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Internal Audit Function and Public Funds Management: The Mediation Influence of Auditor Independence and Integrity

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Abstract: Based on agency theory, the present study aimed to investigate the relationship between the internal auditor function and public funds management, with a focus on the mediating influence of internal auditor independence and integrity in the local government sector. The paper examines the role of internal auditing in enhancing accountability, efficiency, and resource utilization within Uganda's New Public Management framework. It emphasizes the importance of auditor independence and integrity, highlighting the necessity for functional internal audit units. This study contributes to existing literature by investigating the relationship between internal auditing and public funds management, while also considering perspectives on auditing, governance, and public accountability in local governments in Uganda. To evaluate the hypothesized links, data were collected from 109 Local Governments before applying AMOS *v.*20 and Hayes' PROCESS macro procedure to examine the suggested relationships. The results provide empirical support for the direct link between internal auditor function and public funds management and the subsequent indirect association through the mediating influence of internal auditor independence and integrity. The study makes a significant theoretical and practical contribution by explaining how the internal audit function influences public funds management in local governments, particularly in developing-country contexts. The text highlights the importance of auditor independence and integrity in connecting internal audit functions to public financial management. It emphasizes that effective public finance management relies on having not only internal audit units but also competent auditors and robust governance systems. Its originality lies in a theory-driven model and context-specific evidence from Ugandan local governments, providing valuable insights for research and policy.

Keywords: Public Funds Management; Internal Auditor Independence and Integrity; Internal Auditor Function; Local Government

JEL Classification: M42, H83, D73

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1. Introduction

Over the past two decades, the New Public Management (NPM) movement has shaped New Public Funds Management (PFM), leading to extensive reforms in the governance of the public sector by embracing market-oriented models that go against conventional ideas of public service, governments around the world have actively redesigned public institutions (LGs) (Krogh & Triantafillou, 2024). In particular, the NPM movement encouraged a division of labor in which the public sector continued to be in charge of strategic oversight while the private sector was tasked with operational responsibilities (Krogh & Triantafillou, 2024). This reform integrated financial management frameworks, audit procedures, and performance assessment into the public sector while emphasizing market-based models, privatization, and budgetary constraint (Krogh, 2022). More customer choice, enhanced accountability, and increased efficiency were among the expected outcome of this reform (Lapuente & Van de Walle, 2020).

This reform has, however, sparked intense discussion about how it would affect public funds management (PFM), particularly accountability, value for money, and public service expenditure. Despite the increased popularity of the term PFM, the literature unfortunately lacks a clear and concise definition of PFM (Allen et al., 2013). PFM is frequently explained in terms of an annual budget cycle involving budget formulation, budget performance, accounting and reporting, and external security and audit, whose goal is to guarantee that the entity's (LG) public spending is properly planned, implemented, reported, and examined (Kristensen et al., 2019). Tkachenko (2020) refers to the concept PFM as the full cycle of how governments raise, distribute, spend, and account for public resources. It thus, represents an important field that guarantees the effective and efficient use of public funds, promotes economic expansion, and preserves public confidence.

Literature has consistently linked PFM in local governments to several individual and organizational level outcomes, including guaranteeing the efficient, effective, and transparent use of public resources to provide citizens with essential services such as education and health. Effective PFM is central to the functioning of government programs, efficient and effective service delivery, promotion of good governance and overall economic stability and growth (Tkachenko, 2020; Public Finance Management Act, 2015; Okee & Nakimbugwe, 2024; Musau, 2022). Therefore, research on the public funds management (PFM) predictors is essential (Musau, 2022).

The Agency theory (Jensen & Meckling, 1976), which grounds this study, suggests that the principal (LGs) needs to monitor agents' (local government workers') counterproductive work behavior through an effective internal audit functioning (IAF) unit to improve public funds management (PFM) through good practices such as accountability and effective expenditure management. The International Auditing and Assurance Standards Board (IAASB) (2013), conceptualizes IAF as a departmental unit within an organization that carries out assurance and consulting tasks intended to assess and enhance the efficiency of the organization's risk management, internal control, and governance procedures. Bananuka, Nkundabanyanga, Nalukenge and Kawaase (2018) argue that an internal audit function is set up with the intention of assessing the efficacy and efficiency of its operations, ensuring that laws are followed, and assessing its internal controls and risk management system. This study addresses three gaps in the literature. First, Uganda's Auditor General (AG)'s report (2014; 2020) recommended that LGs should establish IAF departments' audit committees that are effective to enhance accountability for improved PFM. However, most empirical studies investigating the relationship between IAF and PFM have relied on data derived from the experience of Indonesia (Ratmonoa & Darsono, 2021), Malaysia (Al-Qadasi, 2024), South Africa (Moodley, Ackers & Odendaal, 2022), Iraq

(Shuwaili, Hesarzadeh & Bagherpour-Velashani, 2024) and the United States of America (Gerrit, Mohammad & Rainer, 2012). Moreover, scholars such as Kamara et al. (2023), Mara, Selena and Rosa (2021) have argued that Studies that associate IAF to PFM are limited, thus making the need for this study apparent.

Second, previous studies have examined the direct link between IAF and PFM (Kamara et al., 2023; Mara et al., 2021; Musau, 2022). However, the exact mechanism by which IAF ensures PFM of LGs is to date less explored in the literature, especially in the African context. To close this gap, we suggest internal audit independence and integrity as an explanatory variable in the IAF-PFM relationship. Ghadi, Fernando and Caputi (2013) argue that including more mediators or moderators in the study model provides a better explanation of the link between the two constructs. Third, the results on the impact of IAF on PFM have been mixed at best. For example, while scholars such as Dzikrullah et al. (2020) and Kamara et al. (2023), have found a positive and significant relationship between IAF and PFM, a study by Chambers and Odar (2015) indicated that internal audit occasionally failed to identify, stop, or even report fraud during the financial crisis. Finally, the three variables of IAF, internal audit independence and integrity, and PFM have not been previously examined in a single study. Using the agency theoretic reasoning (Jensen & Meckling, 1976), we close this gap by examining the effectiveness of internal audit independence and integrity, and the internal audit function as explanatory factors for PFM in a single study. Overall, our findings might hold the key to solving this managerial dilemma. The issue of why and how IAF affects PFM in organizations, and particularly Uganda's LGs, is addressed by this study overall.

As part of problematization, public sector reforms grounded in New Public Management have emphasised internal auditing as a key mechanism for strengthening accountability, transparency, and efficiency in public funds management (PFM). In Uganda, local governments are statutorily required to establish internal audit functions (IAF); however, persistent audit queries, misuse of public resources, and weak accountability continue to undermine effective PFM. While prior studies suggest that internal auditing can enhance financial control and accountability, empirical evidence remains limited, context-specific, and inconclusive, particularly regarding fraud prevention and accountability outcomes. Moreover, most existing studies focus on the direct relationship between IAF and PFM and are largely based outside African local government contexts, limiting their explanatory and contextual relevance. Critically, agency theory suggests that the effectiveness of internal auditing depends on key attributes such as internal auditor independence and integrity, which underpin credible monitoring. Yet, these attributes have rarely been examined alongside IAF and PFM within a single empirical framework. Consequently, it remains unclear how and under what conditions internal audit functions improve public funds management in Ugandan local governments. This unresolved issue constitutes a significant theoretical and practical gap that motivates the hypotheses tested in this study.

2. Theory and Hypotheses Development

2.1. Theoretical Underpinning

This study examines the relationship between IAF and PFM of LGs using the agency theory (AT) (Jensen & Meckling, 1976). The popularity of the AT increased when economists examined risk-sharing between people or organizations (Arrow, 1971). The agency problem- the agents (LG managers) have self-seeking interests and will take advantage of every opportunity to further their own interests-was added to the risk-sharing literature in the agency theory (Jensen & Meckling, 1976). We

suggest this theory because it reduces the entire organization (LG) to two parties: the government (principals) and LG managers (agents), making it simple to understand.

As a result, LG management is held responsible by the government for all actions that they take. In this study's context, the AT suggests that LG management may falsify other accounting records and distort financial statements to further their own self-interested goals (Kaawaase, Assad, Kitindi & Nkundabanyanga, 2016), which may impede improvements in PFM. The accountability and consequently PFM of LGs would suffer if this were to occur. To mitigate this potential risk, the Ugandan government, through the LGA (CAP, 236) mandates LGs to put in place functioning internal audit departments to oversee management's practices that are likely to be counterproductive to the achievement of PFM goals. An internal audit function is thus established as a third eye of the LG to examine and assess internal controls, risk management, and regulatory compliance to better monitor how management carries out its PFM mandate.

Because of the agency risk at the functional management level, internal audit plays a crucial role. Management's compliance with the internal policies of the LG's accountability, including appropriate accounting and controls, can be monitored by a functional internal audit department. Financial statements, one of the accountability channels, run the danger of materially misstating information due to fraud and mistakes if an internal auditor is not present and functional. It is argued that the presence, independence, and competency of the internal audit would improve the LG's inclination toward accountability and improve PFM. Thus, this study makes the case that the internal auditor also keeps an eye on agency risk, which may materialize at the level of functional management.

Likewise, an IAF is established to monitor risk management, regulatory compliance, and internal controls (Cooper, Leung & Wong, 2006). According to agency theoretic logic, an auditor (or, in the case of LGs, the Auditor General) should verify the LG's financial statements and other operations to ensure that there are no material misstatements. To this end, an IAF is established to help ensure accountability and improve PFM. LG managers get funding from taxpayers and donors via the government, who hope that the funds will be used appropriately. Visibility of activities, also referred to as physical output for tangible goods, is one method of verifying resources have been used appropriately.

2.2. Internal Audit Function and Public Funds Management

The internal audit function (IAF), in conjunction with management, directorship, and external audit, is an essential corporate governance mechanism (Mara, Selena & Rosa, 2021). According to the International Auditing and Assurance Standards Board (IAASB) (2013), an internal audit function is one of an organization's assurance and consulting activities intended to assess and enhance the efficacy of the organization's internal control, governance, and risk management procedures. Badara and Siti (2012) define IAF as an organization's function created to review the efficacy and efficiency of its operations, ensure adherence to established regulations, and assess its internal control and risk management system. By providing a systematic and disciplined approach to assessment and improvement of the effectiveness of risk management, control, and governance procedures, IAF aids an organization in achieving its goals. In accordance with the agency theory (Jansen & Meckling, 1976), monitoring is one way to lessen the conflict between agents and owners, commonly known as the agency problems. IAF can thus keep an eye on LG staff conduct and assist in protecting LG resources. To ensure minimal risk and effective internal control, IAF is therefore considered a part of

the monitoring costs that are incurred by the organization. Furthermore, it implies that IAF is necessary to reduce the knowledge asymmetry that exists between the principals (government) and the agents (LG managers) (Sarens & Abdolmohammadi, 2011).

Moreover, Dzikrullah, Harymawan and Ratri (2020) and Kamara et al. (2023) argue that IAF plays a key role in the organization in lowering the likelihood of false and misleading financial statements or misstatements, offering reasonable assurances, and offering an independent consultation on decision-making, practices that spur better PFM in organizations. IAF improves the LG's monitoring environment, thus providing an atmosphere that promotes PFM. Mihret and Grant (2017), contend that a well-financed IAF is more effective at monitoring actions of LG staff to ensure that they deliver (PFM). It has been established that organizations with a well-functioning internal audit are more adept at spotting fraud than those without IAF (Bananuka et al., 2018), which promotes accountability and PFM.

In an effort to improve accountability, the Ugandan government passed the PFMA in 2015, requiring all government agencies to establish functional internal audit units. However, evidence of the role of IAF in promoting PFM has been mixed. For example, a study by Chambers and Odar (2015) indicated that internal audits occasionally failed to identify, stop, or even report fraud during the financial crisis. Such a claim implies that improving accountability and PFM is not a given outcome of the IAF. Conversely, scholars such as Roussy and Brivot (2016), Dzikrullah et al. (2020), and Kamara et al. (2023) argued for improving the functionality of an organization's internal audit order to promote greater accountability, transparency, and management of public funds. As a result, we propose that:

H_1: Internal audit function and public funds management are positively associated in Uganda's LGs.

2.3. Internal Audit Function and Internal Audit Independence, and Integrity

In the context of audit, independence connotes the absence of bias, conflicts of interest, or undue influence that can jeopardize the audit's objectivity (Lokman & Bakri, 2020). On the contrary, integrity is being truthful, conscientious, and accountable when undertaking auditing tasks while abiding by legal and ethical requirements (Arens, Elder & Mark, 2012). Both independence and integrity are essential to preserving the internal audit function's legitimacy and efficacy. The relationship between the internal audit function and its independence and integrity has been the subject of numerous studies (Ziniyeli & Twum, 2024; Chan et al., 2017; Nadirsyah & Mulyany, 2024). The effectiveness of audit committees in monitoring the independence and integrity of internal audits is greatly influenced by the caliber and contribution of the internal audit function (Chan et al., 2017; Ziniyel & Twum, 2024). In their study of internal audit function competence and corporate governance quality, Manasseh (2023), Yu et al. (2015) have shown that corporate governance quality, including internal audit independence and integrity, is positively impacted by the functionality of the internal audit department.

The importance of the internal audit function in improving corporate governance practices, including its role in guaranteeing internal audit independence and integrity, has been widely investigated, especially in corporate governance literature (Mohd, Ahmad, Sri & Rini, 2019; Mohd-Said et al.,2016; Nadirsyah & Mulyany, 2024). The findings emphasize the crucial role of IAF in promoting auditor independence and integrity within the organization. The IAF promotes auditor independence and integrity by guaranteeing segregation of duties, avoiding conflicts of interest, and maintaining a high

degree of technical proficiency and objectivity. Organizational architecture and regulations that guarantee internal auditors are not subject to excessive influence from management or other stakeholders help achieve this. Internal auditors preserve their independence and objectivity by concentrating on process improvement and internal risk management, which enables them to render fair and unbiased assessments (Nadirsyah & Mulyany, 2024; Ziniyeli & Twum, 2024; Mara, Selena & Rosa, 2021). Based on these empirical links, we propose that:

H_2: Internal auditor function and auditor independence and integrity are positively related.

2.4. The Mediation Role of Audit Independence and Integrity

Internal auditing function is a management strategy used by organizations to enhance the management of public finances (Kamara, 2023; Mara, Selena & Rosa, 2021). According to the International Auditing and Assurance Standards Board (IAASB) (2013), IAF refers to an organizational division that performs assurance and consulting activities meant to evaluate and improve the effectiveness of the organization's risk management, internal control, and governance processes. The LG audit unit's effectiveness supports the investment in auditor independence and integrity initiatives and their implementation, which improves PFM (Mara, Selena & Rosa, 2021). Additionally, this phenomenon (PFM) will be strengthened by the internal audit's appropriate operation, which demonstrates strong internal audit function practices like diligence, competence, and robust governance structures, as these compel LG leaderships to prioritize auditor independence and integrity and, consequently, leading to PFM improvements (Kamara, 2023; Enofe et al., 2013; Mara et al., 2021).

LG leadership can significantly impact the independence and integrity of internal auditors (Chan et al., 2017; Ziniyel1 & Twum, 2024) and facilitate improvements in PFM (Mara, Selena & Rosa, 2021) by emphasizing the importance of the IAF, which includes: adopting and adhering to a system of internal controls, compliance with laws, rules, regulations, and contractual agreements, and responding to the needs of the citizens (Brevard County Audit, 2006). Therefore, when the internal audit unit operates well to promote auditor independence and integrity, LGs are more likely to exhibit PFM (Chan et al., 2017; Ziniyel & Twum, 2024). This implies that the independence and integrity of auditors, which in turn support PFM in organizations, depend heavily on the operation and functionality of the organization's internal audit.

According to Bananuka et al. (2018), the organization's internal audit functions in a way that portrays her as abstaining from deviant work behaviors, such as failing to review and evaluate internal control systems, non-compliance with regulations, and making a limited contribution to the enhancement of the organization's risk management procedures. Because of this, it seems likely that the IAF will score highly in terms of reviews and evaluations of internal control systems, regulatory compliance, and the enhancement of risk management techniques that firms have embraced. Numerous studies in the literature examine the relationship between IAF and PFM (Kamara, 2023; Enofe et al., 2013; Mara, Selena & Rosa, 2021).

However, these studies have not accounted for the underlying mechanism by which IAF influences PFM, hence, this relationship remains unexplained or unaccounted for. We suggest internal audit independence and integrity as the most likely way or mechanism that affects the IAF-PFM relationship. The mediating effect of internal audit independence and integrity has been emphasized in earlier research. For instance, using a sample taken from the Sultanate of Oman, Hubais et al. (2023)

discovered that the relationship between auditor competence and audit quality was mediated by internal auditor integrity. Based on this theoretical and empirical reasoning, we anticipate that internal audit independence and integrity will mediate the effect of the internal audit function on PFM. Hence, we suggest that:

H_3. Internal audit independence & integrity mediate the effect of the internal audit function on PFM.

3. Materials and Methods

3.1. Research Design

This study used a cross-sectional design and an explanatory research approach. The justification for this research design is to gain a more comprehensive understanding of public funds management among various local government management staff in different local governments located in Eastern Uganda at a single point in time (Kuye & Akinwale, 2021).

3.2. Participants and Procedure

The survey involved one hundred and fifty (150) LGs in Busoga sub-region, nested in the category of: district LGs, municipal councils, town councils, sub-county councils, and division councils (MOLGs, 2023). Using a simple random sampling technique, a sample of 109 LGs was selected based on Yamane (1967) sampling guidelines, giving every LG an equal chance of being considered to participate in the study (Sharma, 2017). While the 109 LGs constituted the unit of analysis, 478 participants (accounts staff, internal audit staff, heads of department, chief administrative officers, head teachers, members of the LG public accounts committee (LGPAC), and district executive committee (DEC) members) drawn from the 109 LGs in Busoga sub-region formed the unit of inquiry. All the 478 responses were, however, aggregated at the unit of analysis level- the LG. The derived sample size was considered adequate to support further analysis of both the direct and indirect effects.

3.3. Measures

Except for control factors including gender, age, and work experience, this study used validated and traditional measures, with items anchored on a 5-point Likert scale (1-strongly disagree, 2-disagree, 3-neutral, 4-agree, and 5-strongly agree).

3.3.1. Public Funds Management

Public funds management was measured based on PEFA (2016) Framework (2016) and Lawson (2015). Based on Lawson (2015) and the PEFA Framework (2016), public funds management is conceptualized as a two-dimensional construct comprising resource mobilization and expenditure management. Review of previous literature suggests that this is the most widely used measure or instrument for PFM and has constantly provided acceptable psychometric properties (reliability and validity) (Lawson, 2015). Examples of the items are "*The budget desk is in place to ensure that funds are equally distributed to all departments*"; "*All resources are received by service delivery units in this local government*". This scale yielded a reliability coefficient statistic of 0.86.

3.3.2. Internal Audit Function

The internal audit function was measured in line with the works of Chamoun and Greuning (2018) and the Local Government Internal Audit Manual (2007). Consistent with this literature, the internal audit function is measured by three factors of diligence, competence, and governance structures. Sample questions included: Diligence "*Internal audit procedure is followed while executing audit*"; Competence "*Local government Internal audit staff have the minimum qualifications*"; *Governance structures* "*Internal Audit Department exists in the organisation*". This scale produced a reliability coefficient of 0.86.

3.4. Data Analysis Procedure

To determine if the indicators accurately reflected their hypothesized constructs, a confirmatory factor analysis (CFA) was used (Sellbom & Tellegen, 2019). A hierarchical linear model with two levels was created or developed. The suggested conceptual model and hypotheses were examined using the statistical package for the social sciences (SPSS) 21.0 and the analysis of moment structure (AMOS) v.21 (Yuan & Chan, 2016). The links between subdimensions and the relationship between observable indicators and their latent construct were investigated (Williams & O'Boyle, 2015). We also examined the convergent validity, construct validity, as well as construct reliability criteria (Hair, Wolfinbarger & Money, 2015).

3.5. Common Method Bias

Since common methods bias (CMB) is one of the primary causes of measurement error (Podsakoff, MacKenzie, Lee & Podsakoff, 2003), it raises questions about the reliability of the findings on the links between the measures. Spector (2006) pointed out that the use of cross-sectional and self-reported surveys as the primary research instrument, as in this study, raises the most serious concerns about CMB. Keeping in mind the present research methodology (cross-sectional), the threat of CMB is imminent. To address the potential problems of CMB, this study adopted several a priori strategies (Podsakoff et al., 2003; Spector, 2006). First, during the pre-test phase of this research, vague items were clarified or explained, and midpoint scales were provided for every survey item during the pretest study. To reduce the social desirability bias, confidentiality and anonymity were ensured (Spector, Rosen & Richardson, 2019). A post-hoc analysis was performed using Harman's one-factor test (Chiew, Mathies & Patterson, 2019). The results show the appropriateness of the conventional standards (Podsakoff et al., 2003). Thus, the threat of CMB remained insignificant as depicted by these approaches.

4. Results

4.1. Descriptive Statistics and Correlation Analysis

The means, standard deviations, correlations, and reliabilities of the study were calculated, and the results are shown in **Table 1** below. The results demonstrate a positive and significant relationship between the internal audit function and public funds management ($r = .417$, $p < 0.05$), which indicates that IAF causes significant changes in PFM. Additionally, there is a positive and significant correlation between the internal audit function and internal auditor independence and integrity (r

=.265, p < 0.05). These results show that a significant variation in internal auditor independence and integrity is accounted for by IAF. Moreover, from the results, a significant positive relationship between internal auditor independence and integrity and PFM (r =.419, p < 0.05) was established, suggesting the influential role of internal auditor independence and integrity in improving management of public funds in local governments.

Table 1. Results of correlation analysis

	M	SD	1	2	3	4	5	6
LG Name (1)	5.183	3.09	**1**					
LG Yrs of Exp (2)	2.784	1.13	.003	**1**				
LG Type (3)	1.710	1.54	-.148**	-.080	**1**			
Internal audit function (4)	4.038	0.81	-.180**	.152**	-.038	**1**		
Internal auditor independence and integrity (5)	4.354	0.678	-.285**	.196**	.079	.265**	**1**	
Public funds management (6)	3.796	0.64	-.320**	.252**	-.049	.417**	.419**	**1**

Note (s): **Correlation is significant at the 0.01 level (2-tailed); *Correlation is significant at the 0.05 level (2-tailed); Source (s) Authors own work

4.2. Reliability and Validity

Using AMOS *v*.21, we relied on confirmatory factor analysis (CFA) to assess the robustness of the measurement models (IAF, Internal auditor independence and integrity, and PFM) before testing our hypotheses. Throughout the process, for all the study constructs we used construct indicators in line with earlier research (Hair, Hult, Ringle & Sarstedt, 2022). To assess the overall model fit, we used a number of fit indices, such as the Tucker-Lewis Index (TLI), Incremental Fit Index (IFI), Normed Fit Index (NFI), Comparative Fit Index (CFI), and Root Mean Square Error of Approximation (RMSEA). The three factors that make up our baseline model are internal audit function, internal audit independence and integrity, and public funds management, as shown in Table II below.

Table 2. Confirmatory factor analysis results

Models	**χ^2**	**df**	***P***	**CFI**	**IFI**	**TLI**	**NFI**	**GFI**	**AGFI**	**RMSEA**
Public funds management	1.311	19	0.703	.999	1.000	1.000	.981	.989	.978	0.000
Internal audit function	60.69	62	0.524	1.000	.994	.998	.974	.975	.963	0.000
Internal auditor independence and integrity	2.245	26	0.505	1.000	.998	1.001	.980	.983	.971	0.000
Note (s) χ^2- Chi-square; df- degrees of freedom; CFI- Confirmatory factor analysis; TLI- Tucker Lewis Index; NFI- Normed fit indices; and RMSEA- Root mean measure of approximation										

Based on the estimates of the measurement model, the factor loadings (all>0.50), average variance extracted (AVE) (all>0.50), and CR (all>0.81) were all above the suggested minim standard (Hair et al., 2014). Table 1 demonstrates that the AVE values for all the constructs were larger than 0.50, indicating discriminant validity, and all the composite reliability (CR) statistics were higher than AVE values. Besides, the CR values were within the range of 0.7 to 0.84, suggesting sufficient convergent and discriminant validity (Kuppelwieser, Putinas & Bastounis, 2019). The strong convergent validity of the proposed model is further supported by a strong NFI greater than 0.95 for all the measurement models (see Table 2). The PFM, IAF, and internal auditor independence and integrity models'

respective $\chi 2$ statistics of 1.311, 60.69, and 2.24 were not significant at the 0.05 level, indicating that the models well described the data. Other fit indices, including RMSEA, NFI, TLI, CFI, SMR, GFI, and AGFI, confirmed this. The GFI, AGFI, TLI, and CFI all have values between 0 and 1, with values nearer 1 indicating a model that fits data better. Additionally, a well-fitting model is indicated by SRMR values of 0.05 or less and RMSEA values of 0.08 or less. The outcomes of all the study's measurement models met these requirements, as shown in Table 2 and in Figures (1- PFM Model; 2- IAF Model, and 3- internal auditor independence and integrity Model, respectively) **(Appendix 1)**. In general, these findings provide credence to the construct validity of the tools employed in this investigation.

Additionally, values of the variance inflation factor (VIF) were between 2.53 to 3.72, indicating acceptable levels of multicollinearity. Composite reliabilities (CR) were higher than 0.60 and coefficient alpha values were higher than 0.70. These findings showed that the measures had adequate internal consistency (Hair, Black, Babin & Anderson, 2010). In general, the CFA results as shown in **Table 2** for the PFM, IAF, and the internal auditor independence and integrity models, meet acceptable statistical standards (Hair et al., 2010). See **Table 3** showing **Item loadings, *p*-Values, CR, and AVEs for the Measurement Model.**

Table 3. Item Loadings, *p*-Values, CR, and AVEs for the Measurement Models

	Items	Loadings	*p*	CR	AVE
	Expenditure Management		**.001**	**.78**	
PFM	Budget interventions of the LG are according to the district development plan	**.67**			**.68**
	All expenditure is authorised by council	**.69**			
	The internal audit ensures that expenditure is made according to the budget in this LG.	**.68**			
	Revenue audit and investigation conducted regularly	**.59**			
	Resource Mobilization		**.001**	**.80**	
	All resources are received by service delivery units in this LG	**.72**			
	Revenue is realised as projected in the budget	**.73**			
	Internal audit recommendations on public funds management are considered by the external audit committee	**.71**			
	This LG has a Revenue risk management framework	**.67**			
IAI	**Honesty**		**.001**	**.85**	**.73**
	The Internal audit function of this LG does not make any expression without proper evidence	**.81**			
	The internal auditor reports on material facts and figures, uninfluenced by any favor or frown in this organization	**.75**			
	This LG has an internal audit committee independent of management.	**.85**			
	Internal audit committee of this LG appraises the work of internal audit function	**.83**			
	None of the internal audit staff have ever been convicted on issues of Fraud in this LG	**.66**			
	Fairness		**.001**	**.76**	
	The internal auditor of this LG refrains from reckless statements	**.55**			
	The internal audit function safeguards all information received as it may be of confidential nature.	**.83**			
	The internal auditor does not spill out possessed information	**.83**			

	unless there is a statutory, legal and professional requirement to do so.				
	The internal auditor of this LG takes into considerations responses by auditees	**.47**			
IAF	**Diligence**		**.001**	**.78**	**.72**
	Internal audit procedure is followed while executing audit	**.58**			
	Internal auditors carry out due diligence on all LG acquisitions	**.56**			
	Internal Audit function assesses current risk	**.72**			
	Internal Audit function of this LG assesses current control environment	**.78**			
	Internal Audit function is zealous and careful nature in their actions	**.72**			
	Competence		**.001**	**.84**	
	Internal Audit function reviews regulatory reporting requirements	**.71**			
	Internal audit function has capacity to review key risk management functions	**.74**			
	The internal audit of this LG uses the most resent approaches to auditing	**.72**			
	The Head of Internal Audit reviews previous Internal Audit recommendations	**.64**			
	Governance		**.001**	**.74**	
	Internal auditor of this organisation understands the reporting structure	**.98**			
	Internal audit function of this LG maintains an independent valued voice with the growing focus on corporate governance issues.	**.74**			
	Internal audit function reports to the council on quarterly basis	**.62**			
	Appropriate Risk management strategies are prepared by internal audit	**.96**			

4.3. Structural Model and Hypotheses Testing

The best-fitting model for hypothesis testing was identified by comparing two competing models: the mediated and non-mediated models, following Morgan and Hunt's (1994) guidelines. We assessed the SEM models using the criteria recommended by Morgan and Hunt (1994): (1) overall model fit, measured by the CFI; (2) the percentage of hypothesized significant paths ($p < 0.05$); (3) the amount of variance explained, indicated by the squared multiple correlations (SMCs), also known as adjusted R2; and (4) model parsimony, evaluated by the parsimonious NFI. The results of the mediated model, where the core relationship between IAF and PFM was tested by including internal auditor independence and integrity (Fig. 4), show an SMC of 28%, an NFI of 0.994, a CFI of 1.000, and an RMSEA of 0.000, as detailed in Table IV below. When the pathway from internal auditor function to internal auditor independence and integrity was removed in the non-mediated, or alternative, model (Fig. 5), the fit was poor, with an SMC of 23%, NFI of 0.812, CFI of 0.826, and an RMSEA of 0.149. Additional fit statistics support the conclusion that this model fits the data poorly. Therefore, the mediated model in Figure 4 appears to be preferable based on the comparison results, as it has the highest SMC (0.28) (Morgan & Hunt, 1994). Consequently, the research hypotheses were tested using the mediated model (Fig. 4). See Table 5 below.

Figure 4 and Table 5 below clearly define the path estimates (coefficients) from the hypothesized/mediated model. The results show that effective IAF enhances PFM in an LG setting. As a result, IAF significantly improved PFM ($\beta = 0.329$, $p < 0.01$). This supports H1. Additionally, IAF caused a positive and significant increase in internal auditor independence and integrity ($\beta = 0.265$, $p < 0.01$), providing support for H2. This finding indicates that the internal audit function can only succeed or be effective when the environment values the independence and integrity of auditors. Consistent with H3, internal auditor independence and integrity and PFM were positively and significantly related ($\beta = 0.332$, $p < 0.01$). The results suggest that enhancing PFM requires internal auditors to operate with autonomy and integrity.

Table 4. Findings of Model Comparison

Model	χ^2	d/f	*p*	SRMR	NFI	CFI	TLI	GFI	AGFI	RMSEA	SMC
Mediated Model	0.780	2	0.677	0.008	.994	1.000	1.000	.999	.994	0.000	0.28
Non-Mediated Model	25.338	3	0.000	0.076	.812	.826	.652	.856	.883	0.149	0.23
Note(s): RMSEA = Root mean square of approximation; SRMR=Standardized Root Mean Residual; TLI =Tucker- Lewis index; CFI= Comparative fit index; *p < 0.05;											

Source(s): Table by Authors

Table 5. Standardized and unstandardized regression weights for the mediated model

Mediated Model	Unstandardized coefficients (B)	SE	CR	Standardized coefficients (β)	*P-value*
IAF → PFM	.435	.038	6.854	.329	***
IAF → IAI	.324	.066	5.047	.265	***
IAI → PFM	.387	.030	6.894	.332	***
GD → PFM	.017	.061	0.191	.009	.849

Source: Authors own work

4.4. Testing for Mediation

The details of the suggested PFM mediation model were also evaluated. When internal auditor independence and integrity were added as a mediator in the basic relationship between IAF and PFM, the considerable direct effects of IAF on PFM decreased but remained significant. Therefore, a partial mediation type is supported by these results. As indicated by Fig. 4 and Table 6, the standardized direct effect of IAF on PFM is significant (0.417; $p < 0.001$). However, when the mediator (internal auditor independence and integrity) was introduced in the model, the path coefficients of the link between IAF and PFM reduced from (0.417; $p < 0.001$) to (0.329; $p < 0.001$) but the model remained significant. The indirect effect (0.088), approximately 9% constitutes the change. This suggests that internal auditor independence and integrity might have mediated the relationship between IAF and PFM to a considerable extent. This result supports H4: internal auditor independence, therefore, mediates the direct relationship between IAF and PFM. Overall, the mediated model accounts for 28% of the total change in PFM.

Table 6. Direct and indirect effects of IAF, IAI and PFM

	IAF	**IAI**	**PFM**
Standardized total effects			
IAI	0.265	0.000	0.000
Public funds management	0.417	0.332	0.000
Standardized direct effects			
IAI	0.265	0.000	0.000
Public funds management	0.329	0.332	0.000
Standardized indirect effects			
IAI	0.000	0.000	0.000
Public funds management	0.088	0.000	0.000

5. Discussion

The purpose of this study was to determine the mediating role of internal auditor independence and integrity in the relationship between IAF and PFA. The findings revealed that IAF and PFM are positively and strongly linked. This implies that actions and attitudes linked to PFM are influenced by LG's management that emphasizes IAF characterized by strong governance structures, and competent staff that operate with due diligence, and or thoroughness. By offering independent assurance and guidance, assisting in the efficient and effective use of public funds, and guarding against fraud and corruption, the IAF has been able to promote initiatives aimed at enhancing PFM. The LG audit function has achieved this by analyzing risk management procedures, keeping an eye on legal and regulatory compliance, and determining how well internal controls are working. The results are in line with those of Mara et al. (2021) and Kamara (2023), who link IAF to enhanced PFM. Therefore, LG's functioning in today's environment, characterized by budget constraints and tight liquidity, can be realized by embracing a robust IAF that values staff competence, diligence, and the establishment of strong governance structures to support the audit function; this strengthens PFM among LG employees. Moreover, IAF and internal auditor independence and integrity were found to be associated within the LG setting. The results suggest that LGs that value the existence of an operational internal audit unit promote an environment for the independence and integrity of LG staff to thrive. As the LG emphasizes adequate staffing of its LG audit structure with competent staff, auditors reciprocate by operating with efficiency, fairness, and honesty, leading to quality audit reports and, hence, better PFM. The results are consistent with research by Ziniyeli and Twum (2024), Chan et al. (2017), and Nadirsyah and Mulyany (2024) that supported the important function of IAF in fostering the independence and integrity of internal auditors. By guaranteeing a distinct reporting structure, clear boundaries between audit and management tasks, and a commitment to ethical behavior and impartiality, internal audit functions promote independence and integrity of LG internal auditors to undertake their responsibility, which might consequently promote PFM.

Also, this study examined the mediating influence of internal auditor independence and integrity in the relationship between IAF and PFM, with results revealing internal auditor independence and integrity as the mechanism through which IAF impacts PFM. These results suggest that changes in IAF affect changes in internal auditor independence and integrity, which in turn partially contribute to changes in PFM in LGs. Thus, internal auditor independence and integrity signify a mechanism through which the influence of IAF is realized on PFM. The study findings reveal a range of implications for theory and practice as examined below.

5.1. Theoretical Implication

First, this study conceptually expands on our understanding of internal auditor function (IAF) and public funds management (PFM) in the context of local governments in developing nations such as Uganda. This research has contributed to the current body of knowledge by providing a variety of viewpoints on the effects of IAF in the local government sector. By analyzing how IAF assesses and improves the effectiveness of the local government's internal control, governance, and risk management processes, the current study particularly advances auditing research. The findings offer additional evidence of the internal audit function's positive influence on organizational-level outcomes like PFM.

Second, previous studies have largely established that LG public funds management (PFM) is positively impacted by the internal audit function (IAF) (e.g., Kamara, 2023; Enofe et al., 2013; Mara, Selena & Rosa, 2021). However, these studies failed to emphasize the basic mechanism that linked IAF to PFM. Therefore, using the internal audit independence and integrity as one of the primary underlying processes, this study investigates the relationship between IAF and PFM. By exploring the mediating influence of internal auditor independence and integrity in the IAF-PFM relationship, our research advances knowledge of the fundamental process by which IAF impacts PFM. The study findings suggest that by demonstrating an operational internal audit structure, LG management increases the independence and integrity of audit staff, which in turn increases PFM. Our results support the body of research that indicates internal auditor independence and integrity as a significant motivational source for improved PFM (Hubais et al., 2023). Moreover, examining internal auditor independence and integrity as a mediator helps us better understand how and why IAF can increase PFM among LGs.

Finally, prior studies have revealed inconclusive or mixed results about the relationship between the internal audit function and public funds management in organizations (LGs). For instance, while scholars such as Roussy and Brivot (2016), Dzikrullah et al. (2020), and Kamara et al. (2023) found that a functional internal audit structure promotes greater accountability, transparency, and management of public funds, a study by Chambers and Odar (2015) posited contradictory results. These authors argued that an operational internal audit occasionally failed to identify, stop, or even report fraud during the financial crisis, thereby affecting its capacity to improve PFM. Our findings contribute to PFM literature by providing empirical evidence that the internal audit function, underpinned by diligence, competent staff, and strong governance structures, accounts for unique and significant variance in PFM among LGs, thereby providing support for studies by Roussy and Brivot (2016), Dzikrullah et al. (2020), and Kamara et al. (2023). We therefore argue that through IAF, LGs have been able to promote PFM by providing autonomous oversight and assurance that public funds are used most efficiently and effectively, and in compliance with the existing legal regime.

5.2. Practical Implication

First, the results show that IAF significantly predicts PFM. To improve PFM, LG managers must establish a strong and motivating IAF culture within the LGs. Therefore, LGs can realize the full potential of internal audits in advancing PFM by adopting a risk-based approach, using metrics, ensuring transparent communication, implementing data-driven reporting, fostering a collaborative environment, investing in auditor training, and emphasizing follow-up and continuous improvement. Importantly, better service delivery, increased accountability and transparency, and more efficient

resource allocation are all outcomes of LGs effectively managing public finances. Furthermore, improved PFM reduces territorial inequality, promotes sustainable economic growth, and supports good governance.

Second, as was already noted, the statistical results showed that the independence and integrity of internal auditors play a significant mediating role in the relationship between IAF and local governments' PFM. As a result, the findings suggest the need to develop employees high in ethics as this has a positive relationship with local government PFM. Therefore, organizations looking interested in improving PFM should consider employing and training audit personnel with strong ethical conduct. Thus, establishing strong internal controls, enforcing ethical standards, and ensuring transparency in LG actions are all ways to help LG audit staff feel more independent and ethical while executing their mandate, hence promoting good PFM practices. Mostly, the above LG interventions are likely to prevent conflicts of interest, provide sufficient resources for audits, and establish a whistleblower protection framework necessary for improved PFM (Ziniyeli & Twum, 2024; Mara et al., 2021).

5.3. Conclusions

The independence and integrity of internal auditors and IAF have an impact on LG's ability to meet strong PFM requirements. By drawing on the agency theory (Jensen & Meckling, 1976), this study fills the gaps in the IAF-PFM literature by highlighting the critical importance of IAF and behavioral aspects such as internal auditor independence and integrity in improving PFM. This theoretical framework serves as the foundation for the development of the PFM model, specific to Uganda's LGs. Results from the study's analytical approach supported the assertion that improving PFM requires the independence and integrity of internal auditors and IAF. Also, the mediation study showed that the relationship between IAF and PFM is explained by the independence and integrity of internal auditors. Therefore, when IAF and internal auditor independence and integrity are combined into a unified model, LGs can better understand how to enhance PFM. As a result, the independence and integrity of internal auditors contribute to the influence of IAF on local governments' PFM. Using the agency framework, these findings contribute to the body of knowledge on IAF and PFM while providing academics and professionals with a more complex and nuanced understanding of how and why IAF affects PFM in the Ugandan context using agency theory.

5.4. Limitations and Areas for Future Research

This study has limitations, just like any other, and we advise readers to exercise caution when interpreting our findings. Only LGs made up the subject of our investigation, making it a small sample. Future research with larger sample sizes might be carried out in different industries and, or different countries. Also, we observe that approximately 45% of the variation in PFM is predicted by our independent variables (IAF and internal auditor independence and integrity). Future studies could consider replicating or expanding this research in different contexts with additional factors or variables. Further, the study used a cross-sectional design, which makes it difficult to conclude causality. Therefore, since IAF practices like staff competence, diligence, and governance structures are thought to be entrenched in an LG audit unit over time, we recommend a longitudinal study as this may provide a deeper understanding of the causal linkages between IAF and PFM. Despite the

research constraints, we think that the findings of this study offer preliminary empirical support for the relationship between IAF, the internal audit function, and PFM based on data from a developing African nation.

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Appendix1: Measurement Models

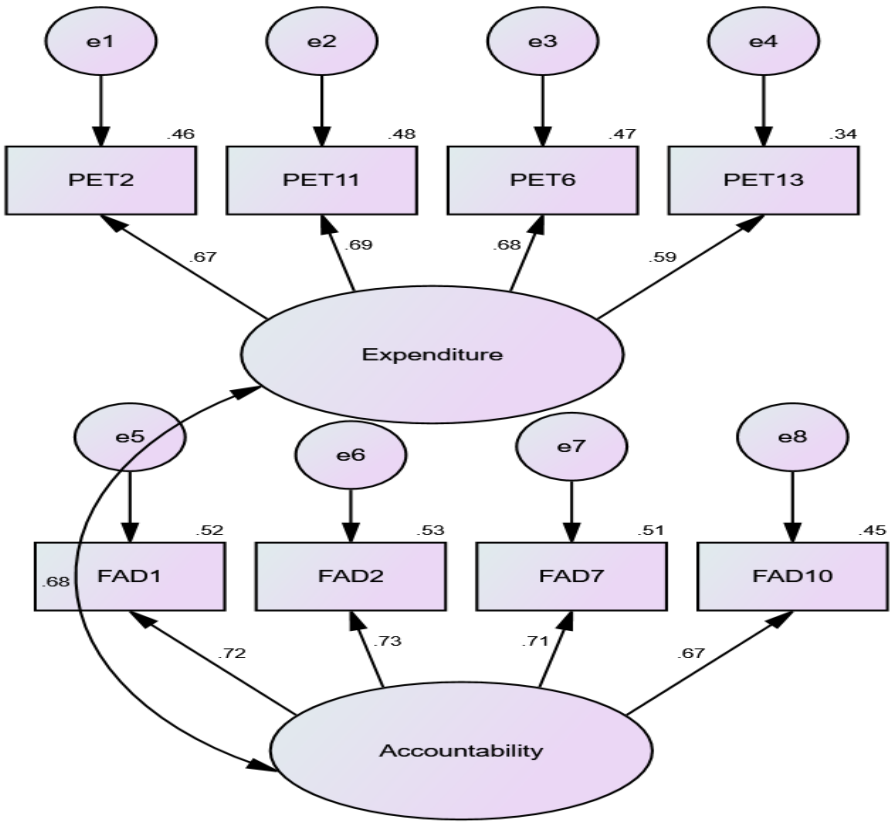


Fig. 1. PFM Model

Goodness of Fit Indices

$\chi 2$ = 1.311; p -value = 0.703, d/f = 19; RMSEA (0.000); TLI (1.000); IFI (1.000); CFI (0.999); NFI (0.981); GFI (0.989) and AGFI (0.978) Key Expenditure- Public Expenditure Accountability- Public Accountability.

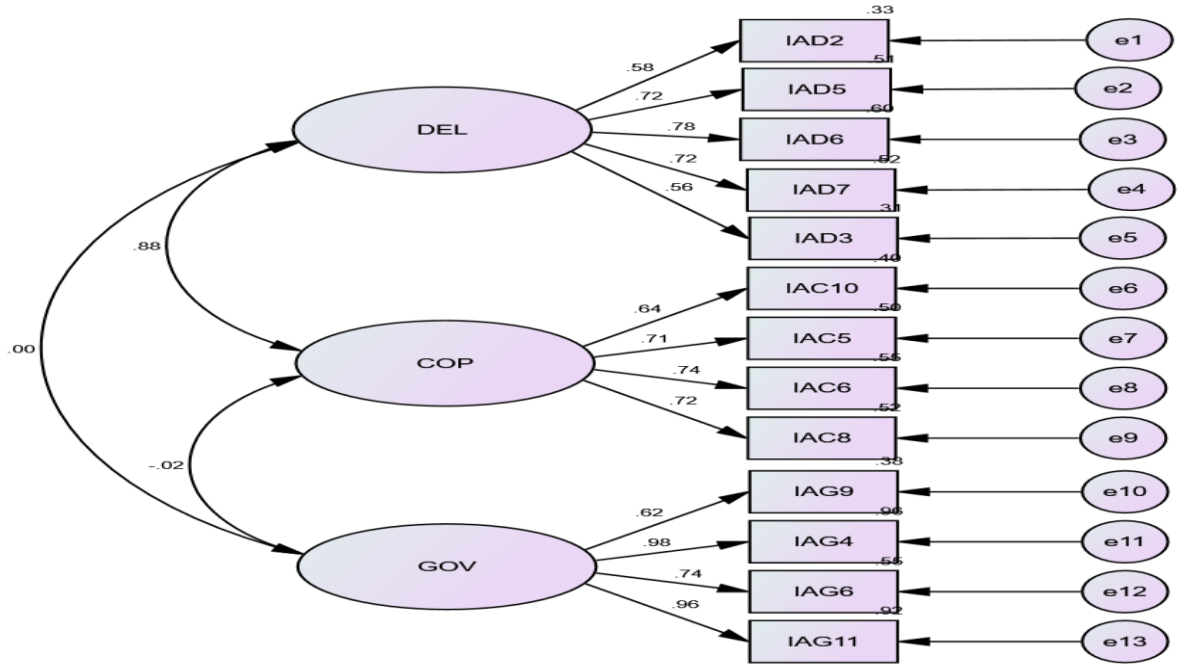


Fig. 2. Internal Auditor Function

Goodness of Fit Indices

$\chi 2 = 60.69$; p -value = 0.524, d/f = 62; RMSEA (0.000); TLI (0.998); IFI (1.000); CFI (1.000); NFI (0.974); GFI (0.975) and AGFI (0.963) Key: Del- Diligence; Cop- Competence; Gov- Governance.

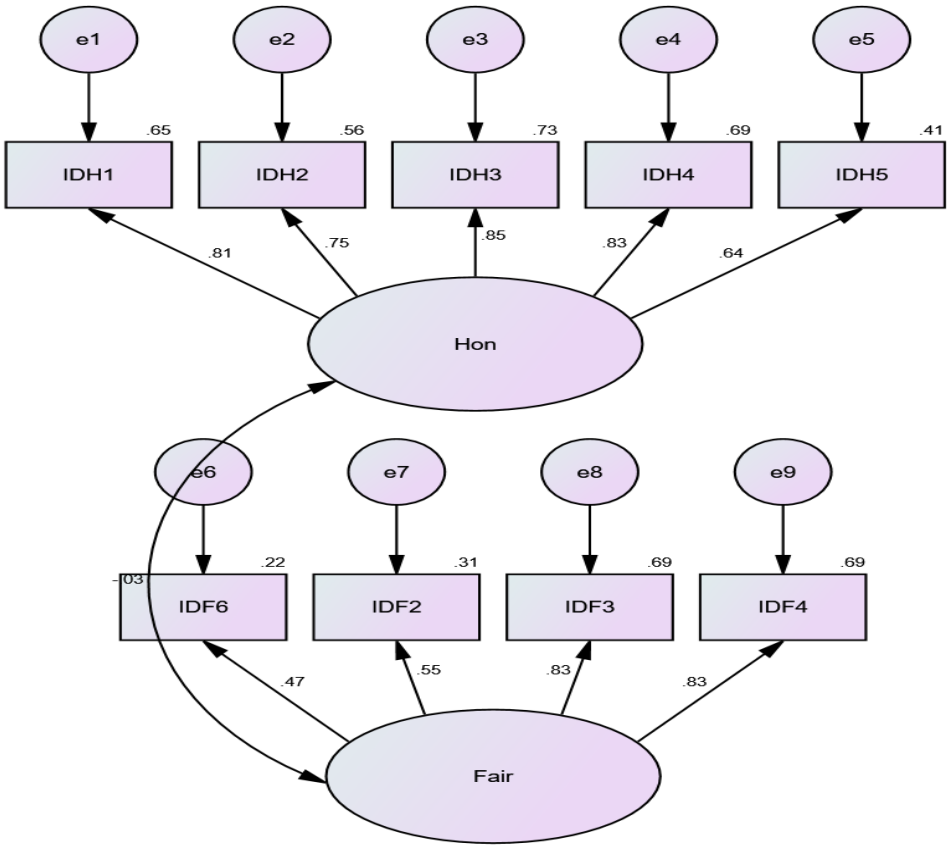


Fig. 3. Internal Auditor Independence and Integrity

Goodness of Fit Indices

$\chi 2 = 2.245$; p -value = 0.505, d/f = 26; RMSEA (0.000); TLI (1.001); IFI (0.998); CFI (1.000); NFI (0.980); GFI (0.983) and AGFI (0.971) Key Hon- Honesty; Fair- Fairness.

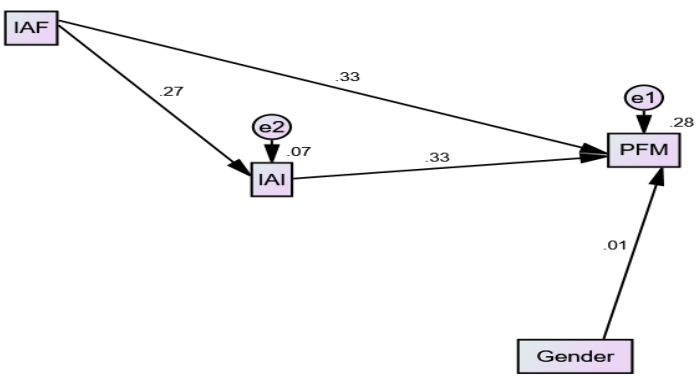


Fig. 4. Mediated Model

Goodness of Fit Indices

$\chi 2 = 0.780$; p -value = 0.677, d/f = 2; RMSEA (0.000); TLI (1.000); IFI (0.999); CFI (1.000); NFI (0.994); GFI (0.999) and AGFI (0.994); Note(s): IAF- internal auditor function; IAI- internal auditor independence & integrity, PFM- public funds management.

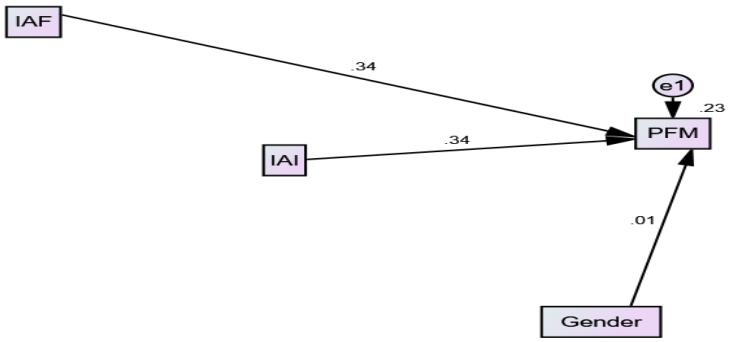


Fig. 5. Non-Mediated Model

Goodness of Fit Indices

$\chi 2 = 25.338$; p -value = 0.000, d/f = 3; RMSEA (0.000); TLI (0.652); IFI (0.830); CFI (0.826); NFI (0.812); GFI (0.865) and AGFI (0.883); Note(s): IAF- internal auditor function; IAI- internal auditor independence & integrity, PFM- public funds management.