

# Determinants of Internal Audit Effectiveness in Selected Hospitals within the Kumasi Metropolis

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**Abstract:**-The study examined the Determinants of Internal Audit Effectiveness in Selected Hospitals within the Kumasi Metropolis using qualitative study. Primary data in the form of administration of questionnaire to (60) respondents was used.

The discovered that internal audit units of the four selected hospitals were effective in the discharge of their duties and further observed that, the determinants of Internal Audit effectiveness included amongst others (arranged chronologically): Higher salaries and incentives of internal auditors (motivation) with a mean score of 2.10, Organizational Independence also had an average score of 1.77, Effective internal controls scored 1.71 as a third variable of internal audit effectiveness determinant, Adequate internal audit charter and frequent internal audit meetings both came fourth and fifth scoring an average of 1.61 respectively, Competent internal audit staff came sixth with a mean score of 1.35, with last but not least being management support which also scored an average mark of 1.29.

Based on the findings of the study, the researcher recommended that there should be separation of powers between the appointing authority of internal auditors and those in charge of determining their incentives and remuneration so as to ensure total independence of internal auditors.

## I. BACKGROUND OF THE STUDY

Good corporate governance system in every organization requires the establishment of internal audit unit. The value and the need to focus on improving strong corporate governance have augmented due to series of corporate failure (bankruptcy and fraud) and financial scandals like earnings restatement to ensure financial reporting quality (Zelege Belay, 2007). These corporate upheavals have driven external regulators to find ways of promoting greater accountability, disclosure and transparency. The main role of corporate governance is to restore the trust and market confidence as well as shareholders. (Carl Rosen, 2010). It has been widely recognized that the role of the internal auditor becomes a continuing contributor in terms of developing good corporate governance practices and structure. There is evidence that an effective internal audit function enables the board to perform its corporate governance duties through organizational involvement, assessment, training, professional guidance and communication at all levels within the organization (Kenneth D'Silva, Jeffrey Ridley, 2007). Audit committee, managers, internal auditors and external auditors play a crucial role in effective control and appropriate leadership within the organization to act in the interest of the shareholders (Sridhar Ramamoort, 2003). Most companies recognized and valued

internal auditing and hence, the role of internal auditors has escalated and is being depended upon to contribute significantly in business improvement, strategic and operations risks (Kenneth D'Silva, Jeffrey Ridley, 2007).

According to the International Standard of Audit (ISA 610), internal audit encompasses analysis appraisal or monitoring activity setup within an entity as a service to the entity, by focusing on examining, evaluating and reporting to management and the directors on the adequacy and effectiveness of components of the accounting and internal control systems. Furtherance to the above, the Institute of Internal Auditors (IIA, 1978) defined internal audit as “an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

Under Ghana's Public Financial Management Act 2016, (Act 921), the Auditor-General has the legal mandate to carry out internal audit activity in the Metropolitan, Municipal and District Assemblies (MMDAs) of Ghana. Previously, staff at the internal audit units of these MMDAs mainly concentrated on pre-auditing of payment vouchers, but this has significantly changed as per Section 83 (3) of the Public Financial Management (PFM) Act 2016, Act 921 as follows:

Section (3) of PFM Act states: An Internal Auditor of the Internal Audit Unit of a covered entity shall

- (a) appraise and report on the soundness and application of the system of controls operating in the covered entity;
- (b) evaluate the effectiveness of the risk management and governance process of a covered entity and contribute to the improvement of that risk management and governance process;
- (c) provide assurance on the efficiency, effectiveness and economy in the administration of the programmes and operations of a covered entity; and
- (d) evaluate compliance of a covered entity with enactments, policies, standards, systems and procedures.

### *Statement of the Problem*

In recent times, plethora financial and accounting scandals have been reported, apart from the Enron and WorldCom scandals some time past. For instance, Chen (2012) posits that incidents of corporate frauds in the form of false financial reporting, irregular transactions, inflated revenues and assets embezzlement have been on the increase the world over. The resultant effects of these accounting manipulations have caused the public and especially investor's to lose confidence and trust in financial reporting, and management team along with their accounting decisions (Anja, 2008).

In order to build public and investor confidence in financial reports and the accounting profession as a whole, attention is being paid to strong corporate governance, particularly effective internal audit units. The internal audit units must not just be set up, but must be seen executing their roles as required, to bridge any expectations gap. To be able to assess the performance of their roles, there is the need for empirical evidence as regards what makes an internal audit unit more effective, hence, the researcher deems it expedient to conduct this study on the determinants of internal audit effectiveness in selected hospitals within the Kumasi Metropolis.

Unfortunately, previous researches similar to this have largely centred on MMDAs (George Tackie et al, 2016), but this research seeks to be industry specific by focusing on the health sector, whose services remain indispensable for majority of the Ghanaian populace. Lack of resources within the health sector could affect their effectiveness and the scarce resources available must be seen to be put to good use; thereby craving the need for the internal audit units to be effective in the discharge of their mandate. **But what constitutes the yardstick or determinants of measuring the effectiveness of the internal auditors? Answers to this question remain the reason for conducting this research.**

Additionally, many studies on the effectiveness of Internal Audit in Ghana and elsewhere have been conducted (see for examples, Mihret & Yismaw, 2007; Asare, 2008; Ernst & Young, 2008; Nomo, 2009; Abbey, 2010; Pricewater house Coopers, 2010; Bota-Avram & Palfi, 2009); Arena & Azzone, 2009); Cohen & Sayag, 2010; Karagiorgos, Drogalis & Giovanis, 2011). Nonetheless, to the best of the knowledge of the researcher, no research has focused on the determinants of Internal Audit effectiveness of hospitals in Ghana and Sub Saharan Africa for that matter.

To this end, the researcher deems it expedient to conduct this study on the "Determinants of Internal Audit effectiveness in selected hospitals within the Kumasi Metropolis".

### *Research Objective*

The general objective of this study was to examine the determinants of internal audit effectiveness in the selected hospitals within the Kumasi Metropolis.

### *Research Question*

1) What are the determinants of internal hospital?

### *Significance of the Study*

The study is particularly important as it will help policy makers know the major determinants of Internal Audit Effectiveness in the selected hospitals so as to enhance the internal audit units to ensure that scarce resources are effectively put to use for robust health delivery.

Additionally, the study is significant as it would add to the inadequate literature on the subject matter.

## II. THEORETICAL CONCEPT OF INTERNAL AUDITING

A theory essentially entails accepted principle or explanation of nature or a cluster of statements or principles devised to unravel a group of facts or phenomena, especially one that has been repeatedly tested or is widely accepted and can be used to make predictions about natural phenomena (Creswell, 2014).

Asare (2009) opines that the modern concept of internal auditing can be identified as dealing with the evaluation and improvement of risk management, control and governance processes. Risk management, control and governance encompass the policy and procedures established to ensure the achievement of objectives and include the appropriate assessment of risk, the reliability of internal and external reporting and accountability processes, compliance with applicable laws and regulations and compliance with the behavioural and ethical standards set for an entity and its employees.

Additionally, the Institute of Internal Auditors(1978) defines **Internal Audit** as "...an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."

### *Internal Audit Effectiveness*

The Institute of Internal Auditors (IIA, 2010) defines internal audit (IA) effectiveness as "the extent (including quality) to which established objectives are achieved." It is the extent to which an internal audit office meets its purposes (Mihret & Yismaw, 2007), and can refer to ability of auditors, internal or external, to achieve established objectives within an organisation (Mizrahi & Ness-Weisman, 2007; Arena & Azzone, 2009; Dittenhofer, 2001; Karapetrovic & Willborn, 2000). The objectives of an internal audit unit for every organisation depend on the goals set out by the management of such an organisation (Pungas, 2003). Even though the degree of internal audit effectiveness tends to vary within organisational levels as well as country (Al-Twaijry et al., 2003), the management of organisations should have a clear objective for internal auditors to achieve, given the available

resources and other means that might aid the achievement of such objectives. It is argued that the effectiveness of an internal audit unit depends on the expectations of relevant stakeholders even though systematic and generally valid measures can be used to gauge IA effectiveness (Dittenhofer, 2001).

#### *Determinants of Internal Audit Effectiveness (Independent Variables)*

The researcher adopted the determinants of effective internal auditing as used by Cohen and Sayag (2010). The first three determinants such as: **professional proficiency of the auditors; the quality of auditing work; and the organizational independence of auditing departments** represent instances where the auditor's interests reflect those of the profession, rather than the employing organization. The last two determinants (career advancement; and top management support) represent instances where the interest of the employing organization takes precedence over that of the internal auditor's profession.

Professional proficiency is the expertise, specialized knowledge and abilities showcased in a field in which one is practicing professionally. Appropriate staffing of an internal audit department (Al-Twajry, Brierley, & Gwillian, 2003) and good management of those staff remain fundamental to the effective operation of an internal audit department. Staff of an IA unit should have the requisite education, training and experience to conduct the full range of audits required by its mandate. Quality of audit work embodies the extent of excellence in the audit work which is normally attained when the audit work is performed according to IA standards.

Organisational independence is the state, condition, quality or process of being independent through organisational placement and reporting lines of the IA department. Independence here symbolizes independence of mind and of appearance of the IA staff. Bou-Raad (2000) argues that the strength of an IA department must be assessed with respect to the level of independence it enjoys from management and from operating responsibilities. Independence of mind requires the auditor to have a kind of mind that allows the expression of opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity and exercise objectivity and professional skepticism. Independence in appearance requires the auditor to eschew instances that will cause others to conclude that they are not maintaining an unbiased attitude and an objective of mind (Musa Adeiza Farouk & Shehu Usman Hassan, 2014). Musa Adeiza Farouk and Shehu Usman Hassan (2014), defined auditors independence as the conditional probability that the auditor will unravel any misstatement in financial statements given that this misstatement was already discovered. Chia-Ah and Karlsson (2010), further opined that the threats to auditors independence are often very significant and thus undermine the auditor's effectiveness in rendering the auditing services.

It becomes even more challenging when the auditor overstays with a client as extended audit tenures have been found to hamper auditor independence (Bamber and Lyer, 2007; Jackson et.al, 2008).

Table 1. Determinants of Internal Audit Effectiveness

	N	Minimum	Maximum	Mean	Std. Deviation
Competent internal audit staff is a fundamental determinant of internal audit effectiveness	60	1.00	2.00	1.3548	.48637
Effective internal control is a guarantee of internal audit effectiveness	60	1.00	4.00	1.7097	.73908
Frequent internal audit committee meeting is a recipe for internal audit effectiveness	60	1.00	4.00	1.6129	.76059
Higher salaries and incentives of internal auditors is a determinant of internal audit effectiveness	60	1.00	4.00	2.0968	1.22079

Source: Authors' construct (2010)

From table 1, the findings discovered that higher salaries and incentives of Internal Auditors was a major determinant of internal audit effectiveness as this variable had a mean score of 2.10 and a standard deviation of 1.22. One could thus reiterate that if internal auditors are adequately motivated, then it is less likely that they can compromise in the discharge of their duties. **The researcher, in tandem with this finding would recommend that, the appointing body of internal auditors should not be the same body to determine their incentives so that internal auditors can completely be independent.**

Additionally, third top most variable as a major determinant of internal audit effectiveness is effective internal controls as this scored average mark of 1.71 and a standard deviation of 0.74. It is worthy of emphasis that, Internal Auditors ensure enforcement of internal controls and if these controls are effective, it enjoins that the internal auditors are also effective and it is not surprising this was aptly placed second. This finding affirms the Established Codes of corporate governance such as the IFAC Code or the UK's Combined Code which highlight the need for businesses to maintain **good systems of internal control** to manage the risks the company faces. It is seen as part of good corporate governance to have an internal audit function to assess and monitor internal control policies and procedures

The second but last major determinant of internal audit effectiveness was competent internal auditors as this determinant had a mean score of 1.35 and a standard deviation of 0.49. This finding asserts Godwin (2001) findings who posited that, internationally, the practice of staffing the IA department with career auditors is becoming less common, with more organizations using the function as a training ground for future management personnel. This practice is

designed to enable the organization train well-rounded senior managers. This finding sharply contradicts Shewamene Hailemariam, (2014) who found competent internal audit staff to have had a significant and positive relationship on the effectiveness of internal audit.

### III. SUMMARY OF KEY FINDINGS

The synopsis of the study, identified the major determinants of internal audit effectiveness to be as follows (stated in order of significance)

- Higher salaries and incentives of internal auditors (motivation). This had a mean score of 2.10
- Organizational independence also had an average score of 1.77
- Effective internal controls scored 1.71 as a third variable of internal audit effectiveness determinant.
- Adequate internal audit charter and frequent internal audit meetings both came fourth and fifth scoring an average of 1.61 respectively.
- Competent internal audit staff came sixth with a mean score of 1.35.
- Last but not least was management support which also scored an average mark of 1.29.

### IV. CONCLUSIONS

The researcher's fundamental objective was to assess the determinants of internal audit effectiveness in selected hospitals of the Kumasi Metropolis, knowing fully well the recent public outcry of corporate governance scandals and the ill use of public funds in some health institutions where patients virtually die because of inadequate beds and other resources.

The researcher believed it is government's intention to enhance best financial management practices and this could be made possible through a robust internal audit function to widen the scope of responsibility, accountability and restrict misapplication and misappropriation of funds or assets.

The results of the study indicate that there exist effective internal audit units within the selected hospitals and it can thus be concluded that internal audit plays a crucial role in effective control and appropriate leadership within the organization to act in the interest of the stakeholders as most hospitals recognize and value internal auditing as a catalysts being depended upon to contribute significantly in business improvement, strategic and operations risks.

It is the researcher's assertion that internal auditors need motivation in the discharge of their functions in order to be independent of management influence and that internal auditors enhance internal controls and operate within acceptable internal charter and standards in lieu of their competence and management support.

### V. RECOMMENDATIONS

Based on the findings and conclusions drawn from this study, the researcher makes the following recommendations:

Firstly, this study recommends that the appointing authority of internal auditors should be different from the body responsible for determining their incentives and remunerations. This is to safeguard their independence

Secondly, the study recommends that since internal audit has become the pinnacle of good corporate governance, there should be a statutory legislation of professional qualifications of internal auditors so as to enhance their independence in mind and appearance since management members with higher qualifications tend to overlook the importance of the internal audit unit and hence, their recommendations.

Thirdly, the study recommends that future studies should be conducted on both private and public health institutions so as to ascertain the veracity and verisimilitude of the findings of this study.

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