

# **Determinants of External Audit Effectiveness: The Case of Amhara National Regional State Bureaus**

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**Abstract:** This paper aims to find out the Determinants of external audit effectiveness when performing its duties and responsibilities to examine the most significant Determinants among them with particular emphasis on Amhara National Regional State budgetary bureaus using mixed research approach. Primary data were collected using questionnaire and Interview by using descriptive statistics and multiple regression analysis methods. The main findings of the study were public sectors' assets had been unable to provide reasonable assurance by auditing whether the general objectives of organizations are accomplished. These indicated that there is Weakness in the internal control of entities which includes effective systems of risk management, an effective internal audit function, internal control and an audit committee as part of the framework of control. To address the problems stated above the public bodies should give due attention to establish an audit committee, comprising nonexecutive members with the responsibility for independent review of the framework of control of the external audit process.

**Keywords:** External Audit, External Audit Function, External Audit Effectiveness, Public Sectors

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## **1. Introduction of the Study**

Auditing is the process by which a competent independent person accumulates and evaluates evidence about quantifiable information related to a specific economic entity for the purpose of determining and reporting on the degree of correspondences between the quantifiable information and established criteria [4].

The principal objective of an audit, in addition to expressing an opinion on the truth and fairness of the financial statements, is also expected to give suggestions on the audit entity's compliance with the applicable authorities, laws, regulations, rules, policies and procedures [1]. This clearly indicates that the Auditor General significantly contributes in promoting accountability and transparency and consequently the necessity to be credible in the eyes of the citizens. As explained above audit has a long history, but researches are rarely conducted in this area. Therefore the purpose of this study is designed to inspect determinants of external audit effectiveness taking government organizations/offices residing in Bahir Dar as a case.

Amhara National regional State Office of the Auditor General, 2011 reported that in consolidated fund the

government body around, 1.7 billion Birr, being unable to collect or produce documentation to support the decision of its management. Regarding property of the organizations, there is no adequate asset management like lack of supporting documents, formal property records, appropriately cross referenced documents, evidencing receipt and issuance vouchers, documenting to support legal government's claims, resulting in insufficient evidence to confirm significant amount of the account receivable.

Not identifying the causes of these inefficiency and ineffectiveness and not addressing them appropriately would inevitably undermine the effectiveness of external audit in the region as well as the country and this definitely is a serious challenge. Amhara National Regional State Office of the Auditor General, 2012& 2013booklet as can be understood from the above statement of the problem that appropriate measures are not taken on auditing results. As far as the researcher knowledge, research papers are rarely done on this area. Others Prior Ethiopian researchers conducted studies on profit- oriented public sectors and internal auditing. On Internal audit effectiveness case of Ethiopian Universities [14]. Assessment of determinants of internal audit effectiveness [5]. Determinants of internal audit effectiveness

[16]. All the above listed researchers' focus was not on external public sectors audit. This study tries to examine determinants of external audit effectiveness in Ethiopia taking Amhara National Regional State Bureaus as a case.

The general objective of this study is to examine the determinants of external audit effectiveness in Amhara National Regional State Bureaus.

Based on the general objective stated above, this study specifically tries:

1. To examine the trend of external audit performance in the region.
2. To explore determinants and see their relationship with effectiveness.
3. To identify the most important determinant of external audit effectiveness.

#### Questions

What are the determinants of external audit effectiveness in public sectors?

How to see the trend of external audit performance in Amhara National Regional State Bureaus?

What level of significance relationships exist between each determinant and external audit effectiveness?

What would happen to the dependent variable, if one of the determinants actually changes and which one is the most important determinant of external audit effectiveness?

## 2. Literature Review

Theoretical review and Empirical Review.

Modern auditing as a separately identified function and as a profession has been developed in the beginning of the 20th century and has become a management oriented profession and established itself as a distinct discipline with a far broader focus rather than mainly focusing on the attestation of the occurrence of financial matters. There are five auditing theories namely, the policeman theory, lending credibility theory, Quasi-judicial theory, theory of inspired confidence and the agency theory [11].

Government auditor's role supports the governance responsibilities of oversight, insight, and foresight. Oversight addresses whether government entities are doing what they are supposed to Oversight to do and serves to detect and deter public corruption. Insight assists decision-makers by providing an independent assessment of government programs, policies, operations, and results. Foresight identifies trends and emerging challenges. Auditors use tools such as financial audits, performance audits, and investigation and advisory services to fulfill each of these roles [13]. The Importance of Supreme Audit Institutions in Curbing Corruption for Reconstruction and Development is worldwide [6].

The Institute of Internal Auditors stated as auditing is a cornerstone of good public sector governance. By providing unbiased, objective assessments of whether public resources are responsibly and effectively managed to achieve intended results, auditors help government organizations to achieve accountability and integrity, improve operations, and instill

confidence among citizens and stakeholders [13]. The importance of auditing in maintaining credible financial markets, and its role in the process of corporate governance [8].

The explanation of the literature suggests an increasing need for interactions among board of directors, management, internal audit and external audit as the four components of corporate governance and presents internal audit as a resource for the external audit [15]. It is necessary to understand the effectiveness of external audit specially public sector external audit in Ethiopia from the perspective of good governance, internal control, risk management, top managements responsibility and Internal audit accountability and transparency. Audit plays an important economic role in serving the public interest to strengthen accountability and reinforce trust and confidence in financial reporting [9]. As explained in the statements of the problem, local researchers conducted in previous time have some related ideas in common. Some focused on profit-oriented sectors that regard to private auditors; Most of them are also focused on the practice of tax auditing and on internal audit function in different aspects. Role of External Auditing in Public Financial Management [10].

As researcher's knowledge no any other studies on public sectors (Bureaus) make a research using issues of good governance, risk management, top management responsibility, internal control and internal audit as the factors those determinants of external audit effectiveness in the amhara national regional state bureaus.

Due to the above gap found on those public sectors, the researcher conducted a research on determinants of external audit effectiveness in Ethiopia taking Amhara National Regional State Bureaus as case.

## 3. The Research Methodology

Amhara is one of the nine ethnic divisions of Ethiopia, containing the homeland of the amhara people. However, to make the study more feasible and manageable, the scope of this study covers only in amhara national regional state of public institutions at the regional level (Bureaus, Agencies, Authorities & offices) whose budgets are fully allocated by the regional government. More specifically forty one regional public institutions in number are found in Bahir Dar.

The researcher used mixed methods because of combining multiple methodologies provide a more complete understanding for research problem than could be obtained through the individual methods alone [16]. The study would mainly focus on testing the determinants of external Audit effectiveness in Ethiopia taking the Amhara National Regional State Bureaus as a case.

When the data are collected for several variables at the same point in time it's called cross-sectional data. The study used cross-sectional type of data. The study used primary data sources. The primary data would obtain through questionnaire and interview. The interview would use to

verify the patterns that develop from the data collected through questionnaires and to inculcate some of the information that could not be accessed using the questionnaire. Their responses options are in the form of a five point Dr. Rensis Likert, type scale: 1) Strongly Disagree (2) Disagree (3) Neutral (4) Agree (5) strongly Agree.

For this study I used purposive sampling technique to identify the respondents from staff, therefore, three respondents are chosen from head (deputy head) of Bureau, support process owner of procurement, finance and property administrator and head of internal audit unit from sample sectors of the amhara national regional state bureaus.

To determine the sample size from the total regional bureaus, agencies and offices at regional level in Bahir Dar city, the researcher used the (Taro Yamane, 1966) formula that is:

$$n = \frac{41}{1+(41(0.05^2))}$$

n=37 Sectors (Bureaus)

Then, simple random sampling method was used to select sample sectors from each number of populations. Thus the primary data was collected using questionnaire from three individuals in each selected sectors (bureaus): one for heads or deputy of bureaus, offices, agency etc., and one process owner of procurement, finance and property administrator support process from each bureau and one head of Internal audit unit from each bureau. The total numbers of respondents are 111 (3x37)

Three parts have been included in the survey; the first part incorporates demographic characteristics, the second part incorporates the testing measurement concerning the five main variables of the study area and third part tick the appropriate answer, each set questions formed a field statement, which covers the questions of the study.

Data are edited, coded, and analyzed to identify the relationship between the independent and dependent variables. Analysis of the data implement by using statistical package for social scientists (SPSS version 22). Correlation coefficients would use to explain the strength and nature of the relationships, predictability and variability between the variables under the study. Model specification  $EAE = \beta_0 + \beta_1(GG) + \beta_2(IC) + \beta_3(RM) + \beta_4(TMR) + \beta_5(IA) + E$

## 4. Results and Discussion

As observed from the responses obtained the sample respondents' sex distribution out of 107 respondents 80 (75%) were males, while 27 (25%) were females. Age distribution of both questioners respondents about 46.7 percent of respondents were fall in the age interval of 31-40 years while the remaining 24.3%, 14.90% and 14% are 45-50 years, 20-30 and 50 and above respectively. 74 (69%) of the respondents' have more than 6 and above years of experience in their organizations which indicated that majority of the respondents' were categorized under the experienced working age group. The educational status of respondents

indicated that majority of the respondents 87 (81%) were first degree holder and 20 (19%) were MSC holders. This partially contributed to the quality of work and an appropriate understanding working circumstances.

In this regard the study aimed to know about Public sector governance that encompasses the policies and procedures used to direct an organization's activities to provide reasonable assurance that objectives are met and that operations are carried out in an ethical and accountable manner [12].

The descriptive statistics is analyzed by using good governance the median and mode results (4.00) and also the mean point is above 3.9 shows that the respondents' consent is all agreed on important of good governance, and the next two statements the median and mode results (2.00), and the mean results below 3 show that the respondents' disagreed on the last two statements.

Regarding remedial actions Only 82 (77%) of the respondents are disagree on that Management takes timely corrective actions based on external audit recommendations. In details, the respondents agreed on key components in ensuring a healthy public sector governance framework but there is no timely corrective actions has been made on external audit recommendations and failure of accountability.

In this section the researcher intended to analyze the role and the support of internal control system for the external audit effectiveness. The descriptive statistics is analyzed by using internal control the mean point 4, the median and mode results (5.00 and 4.00 respectively) show that the respondents' Consent is all strongly agreed and agreed on importance of internal control. This implies that all respondents believe that internal control structures are important in providing reasonable assurance for the general objectives that have been accomplished in the organization.

Risk management whether it is seen as a burden on business, or the means by which business opportunities are maximized and potential losses associated with unwanted events reduced. The mean points above 4 and the median and mode results (5.00) show that the respondents' agreement is all strongly agreed on three items but in the last statement the mean is below 2, the median and mode results (2.00) show that the respondents' disagree on it. About 65 respondents out of the 107 representing 61% disagree on the statement that Sector's Management strong the risk limit in the risk management process and monitors Policies, procedures, and activities that insure that risks are kept within the limits.

Top management responsibilities, the mean point is above 3.8, the median and mode results (4.00) show that the respondents' agree on three items and the median and mode results (3.00) and the mean above average show that the respondents' being neutral on three items. In details, 55 (51%) respondents agreed and 52 (49%) respondents neutral that the management establishes and maintains internal control system. This indicates that all respondents have understood the difference responsibilities of entities' management.

Internal audit have the median and mode results (4.00) and

the mean results above 4 shown that the respondents agree on items. Above, 101 respondents (94%) believe that internal audit positively affect external audit. This fact indicated that the internal and external auditor should work closely together, in particular to co-ordinate activity and maximize audit effectiveness [7]. As it has been clearly indicated in the literature search part in this thesis, by engaging external audit in such a way, potential overlaps and gaps in overall audit coverage can be identified and addressed and it would assist in maximizing the extent to which external audit is able to

rely on the work of internal audit in undertaking its work. There is conclusion that from external auditors' point of view, the most important factor is a quality work performed by internal audit.

The external audit effectiveness of respondents strongly agreed on the audit Recommendations that were balanced, constructive, useful, realistic, and trusted by public and agreed on others external audit effectiveness's components did work according to the audit institution mission.

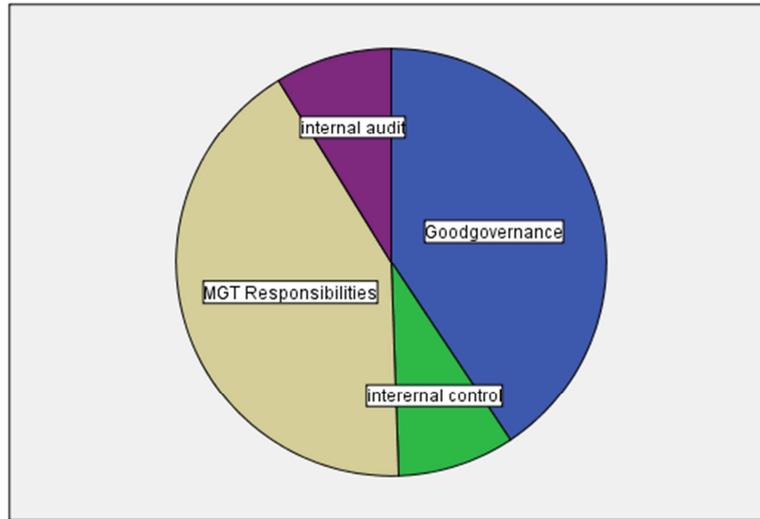


Figure 1. Effects of the independent variables on external audit effectiveness in terms of rank order.

In this study Pearson's Correlation Coefficient is used to determine whether there is significant relationship between Good governance, internal control, risk management, top management responsibility and internal audit independence variables with external audit effectiveness.

The correlation coefficients for the relationships between dependent and independent variables are linear and positive ranging from considerable to strong correlation coefficients.

Table 1. Pearson's Correlation Matrixes.

	GG	IC	RM	MR	IA	EAE
GG	1	.094	-.056	.138	.091	.318**
IC	.094	1	-.059	.076	.268**	.483**
RM	-.056	-.059	1	.010	-.108	.094
MR	.138	.076	.010	1	-.081	.270**
IA	.091	.268**	-.108	-.081	1	.412**
EAE	.318**	.483**	.094	.270**	.412**	1

Table 2. Relationships between Determinants and External Audit Effectiveness.

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Sig.
1	0.682 <sup>a</sup>	0.465	0.438	0.32628	0.000a

It is also strong relationships between all the independent and dependent variables (R=.682, which is >.6) in the model, which implied that the multiple R for the regression between the set of independent variable and the dependent variable respectively characterized as strong below one but has higher

Correlation analysis is shows the strength of the association between the variables involved. There is a significant positive relationship between external audit effectiveness (dependent variable) and independent variable (Good governance, internal control, Risk management, management responsibilities and internal audit). This means external audit effectiveness goes down as public sectors' good governance, internal control, management responsibilities and internal audit goes down.

RQ#2. What level of significance relationships exist between each independent variables and external audit effectiveness? And

RQ #3. What would be the dependent variable, if one of the independent variables actually changes and which one of the independent variables affects more an external audit effectiveness in Amhara regional bureaus?

value, which is better (Gupta, 1999). The beta coefficient of the model in Table 3 indicated that the beta value for the predictors (Good governance, internal control, risk management, management responsibilities and internal audit).

Table 3. Determinants effect on external audit effectiveness.

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	3.295	1.163		2.832	0.006
Good Governance	0.265	0.085	0.231	3.113	0.002
Internal control	0.463	0.097	0.364	4.786	0.000
Risk management	0.508	0.230	0.162	2.211	0.029
Management responsibilities	0.269	0.085	0.235	3.174	0.002
Internal Audit	0.302	0.070	0.331	4.316	0.000

Good Governance 0.265, internal control had 0.463, and Risk management had 0.508 Management responsibilities had 0.269 internal Audit had 0.302 and beta values respectively. Therefore, this implied that if the level of Good Governance increases by 1% external audit effectiveness by 50.8%, if top management responsibility increases by 1% then external audit effectiveness increases by 26.9% if the level of and if internal audit increases by 1% external audit effectiveness increases by 30.2%. As per the results revealed the determinants affect descending external audit effectiveness increases by 26.5%, if internal control increases by 1% external audit order in amount were Risk management, internal control, Internal Audit, and top management responsibilities, Good Governance respectively. Therefore the equation of model using standard coefficient is the following:  $EAE = \beta_0 + \beta_1 (GG) + \beta_2 (IC) + \beta_3 (RM) + \beta_4 (TMR) + \beta_5 (IA) + e$   $EAE = 3.295 + 0.231 (GG) + 0.364 (IC) + 0.162 (RM) + 0.235 (TMR) + 0.331 (IA) + e$

## 5. Conclusions

In this regard it is clear that these concepts of good governance and auditing are strongly related with each other.

About 23% of the respondents agreed that top Managements take timely corrective actions based on external audit recommendations. This implies that most of the public sectors managements (77%) do not apply appropriate internal control system, safeguarded assets, measuring the effectiveness of programs of organization as they are expected to do. External audit plays an important role in providing balanced, constructive, useful, and realistic information that stimulating good governance, internal control, risk management, management responsibilities and internal audit performance in public sector by safe guarding public assets and ensuring good financial management system.

Here, the key matter is taking the appropriate remedial action to strengthening the weak link of the control system with strong penalty systems. Media should play a crucial role in questioning the managers of each organization who fail establishing and maintaining a system of internal control procedures and regarding those findings in which remedial corrective action are not taken. The judiciary must play their roles effectively to ensure that prompt corrective actions are taken to implement the recommendations of auditors and establish an audit committee, encompassing nonexecutive members.

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