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Effect of Risk Assessment as an Element of Internal Control System on the Quality of Financial Reporting Information in Local Governments of Rwanda

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Risk assessment as a component of the internal control system allows the management to stay focused on the entity's pursuit of its operation and produce high-quality financial reporting. Despite the adoption of risk assessment as part of an internal control system for years, Rwanda's local governments faced many persistent problems in their financial reporting information. Thus, this research evaluated the effect of risk assessment as a component of the internal control system on the quality of financial reporting in Rwandan local governments. The study was conducted in the 30 districts of Rwanda. Primary data was collected using the questionnaire, and the reports of the Office of General Auditors of Rwanda were consulted to collect secondary data. The findings from descriptive analysis showed a high level of risk assessment with a mean of 3.87. The level of the quality of financial reporting information was high, with a mean of 4.02. Findings from correlation analysis showed that the correlation coefficient between risk assessment and quality of financial reporting information was 0.648, and the p-value was 0.00. The linear equation from regression analysis showed a constant of 2.135, indicating that if the risk assessment as an independent variable stays constant, a positive change in the quality of financial reporting information of 2.135 is observed. The model shows that for a unit increase in risk assessment quality, financial reporting information is predicted to increase by 0.493 units. The management of local governments of Rwanda has been recommended to put more effort into considering the potential for fraud to assess risks for achieving the objective of avoiding public fund embezzlement.

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INTRODUCTION

The objective of this study was to determine the effect of risk assessment on the quality of financial reporting information in local governments in Rwanda. Risk assessment includes defining and assessing specific threats that may impede the achievement of the institution's objectives. Risk assessment consists of identifying and analysing risks affecting the attainment of the goal and setting the standards to measure the achievement of effective risk management (Shanszadeh & Zolfaghari, 2015).

Risk assessment is one of the components of the internal control system. Kewo & Afiah (2017) define an internal control system as the mechanism used by the board members and the institution's top management. It is also used by employees responsible for providing assurance about achieving the goals. It is the integration of the activities, plans, policies, and efforts of the organisation's people who work together to ensure that the institution can achieve its mission and objectives (Mahadeen et al., 2016). An internal control system was used many years ago. It is common knowledge among accountants, managers, businessmen and women, and academicians that effective internal controls avoid mistakes and fraud that contribute to unqualified opinions of auditors (Olowol, 2015). Several studies have shown the impact of internal control on the reliability of financial reporting of the internal control process. Among them is research carried out in Indonesia by Kewo & Afiah (2017), who found that the internal control system had a positive effect on financial reports. Similarly, Widyaningsih (2016) found that the internal

control system of the company typically improves the reliability of accounting information.

Countries such as Denmark, the Netherlands, Sweden, and the United Kingdom take internal control systems, including risk assessment, in terms of a comprehensive and harmonised approach. Governments must ensure that all public entities maintain and monitor their integral management processes (European Union [EU], 2011). In these nations, the internal control system is designed to manage threats and ensure that companies achieve their goals (Wydrych, 2010). Such priorities are the orderly execution of operations in an ethical, financial, efficient, and effective manner; fulfilment of transparency; compliance with laws and regulations; and resource security, loss, misuse, and harm of resources (EU, 2011). Some countries today, such as France and Portugal, with strong special control institutions, have begun to decentralise internal controls and thus increase public managers' accountability (EU, 2011).

In Nigeria, Augustine et al. (2013) found that an organisation's department of internal control process should be considered more. When there is a poor internal control system, particularly in banking institutions, this can trigger fraudulent acts. They suggested that a strong internal control system should be implemented for each organisation to counter fraud.

Agbenyo et al. (2018) carried out another study in Ghana and analysed the government's Revenue Authority financial reporting information and how it has been affected by the internal control system. They found a positive correlation between

the two variables. They showed that bribery was reduced by using internal control. This provides good financial reporting performance, such as accuracy. In view of the above findings and recommendations, the organisation should implement an internal control system strategically. The research of Nyakundi et al. (2014) in Uganda showed approximately 90% of Abeno small and medium enterprises (SMEs) are closed for a period of three years because of the lack of or weak internal control systems such as risk assessment. Since 2009, local governments in Rwanda (the districts) and other public entities have been recommended to adopt the internal control structure in compliance with COSO framework to achieve the objectives, including providing good quality financial reporting (Minecofin, 2011).

However, the local governments of Rwanda have been faced with many persistent problems in their financial reporting information for many years (OAG, 2019). For instance, the reports of 2018 showed that Districts had poor cash flow planning. This caused a delay in the payment of contracts, resulting in the abandonment and delay of project contracts valued at Frw 56.09 billion, equalling 41% of national contract delay and abandonment (OAG, 2018). The same report showed idle assets valued at Frw 2.88 billion, which occupies 18.14% of the total national idle assets. Internally, generated revenue was omitted from government expenditure for the year ended on June 30, 2018, and this has a negative impact on the oversight and budget allocation effectiveness of the public financial management system as these funds were not made available for budgetary allocation.

The OAG report of 2017 showed that Districts experienced poor financial reporting information, like errors in bookkeeping and errors in financial statements. Major concerns were unexplained differences in opening balances, omitted balances, omitted receivables and liabilities, and delay of contracts totalling Frw 38.23 billion. The report showed a low disbursement to target beneficiaries, reaching 71.66% of the total

disbursements. Also, many unrecorded disbursements were identified (OAG, 2017). The 2016 report showed many non-existent projects that received loans (OAG, 2016). It was noted that the revenue disclosed, including internally generated revenue, was omitted in Districts' financial statements and, ultimately, their consolidated financial statements (OAG, 2015).

The researcher was motivated to conduct this study by the identified problems found in the financial reports and the limited scientific research in the field of internal control systems and financial reporting information in the local government in Rwanda.

LITERATURE REVIEW

Theoretical Review

Positive Accounting Theory

The theory was developed by Watts and Zimmerman (1986). Positive accounting theory is concerned with explaining accounting practices. The theory is based on the assumptions that all people's actions are governed by self-interest and that individuals always act in an opportunist manner to the level that the actions increase their wealth (Watts and Zimmerman, 1986). Positive Accounting Theory focuses on the management's motives for financial reporting choices, using economic models and statistical processing, when there are agency costs and information asymmetry. The theory tries to explain and predict a firm's accounting choices as part of the firm's overall need to minimize its cost of financial and other contracting costs, applying methods and techniques from economics. Opportunistic attitudes and behaviours of managers and their impact on accounting policies have been investigated widely in positive research, and this led different researchers to conduct empirical studies on earning management (Kaya, 2017).

Positive accounting theory expects that the institutions will seek to put systems in place to limit actions that are driven by self-interest (Osho & Ayorinde, 2018). The costs of dealing with problems concerning the agency relationship and installing appropriate mechanisms are referred to

as monitoring costs (Watts and Zimmerman, 1986). This theory is related to the study as by implementing internal control systems, the weakness in providing financial reporting information should be avoided or minimized.

Empirical Review

Risk assessment consists of identifying and analysing risks affecting the attainment of the goal and setting the standards to measure the achievement of effective risk management (Shanszadeh & Zolfaghari, 2015). Risk assessment includes defining and assessing specific threats that may impede the achievement of the institution's objectives (Vasile & Croitoru, 2012). As there are rapid changes in economic conditions organisational and regulatory conditions in the sector, the organisation needs structures that can help detect and resolve strange risks of change.

Risk management is often viewed in today's world as a science that involves the use of numerous advanced and nuanced analytical methods (Aven, 2016). Creating risk management plans based on quantified likelihood and effect can lead to the false assumption that taking control of the risks of the institution (Carlsson & Mattsson, 2019). In fact, the greatest threat to business is often the failure to implement a holistic approach to risk management based on art and science, particularly in the rapidly changing world in which most businesses now operate (Schroeder, 2014).

There is much evidence that the current high level of uncertainty in the business world is going to get worse in the years to come. This trend and the resulting risks for businesses demand a strategic level of attention to risk management, which can lead to competitive advantage (Elahi, 2013).

Risk Assessment and Quality of Financial Reporting Information

The objective of risk assessment is to assess the risks of misstatement of the materials and provide and implement correction majors (PCAOB, 2010). It consists of diagnosing and analysing the material misstatement risk in relation to omitting, incomplete or inaccurate disclosure. It develops

the disclosure of the information, which is important for fairly presenting the financial statement in conformity with standards of financial reporting (COSO, 2013). However, Bartsiotas & Achamkulangare (2016), from their study said that the inexistence of formal and informal risk assessment is a strong challenge faced by most organisations in developing countries.

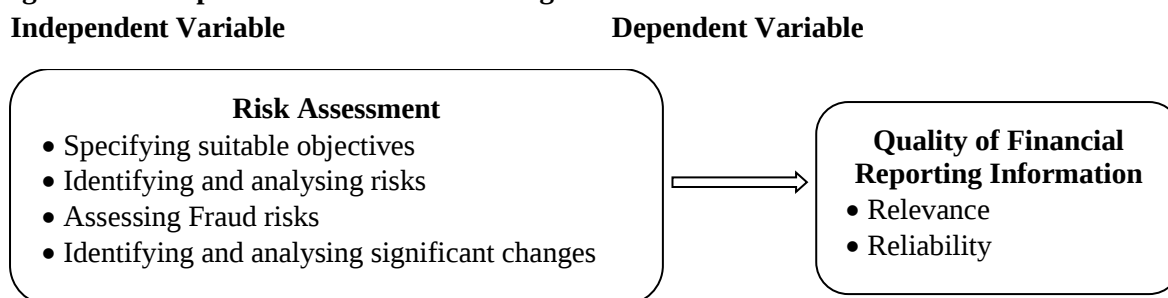
CIMA (2009) showed that in 2007, because of the weakness of risk management, a major British construction firm suffered fraud from the management consisting of accounting irregularities from 2003, including systematic misrepresentation of production volumes and sales. To cover this fraud, the management attempted to sell material at a discounted price, and the fraud went undetected for many years. The external investigation found that the organisation was defrauded £23 million, but the fraud was said to cost the company about £ 40 million due to the written-down value of the business and the cost of the investigation (CIMA, 2009). This implies that having a strong risk management system can help an institution mitigate intentional errors and produce high-quality financial reporting information.

Another study by Akins (2018) called Quality of Financial Reporting Information and Uncertainty About Credit Risks among the Credit Rating Agency at Rice University showed that better financial reporting information is associated with low uncertainty about credit risk among credit rating agencies. The entity's risk assessment process may address how the entity considers the possibility of unrecorded transactions or identifies and analyses significant estimates recorded in the financial statements (Wasedango & Mhaka, 2017). The study by Wadesango et al. (2018), called the effectiveness of risk management systems on financial performance in public settings, showed that risk management has a positive effect on organisational performance through a reduction of fraud risks.

In the case of Rwanda, it is evident that the studies related to internal control systems and the quality

of financial statements are non-existent. Nonetheless, Mutesi (2016) who tried did a study on the internal control system and financial performance in public institutions in Rwanda, specifically the Rwanda Environment Management Authority (REMA). Therefore, this research will add value to the results of these small studies as it moves in the field of financial statements and internal control systems in the districts that are the core institutions for the development of Rwanda.

Figure 1: Conceptual framework of thinking



METHODOLOGY

Research Design

This study is based on a descriptive research design with a mixed qualitative and quantitative approach. The goal of descriptive research is to describe a phenomenon and its characteristics. This research is more concerned with what rather than how or why something has happened (Nassaj, 2015), for the study described the status of implementation of the Risk assessment. It also showed the quality of financial reporting information in the District of Rwanda. The mixed qualitative and quantitative approach involves collecting, analysing, and interpreting quantitative and qualitative data. The reason for using this approach of combining qualitative and quantitative approaches is that it provides a more complete understanding of a research problem than one approach alone (Dawadi et al., 2021).

The study was cross-sectional research. Cross-sectional research is research whose data are collected at one point in time (Zangirolami-Raimundo et al., 2018). Cross-sectional research is mainly characterised by the observation of the variables, whether they are cases, individuals, or

Conceptual Framework

The conceptual framework of this study is made of two variables: an independent variable, which is Risk Assessment, and the dependent variable, which is Quality of financial reporting information. A literature review has identified a positive relationship between Risk Assessment and the Quality of financial reporting information (Akins, 2018). The indicators of each variable are presented in the following figure.

other types of data in a single moment (time). The study has an advantage as it allows the researcher to make direct observations on the phenomenon under investigation in a short time without making follow-up of the participants and collecting information at a lower cost (Zangirolami-Raimundo et al., 2018).

Population and Sampling

The population of this study was made up of 30 Districts, including the local governments in Rwanda. In each District, one chief of the internal control system was purposively selected to answer the questions relating to risk assessment and one member of the district board was selected to answer the questions relating to the quality of financial reporting information. The district board members were selected because their task is to control the district staff who oversee internal control and those who provide financial reports.

Data Collection Instruments

Primary data was collected using a questionnaire as the study instrument (Kumar, 2011). It helped to collect quantitative data. The questionnaire consisted of two sections: section A contained

questions designed to collect information on Risk assessment. Section B contained questions for collecting information related to the quality of financial reporting information (Zohrabi, 2013). The researcher used the questionnaire because it is less expensive and offers greater anonymity (Asiamah, 2017).

Data Analysis

After collection, data were edited, coded, and analysed using SPSS (Arkkelin, 2014).

Descriptive Analysis

Descriptive statistics are concise informative coefficients that summarise a specific data collection, which might be a representation of the complete population or a subset of a population (Bhandari, 2020). The percentage, mean, and standard deviation were computed.

Inferential Analysis

Simple correlation and simple regression analysis were used by the researcher in this study. A simple linear regression model is an equation that shows the effect of the explanatory variable (X) on the predictor variable (Y), which is commonly shown as a straight line. The aim of simple regression analysis is to describe the functional relationship between two variables, where one variable predicts the response variable (Elmanani, 2020).

The model is:

$$Y = \beta_0 + \beta_1 X_1 + \varepsilon$$

With: Y = Quality of financial reporting information; β_0 = constant; β_1 : Slope; X_1 = Risk assessment; ε = error estimate.

FINDINGS AND DISCUSSIONS

Risk Assessment

Five assertions were used to assess the level of risk assessment. For each assertion, the mean and standard deviation was calculated. Findings are presented in *Table 1*. *Table 1* shows that the districts specify the objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives at a high level, with a mean of 4.03 and a standard deviation of 1.00.

The districts identify risks to the achievement of the objectives at a high level, with a mean of 4.03 and a standard deviation of 0.77. The districts analyse risks as a basis for determining how the risks should be managed at a high level, with a mean of 4.10 and a standard deviation of 0.61. The districts consider the potential for fraud in assessing risks to the achievement of objectives at a moderate level, with a mean of 3.10 and a standard deviation of 1.06. The districts identify and assess changes that could significantly impact the system of internal control at a high level, with a mean of 4.10 and a standard deviation of 0.66. In general, the level of Risk Assessment in the District was high, with a mean of 3.87 and a standard deviation of 0.82.

A high level of practice in risk management may be sufficient for the institution. Creating risk management plans based on quantified likelihood and effect can lead to the false assumption that taking control of the risks of the company (Schroeder, 2014). A good risk assessment can lead to a competitive advantage (Elahi, 2013). The districts should continue applying risk management in the future period. However, considering the potential for fraud in assessing risks to the achievement of objectives, it should be improved to a high level as other indicators are applied.

Assessment of Quality of Financial Reporting Information

The quality of financial reporting information was assessed by using two indicators such as relevancy and reliability. The table below summarises the findings.

Table 2 shows that the level of relevancy of financial information was high, with a mean of 4.11 and a standard deviation of 0.77, and the level of reliability of financial information was high, with a mean of 3.93 and a standard deviation of 0.78. In general, the quality of financial reporting information was high, with a mean of 4.02 and a Standard deviation of 0.78.

Primary findings about the quality of financial reporting information have been complemented

by the secondary data from the financial reporting of local governments and the reports from the Office of Auditor General of Rwanda in 2021 and 2022. For instance, in the fiscal year ending June 30, 2021 there was poor quality in financial reports in local governments of Rwanda. Bridge works in Kigali city costing Frw 2,024,536,965 were delayed. The contract had an initial completion date of November 23, 2020. The contract was extended by 19 months and amended to Frw 7,774,274,830. However, the supervision report, dated February 2022, claimed that work was at 58.32% completion. 311 water supply systems were built in ten (10) districts at a total cost of Frw 43,203,701,254. However, 18% were non-functional, while 36% were partially operational, meaning that 54% (Frw 23,329,998,677) of funds were misused. This should delay the target of giving access to clean water to all Rwandans by 2024. Out of 9,610 constructed biogas plants, 54% were not operational due to a lack of capacity to maintain biogas plants, implying a waste of 54% of the project's cost. Schools' funds totalling Frw 2,583,042,875 were transferred to schools with delays of up to 244 days in twelve (12) districts, while school feeding funds totalling Frw 1,455,280,779 were transferred to schools with delays of up to 212 days in thirteen (13) districts. This had a severe impact on school operations, student well-being, and, ultimately, educational quality.

There was a delay of up to 432 days in transferring money totalling Frw 5,344,353,050 from SACCOs to beneficiaries in ten (10) districts and a delay of up to 143 days in transferring monies totalling Frw 4,885,232,650 from Districts to SACCOs in seven (7) districts. Community Health Workers (CHWs) deposited user fees totalling Frw 718,967,043 were idle in the bank accounts of twenty-three (23) districts. This was due to a lack of guidance from the Ministry of Health and MINALOC on how this money would be used. Then, there was the loss of value for money.

The Frw 247,611,275 transferred by MINAGRI to the districts for the purchase of lime for distribution to farmers to increase agricultural output was not used in nine (9) districts. This negatively affected the crop production in the country. In Kigali City, 67% of the expected cost of the Kigali infrastructure project was not reported. In Gisagara District, the water supply system with the cost of Frw 919,693,250 was reported completed while it was not operational. 43% of constructed water supply systems in Muhanga, Nyabihu, Nyagatare, Rusizi, Gatsibo, and Karongi districts were either partially operating or non-functional, while they were reported finished.

Out of 10,913 biogas plants constructed, 8,354 biogas plants, representing 77%, were not operating. While the report showed that they had been paid. This was observed in all districts and the City of Kigali.

The above information shows that there is a big gap in the quality of financial reporting information. Financial reporting supports stakeholders in planning, assessing, and comparing results, as well as taking appropriate action to move them in the right direction. It is also one of the main messages for stakeholders in the organisation to have faith in their relationship. It also includes information about the companies' resources, liabilities, and equity, as well as changes in share capital over time. It also aids in understanding how money is obtained and spent. Another key reason for maintaining financial reporting is to improve the social welfare of employees and other government departments. Businesses must use financial reporting data to comply with rules (Joëlline, 2015).

These financial reports aid stakeholders in benchmarking and making suitable decisions by allowing them to analyse the reports (Birt et al., 2020). It also helps companies raise capital from both internal and external sources (Osadchy et al., 2018). High-quality financial reporting is essential for adhering to and meeting numerous regulations and regulatory requirements (Ochung, 2017). Financial reporting also makes mandated

audits easier (Reid et al., 2019). Financial statements give users additional decision-making capacity and flexibility, which increases the quality of financial reporting (Vesty et al., 2018).

Even if primary data showed good relevancy and reliability of financial reports, secondary data showed poor quality. This means that secondary data can be put into consideration because it has been provided by an independent reviewer, which is the Office of Auditor General. This means that major corrections are necessary to improve the quality of financial reporting information of Rwanda's local governments. This will be done through hiring and retaining competent staff.

Table 1: Level of Risk Assessment

Assertions	SD (%)	D (%)	NS (%)	A (%)	SA (%)	Mean	Std. Dev	Comments
The District specifies the objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives	33.3	23.3	10.0	20.	13.3	4.03	1.00	High
The District identifies risks to the achievement of the objectives	16.7	26.7	36.7	10.0	10.0	4.03	0.77	High
The District analyses risks as a basis for determining how the risks should be managed.	3.3	13.3	40.0	20.0	23.3	4.10	0.61	High
The District considers the potential for fraud in assessing risks to the achievement of objectives.	16.7	23.3	30.0	10.0	20.0	3.10	1.06	Moderate
The District identifies and assesses changes that could significantly impact the system of internal control.	46.7	33.3	6.7	10.0	3.3	4.10	0.66	High
Average						3.87	0.82	High

Legend: 1-1.8 = Very low level; 1.8-2.6= Low level; 2.6-3.4= moderate; 3.4-4.2= high level; 4.2-5 Very high level

Source: Output SPSS, 2021

Table 2: Level of quality of financial reporting information

Variables	Mean	Standard deviation	Comment
Relevancy	4.11	0.77	High
Reliability	3.93	0.78	High
Mean	4.02	0.78	High

Legend: 1-1.8 = Very low level; 1.8-2.6= Low level; 2.6-3.4= moderate; 3.4-4.2= high level; 4.2-5 Very high level

Source: Output SPSS, 2021

significantly high, with a Spearman rho correlation of 0.648 and a P-value of 0.00, which is less than the 0.05 level of significance. Calculating the coefficient of determination (ρ^2) or $(0.648)^2$ is 41.99%. This implies that Risk assessment contributes 41.99% to the quality of financial reporting information of the local Government of Rwanda.

					1	2
Spearman's rho (ρ)	1. Quality of Financial Reporting information	Correlation Coefficient	1.000	.648**		
		Sig. (2-tailed)	.	.000		
		N	30	30		
	2. Risk assessment	Correlation Coefficient	.648**	1.000		
		Sig. (2-tailed)	.000	.		
		N	30	30		

quality of financial reporting information is influenced by Risk assessment. The 62.4% remaining can be attributable to other factors.

association between the variables. Table 5 presents a summary of the findings.

The constant 2.135 indicates that if the Risk assessment as an independent variable is held constant, then there will be a positive change in the quality of financial reporting information by 2.135. The model shows that for every 1-unit increase in Risk assessment, the quality of financial reporting information is predicted to increase by 0.493 units.

Table 6: A linear model of Risk assessment and quality of financial reporting information

Model	Unstandardised Coefficients		Standardised Coefficients	T	Sig.
	B	Std. Error	Beta		
1 (Constant)	2.135	.469		4.550	.000
Risk assessment	.493	.120	.613	4.110	.000

a. Dependent Variable: Quality of financial reporting information.

Source: Output SPSS, 2021

CONCLUSION

Findings from descriptive statistics showed that the overall level of the Risk assessment system was high. The quality of financial reporting information was moderate. Findings from the inferential analysis showed that the Spearman rho correlation between Risk assessment and Quality of financial reporting information was 0.648 and the p-value of 0.00. Regression analysis showed a significant effect of risk assessment on the quality of financial reporting information in local governments in Rwanda.

Recommendations

From the Findings, the researcher constructed the recommendation to different stakeholders:

To the Management of Local Governments of Rwanda

The District should consider the potential for fraud in assessing risks to the achievement of objectives because this indicator was at a moderate level. This will help the District reduce the embezzlement of public funds. The relevancy and reliability of district financial information should be practically improved because findings from secondary data showed poor performance of this indicator. This can be done by hiring competent employees and using IT in their operations.

Local Governments of Rwanda should organise training for the members of the Board of Directors about the analysis of the quality of financial reports. This will help them to identify gaps and take correction majors on time. More effort is needed to enforce Risk assessment because findings showed a significant effect on the quality of financial reporting information of the districts.

For further research

This study should be conducted in other public institutions of Rwanda that have poor quality financial reporting information as it is reported by the Office of Auditor General (OAG), like Government Business Enterprises and ministries.

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