



Effectiveness of Internal Audit Functions in Public Institutions: A Case of Lilongwe City Council

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ABSTRACT

The researcher intended to analyze the role of leaders during change management process in public institutions. The objectives of the research include: to analyze factors that affect internal audit functions in public institutions, to analyze the influence of management in internal audit functions, and to analyze challenges experienced in internal audit functions. The study used a philosophy of positivism and the approach was deductive. The researcher used quantitative as a methodological choice and survey was used a strategy for collecting data. The study was conducted at Lilongwe City Council (LCC). The population of study was 246. The sample size was 107. Stratified random sampling method was used to select the respondents. A questionnaire was used to solicit responses. The researcher used Excel and SPSS to analyze the results. The study found that internal audit functions in councils are not effective. However, the results showed that councils can improve the effectiveness of internal audit functions through provision of adequate support. The research has also found out that management support is key in ensuring effectiveness of the functions. The researcher recommends management should start providing adequate support to the function and that the Board should ensure that people with knowledge of auditing should be appointed into the audit committee.

Keywords: Internal audit function (IAF), Lilongwe City Council (LCC).

1. Introduction

According to Manstz and Sharaf (1961), auditing transcends accounting. The old system of auditing would introduce a person to check the fidelity of another person entrusted with management. O'Reilly et al (1998) explain that even the Babylonians introduced detailed systems of checks and counterchecks in the public finance systems.

Persistent fraud cases that occurred in the modern Europe provided more justification for exercising more control over managers (Whittington and Pany, 1998). Such control systems were eventually adopted in United States of America (USA). In many countries, businesses grew in size, scope and complexity, and needed a comprehensive internal assurance function to critique managerial decisions. Various countries now started to introduce systems that would not only verify efficiency of work but also evaluate the honesty of employees.

Internal audit is described as 'an objective standard assurance that is independent within an organization'. An internal auditor is not accountable to the management and has no direct management responsibility. An internal auditor is expected to pick any transaction or activity for audit and have unlimited access to information. According to the USA department of public expenditure and reform (2018), an independent and objective internal audit function is a key component of good governance. The main goal of internal audit is to provide recommendations on how institutions can improve their operations in order to achieve objectives. According to (Anao, 2012) internal audit should not be confused with supervision or control services whose main goal is to check noncompliance.

As Carmen (2011) explains, best practice of corporate governance entails that the board of directors should oversee operations of the management. The IAF is expected to be accountable to the board. The audit committee is expected to review the reports and present to the board. However, in many circumstances the audit reports find its way into the hands of the management Julien and Riege (2011). According to Toma (2007), management role is just to advise but not to replace the role of the board.

Carmen (2011) defines a public institution is an entity that is established by an act of parliament and capitalized by tax payers' money. Since public institutions are established by statutes or law, they are also referred to as statutory corporations. According to (Carmen, 2011), since the owners of the public institutions are the citizens, a small group of people is appointed to oversee the operations of a public institution on behalf of the citizens. Government is mandated to appoint people into the boards of various public institutions who then appoint the management. Directors act as agents and citizens are the principal. Therefore, the directors are expected to exercise fiducious duty for the institutions they are foreseeing (Goodwin, 2004). Internal auditors therefore are key informants of the directors regarding the performance of an institution.

1.2 Statement of the problem

In Malawi, IAF was introduced in 2003 to improve accountability in the use of public resources. Since then, the internal audit system has undergone some transformations to remove some bottlenecks in the system. Ministries, departments, and agencies now have their own internal audit functions. The expectation is that by institutionalizing the IAF employees would be more accountable and productive in their management of institutional affairs. However, persistent reported cases of fraud, corruption, and theft have been reported in the public service despite having a comprehensive audit system.

1.3 Main objective

To evaluate effectiveness of internal audit functions in public institutions

1.3.1 Specific Objectives

- i. To analyze factors that affect internal audit functions in public institutions
- ii. To analyze the influence of management in internal audit functions
- iii. To analyze challenges experienced in internal audit functions

2. Literature Review

2.1 Empirical evidence

1. Factors affecting internal audit functions

According to Mihret et al (2010), the effectiveness of internal audit is based on support competency, independence, size, and many other factors.

2.1.1 Management support

According to Cohen and Sayag (2010) and Baharaul et al (2014), lack of commitment by management to consider and take action on the recommendations and findings of the internal audit exercises compromises the operation of the audit function. Strakova et al (2021) explains that internal function serves as the eyes and ears of management. However, Alzeban and Gwillian (2014) argue that this is misleading as it can be misconstrued that IAF reports to management. Much as IAF operates based on the level of support from the management, they have to avoid influence of management on their operations (Alzeban and Gwillian, 2013).

2.1.2 Independence

The IAF should exist to add value to management but should avoid to be dependent on the management influence (Alzeban and Sawatu, 2013). Internal are expected to have unlimited access to information within an organization (IPPF, 2017). As Alzeban and Gwillian (2014) explains, auditors must carry out their work without being obstructed to their objectives.

2.2 Influence of management to IAF

2.2.1 Internal audit size

Arena and Azonne (2009) stress that IAF needs to be sufficiently resourced for it to effectively carry out its functions. Management should ensure that IAF is well staffed with experienced and well qualified people (Al et al, 2007). Ahmad et al (2009) agree that the quality of internal audit works improves when there is sufficient staff. In a study of Ysmaw (2007) and Obeid (2010) it was revealed that internal audit functions in most public institutions are under staffed and they have acute shortage of well qualified staff. The limits their ability to effectively perform functions.

2.2.2 Lack of support

According to Hailemariam (2014), management should ensure that it renders adequate support to IAF in order for it to fulfill its obligation. However, Hailemariam (2014) emphasizes that such support should not compromise the interdependence of internal IAF. The support should be manifested in form of providing resources for the achievement of audit objectives (Mafale, 2014).

2.2.3 Lack of independence

Usually, the IAF faces interference in their work from various stakeholders more especially the auditees and management, Cohen and Sayag, 2010). Internal auditors are expected to freely conduct investigations, express opinions and make recommendations on matters of their concern (Mafale, 2014). The audit committee should ensure that the independence of the function is protected and guaranteed (Mafale, 2014).

2.3 Conceptual Framework

Table 2.1

Factors Affecting Internal Audit Functions

Independent variables	Dependent variables
Management support	Internal audit effectiveness
Reporting line	
Incentives	

Source: Researcher

2.4 Theoretical Framework

2.4.1 Agency theory

According to Bebchuk and Fried (2003), an agent is a person assigned by another person, the principal, to carry out a specific task. The theory states that directors of organizations are agents that have fiduciary duty of trust. Agents are expected to put the interests of organizations that they represent ahead of their own personal interests. According to Barnea et al (1985), when the owners of the company and the agents are different, questions arise about how agents use their power to put their personal interest before the interests of the organizations.

2.4.2 Ethical theory

There are four broad categories of ethical theory which include: deontology, utilitarianism, rights and virtues.

2.4.3 Deontology

According to Benjamin (1990), this class of ethical theories states that people should adhere to their obligations and duties when engaged in decision making when ethics are in play. This means that a person will follow his or her obligations to another individual or society because upholding one's duty is what is considered ethically correct. For instance, a deontologist will always keep his promises to a friend and will follow the law.

A person who adheres to deontological theory will produce very consistent decisions since they will be based on the individual's set duties. Deontology contains many positive attributes, but it also contains flaws. One flaw is that there is no rationale or logical basis for deciding an individual's duties. For instance, a businessperson may decide that it is his/her duty to always be on time to meetings. Although this appears to be something good, we do not know why the person chose to make this his duty.

2.4.4 Utilitarianism

According to Williams (1981), utilitarian ethical theories are based on one's ability to predict the consequences of an action. To a utilitarian, the choice that yields the greatest benefit to the most people is the one that is ethically correct. There are two types of utilitarianism, act utilitarianism and rule utilitarianism.

William (1981) states that act utilitarianism subscribes precisely to the definition of utilitarianism. A person performs the acts that benefit the most people, regardless of personal feelings or the societal constraints such as laws. Rule utilitarianism takes into account the law and is concerned with fairness.

On the other hand, Benjamin (1990) states that rule utilitarian seeks to benefit the most people but through the fairest and most just means available. Therefore, added benefits of rule utilitarianism are that it values justice and includes beneficence at the same time. Both act and rule utilitarianism have disadvantages. Although people can use their life experiences to attempt to predict outcomes, no one can be certain that his/her predictions will be accurate. Uncertainty can lead to unexpected results making the utilitarian decision maker appear unethical as time passes, as the choice made did not benefit the most people as predicted.

Another assumption that a utilitarian decision maker must make concerns his/her ability to compare the various types of consequences against each other on a similar scale (Benjamin 1990). According to Williams (1981), comparing material gains, such as money, against intangible gains, such as happiness, is very difficult since their qualities differ to such a large extent. An act utilitarian decision maker is concerned with achieving the maximum good. Thus, one individual's rights may be infringed upon in order to benefit a greater number of people. In other words, act utilitarianism is not always concerned with justice, beneficence or autonomy for an individual if oppressing the individual leads to the solution that benefits a majority of people.

2.4.5 Rights

According to Macintyre (1981), in ethical theories based on rights, the rights established by a society are protected and given the highest priority. Rights are considered to be ethically correct and valid since a large population endorses them. Individuals may also bestow rights upon others if they have the ability and resources to do so.

Macintyre (1981) states that the major complication of this theory on a larger scale is that one must decipher what the characteristics of a right are in a society. The society has to determine what rights it wants to uphold and give to its citizens. In order for a society to determine what rights it wants to enact, it must decide what the society's goals and ethical priorities are. Therefore, in order for the rights theory to be useful, it must be used in conjunction with another ethical theory that will consistently explain the goals of the society.

2.3.2.4 Virtue According to Benjamin (1990), the virtue ethical theory judges a person by his/her character rather than by an action that may deviate from his/her normal behavior. It takes the person's morals, reputation, and motivation into account when rating an unusual and irregular behavior that is considered unethical. One weakness of virtue ethical theory is that it does not take into consideration a person's change in moral character. For example, a scientist who may have made mistakes in the past may honestly have the same late night story as the scientist in good standing. Neither of these scientists intentionally plagiarized, but the act was still committed. On the other hand, a researcher may have a sudden change from moral to immoral character may go unnoticed until a significant amount of evidence mounts up against him/her.

2.4.6 Policeman theory of auditing

This theory considers the auditor as a policeman whose intentions is to watch, detect and prevent errors and fraud in an organization (Egbunike and Egbunike, 2017). Since the time of major financial statements fraud, in the 1940's to date, there have been increasing debate where some sections suggest that auditors must detect and disclose fraud just like a policeman (Egbunike and Egbunike, 2017).

3. Research methodology

The research used positivism philosophy since it is associated with objective view point and quantitative research. The approach was deductive. The population of study comprised employees at Lilongwe City Council. The estimated population was 246. Survey was used as strategy to collect data. Questionnaire was used as a tool to collect data. Stratified probability sampling was used as a way of choosing respondents.

4. Presentations

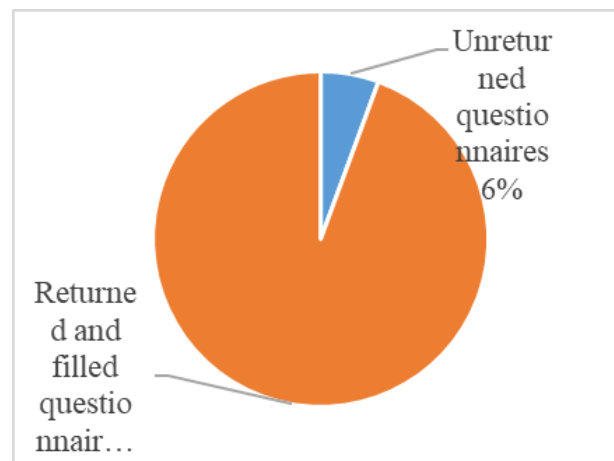
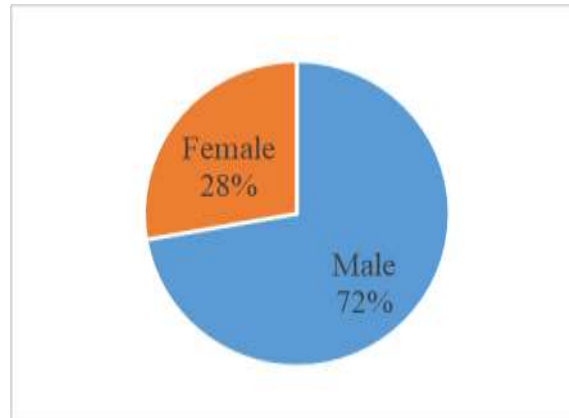


Figure 4.1

Response Rate

**Figure 4.2***Gender Representation***Table 4.1***Academic Qualifications*

Qualification	Frequency	Percent	Valid Percent	Cumulative Percent
Certificate	54	53.5	53.5	53.5
Diploma	27	26.7	26.7	80.2
Bachelor's degree	15	14.9	14.9	95.0
Chartered	2	2.0	2.0	97.0
Master's degree or above	3	3.0	3.0	100.0
Total	101	100.0	100.0	

Table 4.2*Positions of Employees*

Position	Frequency	Percent	Valid Percent	Cumulative Percent
Director	1	1.0	1.0	1.0
Manager	7	6.9	6.9	7.9
Supervisor	37	36.6	36.6	44.6
Junior	56	55.4	55.4	100.0
Total	101	100.0	100.0	

Table 4.4*Departments of Employees*

Departments	Frequency	Percent	Valid Percent	Cumulative Percent
Finance	8	7.9	7.9	7.9
Human resource and administration	13	12.9	12.9	20.8
Health	30	29.7	29.7	50.5
Procurement	12	11.9	11.9	62.4
Commercial	21	20.8	20.8	83.2
Technical	17	16.8	16.8	100.0
Total	101	100.0	100.0	

Table 4.6

Period of Employment

Valid	101
Missing	0
Mean	8.65
Std. Deviation	3.164
Skewness	.379
Std. Error of Skewness	.240
Minimum	2
Maximum	16

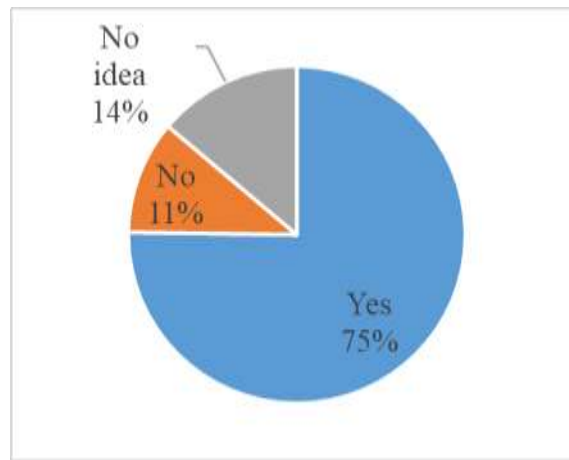


Figure 4.3

Presence of Internal Audit Committee

Table 4.7

Feedback from IAF

	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	4	4.0	4.0	4.0
No	75	74.3	74.3	78.2
No knowledge	22	21.8	21.8	100.0
Total	101	100.0	100.0	

Table 4.8

Whether Employees Finish Assignments on Time or Not

	Frequency	Percent	Valid Percent	Cumulative Percent
Always	18	17.8	17.8	17.8
Sometimes	75	74.3	74.3	92.1
No	8	7.9	7.9	100.0
Total	101	100.0	100.0	

Table 4.9

Employees' Department Relationship with IAF

	Frequency	Percent	Valid Percent	Cumulative Percent
Excellent	37	36.6	36.6	36.6
Good	61	60.4	60.4	97.0
Bad	3	3.0	3.0	100.0
Total	101	100.0	100.0	

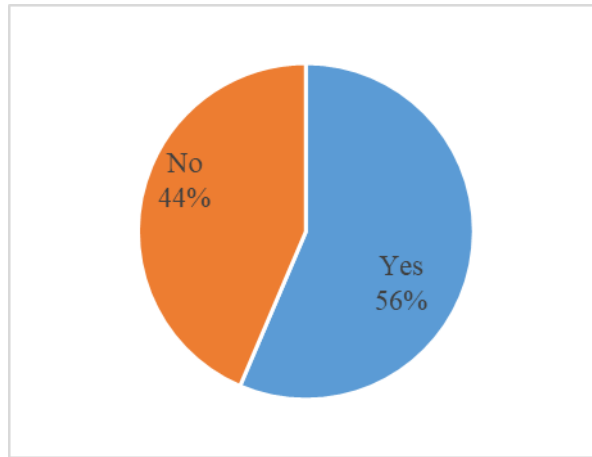


Figure 4.5

Supervisor or junior ever been suspected or accused of resource or financial mismanagement

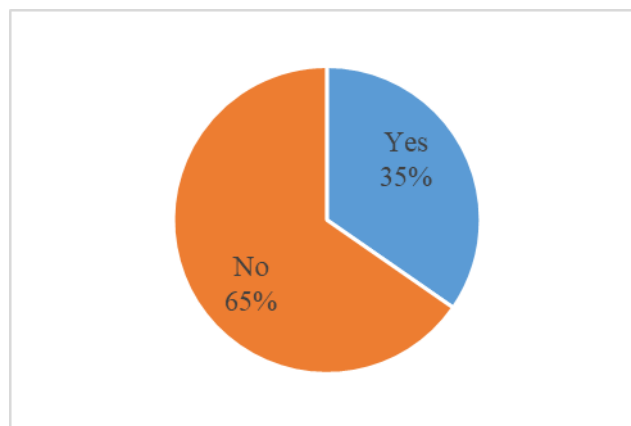


Figure 4.7

Management interference to IAF

Table 4.10

Discovery of fraud or financial management against an employee

Responses	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	8	7.9	7.9	7.9
No	72	71.3	71.3	79.2
No knowledge	21	20.8	20.8	100.0
Total	101	100.0	100.0	

Table 4.11

Dismal of employees due to fraud or financial mismanagement

Responses	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	67	66.3	66.3	66.3
No	32	31.7	31.7	98.0
No knowledge	2	2.0	2.0	100.0
Total	101	100.0	100.0	

Table 4.12*Management's Demands to Comply of IAF*

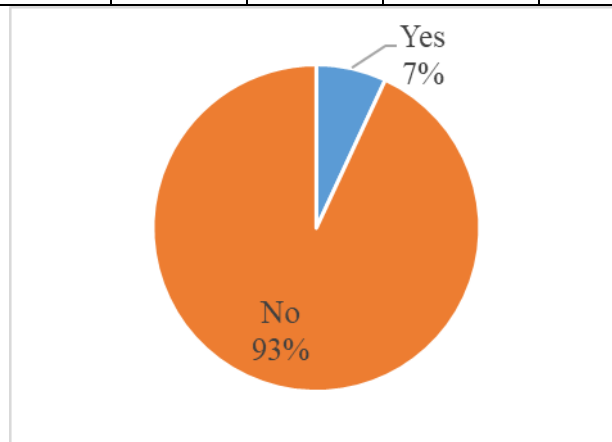
Responses	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	11	10.9	10.9	10.9
No	84	83.2	83.2	94.1
No knowledge	6	5.9	5.9	100.0
Total	101	100.0	100.0	

Table 4.13*Whether Management Provides Employees with Adequate Resources or Not*

Responses	Frequency	Percent	Valid Percent	Cumulative Percent
Always	1	1.0	1.0	1.0
Sometimes	88	87.1	87.1	88.1
No	12	11.9	11.9	100.0
Total	101	100.0	100.0	

Table 4.14*Support for Academic Upgrading*

Responses	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	6	5.9	5.9	5.9
No	95	94.1	94.1	100.0
Total	101	100.0	100.0	

**Figure 4.8***Whether Management Organizes Trainings for Employees or Not*

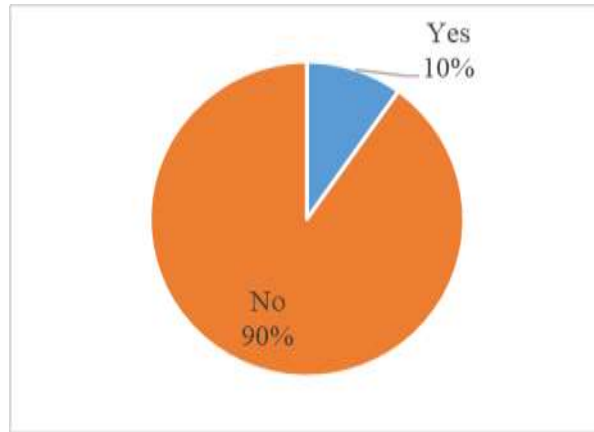


Figure 4.9

Whether Management Treats The IAF Favorably or Not

Table 4.15

Whether Employees Have Ever Witnessed Fraud or Financial Mismanagement by Their Supervisors or Juniors or Not.

	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	62	61.4	61.4	61.4
No	39	38.6	38.6	100.0
Total	101	100.0	100.0	

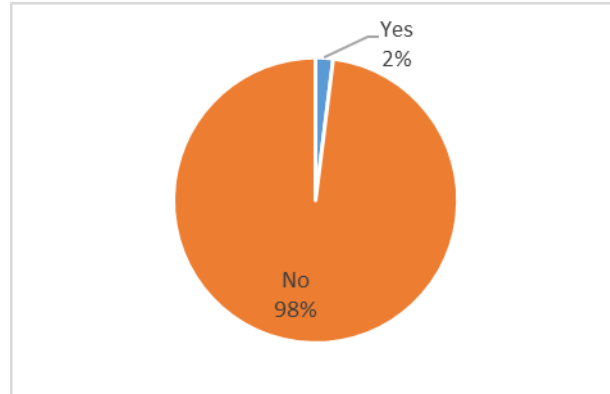


Figure 4.10

Whether Employees Report Fraud or Financial Mismanagement Cases to the IAF or Not

Table 4.16

Whether Internal Audit Committee is Competent or Not

	Frequency	Percent	Valid Percent	Cumulative Percent
Yes	3	3.0	3.0	3.0
No	90	89.1	89.1	92.1
No knowledge	8	7.9	7.9	100.0
Total	101	100.0	100.0	

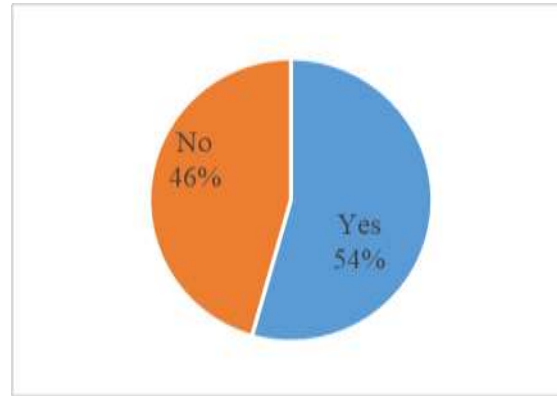


Figure 4.11

Whether Employees Have Plans to Leave their Job or Not

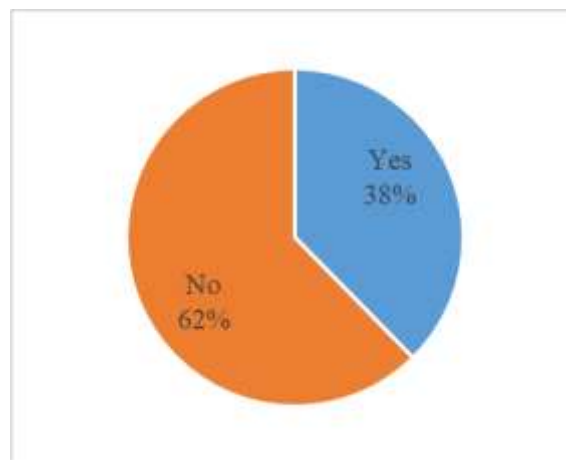


Figure 4.12

Employees' Plans to Leave the Job

5. Findings

The elected councilors are the ones that constitute the council and operates as the board of directors. The audit committee is therefore a subcommittee of the council and reports to the council. Employees agree that the audit committee is very instrumental in the operation of internal audit function.

The results indicate that the IAF does not provide feedback to various departments with regards to audit reports. This is contrary to the observation of Boyle (2012) who contends that an effective system should be able to report back its findings and should provide recommendations on matters that it seems are off the track. The findings also indicate that the IAF enjoys a good relationship with the other department. The results also show that employees cooperate with IAF when they are asked to provide some information. These results collaborate with the findings of Seif and Hussein (2012) who state that a good working relationship with colleagues makes it easier for employees to cooperate when they are requested to provide employees or implement some recommendations.

The results indicate that much as a slight majority of the employees agree that they do not feel any management interference on the operations of the internal audit functions, a considerable number of employees believe otherwise. This is an indication that there is perceived influence on the IAF by management. The results show that the majority of the employees agree that management does not interfere with IAF. This may be an indication that the IAF is perceived independent by some employees.

The findings show that management does not advise concerned employees to comply with the investigations of IAF. This is contrary to the findings of Abdulaziz and Nadal (2013) who argues that management should be central in urging employees to comply with the operations of IAF. These findings may indicate lack of seriousness by management and that it is not committed enough to ensure that IAF is successful in its operations.

The results show that generally, few employees at LCC have the privilege to attend trainings. After running cross-tabulation on SPSS the results show that a few employees but with higher positions are the once who have the opportunity to attend trainings. These findings are contrary to the observation of Alzedan and Gwilliam (2014) who state that employees are supposed to regularly attend trainings to refresh and gain new knowledge about their careers.

6. Conclusion

The researcher concludes that fraud and financial malpractices are taking place in public institutions, especially in councils. However, the IAF is incompetent to identify, isolate and pursue fraud and financial mismanagement cases. The study reveals that other internal control systems in councils are effective such that the management is relying on them to reprimand the culprits of fraud and financial mismanagement. In general, the researcher concludes that the IAF public institutions, especially councils, is not effective enough to carry out its work. However, the researcher believes that the function has the potential to be transformed to be a better tool of corporate governance.

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