The Effect of the Working Relationship between Audit Committees and Internal Audit on Corporate Governance in Public Universities, Ghana

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Abstract

This paper seeks to investigate the effect of the working relationship between the Audit Committee and the Internal Audit function on corporate governance within the public universities in Ghana. The emphasis was mainly on the working relationship from the perspective of the Head of Internal Audit. This is a relationship in which the two can capitalize on what they both contribute to corporate governance. All five public universities were involved in the survey with seventy sets of questionnaires administered to four-set respondents. Findings revealed that there is a relationship between the two but it was not strong enough to promote good corporate governance. This would affect the recognition of the benefit of an effective Audit Committee capable of working with the Internal Audit to promote sound corporate governance. The establishment of the Audit Report Implementation Committee and functions of the Internal Audit Department have put the expectation of the committee on the spotlight to assist the University Councils and Management to ensure the effectiveness of the financial and operational controls. On this note, the work of the Internal Audit and the Audit Committee should function as a team in order to be effective. It is therefore important for the Head of Internal Audit to have respect and confidence in the Audit Committee Chair in terms of skill and knowledge. The responsibility of relationship building rests on the shoulders of the Heads of Internal Audit with support from the team leaders by executing their work professionally. In conclusion, the relationship should be nurtured and made strong through timely and relevant interactions and effective communication.

Keywords: Audit committees, internal audit, effectiveness, corporate governance.

Original Research Article

1. INTRODUCTION

Corporate governance is a system by which companies are run and controlled (Dedman, 2002) (Cadbury Committee, 1992). One of the requirements of corporate governance is that there should be a strong and effective working relationship between the audit committee and internal audit to ensure that, together control systems are built, implemented, and evaluated for quality governance. A strong working relationship between the audit committee and internal audit is essential because management through the two agencies is able to minimize the agency cost associated with corporate governance, and the board of directors is perceived by shareholders as utilizing effectively resources towards maximizing their wealth as well as exercising the duty of care imposed on them by shareholders. Davies Marlene (2008) has stated that the procedure for assessing management’s performance is guaranteed if the audit committee and internal audit work effectively(Davies, 2001). The Financial Reporting Council (FRC) Corporate Governance Combined code (2003) describes the Audit Committee as being the key to good corporate governance. The code requires the audit committee to be solely responsible for arranging audit-related issues and in particular the organization’s relationship with its internal and external auditors(Council, 2003). To establish an effective working relationship, there should be among others things, communication between the audit committee members and the head of internal audit. Firstly the Audit Committee should act as an advisory body, by assisting Internal Audit to implement its charter, activities, and processes to fulfill its responsibilities and maintain effective internal control systems. (Quansah, 2016) To achieve the above function, the Audit Committee and the Internal Audit functions should liaise with the external auditors for the purposes of maintaining and ensuring audit quality and review of external auditors report on the financial statements of the corporate body. Consistent with the above the audit committee and internal audit should review the adequacy of systems of internal controls and
the degree of compliance with material policies, laws and the code of ethics and business practices of the corporate body. There should also be an effective risk assessment and serve as a direct channel of communication between the board and the external auditor of the corporate body, accountants, and compliance officers (if any) of the corporate body. The Audit Report Implementation Committee (ARIC) as it is called in Ghana by the Audit Service Act of 2000 Act 584 section 30, states that any institution which is subject to auditing by the Auditor General shall establish an Audit Report Implementation Committee. This committee shall be part of the governing council or the board of directors. The Audit Report Implementation Committee is to ensure that the heads of institutions under which the Auditor General has the power to audit shall implement all matters in both the internal and external audit reports. The committee is to report on the status of all the implementations and the recommendations made in the reports of both the internal and external auditors. The committee shall report to the board annually and such reports should contain remedial actions taken to avoid or minimize the occurrence of any undesirable features in the audit reports as well as the time frame for the action to be completed. It can be seen from the functions enumerated above that the Audit Report Implementation Committee cannot work effectively without a strong working relationship between them and the internal Auditors. In the public universities, the committee is made up of five members and the chairperson being a council member but not a staff of the university, the vice chancellor is a member as head of the institution, a representative each from the Institute of Internal Auditors and the Internal Audit Agency and one member of the council or the board of directors. The head of Internal Audit and head of Finance have co-opted members. The above functions are common to both the Audit Committee and Internal Audit in the light of the fact that the Audit Committee cannot function without the effective working relationship among them.

The establishment of Audit Committees in public universities in Ghana started in 2008. This is quite recent and not much research has been carried out to determine the relationship between the Audit Committee and the Internal Audit whose roles intersect. At various congresses of the Committee of Internal Auditors in the Public Universities, the need for the establishment of Audit Committees has often been expressed. The Audit Committees have been established to resolve the concerns raised by the heads of Internal Audit. In the light of the foregoing, this research seeks to look at the effect of the working relationship between the audit committees and the Internal Audit on corporate governance. The Audit Service Act 2000 and the Internal Audit Acts of 2003 mandated the public universities to establish audit committees whose functions include advising the University Councils on financial and non-financial issues. Research undertaken by Davies (2001) identified the changing face of internal audit as a result of new roles for Internal Audit in terms of risk management, a more consultative and assurance implied more interaction with the Audit Committee, which indicated a greater audit committee presence (Davies, 2001). In one authority, the “Audit Committee” is an Audit panel comprising wholly of independent consultants which go beyond the CIPFA guidance which recommends that the Audit Committee membership should in an ideal situation be separated from the scrutiny functions (of the scrutiny committee), as a measure to reinforce independence. The past two decades have witnessed Audit Committees becoming more globally important and prevalent. Historically, Audit Committees have always been associated with the roles of overseeing and monitoring management and the external auditor and achieving proper corporate governance and accountability in organizations (Beasley & Salterio, 2001; Vafeas, 2001).

2.1 Related Literature Review – The Internal Audit and Audit Committee

Internal Auditing (IA) as a profession and an activity related to advising organisations regarding how to better achieve their objectives through managing risk (Musah, 2018; Tackie, Marfo-Yiadom, & Achina, 2016) and improving the internal control systems (Millichamp, 2002). However, in many Ghanaian universities, it does appear that internal auditors are merely tolerated due to compliance with regulations; and that given a choice, many of the managements would rather do without the internal audit functions and the relationship among the key players, namely audit committee members, audit committee chairperson, head of the internal audit and team leaders internal audit, in the public universities internal auditing structure is not given the needed attention (Achua & Alabar, 2014).

It is important to note the background to the Audit Committee and its role and responsibility within the private sector. Cadbury (1992) recommended the establishment of an Audit Committee as an important feature within the code of best practice for corporate governance (Code, 1992). Aside the Cadbury report, there are other reports such as the Smith report (2003) that give guidance to company boards in making suitable arrangements for the Audit Committees and to assist directors serving on Audit Committees in carrying out their responsibilities. This report recommended among other things that listed companies must have Audit Committees of at least three non-executive directors, to apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company’s auditors (Smith, 2003). The Smith report (2003), subsequent guidelines, recommendations and other various supporting documentations generated a rich source of research into how the Audit Committees
function and their review of the internal audit. The role of the Audit Committee has evolved and while the audit committee’s basic function which is oversight of the financial reporting process has not changed over the years, their responsibilities have been increased to include risk management, control, compliance and special investigations (Soltani, 2007) This may be one of the reasons why there is a greater expectation of the internal audit function in providing information for the audit committee to fulfill its emerging and changed responsibilities.

The Audit Committee is required as part of its responsibilities to review the internal control procedures and the financial statements and also play a key role regarding any whistle blowing procedure. This is the area of internal audit function, which indirectly means that an effective working relationship between the two is key to sound corporate governance. Gray and Manson (2011), reinforce this in terms of accessibility to information, where “the audit committee should have clear rights to seek information and make decisions to carry out prescribed duties”(Gray & Manson, 2011). By taking a broader overview of corporate governance Collier and Zaman (2005), analyse corporate governance codes in countries in Europe. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation’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(Collier & Zaman, 2005; Verschoor & Luizzo, 2002). Contrary to the above ,internal auditing was regarded as being confined to merely ensuring that the accounting and underlying records of an organisation’s transactions were properly maintained, that the assets management system was in place in order to safeguard the assets and also to see whether policies and procedures were in place and were duly complied with. As times change the concept of internal auditing has undergone significant changes with regard to its definition, scope of coverage and the approach to work. In some organizations the scope of modern internal auditing has been broadened from financial issues to include value for money, evaluation of risk, managerial effectiveness and governance processes.

An effective internal audit function plays an important role in assisting the board to discharge its governance responsibilities. To do that the board and its audit committee has to satisfy itself that internal audit is functioning effectively and efficiently. This new definition covers the scope and objectives of the internal auditing and it varies widely and also depends on the size and structure of the organization and the requirement of its management.

An institute of Internal Auditor’s research project conducted in 2005 highlighted how the role of the head of audit is changing. Cheater (2006) said that “you must be able to help achieve practical solutions that benefits the organizations and to express ideas in simple language” (Cheater et al., 2006). Internal auditing is a profession and an activity involved in advising organizations regarding how to better achieve their objectives through managing risks and improving internal control. Internal auditing involves the utilization of a systematic methodology for analyzing business processes or organizational problems and recommending solutions. The scope of internal auditing within an organization is broad and may include various internal control related activities such as the review of the effectiveness and efficiency of operations, the reliability of financial reporting, investigation fraud, risk assessment, safeguarding of assets and compliance with laws and regulations. Internal audit activities therefore provide assurance on the effectiveness of public sector entities internal control environment and may identify opportunities for performance improvement. This research seeks to investigate the working relationship between audit committees and the internal audit function to enhance corporate governance in the public universities of Ghana. The Sarbanes-Oxley Act of 2002 increased the audit committee’s responsibilities and authority. It raised membership requirements and committee composition to include more independent directors. Companies were required to disclose whether financial experts are on the committee. Also, the Securities and Exchange Commission and the stock exchanges proposed new regulations and rules to strengthen audit committees and internal audit (Act, 2002). Internal Auditing some years back was just a small part of the governance system in an organisation. The introduction of the new system of Internal Auditing in 1999 as the consulting and value-added activity within an organization that is established to improve upon the work of management and also look at the possible risk areas to set out measures to control and minimise them within the risk appetite.

In view of that, this research work would focus primarily on the working relationship from the perspective of the head of the internal audit, also known as the internal auditor and the audit committee and also capitalize on what they both bring to the corporate governance arena. The background to the audit committee framework and the challenges facing the heads of the audit provides a basis from which this research paper develops a survey into the working relationship between the audit committee and internal audit.

2. RESEARCH METHODOLOGY

This study is a survey as it sought the perception and opinion of the target population about a phenomenon, which was the relationship between the
Audit Committee and Internal Audit staff. The emphasis of this research was very much on the working relationship between Audit Committee and the Internal Audit and more especially on the opinion of the heads of Internal Audit on the marriage between the two parties. These views focus on whether the Audit Committee recognizes the importance of having the appropriate skills and understanding to be able to access, utilize and review the performance of both the Head of Internal Audit and the Internal Audit function as part of the corporate governance process. Additional features were to discover whether the roles and responsibilities of the Audit Committee are reflected in the sound working relationship between the component parts which together form the cornerstone of corporate governance within the public universities. This survey-based used the quantitative perspective and questionnaires containing closed-ended questions for identifying the existence of an Audit Committee and its membership and statements for agreement or disagreement form the remainder of the document. The objective was to gather the opinions of the Heads of Internal Audit on the working relationship which exists between them and the Audit Committee. A similar questionnaire was prepared for the chairperson of the Audit Committee with similar or complementing statements. The Likert approach to providing a statement with five options of strongly agree to strongly disagree was used for the various sections of the questionnaire. The literature review has identified knowledge gap and the need to explore it. These are the problems within the public universities on the implementation of the report by the auditors of the organization more especially if the content of the report implicates the chief executive or the head of the institution. Such reports are not well to the satisfaction of the auditors. This agitation had gone on for some time now until the Audit Service Acts of 2000 was passed to give the various boards or councils within the public sector the authority to form the Audit Committees with their powers well spelt out. The objective is to gather opinions of the Heads of Internal Audit, Audit team members and Audit Committee chairs to identify areas that could be used as an example of good practice among the Heads of Internal Audit within the public universities. Though the Act came into force in 2000 most of the public universities formed their Audit Report Implementation Committees between 2008 and 2010. Since it was the desire of the Internal Auditors in the public universities to have their reports implemented by management, this research sought to investigate the effect of the working relationship between the Audit Committee and the Internal Audit on corporate governance. For the purposes of this research, the phrase Audit Report Implementation Committees and Audit Committee are used interchangeably(Soh & Martinov- Bennie, 2011).

The population of this study consisted of all the Heads of the Internal Audit in the public universities and the Chairperson of the Audit Committee, Audit Committee Members as well as staff in the Internal Audit of the various universities. A set of questionnaires were designed for the four groups of people. Out of the sample frame of nine public universities a sample size of four were selected based on the researcher’s judgment because of cost and time constraints and the fact that it was not easy getting the respondents. For this study the sample frame was restricted to the following public universities; the University of Ghana, Kwame Nkrumah University of Science and Technology, University of Education, Winneba, University of Development Studies and University of Mines and Technology. The sampling was carefully done to include only the target group of respondents. In this survey, quantitative data was collected from the primary source in order to answer the research questions objectively. It was what the researcher originally collected from the sample or the targeted population. A structured questionnaire was developed from existing instruments on the effective working relationship between Audit Committee and Internal Audit on corporate governance.

3. RESULTS AND FINDINGS

This section includes the key determinants in establishing a working relationship between the stakeholders in the internal audit department of the public universities in Ghana. Analysis ranging from effectiveness due to understanding of auditing matters to the effectiveness of the Audit Committee among others are presented and discussed.

3.1.Increase in effectiveness due to understanding of auditing matters

According to figure 1,( 21%) of the respondents strongly agreed and 79% agreed that the increase in the effectiveness of the audit committee is due to understanding of audit matters. Audit Committee expertise is highly associated with the effectiveness of the financial and audit reports. Similarly Goodwin (2003) supported the need for audit committee members to have accounting and finance background in addition to being independent of management. The audit
committee operates as an intermediary and a communicator between the internal and external auditors and management (Carcello & Neal, 2003; Goodwin, 2003). The audit committee plays an imperative role in overseeing and controlling the financial reporting process very intimately. Furthermore, it needs to make sure that the financial statement prepared by management is free from any material misrepresentations. To accomplish such an objective, the audit committee must be very strong and effective as a control device of corporate governance.

3.2 Dominant members influence the effectiveness of the Audit Committee

Figure 2 shows the influence of dominant members in the effectiveness of Audit Committee. According to Figure 2, most of the respondents (79%) were neutral, (7%) strongly disagreed and (14%) disagreed to the view that dominant members influence the effectiveness of Audit Committee. If the dominant members are the people who are experts on the Audit Committee, then it would definitely go to affect the committee negatively. On the other hand, if the dominant members do not have much knowledge in accounting and finance the impact will be felt.

3.3 Influence of internal controls on the effectiveness of the Audit Committee

Figure 3 shows the influence of internal controls on the effectiveness of the Audit Committee. It indicates that (21%) of the respondents strongly agreed and (79%) of them agreed that the internal controls have influence on the effectiveness of the Audit committee. When there is sound internal control it enhances the work of the internal audit as well as the Audit Committee. As part of the Audit Committee recommendations, the committee will usually review the institution’s internal control procedures, review financial statements and have a key role in record to any whistle blowing procedures. The universities should identify controls appropriate to maintain the key business risks within defined risk tolerance levels set by the council, bearing in mind cost/benefit considerations or review the process by which this is done and endorsed. The university councils should also be satisfied that suitable individuals have a clear responsibility for maintaining a dynamic risk identification and assessment process and related internal controls.

3.4 Presence of audit resources and effectiveness of the Audit Committee

Figure 4 shows the respondents’ responses regarding the influence of the presence of audit resources on the effectiveness of the Audit Committee. It indicates that (21%) of them agreed while the rest (79%) were neutral. This is an area which is quite interesting because the prices of audit resources will help in the work of the Internal Audit by producing a good report. The presence of the audit resources should have positive impact on the effectiveness of the work of the Audit Committee but the response proved otherwise. Probably (79%) of the respondents were neutral because they did not know the effects of the resources on the work of the Internal Audit and Audit Committee.
3.5 Effectiveness of the Audit committee and audit performance

Figure 5 shows how the audit performance is influenced by the effectiveness of the Audit Committee and this measures the effectiveness of the Audit Committee. It indicates that (43%) of the respondents strongly agreed while (57%) agreed that the effectiveness of the audit committee helps ensure audit performance. This is because they will review the activity of the internal audit, implement their report and ensure that the corporate goals are achieved. The responsibility of the Audit Committee in the area of corporate governance is to assure that the organization complies with pertinent laws and regulations, is conducting its affairs ethically and is maintaining effective controls against employee conflicts of interest.

3.6 Effectiveness of the Audit Committee and profile of Head of Internal Audit

Figure 6 shows the views of the respondents regarding how the Head of the Internal Audit influences the effectiveness of the Audit Committee. It indicates that (29%) of the respondents strongly agreed while (71%) agreed that the profile of the Head of Internal Audit influences the effectiveness of the Audit Committee.

3.7 Effectiveness of the Audit committee enables reporting lines

Figure 7 depicts the respondents’ opinion regarding the effectiveness of the Audit Committee and how the reporting lines facilitate the effectiveness of the Audit Committee. It indicates that (7%) of the respondents strongly agreed, (7%) agreed, (64%) were neutral and (22%) disagreed.

3.8 Effectiveness of the Audit committee enables assurance of audit report

Figure 8 depicts the respondents’ opinion regarding the effectiveness of the Audit Committee with respect to how the assurance of audit facilitates the effectiveness of the Audit Committee. It indicates that (64%) of the respondents strongly agreed whereas (34%) agreed. The effectiveness of the Audit Committee is a great asset to Internal Audit since there is that assurance that reports will be implemented and results will be achieved. When the Audit Committee is effective, it encourages Internal Audit to put up their best to improve the financial and operational activities of the universities.
3.9 Effectiveness of the Audit Committee adds credibility to audit performance

Figure 9 depicts the respondents’ opinion regarding the effectiveness of the Audit Committee and whether it adds credibility to audit performance. It indicates that (57%) of the respondents strongly agreed whereas (57%) agreed.

4. CONCLUSION

This study used a cross-sectional survey and self-administered structured questionnaires as well as quantitative data analysis technique in examining the effect of the working relationship between the Audit Committee and Internal Audit on corporate governance in public universities in Ghana. This depends on the commitment on the part of the individuals such as the Heads of the Internal Audit, Chairpersons and members of the Audit Report Implementation Committee. Universities as institutions of higher learning have taken the initiative to establish the Audit Report Implementation committee as one of the first in the public sector organization in Ghana. Three years after its establishment, the Audit Report Implementation Committee is expected to set the pace for good corporate governance within the universities and the entire public sector in Ghana.

The issues identified included the need to increase the knowledge and understanding of the Audit Report Implementation Committee members of auditing and accounting issues. Though we have two experts on all the committee that is a member from the Institute of Internal Auditors and The Internal Audit Agency their level of commitment was not much seen. These experts can only advise the chairperson on what to do but the final decision lies with the entire membership of the Audit Committee. It could be concluded that there is an established relationship between the Audit Committee and Internal Audit, unfortunately however this is not strong enough to affect the governance systems in the public universities.

5. REFERENCE