

THE COMPATIBILITY BETWEEN INTERNAL AUDIT AND EXTERNAL AUDIT OF RWANDA TRANSPORT DEVELOPMENT AGENCY

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Abstract: *This paper focuses on the compatibility between internal audits and external audits of public institutions in Rwanda. The research problem consists of the incompatibility between internal and external audits owing to the findings pointing to the failure of an internal audit in public institutions. Although both internal and external audits play a crucial role in the day-to-day running and accountability, external audit findings highlighted the misuse of funds and contract irregularities (Auditor-General Office, 2019). This would have counter-checked and limited under the internal audit control, therefore this shows a problem of incompatibility between internal and external audits. It is on this note the researcher aims at finding the levels of compatibility between internal and external audits and their influence on the performance with a special focus on Rwanda Transport Development Agency (RTDA). The qualitative data were obtained using documentation and interviews. Respondents were internal auditors of the Rwanda Transport Development Agency as well as external auditors of the Rwanda Auditor General Office. Findings show that 60% refused the timely assessment, while internal auditing issues are reported regularly at a rate of 80%. The study reveals concerns about the independence and objectivity of Internal Audit work. The level of external auditors' reliance on internal auditors' findings was low. Overall coverage of audit activities is done by ensuring the complement between the internal and external audits. Stringent disciplinary actions should be taken whenever audit reports reveal fraud in the financial statements of public institutions. There is a need to restructure institutional size, besides providing appropriate training to the concerned personnel.*

Key Words: *Internal Audit, External Audit, Compatibility, Public institutions, Rwanda Transport Development Agency.*

1. INTRODUCTION:

In the past decades, much research has focused on the role of audits on transparency and accountability within public institutions (Abbott, 2016). Few studies have explored Internal Auditor specific inputs into external audit processes that are associated with audit delay or availability of personnel (Lambert *et al.*, 2010; Pizzini *et al.*, 2014). Another research path analyzed the level of cooperation and coordination between the external audit function and the Internal Audit Function (Mihret & Admassu, 2011; Prawitt *et al.*, 2011). From these studies, it emerges that external auditor reliance on internal auditors is influenced by four elements: internal auditors' objectivity, internal auditors' competence, their work performance, and the subjectivity of the audit task (Abbott *et al.*, 2016). Few studies have dealt with the operational aspects of this relationship and not enough is known about the utility perceived by the two different professionals (Mihret & Admassu, 2011). In Rwanda, auditors' judgment in the assessment of internal control has assumed an even larger role in the interrelationship between the auditors. The research problem consists of the incompatibility between internal and external audits owing to the findings pointing to the failure of an internal audit in public institutions. Although both internal and external audits play a crucial role in the day-to-day running and accountability, external audit findings highlighted the misuse of funds and contract irregularities (Auditor-General Office, 2019). This would have counter-checked and limited under the internal audit control, therefore this shows a problem of incompatibility between internal and external audits. It is on this note the researcher aims at finding the levels of compatibility between internal and external audits and their influence on the performance with a special focus on Rwanda Transport Development Agency (RTDA). RTDA was chosen due to weaknesses in the implementation of the contract for works of maintenance of Ngoma-Ramiro road (63km) awarded at an abnormal price of Frw 79,722,038 per Km compared to other contracts' prices in the same region of Frw 13,869,584 per Km and Frw 18,092,259 per km as it was pointed in Auditor General's report of 30 June 2019 on page 70.

The main focus of this paper is to examine the compatibility between internal and external audits and how the lapses in internal audits lead to external audit qualifying comments with materiality. The purpose of the paper is to examine the compatibility between internal and external audits and its influence on performance in a public institution by taking Rwanda Transport Development Agency as a case study. Specifically, the paper's objectives include:

Assessing whether the external audit's negative remarks and materiality are a result of the failure of the internal audit; and examine the influence of the audit incompatibility on the organization's performance.

2. LITERATURE REVIEW:

This study used attribution and agency, theories. The attribution theory is a social psychology theory that explores how people interpret events and how they ascribe causes to events. Earlier literature shows that people are inclined to attribute other's behavior to dispositional tendencies (Wilks&Zimbelman, 2004). Attribution theory thus advocates for auditors to report on the effectiveness of the firm's internal control.

The agency theory is used to emphasize the functions and the essence of internal audits in an organization (Wobschall, 2011). This theory helps to explain the demand for audit and its roles. For instance, the concept of mistrust entails that management has to be monitored and their activities regulated.

Previous studies reiterated that effective internal audit services can in particular help reduce overheads, identify ways to improve efficiency, and maximizes exposure to possible losses from inadequately safeguarded company assets all of which can have a significant effect on the bottom line (Fadzil *et al.*, 2005). A survey conducted by

According to (Bananuka, *et al.*, 2017), internal auditors, in general, perceive their roles as reporting on the system for generating financial information and on the reliability of financial statements; conducting periodic reviews to confirm whether management complies with applicable legislation and regulation; review of whether management ensures company objectives are met; evaluating means of safeguarding company assets and also verifying their existence; evaluating operating effectiveness of governance structures and processes and, supporting the audit committee in its oversight functions.

Donelson, *et al.* (2016) assessed the internal control weaknesses and financial reporting fraud. The study felt that 92% of internal audit directors appreciated that external auditors make full use of the expertise of the internal audit staff; 50% of internal audit directors perceived that the relationship between internal audit and external audit is an excellent one, while 31% appreciated this relationship as good (Quantivate,2019).

Studies have shown that external auditors' effort is negatively correlated with the overall quality of the IA function (Desai *et al.*, 2011). The appropriate reliance of External Audit on Internal Audit can achieve significant benefits such as planning common goals and ensuring timely audits (Lambert *et al.*, 2010).

External audits' reliance on and use of internal audits' work can lead to efficiency improvements between eliminating the duplication of work thus reducing the cost of the external audit and the respective audit fees (Chen *et al.*, 2017). Internal audits deemed by external audits as not sufficiently professional and independent might discourage cooperation due to external audits' perception of potential threats to the external audit quality (Pizzini *et al.*, 2015).

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2.1. SIGNIFICANCE OF THE STUDY:

Most companies are consistently facing challenges arising from misappropriation of funds, and fraud, often destabilizing their operations. This information is either disclosed or hidden from the shareholders in the financial reports. In such a situation, the management will have to work to maintain a business position on the economic map. Improper reporting gives the wrong impression of a business, putting it at risk of both legal and in-house challenges. This results in greater responsibilities faced by the management (Brewster *et al.*, 2016). Market environments are a fast-growing complexity, added to the fact that it quickly transforms and changes, which entails businesses to concentrate on factors that are most critical to the existence of the organizations. These factors include carrying out cohesive internal and external audits to ensure the reports produced are reliable and can be accounted for. From the foregoing, shareholders of businesses must be assured of a true and fair reflection of the business through efficient reporting. Studying the crucial matters relevant to the company to serve the purpose as well as its objectives will determine and identify its success. In this light, this study aims on analysing the need for cooperation between internal and external auditors during the report preparation process. Additionally, it will serve as a guideline for other companies that are desirous of a true and fair reflection. This study will also be significant to companies in Jordan. The survey of the research study will help determine how the relationship between internal and external audits affects the reporting process. This will also help initiate and implement management, as it may pinpoint ways to ensure an increased relationship, which could mostly be relevant to the achievement of shareholder satisfaction. Most companies are consistently facing challenges arising from misappropriation of funds, and fraud, often destabilizing their operations. This information is either disclosed or hidden from the shareholders in the financial reports. In such a situation, the management will have to work to maintain a business position on the economic map. Improper reporting gives the wrong impression of a business, putting it at risk of both legal and in-house challenges. This results in greater responsibilities faced by the management (Brewster *et al.*, 2016). Market environments are a fast-growing complexity, added to the fact that it quickly transforms and changes, which entails businesses to concentrate on factors that are most critical to the existence of the organizations. These factors include carrying out cohesive internal and external audits to

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3. MATERIALS AND METHODS:

The study adopted a qualitative approach with a single case study described among others in public institutions. A semi-structured interview and documentary analysis allowed us to gain an understanding of the external and internal audit existence. The researcher used a descriptive and exploratory research design to determine the compatibility between internal and external audits. The study selected RTDA because of weaknesses found in the implementation of the contract for works of maintenance of Ngoma-Ramiro road(63km) awarded at an abnormal price of Frw 79,722,038 per Km compared to other contracts' prices in the same region of Frw 13,869,584 per Km and Frw 18,092,259 per km as it was pointed in Auditor General's report of 30 June 2019 on page70. The research includes the organization's employees. In this research, the population is composed of senior managers and staff involved in auditing activities. It is composed of officials from different categories within an organization and one official from the auditor general's office as an external audit staff.

4. ANALYSIS AND DISCUSSION: The study results were reported using the absolute variations indicators using content analysis for efficiency, mitigation, and assessment.

4.1. Assessment of whether the external audit's negative remarks and materiality are a result of the failure of the internal audit

The first objective of the paper was to assess whether the external audit's negative remarks and materiality are a result of the failure of the internal audit. Results indicated that 60% reiterate no existence of timely assessment of organizational operations at RTDA. Internal auditor issues in the organization's operations are reported regularly to the RTDA director-general at a rate of 80%.

Results indicate that 70% that the size and structure of RTDA are wide while 30% reiterated that the size is not wide. Based on findings the internal audit functions are limited due to the size and this causes the failure of the internal audit department compared to other public institutions.

The study reveals that 80% disagree with the existence of internal auditor's independence and objectivity of Internal Audit work. The study revealed that 80% confirmed zero collaboration between the organization department and both internal and external audit to detect errors in advance and urged that it is all in all due to the size and incompatibility of internal and external audit on the same scene of operation and performance.

4.2. Influence of the audit incompatibility on RTDA's performance

This objective sought to establish the influence of audit incompatibility on RTDA's performance. Results on the impact of audit incompatibility on ascertaining true and fair view of financial reports felt that 70% agreed with the statement. Moreover, 50% agree with the influence of audit incompatibility on the credibility of financial reports at RTDA, 70% agree that audit incompatibility improves the correctness of books of accounts and 60% agreed that audit incompatibility instills confidence in users.

5. FINDINGS:

The findings of this study clearly show that lack of operation assessment has contributed to the failure of internal audit, and the existence of a low level of willingness to correct errors and mistakes. The study shows that internal audit staff at RTDA is insufficient compared to the size, capacity, and institutional operations because one auditor cannot cover all institution operations, doubts about independence and objectivity of the Internal Audit function, zero collaboration between the department and both internal and external audit to detect errors in advance. This implies that the failure of internal audits will be attributed to the lack of effective collaboration in detecting errors. This study did not contradict the observation of Fadzil *et al.*, (2005) which reiterated that effective internal audit services can in reducing overheads, and maximizing exposure to possible losses from inadequately safeguarded company assets all of which can have a significant effect on the bottom line. A study carried out by Davidson, *et al.* (2013) on the effect of continuous auditing on the relationship between Internal Audit sourcing and the external auditor's reliance on the Internal Audit function, felt that from internal audit's point of view, the relationship with the external audit is only ostensibly a very good one, and however, questions addressing causality were omitted from his survey. Results to the second objective show impact of audit incompatibility on ascertaining true and fair view of financial reports, the credibility of financial reports, and the correctness of books of accounts. The study findings concur with Desai *et al.* (2011) on the fact that external auditors' effort is negatively correlated with the overall quality of the IA function, by how Internal Audit activities are organized. From these studies, it emerges that external auditor reliance on internal auditors is influenced by four elements: internal auditors' objectivity, internal auditors' competence, their work performance, and the subjectivity of the audit task (Pilcher *et al.*, 2013). The present study concludes that despite the cooperation between the external auditors and the Internal Audit function, the paper did not make a comparison of many public institutions on compatibility between internal and external audits.

6. RECOMMENDATIONS

The study recommends the need of adopting necessary measures from public institutions should be taken to the management of those institutions in the cases where they fail to rightly, correctly, and timely implement the auditor general office recommendations. Disciplinary actions should be taken whenever audit reports reveal fraud in the financial statements of public institutions. There is a need to restructure institutional size, training is needed. It is very important to resize RTDA because it is impossible for one internal audit to control and make a timely assessment for such institutions. A joint operation of the organizational department with internal and external audits for early detection of error and fraud for operation effectiveness should be encouraged at RTDA. The study recommends that the independence and objectivity of internal auditors should be encouraged to increase performance indexes and appraisal by external auditors.

7. CONCLUSION:

The key issue that is considered important is compatibility between internal and external audits in public institutions. The main purpose of this paper was to establish the compatibility between internal and external audits in discovering abnormalities and fraud in public institutions. Indeed, internal auditors consider the cooperation between internal and external audits to be limited, although external auditors are rather more positive on the extent of cooperation

in circumstances where the Internal Audit is perceived as being professional in its work. The study concludes that the overall coverage of audit activities is done by ensuring the complementarity between the internal and external audits. The internal auditor can use the results performed by internal auditors, but this cannot reduce the external auditor's duties. The external auditor has as the pertinent role to limit risks, block new errors and fraud, elaborate clear procedures for all functions undertaken inside an institution, as well as identifying and managing risks.

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