Internal Audit Function and the Fundamental Qualitative Characteristics of Financial Report of Listed Manufacturing Companies in Nigeria

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Abstract

Financial reporting quality motivates the economic decisions of stakeholders and attracts investors to the organization. Current financial reporting practices are criticized for being of poor quality because of inherent agency conflicts, information asymmetry and fraudulent financial reporting that have resulted in wrong investment decisions and corporate failures. This study therefore evaluated the effect of Internal Audit Function (IAF) on financial reporting quality as proxied by relevance and faithful representation of financial information of listed manufacturing companies in Nigeria. The study adopted survey research design. The population comprised 1,192 senior staff members in the accounting, internal audit, board members and audit committee members of the 56 manufacturing companies listed in the Nigerian Stock Exchange. Convenience sampling technique was used to select a sample of 330 respondents determined using Taro Yamane's formula. Three hundred and thirty copies of a structured and validated questionnaire were administered to respondents and 277 were retrieved. representing 84% response rate. Cronbach's alpha reliability coefficients for the constructs ranged from 0.72 to 0.89. Data were analyzed using descriptive and inferential (multiple regression) statistics. Findings revealed that IAF exerted a significant effect on relevance (Adj.R^2 = 0.143, $F_{(5, 271)}$ = 10.240, p < 0.05) and faithful representation (Adj.R^2 = 0.159, $F_{(5, 271)}$ = 11.444, p < 0.05) of financial reporting. This study concluded that internal audit function enhanced financial reporting quality of listed manufacturing companies in Nigeria. The study recommended that the Financial Reporting Council of Nigeria and the Securities and Exchange Commission should enforce the disclosure of internal audit reports and management responses to it, in order to enhance the relevance and faithful representation of financial reporting.

Keywords: Financial reporting quality, Financial reporting risk, Faithful representation, Internal audit function, Internal control system, Relevance, Risk management

1. Introduction

Financial reporting, which shows an organization's assets, equity, expenses, revenue, and liabilities, is a critical source of externally valid and verifiable information to investors and other stakeholders on its operations (Amahalu & Obi, 2020). Financial reporting's major goal is to offer high-quality financial information about a company's economic activities that financial capital providers and other stakeholders may use to make investment, credit, and resource distribution decisions (International Accounting Standards Board (IASB), 2018). Companies are consequently required to provide financial reports that give economic information about the company to its stakeholders in a transparent manner. However, the report must be of high quality to avoid inaccuracies and fraud, which could impede users from making informed investment selections (Mahmoud & Adebisi, 2017). Low-quality financial reporting is to blame for a lot of disastrous investment decisions made by investors and other stakeholders (Zayol, Agareg & Eneji, 2017). The IASB (2018) defines financial report quality as the relationship between fundamental and enhancing qualitative characteristics. The essential qualitative characteristics that regulate the information contained in financial reports are the basic qualitative characteristics, whereas the enhancing qualitative characteristics are the information that can add value to the financial report after the fundamentals are in place. Relevance and faithful depiction are the

two most important qualitative characteristics of financial reporting. As a qualitative assessment of financial reporting quality, this study focuses on relevance and faithful representation. It is recognized in accounting practice and in the literature, that there are some risks and uncertainties associated with financial and non-financial information contained in financial reporting (Uwuigbe et al., 2019). According to Oduware (2015), these risks are the risk of misstatement and error in audited financial statements. Financial scandals in the international business community over the last three decades further strengthened the importance of investors' confidence in the quality of financial reports. In essence, the necessity for financial reporting to meet the expectations of investors and other stakeholders cannot be exaggerated (Al-Shetwi1, Ramadili, Chowdury & Sori, 2011). In furtherance to the above, the accounting profession and those charged with oversight functions have attempted to mitigate these risks by taking several steps which includes: adoption of International Financial Reporting Standards (IFRS), ensuring transparency by the disclosure of governance rules, the inclusion of non-financial capitals to corporate reporting by advocating Sustainability and integrated reporting. Despite all these interventions, risks and uncertainties remain. Therefore, the focus is on internal audit functions to further ensure the quality of financial reporting (Gamayuni, 2018). The Internal Audit Function (IAF) is also described as a valuable corporate governance component for companies with the ability to assess the adequacy of risk and internal control and thereby ensure that financial reporting is qualitative (Fülöp & Szekely, 2017).

1.1 Statement of the Problem

The discussion on the financial reporting quality remains a crucial issue. In the same way, relevance and faithful representation quality of financial reporting seem to be lacking in the content of financial reports offered for the use of stakeholders. This is evident in the corporate scandal involving Enron, WorldCom and Xerox. These companies were in good financial condition, but were liquidated by insider trading, fraudulent borrowing, and aggressive profit manipulation (Erin, Olojede & Ogundele, 2017). The 1999 Report of the Governance Commission, including the New York Stock Exchange; The Cadbury Report, 1992; The 1992 COSO Report reaffirms the importance of the internal audit function in corporate governance requirements. However, there was inconsistency in the acceptance of the internal audit function as a pillar of corporate governance by relevant stakeholders (IIA, 2003). The New York Stock Exchange (NYSE) in 2002 required that public companies have a functioning internal audit system, but Carcello, Hermanson, and Neal (2002) discovered that this requirement is underplayed by US companies. Similarly, Carey, Craswell and Simnett (2000) found that most Australian listed companies do not have an internal audit department, despite the fact that Australian regulatory agencies are committed to a strong governance structure. As a result, previous studies on the impact of the IAF on the quality of financial reporting were inconclusive. Some results found a positively significant relationship (AlFatlawi, 2018; DeSimone, 2017; Drogalas, Arampatzis & Anagnostopoulou, 2016; Khalil, Omar & Samer, 2019; Musa, 2016;Ogoun & Atagboro, 2020; Rahmatika, 2014; Ziniyel, Otoo & Andzie, 2018; Tambingon, Yadiati & Kewo, 2018), others have reported insignificant association (Al Shetwi et al. 2011; Ejoh, & Ejom, 2014; Laković, Smolović & Stanovčić, 2016) and adverse effects (Shireenjit, Satirenjit, Nava & Cooper, 2013). Therefore, this study empirically examined the impact of the internal audit function on the quality of financial reporting in Nigeria's private sector, measured by fundamental qualitative characteristics (relevance and faithful representation).

1.2 Research Objective

This study examined the following objectives:

1. The effect of internal audit function on the relevance of financial reporting of listed manufacturing companies in Nigeria.
2. The effect of internal audit function on faithful representation of financial reporting of listed manufacturing companies in Nigeria

2.0 Literature Review

2.1 Conceptual Review

According to the IASB (2018), the quality of financial reporting is expressed in terms of basic and enhanced qualitative characteristics. Fundamental qualitative characteristics are important characteristics that determine the information contained in financial reporting. On the other hand, enhancing qualitative characteristics is information that can add value to financial reporting once the fundamentals are firmly established. The fundamental qualitative characteristics of financial reporting are: Relevance and Faithful representation; while the enhancing characteristics are: verifiability,

timeliness, understandability and comparability. This study concentrated on relevance and faithful representation as the measure of financial reporting quality.

2.1.1 Relevance

According to the IASB (2010), information is relevant when the message therein is available to impact the current investment decisions of investors and other users of financial reporting (Erin, Olojede & Ogundele,). 2017). It is the capability of financial reporting to affect the resources allocation decision of its users to an organization (Enyi, Adegbie, Salawu, and Odesanya, 2019). This can be affected by the content, value and scope of the information. According to Ezelibe, Nwosu, and Orazulike (2017), the value of financial reporting depends on its relation to the most important issues for stakeholder assessment and decision making. This requires the financial reporting information must be both confirmatory in value and predictive in nature or to have at least one attribute (IASB, 2010). This happens when financial reporting information helps users evaluate, modify, and confirm the company's future performance and past valuations. The predictive nature of financial reporting lies in its ability to support the methods used by stakeholders to predict the future performance of a company, and its confirmatory value lies in its ability to support a company's previous assessments (Enyi, et al., 2019). Fair value is recognized as a key attribute of relevance (Herath & Albarqi, 2017). The use of fair value in a company as a measurement tool, depicts a high level of relevance in financial reporting (Beest et al., 2009). Moreover, Beest et al. (2009), opined that financial reporting played a key role in the determination of the degree of relevance to its users by, revealing futuristic or feed forward information, making events about commercial prospects and threats known, and making explanations on how major economic activities and vital transactions affect organizations Financial reporting information is also relevant if its connection with the charting of share prices is significant, which will eventually make it applicable to decision making in the capital market (Sutopo, Kot, Adiati & Ardila, 2018).

2.1.2 Faithful Representation

Faithful Representation, was introduced as one of the qualitative characteristics of financial reporting, replacing reliability, which was one of the main qualitative characteristics of financial reporting in the 2010 IASB framework. According to the IASB (2010), faithful presentation means that financial reporting must fairly disclose the true economic events that it intends to represent or symbolize. Financial reporting should be objective and balanced (Aifuwa, et al., 2018). This means that the financial statements which is faithfully represented must be complete, neutral and error-free. The IASB conceptual framework for financial reporting stated that completeness means full disclosure of all information, explanations and description of all realities about an organization that are crucial for the report to be decision relevant for stakeholders; while neutrality indicates that the report must be unbiased and free from misrepresentations of transactions, activities and contracts; and freedom from error signifies lack of misstatements, mistakes and omissions (Enyi, et al., 2019). It has been established in literature that the report of independent auditors' is valuable to financial reporting because it provides reasonable assurance on the extent to which the annual report portrays economic events faithfully (Willekens, 2008). Also, the faithful presentation of financial reporting is affected by the disclosure of corporate governance information (which is the report on how an organization is controlled and managed) in the annual report (Beest et al., 2009). The clarification of assumptions and the explanation of estimates and the accounting principles used in the preparation of financial reports enhances faithful representation. The discussion and explanation of positive and negative changes and events and their implications on the financial results of a company enhances faithful representation (Herath & Albarqi, 2017).

2.2 Theoretical Development of Hypothesis

This study adopts the Agency theory and Stakeholders' theory as the basis for this investigation. The two theories were adopted because the agency theory recognizes the presence of conflict of interest between investors and management and since investors know less than management about a company, it is necessary for internal auditors to monitor the activities of management to provide further assurance on the quality of the financial reports presented by management. Stakeholder theory has been selected to recognize all stakeholders' rights to quality financial information that the internal audit department seeks to influence through daily reviews of company transactions and financial statements.

2.3 Empirical Review

2.3.1 Internal Audit Function and Relevance

A research conducted on the effects of internal audit report disclosure on perceived financial reporting reliability by Holt and DeZoort (2006) who found that respondents (investors) agreed that they regard the financial reports of companies that prepare internal audit reports to be more credible than those that do not produce the internal audit reports. In a survey conducted by Holt and DeZoort (2006) on the impact of disclosure of internal audit reports on the reliability of financial reports, respondents (investors) agreed that they esteem the financial reports of companies that disclose internal audit reports to be more reliable than those who do not disclose the internal audit reports. Holt, DeZoort, and Deborah (2008), when looking for evidence to support the conclusions of Holt and DeZoort (2006), investigated the need for disclosure of internal audit reports to external stakeholders to improve governance and transparency, It was concluded that the internal audit report supplements current disclosures regarding corporate governance and is likely to increase stakeholder confidence in the quality of corporate governance. They also argued that a higher level of transparency could encourage companies to invest more in internal audit. According to Spanos (2005), good corporate governance practices reduce investor investment risk, attract financial capital and improve corporate performance. Internal audit also serves as an important function related to the internal control of an organization by providing reasonable assurance about the ethical value of management and the reliability of financial information (AlBaidhani, 2016). Agyei Mensah (2016) also finds that disclosure of internal audit information and board composition information plays a key role in reducing the cost effect of agency and the lack of information that may confront corporate stakeholders (Agyei-Mensah, 2016). According to Nashwa, (2003), financial scandals are evidences of the failure of the internal audit function in producing financial statements that are reliable, of high quality, which is relevant to the information needs of users. In addition, internal audit function helps in the attainment of corporate objectives and improves the legitimacy of financial reporting (Koutoupis & Pappa, 2018; Gamayuni, 2018). Sitorus, Setiyawati and Mappanyuki (2019), in their study on the effectiveness of the internal control system on the quality of financial statements with the implementation of internal audits as a moderation variable; they found that internal control system is only effective and has an effect on the quality of financial report after being moderated by internal audit.

2.3.2 Internal Audit Function and Faithful Representation

Al-Fatlawi (2018), conducted a research on the role of internal auditing and internal control system on the financial performance quality in the Indonesian banking sector. They found that both the internal audit and the internal control system have a significant positive effect on the prevention of accounting fraud, which means, that the better the internal audit function and internal control system the better will be ability of companies to prevent accounting fraud and therefore the more faithfully represented the financial report will be. Prawitt, Smith and Wood (2008), examined the relationship between internal audit function quality and earnings management. They found that internal audit function quality is connected with a reasonable or moderate level of earnings management. Rogers and Stocken (2005), in their research have showed that management forecasting are more biased when distortion is rather difficult to detect. While Schwartz and Young (2002), found that management's communications are more likely to be biased when they are not verified by a third party. This means that the presence of an internal audit function on a continuous verification of transactions may prevent distortions and biases in financial reports. Davidson, Goodwin-Stewart and Kent (2005), carried out an investigation on internal governance structures and earnings management, using a sample of 434 Australian companies, they found that the presence of an internal audit function is not connected with a reduced level of earnings management in Australia. Contrary to this conclusion, the study of (Holt & DeZoort, 2009) on internal audit function provides that internal audit function enhances corporate internal control environment which will be revealed in a better quality financial reporting in terms of reduction in error reporting, decrease in financial reporting irregularities and increase the confidence of investors in the effectiveness of internal control and the reliability of financial reporting (Holt & DeZoort, 2009). García, Barbadillo, and Pérez, (2012) carried out research on audit committee, internal audit and the quality of earnings, in some Spanish companies, they found that internal audit function is germane to the reliability of financial statements. In a recent study done by Enyi, Adegbie, Salawu, and Odesanya (2019), on ethical principles and faithful representation of financial reports of quoted companies in Nigeria; it was concluded that the application of ethical principles in the preparation of financial reporting positively impact on faithful representation of the financials. An ethical internal audit department will affect faithful representation of financial reporting.

2.4 Conceptual Framework

INDEPENDENT VARIABLE   **DEPENDENT VARIABLE**

INTERNAL AUDIT FUNCTION   **FUNDAMENTAL   CHARACTERISTICS   OF FINANCIAL REPORTING QUALITY**
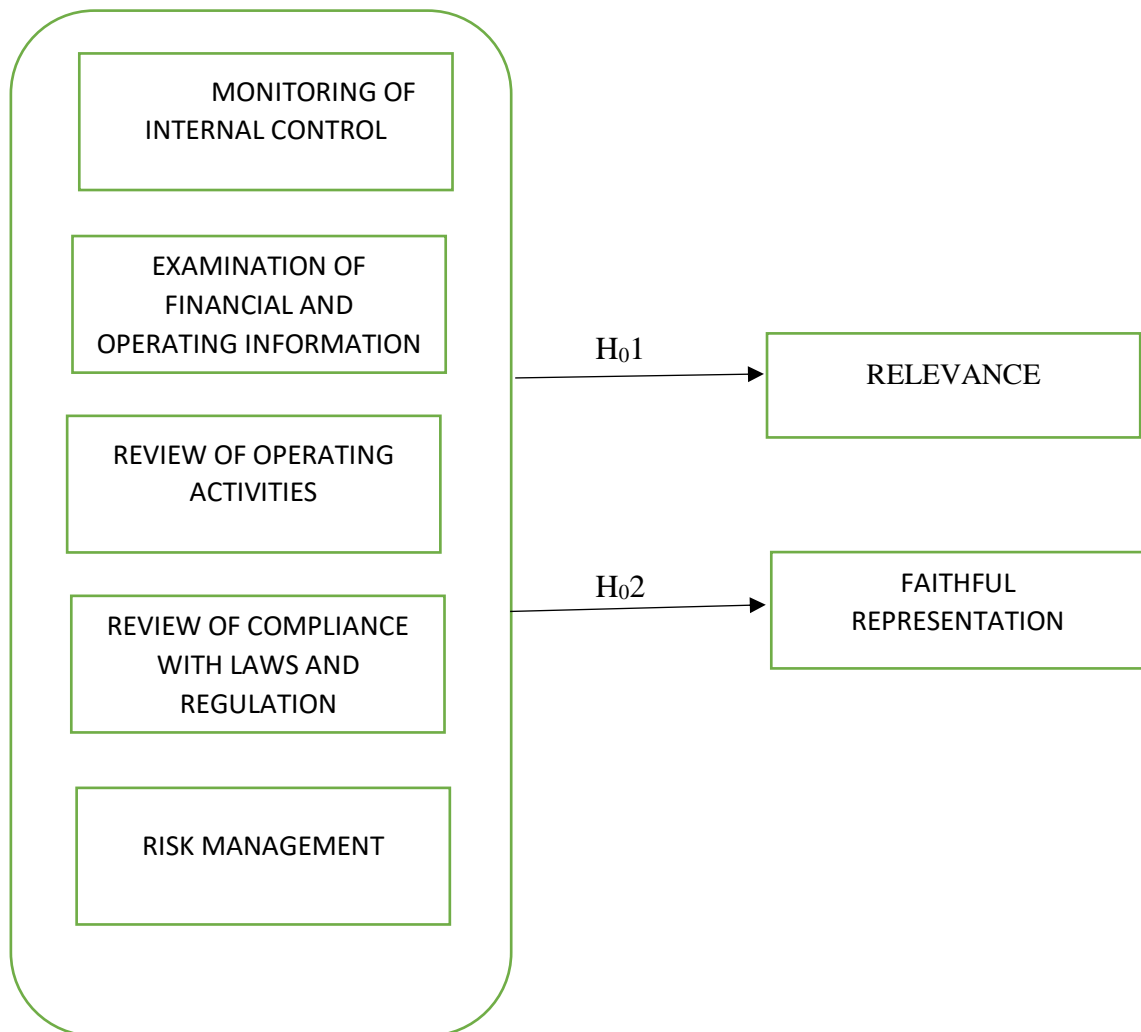

Fig 1: *Researcher's Study, 2022*

3.0 Methodology

This study used survey research design because it involved perceptions which were qualitative in nature. Questionnaire was administered to the target population to elicit their perception on the impact of internal audit function on financial reporting quality of listed manufacturing companies in Nigeria. The population of the study consisted of the senior staff members in the accounting, internal audit, management and audit committee members of the fifty-six manufacturing companies listed in the Nigerian Stock Exchange (NSE) as at 11th November, 2021. The population consisted of 592 staff in the consumer goods companies; 439 staff in the industrial goods sector and 161 in the health sector; making a total of 1192 staff members of the listed manufacturing companies in Nigeria. The manufacturing sector in Nigeria was classified into consumer goods (25), industrial goods (23) and healthcare companies (8) according to NSE Daily Activity Summary (Equities), 2021.Convenience sampling technique was adopted in the selection of the manufacturing companies in Lagos and Ogun state of Nigeria as samples for this study. This was as a result of the porous security situation in Nigeria and out of the fifty-six companies listed in the Nigerian Stock Exchange forty-five were located in Lagos and Ogun states. Taro Yamane's formula $[n = N/1+N(e)^2]$ was used on the number of staff specified in the population to determine the number of respondents that was used as sample size for this study. Stratified sampling technique was used to select the respondents from each stratum for this study.

$[n = N/1+N(e)^2]$
Where: n = sample size
N = total population
e = error term = 0,05
$n = 1192/1+1192(e)^2 = 300$

An adjustment upward of 10% of the sample size of 300 which is 30 was done to take care of possible response issues. This brought the total sample size to 330 for a total coverage of the sample (Asika, 2009). The sample size was apportioned between each group in the proportion that each group has to the total population. This was calculated thus:

Consumer goods companies = 592/1192 x 330 = 164
Industrial goods companies = 439/1192 x 330 = 122
Health care companies =161/1192 x330 = 44

A well-structured questionnaire developed by the researcher was used to obtain the perception of respondents on the variables used to measure internal audit function and financial reporting quality of listed manufacturing companies in Nigeria. This was validated and certified by experts in the subject matter and versatile in research. This is to ensure that the research instrument assessed all its construct interest, measured the characteristics of research variables and measured what the research intends to measure. For construct validity, the questionnaire was divided into sections. Construct validity was measured statistically using Exploratory Factor Analysis (EFA) The main measures used to test the validity of an instrument in exploratory factor analysis include the Kaiser-Meyer-Oklin's (KMO) measure of sampling adequacy and Bartlett's Test of Sphericity. The study employed the KMO sampling adequacy and Bartlett's Sphericity test to determine whether the statements comprising each variable's research instrument actually measured what was intended. The rule of thumb is that if the result of the KMO is greater than 0.5, and the Bartlett test of Sphericity for each of the variables is less than 5%, which indicated a highly significant relationship between the variables in measuring the variables under study. In this study, the KMO test for each variable was greater than 50%, and the Bartlett test of Sphericity result is less than 5%, indicating that the questionnaire items for each construct actually measured what was intended. The KMO and Bartlett test of Sphericity result is shown in Table 3.01 below.

3.1 Test of Validity

Table 3.1 KMO and Bartlett's Test of Sphericity

S/N	Variables	No. of Items	KMO	Bartlett Test
	Dependent Variables (DV) – Financial Reporting Quality	30		
DV1	Relevance	5	0.649	0.010
DV2	Faithful Representation	5	0.517	0.000
	Explanatory Variables (EV) – Internal Audit Function	25		
EV1	Monitoring of internal controls	5	0.801	0.000
EV2	Examination of financial and information	5	0.778	0.000
EV3	Review of operation activities (ROA)	5	0.737	0.000
EV4	Review of Compliance with laws and Regulations	5	0.740	0.011
EV5	Risk Management	5	0.570	0.000

Source: Researcher's Field Survey, 2022.

In this study Cronbach's Alpha was used to test the internal consistency and reliability of the variables. The Cronbach's alpha is an estimate of the internal consistency and reliability because it determined how all the construct in the research instrument relate to one another (Mills & Gay, 2016)

Cronbach's Alpha was applied to the result of the pilot study conducted. A prior test of the research device was done on 60 respondents who are not a part of the 1192 respondents of the study. The outcome of the pilot study showed that the research device was reliable, as the Cronbach's alpha of the scale for each of the variable was higher than 0.70. The result of the Cronbach Alpha for each of the variables is presented in the table below Table 3.02

3.2 Test of Reliability
Table 3.02 Internal Consistency Reliability Result

S/N	Variables	No. of Items	Cronbach's Alpha
	Dependent Variables (DV) – Financial Reporting Quality	30	
DV1	Relevance	5	0.782
DV2	Faithful Representation	5	0.847
	Explanatory Variables (EV) – Internal Audit Function	25	
EV1	Monitoring of internal controls	5	0.853

EV2	Examination of financial and information	5	0.822
EV3	Review of operation activities (ROA)	5	0.818
EV4	Review of Compliance with laws and Regulations	5	0.768
EV5	Risk Management	5	0.848

Source: Researcher's Field Survey, 2022.

The questionnaire was divided into three (3) sections. Section A contained the demographic attributes of respondents, section B contained assessment of information about internal audit function, section C contained statements that elicited information about qualitative characteristics of financial reporting. A five-point Likert-type scale questionnaire (Strongly disagree, Disagree, Neutral, Agree and Strongly agree) was used to collect data. Since the answers in the scale were qualitative, for each caliber, the weight of 1, 2, 3, 4, and 5 was attached and converted into quantities using the code manuals.

3.3 Model Specification

The following proxies and regression models were adopted to investigate internal audit function and financial reporting quality.

$Y = f(X)$

Y = Dependent Variable

X = Independent Variable

FRQ = f (IAF)   **Main objective**

$Y = y_1, y_2$

Where:

y_1 = Faithful representation   (FR)

y_2 = Relevance   (RL)

$X = x_1, x_2, x_3, x_4, x_5$

Where:

x_1 = Monitoring of internal control   (MIC)

x_2 = Examination of financial and operating information   (EFO)

x_3 = Review of operating activities   (ROA)

x_4 = Review of compliance with laws and regulations   (RCR)

x_5 = Risk management   (RMG)

Model 1

$RL_i = \beta_0 + \beta_1 MIC_i + \beta_2 EFO_i + \beta_3 ROA_i + \beta_4 RCR_i + \beta_5 RMG_i + \mu_i$

Model 2

$FR_i = \beta_0 + \beta_1 MIC_i + \beta_2 EFO_i + \beta_3 ROA_i + \beta_4 RCR_i + \beta_5 RMG_i + \mu_i$

4.0 Analyses, Results and Discussion

4.1 Descriptive Statistics

To gather the data, 330 copies of the questionnaire were circulated to the respondents in the manufacturing companies listed in Nigeria in their head offices out of which 277 questionnaires were filled and returned, this represented about 84 percent of the questionnaire distributed. This could be because the respondents were middle and top managers in the listed manufacturing companies who have busy schedule and could not spare the time to fill the questionnaire. The gender distribution of the respondents showed that more female participated in the survey than male. However, this statistic has no effect on the quality of response received for the purpose of analysis. The statistics for age of respondents revealed that more than 70% of the respondents were over 41 years in age meaning that highly productive, effective and experienced people were captured for the study. This contributed significantly to the achievement of the objective of this study. The category of respondents who participated in this study cut across all classes identified as the target respondents for the study, they therefore have the capability and knowledge required to respond to the statements made in respect of variables in the questionnaire. The statistics for length of service indicated that over 70% of the respondents have worked for over 6years in their organisations. This revealed that highly experienced respondents who possessed adequate number of years of working knowledge of the organisations were sampled in the study, they were thus, able to contribute significantly to achieve the aims of the study. The statistics for highest level of education and professional qualification for the 277 respondents revealed that all of them have at least Higher National Diploma (HND) and all were professionally qualified. This shows that the participants in this study were lettered and are able to give informed responses to the statements made in the questionnaire.

4.2 Test of Hypotheses

4.2.1 Test of Hypothesis One

Research Hypothesis one (H_{01}): Internal audit function does not significantly affect the relevance of financial reporting of listed manufacturing companies in Nigeria.

Table 4.2.1: Internal Audit Function and Relevance of Financial Reporting

Dependent Variable: RL	Model One			
	Coefficient	Std. Error	T Stats	Prob.
(Constant)	2.549	.155	16.452	.000
MIC	-.205	.087	-2.362	.019*
EFO	.567	.139	4.083	.000*
ROA	-.220	.153	-1.435	.152
RCR	.058	.094	.623	.534
RMG	.112	.096	1.172	.242
Adjusted R^2	0.143			
F-Stat	10.240 (0.00)*			

Dependent Variable: Relevance (RL)   ***significant at 5%**

Source: Researcher's Study, (2022)

Model 1

$RL_i = \beta_0 + \beta_1 MIC_i + \beta_2 EFO_i + \beta_3 ROA_i + \beta_4 RCR_i + \beta_5 RMG_i + \mu_i$

$RL_i = 2.549 - 0.205 MIC_i + 0.567 EFO_i - 0.220 ROA_i + 0.058 RCR_i + 0.112 RMG_i + \mu_i$

t-test = 16.452 - 2.362   + 4.08 - 1.435   + 0.623 + 1.172

4.2.2 Test of Hypothesis Two

Research Hypothesis Two (H$_{02}$): Internal audit function does not significantly affect faithful representation of financial reporting of listed manufacturing companies in Nigeria.

Table 4.2.2: Internal Audit Function and Faithful Representation of Financial Reporting

Dependent Variable: FR	Model Two			
	Coefficient	Std. Error	t-Stats	Prob.
(Constant)	3.853	.181	21.245	.000
MIC	-.193	.102	-1.899	.059
EFO	.169	.163	1.041	.299
ROA	.062	.179	.343	.732
RCR	.610	.110	5.566	.000*
RMG	-.668	.112	-5.970	.000*
Adjusted R^2	0.159			
F-Stat	11.444 (0.00)*			

Dependent Variable: Faithful Representation (FR)   ***significant at 5%**

Source: Researcher's Study, (2022)

Model 2

$FR_i = \beta_0 + \beta_1 MIC_i + \beta_2 EFO_i + \beta_3 ROA_i + \beta_4 RCR_i + \beta_5 RMG_i + \mu_i$

$FR_i = 3.853 - 0.193 MIC_i + 0.169 EFO_i + 0.062 ROA_i + 0.610 RCR_i - 0.668 RMG_i + \mu_i$

t-test = 21.245 -1.899 + 1.041 + 0.343 + 5.566 - 5.970

Interpretation

From the multiple linear regression estimate of model 1, the signs of the coefficient of the independent variables in table shows that monitoring of internal control have a negative effect on relevance, with a coefficient of -0.205. This negative effect is statistically significant as the t-statistics significance level shows 0.019 which is less than 0.05 significant levels chosen for this study. Examination of financial and operating information has a negative effect on relevance, with a coefficient of 0.56. This positive effect is statistically significant as the t-statistics significance level shows 0.000 which is less than 0.05. Conversely, review of operating activities has a negative effect on relevance, with a coefficient of -0.220. This negative effect is however not significant as the t-statistics significance level shows 0.152 which is higher than 0.05. In opposite manner, review of compliance with laws and regulations has a positive effect on relevance, with a coefficient of 0.058. This positive effect is however not statistically significant as the t-statistics significance level shows 0.534 which is greater than 0.05. Finally, risk management has a positive effect on relevance, with a coefficient of 0.112. This positive effect is also not statistically significant as the t-statistics significance level shows 0.242 which is greater than 0.05. The Adjusted R-square of the model showed that about 14.3% variation in relevance of financial reporting can be explained by all the measures of internal audit function, the remaining 85.7% variation in relevance of financial reporting are caused by other factors outside of this model. Thus, the coefficient of determination shows that the model has a weak explanatory power. However, the F-test showed a probability value of 0.00 which is less than the 5% level of significance adopted for this study which indicates that the explanatory variables are statistically significant. This means that the cumulative effect of the measures of internal audit functions have a positive significant effect on relevance of financial reporting quality in listed manufacturing companies in Nigeria. Thus, at a level of significance of 0.05, the F-statistics is 10.240, the P-value of the F-statistics is 0.000 which is less than 0.05 the study rejected the null hypothesis and accept the alternate that internal audit function significantly affect the relevance of financial reporting in listed manufacturing companies in Nigeria. In model 2, from table 4.2.2, the sign of the coefficient of the independent variables shows that monitoring of internal control has a negative effect on faithful representation, with a coefficient of -0.193. This negative effect is statistically not significant as the t-statistics significance level shows 0.059 which is greater than 0.05 significant levels chosen for

this study. Examination of financial and operating information also has a positive effect on faithful representation, with a coefficient of 0.169. This positive effect is however not singularly significant as the t-statistics significance level shows 0.299 which is higher than 0.05. Also, review of operating activities has a positive effect on faithful representation, with a coefficient of 0.062. This positive effect is however not significant as the t-statistics significance level shows 0.732 which is higher than 0.05. In like manner, review of compliance with laws and regulations has a positive effect on faithful representation, with a coefficient of 0.610. This positive effect is however statistically significant as the t-statistics significance level shows 0.00 which is less than 0.05. Finally, risk management has a negative effect on faithful representation, with a coefficient of -0.668. This negative effect is also statistically significant as the t-statistics significance level shows 0.00 which is less than 0.05. The Adjusted R-square of the model showed that about 15.9% variation in faithful representation of financial reporting can be explained by all the measures of internal audit function, the remaining 84.1% variation in faithful representation of financial reporting are caused by other factors outside of this model. Thus, the coefficient of determination shows that the model has a weak explanatory power. However, the F-statistics showed a probability value of 0.00 which is less than the 5% level of significance adopted for this study which indicates that the explanatory variables are statistically significant. This means that the cumulative effect of the measures of internal audit functions have a positive significant effect on faithful representation of financial reporting quality in listed manufacturing companies in Nigeria. Thus, at a level of significance of 0.05, the F-statistics is 11.444, the P-value of the F-statistics is 0.000 which is less than 0.05 the study rejected the null hypothesis and accept the alternate that internal audit function significantly affect the faithful representation of financial reporting in listed manufacturing companies in Nigeria.

4.3 Discussion of Findings

The first hypothesis of the study examines the effect of internal audit function on the relevance of financial reporting of listed manufacturing companies in Nigeria. This finding corroborates the study conducted on the effects of internal audit report disclosure on perceived financial reporting reliability by Holt and DeZoort (2006), they found that investors (who are the respondents) agreed that they regard the financial reports of companies that prepare internal audit reports to be more credible than those that do not produce the internal audit reports. Holt, DeZoort, and Deborah (2008), while seeking corroborative evidence on the conclusion of Holt and DeZoort (2006) carried out a study on the need for an internal audit report for outside stakeholders to improve governance and transparency, it was concluded that an internal audit report has the prospect of complementing current governance disclosures and improve stakeholder confidence in governance quality. According to Spanos (2005), good corporate governance practices also reduce investment risk for investors, attract financial capital and improve corporate performance. This finding can also be explained by the theories of information asymmetry, signaling stakeholders and agency. The disclosure of internal audit report will make available to all stakeholders' private information, thereby reduce information asymmetry and agency cost, and signal to capital market participant that disclosing companies are better for capital investment than non-disclosing companies. This finding is however against the conclusion of Nashwa, (2003), that financial scandals are evidences of the failure of the internal audit function in producing financial statements that are reliable, of high quality which is relevant to the information needs of users. However, in a more recent study by Sitorus, Setiyawati and Mappanyuki (2019), on the effectiveness of the internal control system on the quality of financial statements with the implementation of internal audits as a moderation variable; they found that internal control system is only effective and has an effect on the quality of financial report after being moderated by internal audit. Wambui (2019) also states that improved financial reporting quality results from ensuring the correctness and reliability of accounting records which can only be done through the continuous auditing by the internal audit function. The second hypothesis of the study examines the effect of internal audit function on faithful representation of financial reporting of listed manufacturing companies in Nigeria. In table 4.2.2, hypothesis two predicts a positively significant relationship between internal audit function and the faithful representation of financial reporting, thus, the null hypothesis is rejected and it is concluded that there is a significant relationship between internal audit function and faithful representation of financial reporting of listed manufacturing companies in Nigeria. This result upholds the previous study of Al-Fatlawi (2018) on the role of internal auditing and internal control system on the financial performance quality in the Indonesian banking sector. He found that both the internal audit and the internal control system have a significant positive effect on the prevention of accounting fraud, which means, that the better the internal audit function and internal control system the better will be ability of companies to prevent accounting fraud and therefore the more faithfully represented the financial report will be. This study also substantiates the conclusion of Prawitt, Smith and Wood (2008), who examined the relationship between internal audit function quality and earnings management. They found that internal audit function quality is connected with a reasonable or moderate level of earnings management. Rogers and Stocken (2005) in their research showed that management forecasting are more

biased when distortion is rather difficult to detect. While Schwartz and Young (2002) found that management's communications are more likely to be biased when they are not verified by a third party. This means that the presence of an internal audit function on a continuous verification of transactions may prevent distortions and biases in financial reports. Contrary to the findings of this study, Goodwin-Stewart, & Kent (2005) carried out an investigation on internal governance structures and earnings management, using a sample of 434 Australian companies, they found that the presence of an internal audit function is not connected with a reduced level of earnings management. Meanwhile, contrary to this conclusion, some studies on internal audit function provides that internal audit function enhances corporate internal control environment which will be revealed in a better quality financial reporting in terms of reduction in error reporting, decrease in financial reporting irregularities and increase the confidence of investors in the effectiveness of internal control and the reliability of financial reporting (Gordon & Smith, 1992; Holt & DeZoort, 2009; Schneider Wilner, 1990)

4.4 Implication of Findings

The implication of these findings is that manufacturing companies and their management and board should be concerned about investing in the internal audit function, to enhance transparency, improved control environment and disclosure of full information in their financial reports. This will reduce reporting errors, prevent financial reporting irregularity, improve investors' confidence in the effectiveness of corporate oversight and enhance the reliability and faithful presentation of financial reporting. As it concern investors, the main beneficiaries and users of financial reporting, companies that operate a strong internal audit function should be seen as disclosing better quality financial reports and increased capital allocation in terms of investment of higher resources should be directed towards them while divesting from companies that do not operate strong internal audit function. For financial analysts and capital market operators, since a significant positive effect is revealed to exist between internal audit function and financial reporting quality of listed manufacturing companies in Nigeria, they are provided with appropriate foundation for dialogue and analysis of the performance and position of the companies for capital investment or divestment. The findings of this study have implication for internal auditors, external auditors and other accounting practitioners. The result of the study has revealed that the internal auditor has a professional significantly effect on the fundamental qualitative characteristics of financial reporting quality which are the vital features which govern the information contained in financial reports; they are therefore expected to assure the monitoring of internal control, examination of financial and operating information, review of operating activities, review of compliance with laws and regulation as well as risk management

5.0 Conclusion and Recommendation

5.1 Conclusion

The study concluded that a positive and significant relationship exists between internal audit function and relevance as well as faithful representation of financial of listed manufacturing companies in Nigeria This means that the operation of internal audit function in listed manufacturing companies in Nigeria and the disclosure of internal audit report will improve financial reporting quality through the benefits of transparency, efficient internal management of companies, better stakeholders' confidence, near optimal allocation of financial capital and other resources and improvement in the efficiency of the Nigerian Stock Exchange. These improvements are experienced as a result of reduction in information asymmetry, reduction in financial reporting risks and enhanced economic information atmosphere in the Nigerian corporate environment.

5.2 Recommendations

1. The tertiary institutions, accounting professional bodies and professional accounting educators should improve, upgrade and update their curriculum so as to be able to teach and lecture accounting students and professionals on internal auditing as a distinct and full-fledged profession (as external auditing and taxation is taught in full) and not as a "by the way addendum" to topics on auditing.

2. The regulatory authorities' Financial Reporting Council of Nigeria (FRC) and the Security and Exchange Commission (SEC) should enforce the disclosure of internal audit report and management response to it in listed manufacturing companies in Nigeria.

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