

**ENSURING THE EFFECTIVENESS OF INTERNAL AUDIT UNITS IN PUBLIC  
SECTOR INSTITUTIONS IN GHANA- MDAS/MMDAS IN PERSPECTIVE**

**Matthew Brains Kudo (Lecturer)**  
Ho Technical University, Ghana  
Department of Accounting and Finance  
P.O. Box HP 217  
Ho Volta Region, Ghana  
E-mail: [kutsidok@yahoo.com](mailto:kutsidok@yahoo.com)

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**ABSTRACT:** *The article identified and analysed generally accepted factors or best practices that ensure or indicate the effectiveness of an Internal Audit Unit in public and private sector organizations. The aim was to use those factors identified from literature to design a model (conceptual framework) that can be used by public sector organisations in Ghana for measuring and ensuring the effectiveness of Internal Audit Units. The method used, which was only qualitative, was to search through empirical, legal and regulatory and professional literature for those factors that were known to ensure the effectiveness of IAUs. Eight important factors that became the parameters of a new model were identified. It was concluded that there are sufficient provisions that create the desired efficiency of Internal Audit Units in Ghana given the legal and professional environment. It was recommended that MMDAs and the Internal Audit Agency should adopt the model developed here to measure the effectiveness of Internal Audit Units in their organisations.*

**KEYWORDS:** *Internal Audit Unit; effectiveness; MMDAs, Ghana*

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## **INTRODUCTION**

Internal audit has become a key strategic and success factor issue for the effective and efficient governance of many organisations in the world (Watts, 2014). In both public and private sectors, Internal Audit Units (function) are now considered as vital to the internal health of organisations so that operational and financial activities of the organisation should be properly aligned to stakeholders' interest (Solomon, 2007). It is therefore the priority of most managers, regulators, governments and board of directors that their organisations' Internal Audit Units were robustly effective to achieve organisational objectives. As noted by Mihret and Yismaw (2007), the effectiveness of the Internal Audit Unit depends on the 'extent to which an internal audit office meets its *raison d'être*'.

The government of Ghana for some time had been continuing to reform the Public Sector Financial Management System which brings the internal audit function to the frontline for the achievement of public sector accountability. The introductory paragraph of the Ghana Internal Audit Agency's Internal Audit Standard (2006) emphasised that among the key objectives of the reform programme are the transfer of budgetary authority to the Ministries, Departments and Agencies (MDAs) and Metropolitan, Municipal and District

Assemblies (MMDAs) to ensure efficiency and effectiveness in the use of the Government's resources (Internal Audit Standard, 2006). To this end the role of Internal Audit in public sector in Ghana has become critical. As a first step in strengthening and emphasizing the role of Internal Audit in the Public Sector, the Internal Audit Agency Act, 2003 (Act 658) has been passed and the Internal Audit Agency established. Pursuant to this, the Internal Audit Regulations 2011 (L.I 1994) had also be passed.

The concern of this article was that it is a different thing to have a good intention and to pass an act and establish Internal Audit Units (IAU) on one hand and another thing to ensure that the Internal Audit Units are effectively functioning. As observed by IIA, IPPF-Practice Guide (2010) Internal audit effectiveness and efficiency should be monitored and assessed periodically as part of the internal audit process. This article is the first of two parts write-up. The aim of these articles were to identify and analyse generally accepted factors or best practices, legal and professional literature, which indicate the effectiveness of an Internal Audit Unit in an organisation. Then using those factors, this first of two part article:

- i. Briefly, review extant experiential and theoretical literature, codes and standards pertaining to the importance of ensuring the effectiveness of Internal Audit Units in an organisation.
- ii. Modelled a framework from literature, those factors that may indicate the effectiveness of Internal Audit Unit in an organisation.
- iii. Surveyed and analysed legal and regulatory documents of Ghana to establish the extent to which a sound environment has been created for the effective functioning of Internal Audit Units.

In a follow up article, the conceptual framework designed in this first article will be used as a tool to measure the effectiveness of Internal Audit units in MMDAs in Ghana through the administration of questionnaire to Internal Audit Unit staff. The Volta Region will be used as a case study.

## **CONTEXTUAL LITERATURE REVIEW**

Effectiveness had been defined by the Canadian Institute of Chartered Accountants, cited by Cascarino and van Esch (2007) as the extent to which a program achieved its goals or other intended effects. Arena and Azzone (2009) proposed a three dimensional model for the effectiveness of Internal Audit Unit namely: the characteristics of the internal audit team, the audit processes and activities, and the organizational links. Dettenhofer (2001) had also identified five traditional characteristics of an effective Internal Audit Unit as: independence, professional proficiency, scope of work, performance of audit work, and management of the internal audit department. On its part, the Internal Audit Agency of Ghana Standard (IAAG, 2006) identified ten key features of an effective Internal Audit Unit. These were; the scope (Internal Audit Charter); independence; Audit Report Implementation Committees; Relationship with Management, other auditors and other Review Bodies; and Staffing, Training and Development. The rest were: Audit Strategy; Management of Audit Assignments; Due Professional Care; Reporting; and Quality Assurance. Further to this, the Internal Audit Regulations, 2011 (L.I. 1994) in an attempt

to ensure the effectiveness of internal audit in Ghana was arranged to deal with the Mandate and role of the Agency (IAA), Governance and conduct of internal audit, Protection of internal audit and grievance procedure and internal audit records and reports.

A related classification of IAU effectiveness was by the Australian Internal Audit Office (AIAO, 2007) which outlined fifteen (15) major features of a 'Better Practice Internal Audit Unit'. Five of these features indicated that an effective IAU should be operationally independent; appropriately positioned in the entity; focused and had audit plans; had sufficient financial resources; advised the audit committee and management on current developments. Mihret and Yismaw (2007) argued that internal audit quality and effectiveness was a function of the level of staff expertise, the scope of services provided and the extent to which audits were properly planned, executed and communicated. Van Gansberghe (2005) also noted that internal audit effectiveness in the public sector depended on the following: conceptual framework; perceptions and ownership; organisation and governance framework; legislation and regulations; improved professional competence; and adequacy of resources to carry out internal audit. Using the balanced scorecard approach of Kaplan and Norton (1993) in measuring internal audit performance, Frigo (2002) also provided a four dimensional framework by which Internal Audit Unit effectiveness could be assessed. According to Frigo (2002) these consisted of: Board Audit Committee; Internal Audit Process; Management and clients; and Innovation and capabilities. Holroyd (2009) however observed that Frigo's (2002) model was only a variation of the balanced scorecard approach as adapted for Internal Audit Units by the Practice Advisory Standard 1311-2, IIA Inc, 2005. This also had four areas of performance category framework as:

- **Internal customers**, such as the board, audit committee, senior managers and operational managers.
- **External customers**, such as regulators and external audit.
- **Internal audit processes**, such as audit planning, audit engagements and reporting.
- **Innovation and learning**, such as training and development, technology and industry knowledge. (Practice Advisory Standard 1311-2, IIA Inc, 2005)

From the foregoing, it should be noted that there were varied but similar key factors of an Internal Audit Unit effectiveness looked at from different perspectives by different researchers as well as national and international technical bodies. Based on the understanding from literature reviewed here, the study had adopted some of the commonest of the factors that could ensure the effectiveness of IAUs and used these factors to design the model (conceptual framework) for measuring the effectiveness of the Internal Audit Units in an organisation. The model had eight perspectives for which outline was provided below:

- i. Existence and Competence of Audit Committee
- ii. The Independence of the Internal Audit Unit
- iii. Status of Internal Audit Unit in the entity and relationship with management
- iv. Clarity and Scope of Internal Audit Unit (Audit Charter)
- v. Professional Competence of Internal Audit Unit
- vi. Adequacy of resources for Internal Audit Unit's work

vii. Provision assurance and consulting services by the Internal Audit Unit

viii. Extent of Internal Audit Report Implementation

It was important to do these type of modelling because establishing such performance measures critically determine if an audit activity was meeting its goals and objectives, consistent with the highest quality practices and standards (IIA, IPPF-Practice Guide, 2010).

## **METHODOLOGY**

The method utilized was mainly qualitative. This was done through collection of information by surveying and analysing empirical literature and documents such as laws, regulations and professional standards in Ghana and elsewhere that relate to internal audit. In other words, it was just about critically reading and looking for those provisions that related to internal audit and classifying them under the perspectives in the model. Some of the documents (all Ghanaian) surveyed and analysed were:

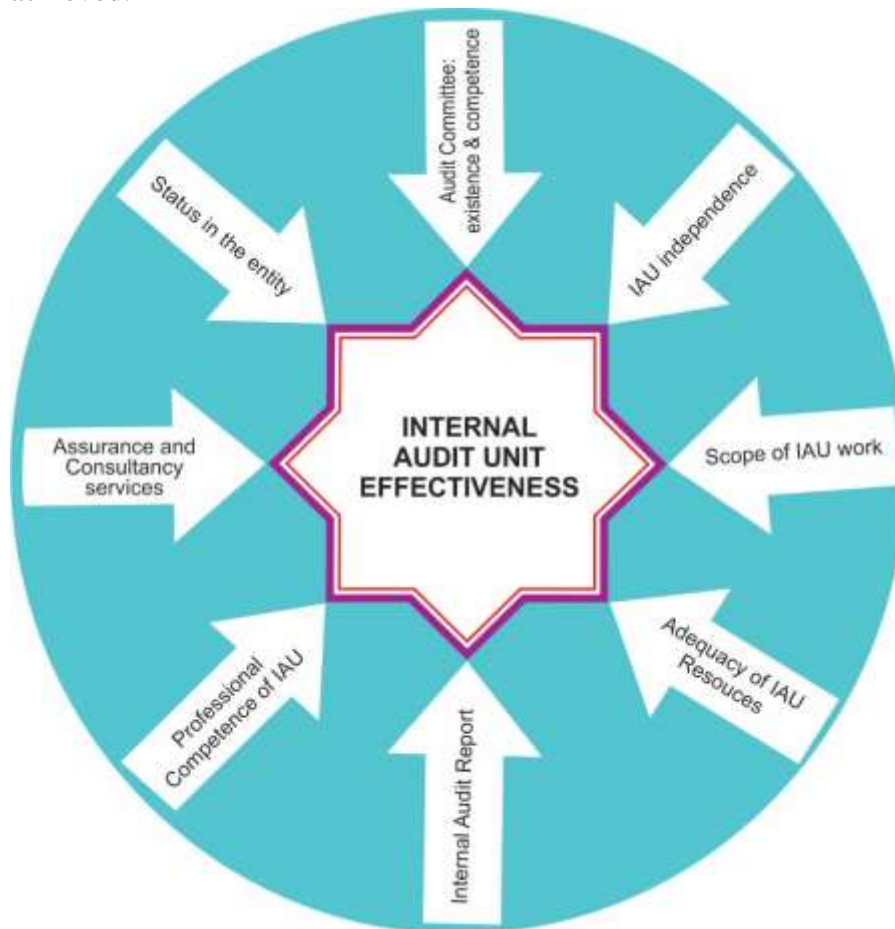
- ✓ The Audit Services Decree 1972 N.R.C.D (49).
- ✓ The 1992 Constitution of the Republic of Ghana
- ✓ the Ghana Local Governments Acts 1993 (ACT 463)
- ✓ the Audit Services Act 2000 (Act 584)
- ✓ Financial Administration Act 2003 (Act 654)
- ✓ Internal Audit Agency Act 2003 (Act 658) - IAAG
- ✓ Internal Audit Regulations, 2011 (L.I.1994)
- ✓ Internal Audit Agency of Ghana's (IAAG) Standard 2006,
- ✓ IAAG Internal Audit Manual 2007

This approach was adopted because according to Cooper and Schindler (2008) document analysis was useful when evaluating historical or contemporary confidential or public records, reports, government documents and opinion to arrive at a conclusion. For the analysis, information gathered about internal audit provisions were classified and analysed (reported) under each of the eight (8) perspective of the model (Conceptual framework) designed (*see section 3.1 below*). The style used was that each perspective of the model looked at the provisions from professional and legal documents from the Ghanaian environment. In order to maintain originality of the sources of legal or professional provisions, direct quotations were extensively used in some cases.

## **METHODOLOGY: THE MODEL (CONCEPTUAL FRAMEWORK)**

The eight key factors identified in the contextual literature review section as the factors that indicate Internal Audit Unit's effectiveness was used to design the model which guided results and analysis. The model was very useful because it provided easy parameters within which this paper focused attention and anybody wishing to measure the effectiveness of internal audit units could apply. It was conceptualised (as depicted in figure 1 below) that all the eight factors in the oval, though independent, work in an interrelated manner to

determine the overall environment within which the effectiveness of an IAU could be achieved.



**Figure 1: The 8-Point Star Model of an Internal Audit Unit's Effectiveness**

In comparison, the model developed here could be seen as a broader version of what Mihret and Yismaw (2007) referred to as factors that influenced internal audit effectiveness. These were outlined as: organisational setting; internal audit quality; management support; and audit attributes. These factors were depicted on a four dimensional diagram that according to Mihret and Yismaw (2007) were intricately linked and from which the effectiveness of a dynamic internal audit process could result. Similarly, the 8-star model proposed here was a kind of expansion of Arena and Azzone's (2009) three dimensional model which according to them ensured effectiveness of Internal Audit Unit. They identified these characteristics as the internal audit team, the audit processes and activities, and the organizational links.

## **RESULT PRESENTATION AND ANALYSIS**

The discussion and analysis of the 8-Point Star Model now follows in the following sections. Each section represented the perspective in the model and the findings in the various laws, regulations and professional documents studied were discussed under them.

### **Existence and Competence of Audit Committee**

It was observed that initially not much provision was made for the establishment of an audit committees regarding internal auditing practice in Ghana. For example, the Local Government Act 1993 (Act 462) made no reference at all to the audit report implementation committee or its equivalent, though it had created various functional committees at the MMDAs. However, Section 30 of the Audit Services Act 2000 (Act 584) and the Internal Audit Regulations, 2011 (LI 1994) made provisions for the establishment and functions of an Audit Implementation Committee (ARIC) in all public institutions including MMDAs which were subject to audit by the Auditor-General. The Act made the ARIC responsible for ensuring that audit reports were pursued and implemented and should write a report on the level of the implementation of audit reports. The Internal Audit Agency Act 2003 (Act 658) also made a reference to the Audit Report Implementation Committee (ARIC) under Section 16:8 which required that the ARIC should be responsible for the implementation of the recommendations of an internal audit report.

The IAAG standard (2006) section 300:1 treatment of the issue of ARIC was just a repetition of this requirement except the addition that the ARIC should comprise of some members of the “Governing Body” ‘ and ‘ “non-members of the Governing Body” ‘ of the MDA/ MMDAs. However, sub-section 3 of section 300 of the IAAG standards made the ARIC an adviser to the Head of the MDA/MMDA (i.e. the District Chief Executive) and not the governing body. This seemed to conflict with Section 30 of the Audit Services Act 2000 provisions. In the context of international best practice of corporate governance and audit, making the ARIC responsible to the Chief Executive Officer instead of the governing body clearly did not allow for an effective audit committee at the MDA/MMDAs, and therefore indirectly affects the effectiveness of the IAUs.

### **The Independence of the Internal Audit Unit**

Section 200 of the IAAG Standard (2006) required that the internal audit should be sufficiently independent of those activities it audited so that it would be able to perform its duties with an impartial and effective professional judgments and recommendations. The standard also demanded that the IAU should not exercise any executive responsibilities. However, further reading of the standard indicated that actual independence of the internal auditor could not be achieved at an MDA/MMDA. This was because the Internal Audit Head was to be responsible and report to the MDA/MMDA Chief Executive (*see* Section 210:4 of the IAAG Standard and section 11 of the IAR 2011 (LI1994)) and not the Audit Implementation Committee (ARIC) as required by section 30 of the Audit Services Act 2000 (Act 584). This clearly was at variance with provisions in the IAA Act section 16:3 which required the IAU head to report to the Director General of the IAA. A further conflict with Section 210:4 of the IAAG Standard was the requirement of Local Government Act

1993 (Act 462) Section 120. Section 120:2 said that the IAU head was to be responsible to the MMDA in the performance of the functions of the IAU while sub-section 3 stated that the report of the head of internal audit should be submitted to the presiding member of the MMDA and not the District Chief Executive. Thus the IAA Act's requirement to report to the Director General and the LG Act's requirement of the IAU head to be responsible to the District Assembly by submitting its report to the presiding member rather than the DCE would much more guarantee auditor independence than Section 210:4 of IAAG Standard requirement.

### **Status in the entity and relationship with management**

The Local Government Act 1993 (Act 462) provided in Section 120 that MMDAs should have an Internal Audit Unit and that the head of the IAU should be responsible to the MMDA in the performance of its functions. It was noted, however, that though the LG Act 1993 (Act 462) required the existence of an Internal Audit Unit at the MMDAs, it did not include IAUs as a department in the First Schedule of Section 38 of the Act, which specified the establishment of other Departments under MMDAs. The IAA Act 2003 provided the solution when it added to these requirements and sought to fill in the vacuum that was created by LG Act 1993. Thus, in addition to requiring the establishment of IAUs, the IAA Act 2003 section 16 specifically stated that there should be appointed for each Internal Audit Unit an officer to ensure an effective and efficient internal auditing of an MMDA.

This was what led to the establishment of Internal Audit Units in almost all the MMDAs since 2003 with personnel manning every established unit. In addition, IAAG Standard (2006) S210.1 requires that the Status of the IAU head should be at a management position. Also in Sections 410:1-7 under the 'Principles of Good Relationships' heading, the IAAG Standard encouraged heads of IAUs to maintain cordial working relationship with all the stakeholders in the MMDA. With regard to relationship with the Audit Report Implementation Committee, S310 (4) of the IAAG Standard required that the IAU head should attend ARIC meetings and make further contributions to audit findings in case of dispute by the audited. These requirements provided legal and professional backing to the IAUs in MDAs/MMDAs thus consolidating their status on the organisational structure.

### **Scope of Internal Audit Unit Work (Audit Charter)**

The Audit Agency of Ghana Standard (2006) Section 110, titled Internal Audit Charter, dealt with the issue of the audit charter and the IAU work. It said the purpose, authority and responsibility of the IAU should be defined by the Governing Body, Head of MDA/MMDA and other autonomous bodies in an Internal Audit Charter to be in line with the directives issued by the Internal Audit Agency.

Another provision in the laws which touched on the scope of Internal Audit remit in the public sector was the Financial Administrative Act 2003 (Act 654) which required in section 44 that the internal audit of public institutions should be carried out in accordance with any enactment for the time being regulating internal auditing of public institutions. Further to this Section 3 (ss. 1 and 2) of the IAA Act 2003 improved upon this requirement

by charging the Internal Audit Agency to set standards and procedures for the purposes of internal audit at the MDAs/MMDAs. The IAA fulfilled this requirement by developing and publishing the Internal Audit Standard (September 2006) and the Internal Audit Regulations and Manuals (January 2007) for use by internal auditors at MDAs and MMDAs.

### **Professional Competence of Internal Audit Unit**

Section 500 of the IAAG Standard provided for the need for competent Staffing, Training, and Development. Specific professional qualification was required for the head of the IAU under Section 530.9 of the IAAG Standard. This asked that the IAU head should have a minimum professional qualification in accountancy or internal auditing preferably a certificate from the Institute of Chartered Accountants, Ghana (ICA), Association of Chartered Certified Accountants (ACCA) or the Institute of Internal Auditors (IIA) or any other relevant professional qualification.

Further, Section 18(a) of the IAA Act 2003 (486) required that Internal Auditors should exhibit the highest level of professionalism in the gathering, evaluating and communicating of information when auditing, and should act only in areas for which they have the necessary knowledge, skills, experience and competence. To achieve this, the standard required that staff of the IAU should make themselves available for continuous professional development programmes. Section 510 Principles of Staffing, Training and Development summed up the required professional standard for the IAU. It required that: *Internal audit should be appropriately staffed in terms of numbers, grades, qualification levels, and experience, having regard to its objectives and to these standards. Internal auditors should be properly trained to fulfil their responsibilities and should maintain their professional competence through an appropriate ongoing development programme.*

Here the regulations had set the tone for the competency content of the IAU which met best practice in audit and governance terms. Setting these high quality standards for Internal Audit Unit's professional competences would ensure that IAUs were effective.

### **Adequacy of resources for internal audit work**

The adequacy of resources of the internal audit work was also identified as a principal factor in ensuring the effectiveness of IAU in an organisation in this model. The surveyed sources revealed that section 210:6 of the IAAG Standard charged the head of the MDA/MMDA to ensure that the IAU is adequately resourced. It directed that the IAU head of the MDA/MMDA must fully support the work of the Internal Audit Unit by adequately providing for resources to the Unit to be able to perform its duties without interference and gain the co-operation of other personnel where necessary. Apart from this, the rest of the standard placed the onus on the head of the IAU to establish the resources and skills necessary for the delivery of its plans, strategies, and management of the unit. These part of the provisions appeared to be inadequate and may make resource allocation to the IAU less mandatory and unimportant to those who actually controlled the resources. This would consequently affect IAU effectiveness if resources were not sufficiently available for its work.



**Provision of assurance and consultancy services**

If the Internal Audit Unit was sufficiently and appropriately qualified as required by Section 500 of the IAAG Standard then it would be well placed to provide other services to the organisation apart from traditional compliance audit work. This was because even the new definition of internal audit and management expectations went beyond compliance audit to include provisions of governance, control and risk management assignments. Section 720.1 of the IAAG Standards required that the IAU should assist the MDAs/MMDAs by:

*evaluating and identifying significant exposures to risk and contributing to the improvement of risk management and control systems.*

Further, Section 720.2 of the Standard asked the IAU to assist the MDAs/MMDAs in maintaining internal control. It demands that:

*Based on the results of the risk assessment, the Internal Audit Unit should design audit procedures so as to have assurance of adequacy and effectiveness of controls encompassing the MDA/MMDA's governance, operations and information system*

These requirements effectively recognised the role of IAUs in providing assurance and consultancy services to the MDAs/MMDAs in achieving their objectives. This was a signpost of ensuring the effectiveness of the IAUs.

**Extent of Internal Audit Reports**

The IAA Act 2003 section 16 requires that An Internal Audit Unit established under subsection (1) should report on the internal audit it carries out to the Director-General of the Agency. In addition, the Local Government Act, 1993 section 120 required the IAU head to report at regular intervals to an appropriate authority. It specifically provided that:

✓ *The head of the Internal Audit Unit shall at intervals of three months, prepare a report on the internal audit work carried out by the unit during the period of three months immediately preceding the preparation of the report, and submit the report to the presiding member of the Assembly. (s.3)*

✓ *Without prejudice to the generality of subsection (3), the head of the Internal Audit Unit shall make in each report the observations that appear necessary as to the conduct of the financial affairs of the Assembly during the period to which the report relates. (s.4)*

✓ *The head of the Internal Audit Unit shall send a copy of each report prepared under this section to the Minister [of local government], the District Chief Executive and to the regional co-ordinating council. (s.5)*

Section 30:2 of the Audit Services Act 2000(Act 584) on its part required that the ARIC should ensure that the head of the institution (MDA/MMDA) follow-up on the implementation of matters raised in all audit reports and annually prepare a statement indicating the degree of implementation of recommendations made in audit reports. Subsection 3 requires that such a statement:

*Shall show remedial actions taken or proposed to be taken to avoid or minimise the recurrence of undesirable features in the accounts and operations of the institution, body or organisation and the time frame for action to be completed.*

In addition, the IAR 2011(LI 1994) in section 4 and other related sections emphasised the importance of internal audit reporting and implementation.

These requirements provided the legal basis for compulsory reporting by the IAU to the appropriate authorities who should ensure that audit recommendations are implemented. Thus, the laws and standards make internal audit reporting the final output that will necessarily indicate IAU effectiveness.

## **CONCLUSION**

From the literature review it was concluded that to ensure the effectiveness of an Internal Audit Unit (Unit) in an organisation, there were eight critical factors to be considered. These factors work in an independent but interrelated manner to ensure the effectiveness of IAU in the organisation. These factors were developed into an 8-Point star model which could be a useful tool to many organisations wishing to evaluate the effectiveness of their IAUs.

From the standards and legal provisions in Ghana, it was clear that under the model used sufficient provisions have been made for the effective functioning of IAUs in Ministries and Departments and Metropolitan, Municipal and District Assemblies (MDAs/MMDAS)

## **RECOMMENDATIONS/IMPLICATION TO PRACTICE**

It was recommended that organizations especially MDAs/MMDAs who had established Internal Audit Units in their organizations take off some time to evaluate the effectiveness of their functions to ensure that the objectives for which they were established were being achieved. Using the 8-Point Star Model developed in this article, MDAs/MMDAs could now measure IAU's effectiveness and may come out with results that could go a long way to improve the organization's quest for success.

A further recommendation was that the Internal Audit Agency should consider utilising this model developed here and applying the legal, regulatory and standard requirements to assess the effectiveness of internal audit units in Ghana. This would help the agency to evaluate the efficiency of its internal audit units within the context of generally accepted internal audit practices and also within the laws, regulations and standards under which they operate.

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