

**MENTOR | The Journal of Business Studies**

Faculty of Commerce and Management, Eastern University, Sri Lanka

JBS**IMPACT OF INTERNAL AUDIT QUALITY ON THE FINANCIAL PERFORMANCE OF LISTED COMPANIES IN SRI LANKA****R.M.K.L.K. Rathnayake^{a*} T. Paranthaman^b**^{ab}Department of Commerce, Faculty of Commerce and Management, Eastern University, Sri Lanka.**ABSTRACT**

The study is aimed to find out impact of internal audit quality on the financial performance of listed companies in Sri Lanka. The internal audit quality is considered as independent variable, measured using the four dimensions of independence of internal auditors, internal audit standards, professional competence and internal control. The financial performance considered as is dependent variable, measured by return on assets. Primary data is collected through questionnaires from one hundred and seven (107) internal audit management level employees and the secondary data was collected from the annual reports of listed companies. The data is analyzed using descriptive statistics, correlation and regression analysis. The results showed that there is a positive significant relationship between internal audit quality and financial performance of listed companies in Sri Lanka. Moreover, among dimensions of internal audit quality, professional competence and independence of internal audit are the most influencing factors on financial performance. Independence of internal audit should be made more effective in financial performance and when the internal auditor more independence to do their activities, it is caused to increase financial performance of listed companies. Hence, the listed companies should enhance the internal audit quality to get positive results in financial performance.

Keywords: *Internal Audit Quality, Financial Performance, Independence of Internal Auditors, Internal Audit Standards, Professional proficiency, Internal Control*

**Corresponding* paranthamant@esn.ac.lk

© Faculty of Commerce and Management, Eastern University Sri Lanka. All rights reserved.

1. Background of the Study

Internal audit quality becomes essential for an organization to manage their resources and improve their financial performance. Failing to maintain a financial statements quality by a firm with material misstatements, leads to fraud, big financial scandals, losses, and defalcation. Hence, good internal audit quality plays a major role in supporting the management by providing reasonable assurance of the financial performance of the whole organization. Internal audit, along with internal controls, ensures the maintenance and preparation of financial statements in terms of compliance with financial reporting standards, rules, and regulations applicable when preparing the financial statements of the company (Ahmeti et al., (2022), Abdullahi Bala Ado, N. R. (2020)).

According to Vijayakumar (2012), internal audit function improves governance and implementation of internal controls framework, which raises awareness in the management regarding the advancement or delay in achieving the company's objectives and goals.

Internal audit quality is the combined possibility that an auditor will become aware of and address material misstatements. In this case, the meaning of assurance quality consists of two approaches: the ability to identify misstatements and the willingness to disclose misstatements discovered in an assurance engagement. The measurement of internal audit quality is capturing into two variables, professional qualifications and the auditing experience of the internal audit staff (DeAngelo, 1981).

Audit quality is appropriate when it follows all SLAUS that best practices and assurances designed to give a true and fair view of the company's financial performance over time. Financial performance is best described when a company represents its condition without material misstatements and the associated risks. The measurement of outcomes of the organization's operations and policies in financial terms is what defines financial performance (Dunjia, 1997). Firm performance which is a dependent variable is assessed on a few indicators. Return on Assets (ROA), Return on Equity (ROE) and Return on Investments (ROI) are mentioned as three main indicators of accounting-based performance to check the performance of the organization and capture their internal efficiency (Schiuma, 2003). Moreover, according to Marion Hutchinson (2009), Ardi (2022) and Saddam (2020) has reviewed using several regressions analyses that Internal Audit Quality and firm's financial performance exists a positive correlation.

The independence of the members of audit committees is positively related to the financial performance of the organizations, and therefore heads of departments should not be involved as a member of audit committees because of its negative impact on financial performance (Mujeeb, 2020). When the internal auditors follow the rules and procedures that govern the internal audit profession, compliance with the Sri Lanka Auditing Standards (SLAuS), and Sri Lanka Accounting Standards (LKAS and SLFRS) are the most important factors that help improve financial performance (Marika Arena, 2006). Therefore, there is a positive complementary relationship between internal audit independence, auditors' accounting experience, regular internal audit meetings and internal audit effectiveness (Ken, 2006).

Moreover, according to Farouk (2014), audit quality is an essential element in maintaining the financial performance of companies, while Abdullahi (2020) emphasizes that objective quality control provides the basis for confidence in the integrity and reliability of reports, which is extremely important for the efficient functioning of markets and also improves financial performance.

Code of Best Practice on Corporate Governance 2013 issued jointly by Securities and Exchange Commission of Sri Lanka (SEC) and Institute Chartered Accountants of Sri Lanka (ICASL) recognized the significant contribution of Internal Audit, and it provides best practices for companies that can be adopted when setting up an audit function. In Sri Lanka internal audit has increasingly become crucial specially in Listed Companies

since Colombo Stock Exchange (CSE) requested to all listed firms to have an internal audit department. And internal audit function should be established by the Board of Directors, and it has to be independent of the activities they audit as per the security and exchange commission of Sri Lanka Act, No.19 of 2021.

Despite the existence of a sophisticated system of internal control and internal audit teams in listed companies, a number of companies continue to experience financial distress especially due to current situation facing Sri Lanka which has threatened their survival in the competitive business industry as well.

Therefore, this study attempts to identify the impacts of internal audit quality on the financial performance among listed companies and the audit practices that currently implemented in Sri Lanka.

2. Problem Statement

The recent global financial crisis has led to questioning of how successful internal audits are both in its conventional role of monitoring compliance with internal controls and financial probity and its role as an integral part of the risk management culture in large business entities, whether in the private or public sector (Abdulaziz Alzeban, 2014; Kumbirai & Webb, 2010).

Due to increasing competitiveness and economic requirements, many companies have introduced various control and monitoring tools, including internal audit systems. As suggested by the Chartered Institute of Internal Auditors (2017), the main reason for the need for internal as well as external audits is to separate the ownership of organizations from their departments so that the audit includes the process of auditing and controlling their opinion on quality and reliability of the annual financial statements. Indeed, strengthening the audit department independence, regular meetings, and continuous training of auditors to keep pace with the modernization of standards that regulate the profession of audit activities, contribute significantly to enhancing the performance of organizations (Abdulaziz Alzeban, 2014).

Eshitemi (2016) found that positive relationship between audit quality proxies (audit firm size, independence, qualification of the audit team and auditor's experience) and financial performance. Abdullahi (2020) states that there is a slight positive correlation between audit fee and financial performance whereas a positive and statistically significant relationship between auditor independence and financial performance in Nigerian listed firms. Gekula (2020) found that professional competence, internal auditing factors, internal auditing standards and interdependence of internal audits were found to have positive significant correlation on financial performance in public sector in Tanzania. Where as, Mohammad (2018) emphasized that audit committee financial and accounting expertise has a negative relationship with financial reporting quality. Ahmeti et al., (2022) states that the efficiency of internal audit had a negative impact on the financial performance of insurance companies operating in Kosovo.

Hence, previous studies show some contradictions in their finding on the impacts of internal audit quality on financial performance and most of studies focusing on single industry in similar studies. According to Ardi (2022) it is mainly focused on insurance companies and Saddam (2020) mainly focused in Commercial Banks. Further, previous studies did not much pay attention regarding impact of internal audit quality on the financial performance in listed Companies. In this regard, it is very important to examine **"Impact of Internal Audit Quality on the Financial Performance of Listed Companies in Sri Lanka."**

3. Research Questions

According to the above research problem research questions are derived as following.

1. What is the level of internal audit quality of Listed Companies in Sri Lanka?
2. What is the impact of internal audit quality on the Financial Performance of Listed Companies in Sri Lanka?

4. Research Objectives

This research work is designed to achieve the following specific objectives.

1. To determine the level of internal audit quality of Listed Companies in Sri Lanka?
2. To examine the impact of internal audit quality on the financial performance of Listed Companies in Sri Lanka?

5. Significance of the Study

Compared to other countries, Sri Lanka has relatively fewer articles and journals on the current audit practices affecting the financial performance of listed companies. As such, there are very few sources to study the impact of internal audit quality on financial performance.

The internal audit is very important when obtaining reasonable assurance about whether the financial statements are free from material misstatements and how eventually it impacts on financial performance in the organization. Therefore, this study will provide useful insight into the CSE on the current status of the internal auditing in the listed firms. Finally, the research will be of interest to scholars and researchers who may wish to broaden their knowledge of how financial performance in various kinds of listed companies' impact by internal audit quality.

6. Scope of the Study

This study focused to the Listed companies in Sri Lanka and depends on both primary data and secondary data using random sampling method among population of 294 listed companies in CSE. This gives an analysis of a sample study of the impact of internal audit quality on the financial performance.

7. Conceptualization and Operationalization

The variables are used to investigate the effect of internal audit quality as an independent variable on financial performance as a dependent variable of selected listed companies in Sri Lanka. The internal audit quality measured using the dimensions of independence of internal audit, internal audit standards, professional proficiency and Internal Control while the dependent variable is financial performance which is measured by Return on Assets (ROA).

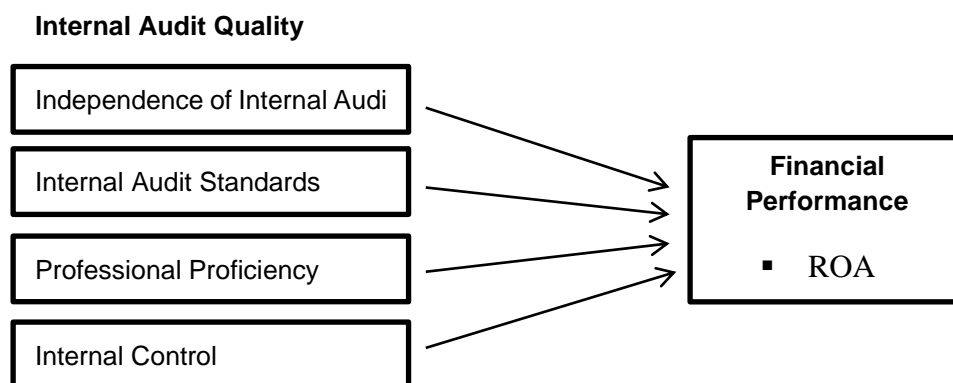


Figure 1: Conceptual Framework

8. Literature Review

Internal Audit Quality

As per Sri Lanka Auditing Standard 610 issued by ICASL “Internal auditing means an appraisal activity established within an entity as a service to the entity and its functions include, amongst other things, monitoring internal control.” Those definitions place a strong emphasis on two key components of audit quality. They are the independence and objectivity of the auditor in making decisions on a found misstatement and the professional competence of the audit company in assessing the risk of misstatement detection. Also, Adeyemi (2010) argues that internal audit quality is the market's estimated joint probability that an auditor will simultaneously discover a flaw in the company's accounting system and report that flaw, implying that the auditor has both technical competency and professional knowledge while performing the audit to identifying errors in the audit process and maintaining independence to ensure those material errors and omissions in the auditor's report are corrected or disclosed.

Audit quality, according to Davidson (1984), indicates the accuracy of the auditor's financial information reporting. Additionally, according to Davidson (1993) the definition of an audit quality relies on the auditor's capacity to detect and correct major profit misstatements and manipulations. These definitions have all provided useful clarification of what audit quality actually means. Another definition of audit quality places a strong focus on the veracity of the auditor's conclusion. According to Titman & Trueman (1986), high quality audit must be

maintained for financial statement information to be trustworthy and serve the reasons for which they are intended. This makes it possible for investors to evaluate a company's value more precisely and make defensible decisions. According to Schauer (2002), a better audit increases the probable that the financial statements accurately reflect the entity's financial situation and operational outcomes.

Although audit quality is no longer a new concept in the context of auditing, there does not appear to be a commonly accepted measuring framework for it as of yet (IAASB 2014). Using direct metrics like bankruptcy, financial reporting conformance with generally accepted accounting principles, quality control review, and SEC performance are two perspectives on how audit quality should be monitored.

Internal audit quality has been selected as the independent variable. Internal audit quality is an important factor which enhance financial performance of firms (Ado, Rashid, & Mustapha, 2020). Further, internal audit quality is crucial factor for every company to achieve efficiency and effective management of resources. Furthermore, internal audit quality involves increasing financial performance and also it acts as a key implementation strategy of the accounting system. In addition, internal audit quality supports management of the companies to check the work each department within the firm as a whole (Amoh, 2017).

Moreover, internal audit quality is an essential part for every organization and it assists not only creates discipline in the organization, improves risk management but also to achieve organizational objectives, enhance shareholders wealth, provide accurate information to financial accounting information users.

Independence of Internal Audit

Anojan (2022) stated that internal audit should be independent and it is necessary activity for risk assessment and implementation of internal control system of the company. Internal audit focus on mainly to ensure the effectiveness and efficiency of operations, enhance reliability of the financial information as well as comply with the legal requirement of the company. Furthermore, internal audit covers financial activities and non-financial activities of the company (Amanuddin & Divyaa, 2014).

According to Chun (1997), independence is necessary for auditing and internal auditors should be independent of both personnel and operational activities of the company. Andalso, internal auditors should present their opinions, conclusions and recommendation honestly. Therefore, independence is needed for efficiency of internal auditing, effective achievement of the organization.

Internal Audit Standards

Glazer and Jaenike (1980) stated that working in compliance with internal auditing standard contributes the effectiveness of auditing. Further, Josephine (2019) emphasized that complying with audit standards is the most crucial contributor which is the most crucial contributor which is added value to internal auditors. Moreover, audit standards not only influence financial performance but also contribute risk management, control and governance. In addition, professional standards recognize that internal auditors also provide services regarding information other than financial reports.

According to Bou- Raad (2000), compliance with internal audit standards is not only a legal requirement but also it is an influential factor on financial performance because the scope of an auditor's duties involves the evaluation of areas in which a high level of judgment is involved.

Professional Proficiency

Internal auditors play crucial role in fraud detection because lot of frauds are identified by the internal audit function. Therefore, internal auditors can increase their efficacy due to the importance of effective fraud detection (KPMG, 2003). Furthermore, internal auditors highly provide efficiency and professional services to every firm because they have high professional competence and experience (Anojan, 2022).

Internal Control

Asare (2009) states that internal control, as a control measure, ensures effective substantial monitoring of wealth substance purchased and actual consumption to prevent fraud and financial crises in addition to reducing potential for dishonesty through the confirmation of procurement process. In addition to this, internal control has been asked to evaluate the effectiveness of management's direct practices while implementing effective authorities and controls.

Whittington and Pany (2001) take note of that by influencing the control's awareness of association, internal control influences the nature of the business. They had further stated that the internal control is seen as the inner control factors comprise; sincerity and principled gauges of staff responsible for making, associations, and checking the controls, commitment and capacity of people performing assigned obligations, or internal audit committee, administration viewpoint and working style, and business arrangement, which may be well-organized.

Financial Performance

Financial performance is generally used to measure a firms' overall financial health over a given period and can also be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Fatihudin, Jusni, & Mochklas, 2018). Financial performance is a subjective measure of how well a firm can use assets from its primary mode of organization to generate revenues (Poongavanam, Sait, Srinivasan, & Rengamani, 2017).

According to Veena and Patti (2016), financial performance is strengthening of financial position and it supports to identify the financial strengths and weaknesses of the firm. Furthermore, they mentioned that financial performance is the degree to which financial goals are being or has been achieved. To measure

financial performance different categories of financial ratios are used. Most of the organizations are used ROA and ROE to measure the financial performance. For this study, ROA is used to measure the financial performance.

Return on Assets (ROA) is a profitability ratio which assists to determine how effectively a company can earn a return on its investment in assets. In other words, ROA is an efficiency measure that explains how efficiency and effectively company is using its assets to generate profits. The greater ratio is better for the company (Fatihudin, Jusni, & Mochklas, 2018).

If a particular company has higher ROA, it implies that the company can generate higher profits and it tends to attract more investors to buy the shares of the company. Therefore, ROA is used as a dimension of financial performance in this study.

$$\text{Return on Assets (ROA)} = \frac{\text{Net profit after interest and taxes}}{\text{Total Assets}} \cdot 100$$

Table 1: Operationalization of Variables

Variables	Dimensions	Indicators	Source	Measure
Internal Audit Quality	Independence of Internal Audit	Essence of auditing	(Amoh, 2017; Josephine, 2019)	Five Point Likert Scaled Questionnaire
		Required for efficiency		
		Independent of internal auditor		
		Integrity of auditor's opinion		
		Without interference		
		Non conflict of interest		
	Internal Audit Standards	Contribute for effectiveness of audit	(Amoh, 2017; Josephine, 2019)	Five Point Likert Scaled Questionnaire
		Add value for internal auditors		
		Influence performance		

		Provide services regarding information		
		Compliance with audit standards		
		Contribute to risk management		
	Professional Proficiency	Fraud detection	(Amoh, 2017; Josephine, 2019)	Five Point Likert Scaled Questionnaire
		Identify frauds		
		Enhance efficacy of auditors		
		Cognitive ability		
		Undertake audit function		
		Education in auditing		
	Internal Control	Segregation of duties	(Abdullahi, 2019)	Five Point Likert Scaled Questionnaire
		Authorization of Transactions		
		Retention of records and maintaining		
		Managers' Supervision		
Financial Performance	Return on Assets	ROA= Net profit after interest and tax/ Total Assets	(Amoh, 2017; Ado, Rashid, Mustapha, & Ademola, 2020)	Ratio

9. Hypotheses Development

According to Amoh (Anon., 2017), findings proposed that the independent variable of internal audit quality which is proxied by professional proficiency, independence of auditors, quality of work and top management support have a significant positive relationship with financial performance of listed firms on Nairobi Securities Exchange. Furthermore, Josephine (Anon., 2019) examined the effect of internal audit (which is measured by internal audit standards, independence of internal audit, professional competency and internal control) on financial performance of commercial banks in Uganda. According to the regression results all four independent factors had a positive effect on financial performance. Ezejiofor and Okolocha (Anon., 2020) investigated, internal audit function on financial performance, investigated whether internal audit control and internal audit procedures effect on financial performance. According to the regression analysis results, showed that all two independent factors had a substantial effect on financial performance of commercial banks in Nigeria. Hence, the main hypothesis of this study is developed as given below.

H₁: The internal audit quality and its dimensions positively impact on financial performance of listed companies in Sri Lanka.

10. Methodology

Study population of this study identifies as all the listed companies on Colombo Stock Exchange (CSE) in Sri Lanka during 2021-2022 as at 31st January 2023, totally there are 290 listed companies. The sample issued for 110 listed companies in Sri Lanka representing 10 GICS sectors. The primary data is collected through questionnaire from 107 professionals who worked under finance department and coordinated with the audit teams, audit managers and chartered accountants in selected listed companies in Sri Lanka. The secondary data of ROA is collected from annual reports which are available in Colombo Stock Exchange (CSE) of selected listed companies.

Data were analyzed to identify the relationship between internal audit quality and financial performance of listed companies in Sri Lanka. In this study descriptive statistics and correlation and regression analysis were used. Multiple regression analysis is utilized to investigate critical factors of dependent variable with each independent variable.

In this study has used multiple regression analysis to find out the effect of independent variable on the dependent variable. In this study, following regression model is developed.

$$Y = \beta_0 + \beta_1 IIA + \beta_2 IAS + \beta_3 PP + \beta_4 IC + \epsilon$$

Where,

Y = Financial Performance (ROA)

β_0 = Intercept of formula

IIA = Independence of Internal Audit

IAS = Internal Audit Standard

PP = Professional Proficiency

IC = Internal Control

ϵ = Random Error Term

Hypothesis Testing

The hypothesis falls in one tailed test, in which the alternate hypothesis shows the positive direction in its structure. Hypothesis is tested by choosing a probability level of significance (p value) for measuring the error judgment. A significance level of 5 percent ($p = 0.05$) is chosen as the maximum probability of rejecting a true Null Hypothesis. Conversely, $1 - p$ (95 percent) connotes the level of confidence which is the probability ($1 - p = 0.95$) that the test has accepted a true Null Hypothesis.

Hypothesis Testing using Correlation

H0: There is no significant relationship between two given variables.

H1: There is a significant relationship between the two given variables.

Hypothesis Testing using Regression Analysis

Using Simple Regression:

The Simple Regression Equation is $Y = A + B_1 X_1$

H0: $B_1 < 0$ (X_1 variable does not impact Y variable or negatively impact Y)

H1: $B_1 > 0$ (X_1 variable impacts positively and significantly Y variable)

Hypothesis Testing using ANOVA

The null hypothesis for ANOVA is that the mean (average value of the dependent variable) is the same for all groups. The alternative or research hypothesis is that the average is not the same for all groups. The ANOVA test procedure produces an F statistic, which is used to calculate the p-value. As describe in the topic on Statistical Data Analysis if $p < .05$, we reject the null hypothesis. We can conclude that the average of the dependent variable is not the same for all groups.

11. Study Findings

Personal Information

This section covers the analysis of personal information which was collected 107 out of 110 respondents. Personal profiles of the key respondents shows that 65% respondents are male. The majority of respondents were in between 41-50 age groups which are 35% while 28% of respondents were in between 31-40 age groups. The education level of the respondents reveals that 54% of the respondents have professional qualification, and 34% of the respondents were qualified bachelor degree while 7% of the total respondents were master degree holders.

The designation of the respondents, 38% of the total respondents were internal audit manager while 32% of the total respondents were certified internal auditors. And also, 24% of the respondents were chief audit executives and 6% of the total respondents were certified information system auditor. The experience of the respondents. 37% of respondents have 11-15 years' experience while 35% respondents have 6-10 years' experience. Further, 15% have more than 15 years' working experience while 13% have less than 5 years working experience.

Analysis of Reliability

The reliability of internal audit quality was analyzed by its dimensions of independence of internal audit, internal audit standards, professional proficiency and internal control. Cronbach's Alpha Coefficients were false above 0.7 levels that all the variables have satisfactory results, and the internal consistency of all instruments was satisfactory.

Level of Internal Audit Quality

The overall mean value for internal audit quality is 4.12 with 0.57 standard deviation. Since the mean value falls between the range of $3.5 < X_i \leq 5.0$, it indicates that internal audit quality is at a high level. The mean values of four dimensions of internal audit quality, professional proficiency has the highest mean value compared to other dimensions.

Table 2: Mean and Standard Deviation for Internal Audit Quality

Variable	Mean	Std. Deviation
Independence of Internal Audit	4.07	0.52
Internal Audit Standards	4.15	0.48
Professional Proficiency	4.20	0.58
Internal Control	4.05	0.71
Overall Mean Value of Internal Audit Quality	4.12	0.57

(Source: Survey Data)

Correlation and Regression Analysis

Pearson's correlation analysis is used to identify the relationship between the independent variable (internal audit quality) dependent variable (financial performance).

Relationship between Internal Audit Quality and Financial Performance shows that the Coefficient of correlation (r) is 0.513 which is between in the range of ($r = 0.5$ to 1.0) and it can be identified as a strong positive relationship ($r = 0.513$, $p < 0.01$) between internal audit quality and financial performance.

Table 3: Model Summary of Simple Regression Analysis for variables of Internal Audit Quality

Method	Independence of Internal Audit	Internal Audit Standards	Professional Proficiency	Internal Control
R	0.467	0.590	0.437	0.248
R Square	0.218	0.348	0.191	0.062
Adjusted R Square	0.210	0.341	0.183	0.053
Std. Error	5.59156	5.10603	5.68682	6.12443
F	29.222	55.962	24.763	6.881
Sig. F	0.000	0.000	0.000	0.010
b- Constant	-11.185	-20.444	-8.638	2.470
b- Value	5.544	7.667	4.745	2.189
Std. Coe. Beta	0.467	0.590	0.437	0.248
T- Value	5.406	7.481	4.976	2.623
Sig. T	0.000	0.000	0.000	0.010

Source: (Survey Data)

According to simple linear regressions, it can be concluded that independence of internal audit, internal audit standards, professional proficiency and internal control have a significant impact on financial performance of

listed companies in Sri Lanka. According to the simple regression analysis, R square is 0.264. That means there was 26.4% of the variability in financial performance was explained by the internal audit quality. Internal audit quality has a positive effect on financial performance of listed companies in Sri Lanka ($t = 6.130$, $p < 0.05$, $\beta = 6.893$).

Table 4: Model Summary of Multiple Regression Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.636 ^a	0.405	0.381	4.94851

a. Predictors: (Constant), IIA, IAS, PP, IC

b. Dependent Variable: FP

Table 5: Coefficient of Regression

Model 1	Unstandardized Coefficient		Standardized Coefficient	t	Sig.
	B	Std. Error	Beta		
(constant)	-25.697	4.604		-5.581	0.000
Independence of Internal Audit	2.901	1.309	0.244	2.216	0.029
Internal Audit Standards	4.721	1.373	0.363	3.439	0.001
Professional Proficiency	3.397	1.439	0.313	2.361	0.020
Internal Control	-2.130	1.180	-0.241	-1.805	0.074

a. Dependent Variable: Financial Performance

Source: (Survey Data)

In addition to the results of multiple regression analysis, the researcher attempted to identify the most influencing factor that affecting financial performance. The beta value under unstandardized coefficient, it is concluded that internal audit standards has the most significant influence on financial performance of listed companies in Sri Lanka ($t=3.439$, $p<0.05$, $\beta=4.721$). In addition, independence of internal audit ($t=2.216$, $p<0.05$, $\beta=2.901$) and professional proficiency ($t=2.361$, $p<0.05$, $\beta=3.397$) is important factors to the financial performance. Therefore, it can be concluded that internal audit standards and independence of internal audit and professional proficiency are positively impacting on financial performance of listed companies in Sri Lanka. And also, there is no any effect of internal control ($t= -1.805$, $p>0.05$, $\beta= -2.130$) on financial performance.

According to results, financial performance of listed companies in Sri Lanka is more relay on the internal audit standards and independence of internal audit of internal audit quality. In other words, among dimensions of internal audit quality, professional proficiency and independence of internal audit are the most influencing factors on financial performance. Therefore, listed companies in Sri Lanka should focus on improve their financial performance by improving their internal audit quality determinants of professional internal audit standards and independence of internal audit. According to the findings and discussion, listed companies must take much consideration about those factors of internal audit quality to maximize their financial performance.

12. Limitations of the Study

This study was limited to 107 listed companies in Sri Lanka and not considered other listed companies. And also, this study only focuses on four dimensions as independent variables such as independence of internal audit, internal audit standards, professional proficiency and internal control. There are lots of factors related to internal audit quality and financial performance. But this study only considers one independent variable and under those four dimensions. This study used a quantitative method with a questionnaire. Therefore, it has a risk of bias. To acquire a fuller understanding, it is required to increase the scope of the study sample and include other variables, as well as to utilize a qualitative method. The sample size of this study is relatively small. This study only considered a sample of 107 out of 110 respondents. If the sample size is large, the accuracy of findings may be raised. The researcher is only able to collect data from 107 out of 110 respondents due to limited time frame.

13. Suggestion for Future Study

Future researchers can be taken into actions to improve further research by overcoming the limitation of this study. Hence, the following suggestions are suggested by the researcher to improve future research.

Future researchers can expand the sample size of this study. This study only concern about 107 listed companies. A larger sample study is needed to confirm the rational findings. If the sample size is large, the accuracy of findings may be increased. Therefore, future researchers can use more listed companies for their samples. Another limitation of this study is only taking a small period to collect the data. So, future researchers can take a long period to collect the data and to get more effective results.

And also, this study focuses on four dimensions as independent variables. Internal audit quality and financial performance are influenced by many factors. Hence, future researchers can pay attention on other factors which affect to these two variables. This study only employed quantitative research but, in the future, if anyone can apply both quantitative and qualitative methods. It will provide more effective information rather than using only quantitative techniques.

14. Conclusion

The main purpose of the researcher was to find out the relationship between internal audit quality and financial performance of listed companies in Sri Lanka. The research was conducted based on 107 listed companies on Colombo Stock Exchange in Sri Lanka. Descriptive statistics, correlation analysis, and regression analysis were used to obtain the research findings related to the research problem. Frequency analysis was used to identify the sample profile, descriptive statistics were used to investigate the level of internal audit quality and financial performance of listed companies in Sri Lanka. And also, correlation analysis was used to examine the relationship between internal audit quality and financial performance and regression analysis was used to examine the impact of internal audit quality and financial performance of listed companies Sri Lanka.

The level of the internal audit quality is at a high level in this study. The relationship between internal audit quality and financial performance of listed companies in Sri Lanka shows is a strong positive relationship. The independence of internal audit, internal audit standards, professional proficiency and internal control have a significant impact on financial performance of listed companies in Sri Lanka. Internal audit standards has the most significant influence on financial performance of listed companies in Sri Lanka. In other words, among dimensions of internal audit quality, professional proficiency and independence of internal audit are the most influencing factors on financial performance. Therefore, listed companies in Sri Lanka should focus on improve their financial performance by improving their internal audit quality determinants of professional internal audit standards and independence of internal audit.

Based on the findings of the study, it is recommended that listed companies should maintain the internal audit quality properly since it is seen to positively affect financial companies to a great extent.

Competing Interests: The authors declare that they have no competing interests.

Acknowledgement: Authors are grateful to thank the referees for the useful comments also expressed sincere thanks to the editorial board for effort to publish this article.

References

- Abdulaziz Alzeban, D. G. (2014). Factors Affecting the Internal Audit Effectiveness: A survey of the Saudi Public Sector. *Journal of International Accounting, Auditing and Taxation*, 74-86.
- Abdullahi Bala Ado, N. R. (2020). The Impact of Audit Quality on the Financial Performance of Listed Companies Nigeria. *Journal of critical reviews*, 37-41.
- Alagiyawanna A.M.U.D, Perera K.H. (2022), The impact of internal audit practices on financial performance of banking, finance and insurance companies in Sri Lanka, *8th International Conference Accounting Researchers and Educators (ICARE 2022)*, Department of Accountancy, Faculty of Commerce and Management Studies, University of Kelaniya Sri Lanka. Available at: <http://repository.kln.ac.lk/items/a8ca4630-eed1-4de8-a274-0b224e390e5d>
- Alzeban, A. &. (2014). Factors affecting the internal audit effectiveness: A survey of the Saudi public sector. *Jsournal of International Accounting, Auditing and Taxation*, 74-86.
- Ahmeti, A., Kalimashi, A., Ahmeti, S., & Aliu, M. (2022). Impact of internal audit quality on the financial performance of insurance companies: Evidence from Kosovo. *Journal of Accounting, Finnce and Auditing Studies*, 175-186.
- Arens, A. A. (2012). Auditing and assurance services: an integrated approach. Boston: Prentice Hall.
- Aryan. (2015). The Relationship between Audit Committee Characteristics, Audit Firm Quality and Companies' Profitability. *Asian Journal of Finance & Accounting*, 215-226. 12
- Ashton, R. E. (1982). Audit Detection of Financial Statement Errors. *The Accounting Review*, 751-765.
- Badara, M. A. (2013). The journey so far on internal audit effectiveness: A calling for expansion. *International Journal of Academic Research in Accounting, Finance and Management Sciences*, 340-351.
- Baxter, P. A. (2009). Audit committees and earnings quality. *Journal of Accounting and Finance*, 267-290.
- Accounting and Auditing Standard Committee*. (2017). Retrieved from <http://www.slaasc.lk/auditing/#>
- Alhassan, E. &. (2018). Determinants of Internal Audit Effectiveness in State Owned Enterprises (SOEs) in Ghana. *Journal of Accounting and Management*, 52-68.
- Alves, S. (2013). The impact of audit committee existence and external audit on earnings management: Evidence from Portugal. *Journal of Financial Reporting & Accounting*, Vol.11, No.2, 143-165.
- Bello, S. M. (2018). Internal audit quality dimensions and organizational performance in Nigerian federal universities: the role of top management support. *Journal of Business & Retail Management Research*, 156-170.
- Brahmadev Panda, N. M. (2017). Agency theory: Review of Theory and Evidence on Problems and Perspectives. *Indian Journal of Corporate Governance*, 74-95.
- Caramanis, C. &. (2008). Audit effort and earnings management. *Journal of Accounting and Economics*, 116-138.
- Ching, C. (2015). The relationship among audit quality, earnings management, and financial performance of Malaysian public listed companies. *International Journal of Economics and Management*, Vol.9, No.1, 211-231.
- Choi, J. H. (2014). Association between Big 4 auditor choice and cost of equity capital for multiple-segment firms. *Accounting & Finance*, 135-163.
- Chun, C. (2007). Functions and objectives of internal audit and their underlying conditions.
- Cooper, B. J. (2009). Commitment to independence by internal auditors: the effects of role ambiguity and role conflict. *Managerial auditing journal*.

- Davidson, A. G. (1984). Auditor Concentration and the Impact of Interlocking Directors. *Journal of Accounting Research*, 313 - 317.
- Davidson, R. A. (1993). A Note on Association between Audit Firm Size and Audit Quality. *Contemporary Accounting Research*, 479 – 488.
- DeAngelo, L. (1981). Auditors independence, " low balling", and disclosure regulation. *Journal of Accounting and Economics*, 113-127.
- Dunjia, Y. J. (1997). Performance audit in the service of internal audit. *Managerial Auditing Journal*, 192-195. 13
- DeAngelo, L. E. (1981). Auditor Independence, 'Low Balling', and Disclosure Regulations. *Journal of Accounting and Economics*, 113-127.
- Eighme, J. E. (2002). Internal auditors' roles in overcoming the financial reporting crisis. *Internal Auditing*, 3-10.
- Ejoh, N. O. (2014). The effect of internal audit function on the financial performance of tertiary institutions in Nigeria. *International Journal of Economics, Commerce and Management Vol. II(10)*. Retrieved from <http://ijecm.co.uk/>
- Eshitemi, O. (2016). Effect of Audit Quality on the Financial Performance of Listed Parastatals in Nairobi Security Exchange. *Social Science and Humanity Journal*, 186-199.
- Esmailjee. (1993). Internal Controls: The Case Study of Nyayo Bus Service.
- Ezejiolor, O. (2020). Effect of Internal Audit Function on financial performance of Commercial banks in Nigeria. *International Journal of Advanced Academic Research (Social and Management Sciences)*, Vol. 6, 44-54.
- Fagbemi, A. (2010). Audit Quality, Corporate Governance and Firm Characteristics in Nigeria. *International Journal of Business and Management*, 171-172.
- Farouk, M. a. (2014). Impact of Audit Quality and Financial Performance of Quoted Cement Firms in Nigeria. *International Journal of Accounting and Taxation*, 1-22.
- Schiurma, B. M. (2003). Business performance measurement \pm past, present and future. *Managerial Auditing*, 680-687.
- SEC of Sri Lanka, I. (2013). *Code of Best Practice on Corporate Governance 2013*. ICASL.
- Vickneswaran, A. (2022). Factors Affecting Internal Audit Reporting on Public Sector in Sri Lanka. *Journal of Accounting and Business Education*, 3-8.
- Vijayakumar, A. N. (2012). Internal Control Systems: Effectiveness of Internal Audit in Risk Management at Public Sector Enterprises. *BVIMR Management Edge*, 8
- Hassan, M. A. (2014). Impact of Audit Quality and Financial Performance of Quoted Cement Firms in Nigeria. *International Journal of Accounting and Taxation*, 2(2), 1–22.
- Hua, C. H. (2016). Malaysia Financial Reporting Practices and Audit Quality Promote Financial Success: The Case of Malaysian Construction sector. *Uimas Review of Accounting and Finance*, 36-50.
- Julius Gekula, D. I. (2020). The Effects of Internal Auditing on Financial Performance of Public Sector Organization in Tanzania a case of Ilala Municipal Council. *International Journal of Research and Analytical Reviews*, 478-489.
- Ken, J. G.-S. (2006). Relation between external audit fees, audit committee characteristics and internal audit. *Accounting and Finance*, 387-404.

- Lopes, A. (2018). Audit Quality and Earnings Management: Evidence from Portugal. *Athens Journal of Business & Economics*, Vol.4, No.2, 179-192.
- Mohammad, W. (2018). The Effect of Audit Committee Characteristics on Financial Restatements in Malaysia. *Journal of Asia-Pacific Business*, 4-22.
- Marika Arena, M. A. (2006). Internal audit in Italian organizations; A multiple case study. *Managerial Auditing Journal*, 275-292.
- Marion Hutchinson, M. M. (2009). Internal Audit Quality, Audit Committee Independence, Growth Opportunities and Firm Performance. *Corporate Ownership & Control*, 50-63.
- Mujeeb, I. S. (2020). Involvement of Board Chairmen in Audit Committees and Earnings Management: Evidence from Malaysia. *Journal of Asian Finance, Economics and Business*, 233-246.
- Ndege, J. O. (2012). *Performance and financial ratios of commercial banks in Kenya from 2006-2010*. Retrieved from University of Nairobi Research Archive: <http://erepository.uonbi.ac.ke:8080/xmlui/handle/123456789/12812>
- Nisansala T.S., Perera K.H. (2019), An Empirical Study on the Effect of Internal Audit Function on Financial Performance of Commercial Banks in Sri Lanka, *Abstract proceedings: International Research Conference. Rajarata University of Sri Lanka (RIRC 2019)*, Available at: <https://www.rjt.ac.lk/wp-content/uploads/2022/08/RIRC2019-conference-booklet.pdf>
- Omwenga, J. (2016), Audit Quality and Financial Performance of Companies Listed in Nairobi Securities Exchange." Available at: https://www.academia.edu/64845455/Audit_Quality_and_Financial_Performance_of_Companies_Listed_in_Nairobi_Securities_Exchange
- Pasework, W. S. (1995). Legitimacy Claims of the auditing profession vis-a-vis the behaviour of its members: An empirical examination. *Critical Perspectives on Accounting*, 77-94.
- Saddam A, H. I.-K. (2020). The Impact of Internal Audit Quality in Financial Performance of Yemeni Commercial Banks: An Empirical Investigation. *Journal of Asian Finance, Economics and Business*, 867-875.
- Salehi, M. a. (2016). Audit committee impact on the quality of financial reporting and disclosure: Evidence from the Tehran Stock Exchange. *Management Research Review*, 1639-1662.
- Sewwandi W.A.U. and Abeygunasekera A.W.J.C. (2021), "Internal Audit Function and Financial Reporting Quality: Study of the Sri Lankan Banking Industry", *12th International Conference on Business and Information (ICBI 2021)*, University of Kelaniya, Sri Lanka. Publication.
- Schauer, P. (2002). The Effect of Industry Specialization on Audit Quality: An Examination Using Bid-ask Spreads. *Journal of Accounting and Finance Research*, 76-86.
- Shahanif Hasan, A. A. (2020). The Impact of Audit Quality, Audit Committee and Financial Reporting Quality: Evidence from Malaysia. *International Journal of Economics and Financial Issues*, 272-281.
- Shankaraiah, K. a. (2017). Audit Committee Quality and Financial Reporting Quality: A Study of Selected Indian Companies. *Journal of Accounting and Business Dynamics*, 1-18.
- Titman, S. &. (1986). Information quality and the valuation of new issues. *Journal of Accounting and Economics*, 159-172.
- Vijayakumar, A. N. (2012). Internal control systems: Effectiveness of internal audit in risk management at public sector enterprises. *BVIMR Management Edge*, 1-8.
- Volosin, E. (2008). The theories of audit expectations and the expectations gap. *GRIN Verlag*.
- Wheeler, D. F. (2003). Focusing on value: Reconciling corporate social responsibility and a stakeholder approach in a network world. *Journal of General Management*, 1-28.

- Wong, K. (2011). Audit committee characteristics, family control and earnings management: Evidence based on Hong Kong firms after corporate governance reform in 2004. *Hong Kong Polytechnic University*.
- Ziniyel, D. O. (2018). Effect of internal audit practices on financial management. *European Journal of Business, Economics and Accountancy*. 6(3), 2056-6018.
- Zureigat, Q. M. (2011). The effect of ownership structure on audit quality: Evidence from Jordan. *International Journal of Business and Social Science*, 2(10).