works on financial management, the following sub-parts present theories which have been employed in our study. This is followed by review of previous studies related with our current study.

### 2.1 Theoretical Literature Review

Our study was guided by two theories namely; the lending credibility theory and the contingency theory as explained hereunder:

#### 2.1.1 The Lending Credibility Theory

According to Hayes et al. [17] "the lending credibility theory suggests that the primary function of the audit is to add credibility to the financial statements. In this view the service that the auditors are selling to the clients is credibility. Audited financial statements are seen to have elements that increase the financial statement users' confidence in the figures presented by the management (in the financial statements). The users' are perceived to gain benefits from the increased credibility, these benefits are typically considered to be that the quality of investment decisions improve when they are based on reliable information". "The theory helps to understand and explain the behaviour of business or organisation actors" [18].

#### 2.1.2 Contingency Theory

Daft [19] stated that "contingency means, one thing depends on other things. Audit functions are task-oriented and can be loosely structured. The functions also can vary depending on the organisation undergoing audit and the type of services being undertaken. The auditors should carefully inspect and ensure that the work is well done. The contingency theory can be applied to an audit team's structure". According to Fjeldstad et al. [20], "audit managers usually receive audited projects. They create audit teams for the projects appointing auditors based on skills and experience in their specific areas of jurisdiction and also basing on auditor's availability for the work to be done. The purpose of auditing projects includes evaluation of production processes, inspection of organisation accounts, and assessing compliance with accounting standards. Quality and output of audits remain assured when audit teams use resources according to skills and training they have. An auditor who is experienced in auditing financial statements is usually effective in his work".

Moreover, "the contingency theory of leadership and management states that there is no standard method by which organizations can be led, controlled and managed. Organizations and their functions depend on various external and internal factors. The functions of audits are themselves, types of organizations that are affected by various factors in the environment. The presence of such factors is why auditing can be managed by applying the contingency theory, with a recognition that processes and outcomes of audits are dependent on variable and contingent factors. On a broad level, the audit process is straightforward. Auditors require access to documents, systems, policies and procedures to manage an audit" [20]. Daft [19] stated that "contingency means, one thing depends on other things. Audit functions are task-oriented and can be loosely structured. The functions also can vary considerably, depending on the area of a company under audit and the type of business model, so auditors must carefully manage their inspections and take variables into account to get the job done".

The contingency theory also can be applied to an audit team's structure [21]. Typically, audit team managers receive audit projects. They then create audit teams for the projects, selecting auditors based on expertise and experience in

the subject areas, and on auditor's availability, all of which add up to contingencies for any given audit. Audit teams use a mix of structure and contingency to get the output rolling quickly. This theory has been criticized because it depends on the leadership and management structures which can easily be manipulated by individuals for their own self-interest.

## 2.2 Empirical Literature Review

As it has been declared in the introductory part of this study, various studies have been conducted related with internal audit attributes in different countries and settings. Recognising this, under empirical literature review we intend to appraise such studies. This goes as follows:

Mulinda et al. [22] examined "the role of internal audit practices on risk management and revealed that most of internal audit personnel lacked basic Information Technology (IT) skills, quality assurance machinery was lacking, and monitoring and evaluation mechanisms were absent". Similarly, Samagwa [23] study to "explore the efficiency of internal audit in risk management control identified lack of internal audit charter and performance gap of the internal audit department as challenges facing internal auditors on assessing risk management in Tanzania".

Apart from that, Unegbu and Kida [24] conducted "a study on the effectiveness of internal audit practices as instrument of improving public sector management in Nigeria and revealed that internal auditors failed to effectively check frauds in the public sector management. This was accelerated by inadequate staffing, presence of small number of public sector audit departments, lack of management support in implementing suggestions in audit. Also lack of knowledge and experience on the use of computers and computer aided audit programmes, lack of progressive career structure, and lack of conducive working environment of audit staff, inadequate staff remunerations, lack of accountability and lack of professional officeholders were also reported as contributing factors".

Flesher and Zanzig [25] concurring to Deloitte [26] pointed out the "lack of congruence in understanding among stakeholders concerning what makes Internal Audit a value-added activity and of effectiveness. The result is underutilized

audit services, ignored audit recommendations and continued marginalization of Internal Auditor in the corporate governance debate. Not delivering what is promised damages Internal Auditor's credibility and jeopardizes its relevance in the professional environment".

In addition to that, Kagashe [27] assessed "the effectiveness of internal audit services unit in safeguarding public resources in LGAs in Tanzania. A sample of 25 respondents was used to provide research data. The study revealed that Internal Auditor's (IA) reports lack of sound internal control over the council's resources as a result of management laxity over instituting, supporting and supervising the internal control is place. The study also revealed that Internal Audit Unit lack independence in carrying out audit functions in terms of reporting mechanism and programme of work". "Other problems facing Internal Audit Units identified by this study was lack of financial and material support, lack of management support in implementing audit recommendations, lack of essential expertise, and inadequate knowledge and experience of Internal Auditors [28-34]".

Another study was done by Twaweza [35] in Tanzania and exposed that LGAs need to institute strong measures in order to ensure execution of audit recommendations for financial accountability improvement. The suggestions put forward were actors such as LAAC needs to work powerfully for supervising the financial audit in LGAs. Yet, there were some weaknesses in responding to queries on audit and implementing audit recommendations that rose. However, the study could not explore the competence possessed by auditors.

Finally, a study conducted by Ejoh [8] on the effectiveness of internal control system to achieve value for money (VFM) in School Facilities Grants (SFG) exposed that the achievement of the SFG Programme was due to the set objectives, work plans and targeted objectives and programs for the attainment of VFM. It was found that competence was lacking due to lack of members who would play their part in advising the affairs of the committee.

## 2.3 Study Variables

For the intention of examining the impact of internal audit practices on financial management of the LGAs in Tanzania, internal audit practices

and financial management consist of independent and dependent variables respectively. Internal audit practices is measured by using three sub-variables namely professional proficiency, internal audit independence and quality of audit works while financial management being is measured by series of statements accompanied with likert scale.

### 3. RESEARCH METHODOLOGY

#### 3.1 Study Area, Target Population and Sample Size

This study was conducted in Morogoro Municipality in Tanzania, being one of the LGAs which have not been fully tapped with regard to human resources, budgetary control, financial accountability and risk management. This follows numerous cases of misuses of public fund, frauds, errors, loses and poor handling of public funds and poor governance reported in the CAG reports of 2018/2019 & 2019/2010. In this study the target population included staff working in finance and trade department, audit department, representative from audit committee and heads of departments in Morogoro Municipality. Purposive sampling was used and it is a non-probability sampling, which refers to sampling procedures where the sample for the study is deliberately selected by the researcher [36]. The sample included 60 respondents from finance and trade department, audit department, representative from audit committee and heads of departments in Morogoro Municipality as shown under Table 1.

**Table 1. Sample size (N=60)**

No	Category	Sample Size
1	Finance and trade department staff	34
2	Internal audit department staff	02
3	Audit committee members	07
4	Heads of other department	17
<b>TOTAL</b>		<b>60</b>

#### 3.2 Research Approach and Design

The study used quantitative approaches. Quantitative approach makes use of questionnaires, surveys and experiments to gather data that is revised and tabulated in

numbers, which allows the data to be characterised by the use of statistical analysis [37]. The study utilized a survey study design being the best and systematic way of obtaining information for variables that are difficult to observe and inexpensive access to the organization [36].

#### 3.3 Data Collection Tools

In this study, primary data were collected through questionnaires. These questionnaires were self-administered. Both open and close ended questions were designed for the respondents [38].

#### 3.4 Validity and Reliability of Study

Reliability and validity are concepts used to evaluate the quality of research. They indicate how well a method, technique or test measures something. Reliability is about the consistency of a measure, and validity is about the accuracy of a measure. In order to validate the instruments in this study, the researcher subjected the instruments to content validity that covered the entire domain related to the variables used or construct it was designed to measure such as investing in human capital, income generating activities and education outcomes received greater coverage or more depth. Also experts were asked their opinion about whether an instrument measures the concept intended. Their comments and suggestions were incorporated into the final draft of the research instruments. A correlation coefficient was used to assess the degree of reliability. If a test is reliable it should show a high positive correlation where an acceptable reliability score is one that is 0.7 and higher [37]. Therefore, Cronbach's ( $\alpha$ ) alpha was used to test and determine the internal consistency of an instrument. The test obtained Cronbach's alpha of 0.8 which is acceptable [39].

#### 3.5 Data Analysis

Quantitative data were analyzed by applying descriptive analysis and multiple regression analysis [40]. This was aided by Statistical Packages for Social Science (SPSS Version 20). Multiple regression analysis was used to predict the relationship that exists between variables as assumed that more than one independent variables and one dependent variable are used. The following regression model was used.

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \epsilon$$

Whereby:

- Y = Dependent Variable (Financial Management Performance)
- $\beta_0$  = y intercept (Constant)
- $\beta_1$  = regression coefficient of professional proficiency
- $\beta_2$  = regression coefficient of internal audit independence
- $\beta_3$  = regression coefficient of quality of audit works
- $X_1$  = Professional proficiency
- $X_2$  = Internal audit independence
- $X_3$  = Quality of audit works
- $\epsilon$  = error term

#### 4. RESULTS

The following sub-parts, presents the descriptive statistics of demographic characteristics of the respondents followed by the results of multiple regression analysis.

##### 4.1 Results for Demographic Characteristics

The demographic information included in our study is gender, age, length in service with the organisation and education level. As presented in Table 2, male respondents were 38 equivalents to 63.3 percent while the remaining were female respondents. In case of age group, most of the

respondents belong to age group between 21 years to 30 years which is equivalents to 36.7 percent. For the length in service (working experience), Table 2 indicates that majority of them have 8 years and above representing 42 respondents equivalents to 70 percent. Results for educational level of the respondents suggests that, 32 respondents standing for 53.3 percent holds bachelor degrees. Other descriptive information are as shown in Table 2.

##### 4.2 Multiple Regression Analysis Results

It should be recalled that, specifically the purpose of this study was to examine the influence of professional proficiency, internal audit independence and quality of audit works on financial management. To achieve such influence, multiple regression analysis was undertaken and its findings presented in Tables 3 and 4.

The results indicated that, the model was statistically significant at ( $p < 1.000$ ). The regression analysis indicated that the coefficient of correlation R was 0.983 an indication of positive relationship between variables. Coefficient of adjusted determination  $R^2$  was 0.964 which changes to 96.4% an indication of changes of dependent variable that can be explained by professional proficiency, internal audit independence and quality of audit works. The residual of 03.6% can be explained by other variables beyond the scope of the current study.

**Table 2. Demographic information (N=60)**

Category	Frequency	Percentage %
<b>Gender</b>		
Male	38	63.3
Female	22	36.7
<b>Age (in years)</b>		
< 20	03	05.0
21-30	22	36.7
31-40	14	23.3
41-50	09	15.0
51 and above	12	20.0
<b>Length in service (in Years)</b>		
1-2	0	0.0
3-4	8	13.3
5-7	10	16.7
8 and above	42	70.0
<b>Education level</b>		
Diploma	08	13.3
Degree	32	53.3
Masters	18	30.0
PhD	02	3.4

**Table 3. Regression model summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Sig
1	.983 <sup>a</sup>	.966	.964	.291	0.000

**Table 4. Results for multiple regression analysis: Determinants of financial management in LGAs**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	(0.112)	0.072		(1.557)	0.0125
Professional proficiency	(0.073)	0.044	(0.067)	(0.1.649)	0.105
Internal audit independence	0.814	0.048	0.826	17.082	.000
Quality of audit works	0.360	0.065	0.244	5.551	.000

Regression coefficients on Table 4 suggest that, all variables were significant predictors ( $p < 1.000$ ) of the model. In case of the regression model, these results could be presented as follows:

$$Y = -0.112 - 0.073 \beta_1 + 0.814 \beta_2 + 0.360 \beta_3 + \epsilon$$

**5. DISCUSSION OF THE FINDINGS**

The researcher intended to examine how professional proficiency, internal audit independence and quality of audit works explain financial management in the LGAs. Basing on this, we conducted multiple regression analysis and its results are as presented in Tables 3 and 4. The next sub-parts discuss the findings:

**5.1 The Influence of Professional Proficiency on Financial Management**

According to results presented in Table 4, professional proficiency of the internal auditors has negative influence on financial management in the concerned LGAs. Although such relationship is negative, it is not significant. From these findings, it could be explained that professional proficiency of internal auditors doesn't have any contributing effects on adequate financial management in the LGAs. On the other hand, these results inform that one unit increase in professional proficiency explains negative decrease in financial management by 0.073. These findings concur with Evans et al. (2013) who reported that investing in professional proficiency among the auditors

result in effective management of public resources.

**5.2 The Influence of Internal Audit Independence on Financial Management**

The relationship between internal audit independence and financial management is statistically significant. Such relationship is statistically positive. These results means that, existence of internal auditors who are independent in their work add value towards effective financial management in the LGAs. In addition to this, an increase in one unit of internal audit independence contributes to unit decrease of financial management in the LGAs by 0.814. This is in agreement with Rawsal (2018) who reported that when independence is linked with management support results into effective financial management.

**5.3 The Influence of Quality of Audit Works on Financial Management**

There is a positive and significant correlation between quality of audit works and financial management, as shown in Table 4. This tells us that, provision of quality internal audit assignments play a significant role in effective and efficiency financial management practices in the LGAs. Also, one unit increase in quality of audit works explains decrease in financial management by 0.360. This is in line with Banerjee and Jackson [41] who asserted that lifting the quality of audit works results into financial management.

## 6. CONCLUSION, RECOMMENDATIONS AND AREAS FOR FURTHER STUDIES

This study intended to explore the impact of internal audit practices on financial management of the Tanzanian LGAs, mainly at Morogoro Municipal. From our findings it can be concluded that, internal audit independence and quality of internal audit work significantly affects financial management practices in the stated LGAs. On the other hand, internal audit proficiency has no negative insignificant impact on financial management.

Basing on our findings and discussions presented above, it is highly recommended that LGAs should ensure that internal auditors are always equipped with relevant audit experience to enable them carry out their activities with confidence. Also, independence of internal auditors in Tanzanian LGAs must be significantly emphasized in order to ensure effective operations and management of public resources.

Since our study concentrated only in one Municipal Council (Morogoro Municipality), it is recommended that future studies should consider the remaining Municipals in Tanzania. Moreover, consideration of qualitative research approach will add more in-depth understanding on how internal audit practices explain effective financial management principles in Tanzania. This can be achieved by applying focus group discussion, interview and other relevant means of data collection apart from survey instrument which is constrained by biasness.

### COMPETING INTERESTS

Authors have declared that no competing interests exist.

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