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Independence of the Internal Auditing Independence and Accountability of Child Funded NGOs on Uganda

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Abstract

***Purpose**: The purpose of this paper is to examine the relationship between the independence of the independence internal audit function and Accountability. The major aim was to examine the relationship between internal audit function and Accountability of Child funded NGOs in Uganda.*

***Design/methodology/approach:** Data was collected through a self-administered questionnaire of 97 NGOs out of which 84 responded. The data was analysed through Correlational and Ordinary Least Square regression.*

***Findings:** The results suggest that independence internal audit function has a positive significant effect on accountability. The Chief Internal Auditors were also confident that their Internal Audit Functions received the necessary respect within their NGOs to enable them to perform competently. This is in line with the reporting line where internal auditors agreed to have cooperation of both the board and management.*

***Research limitations/implications:** Only a single research methodological approach was employed and future research through interviews could be undertaken to triangulate. Furthermore, the findings from the present study are cross-sectional.*

***Practical implications:** In order to have a significant interpretation of the results of the relationships between study variables. This enables practitioners and scholars to know and make genuine resolutions and conclusions that enhance Accountability.*

***Originality/value:** This is one of the first studies on Ugandan Child Funded NGOs testing the impacts of the most important of all governance mechanism as well as internal audit practices. This extends the knowledge not only for academics and Donors but for Ugandan policy makers in particular and for community regulators in other emerging markets in general.*

Keywords: *Internal Audit, independence, Disclosure, Transparency, NGOs, Child funded, Accountability, Uganda*

Introduction

The key purpose of corporate accountability mechanisms is to hold managers of organisations accountable for the social, environmental and economic outcomes (or impacts) arising from the actions (policies, practices and activities) of their organization (Gray, 2002). NGOs play an important role for socio-economic development. In spite of a great importance, it is strange that for long, it could not draw towards the mindfulness of the researchers as it desires (Bhunia et al, 2011). The current fraud and corruption case have raised attentiveness and created demand for accountability by donors and other stakeholders. Governance mechanisms suggest one way to demonstrate accountability is through the use of strong internal audit practices. The paper reports results of a study carried out to determine the effect of internal audit independence on Accountability of Uganda Child funded NGOs. Specifically, the study investigated whether internal audit independence has an effect on Accountability.

Recent growth calls for, and examination of, the accountability of non-governmental organisations (NGOs). Such calls raise a number of intriguing issues about, the nature of accountability, the rights of those who call for it as well as unresolved issues about the means for its discharge. The recent methodologies to donations currently under consideration rely significantly on accountability as a means to safeguard aid (Gray, Bebbington, & Collison, 2006).

Empirical studies from elsewhere support the view that improved internal audit result into accountability (Dellaportas, Langton, & West, 2012); Bracci, 2014; Ebrahim, 2003). Furthermore, Christopher (2010), observed also that poorly governed NGOs have accountability issues than better managed ones. Several studies have been undertaken as regards to corporate governance and accountability (Sanda, Aminu and Garba. et al., 2005), Kyereboah-Coleman and Biekpe (2006), none of the studies specifically addresses the impact of Internal Audit Independence on NGO's accountability in Uganda (Williamson and Dom, 2010). Internal auditing (IA) serves as an important link in the business and financial reporting processes of corporations and not-for-profit providers (Reynolds 2000). Internal auditors play a key role in monitoring a company's risk profile and identifying areas to improve risk management (Goodwin-Stewart and Kent 2006).; Tauringana, 2014; Nkundabanyanga, Ntayi, Ahianzu & Ssejjaka, 2014).

Likewise, Transparency International (2012), has reported numerous cases involving financial mismanagement and difficulties of NGOs in Uganda. The Donors recently reported a massive reduction in the donor support to Uganda due to failure by the most NGOs to account for the funds, according to the report; Employees and Administrators embezzled more than $3.5 million from the NGOs during a three-year period. These thefts were attributed to ``a lack of accountability, coherent out-side auditing'' and ``a system that relies mainly on faith to control the flow of cash'' (Fialka, 1995) and yet; Uganda is highly aid dependent. Paris Declaration surveys have found that the proportion of aid to GoU using country systems declined from 60% in 2012 to 50% in 2013; that using national procurement systems declined from 54% to 37% (ibid).

Nevertheless, the relationship between internal auditing independence, and its influence on accountability in Child Development Organisations in developing countries like Uganda have received minimum research attention (Assad & Goddard, 2010). According to Christopher (2010), the reports show that NGOs in Uganda are losing funding because of transparency and accountability gaps with lack of transparency regarding aid commitments and disbursements as well as blockages in information flows among NGOS and the state as major barriers to improving accountability (Trade Mark East Africa, 2014 (Habyarimana, 2003; OECD, 2009; World vision, 2010). This contributes to malicious systems, with weak accountability and poor governance; this has enforced donors to prioritise project aid (Okoboi, Muwanika, Mugisha, & Nyende, 2011). This study is expected to enable scholars and practitioners to have a more definite and direct understanding of the implication of internal audit independence on accountability.

Literature Review

Internal auditing has become a factor of the new accountability and control era. The manner in which public sector entities maintain internal control and how they are held accountable has evolved to require more transparency and more accountability from these organizations that spend investor or taxpayer funds. This trend has significantly impacted how management implements, monitors, and reports on internal control (INTOSAI, 2016). In particular, best practices in internal auditing can be introduced into organizations as elements of effective accountability. Rupsys (2009) argues that as organizations strive to improve in emerging countries, so does the practice of internal auditing. Internal Audit is an effective method of verifying the execution of accountability. The IIA (1999) defines Independence of the internal audit function as the freedom from conditions that threaten objectivity or the appearance of objectivity. Such threats to objectivity must be managed at the individual auditor, engagement, functional and organizational levels. For internal auditors, independence is the freedom from conditions that threaten the ability of the internal audit activity or the chief audit executive (CAE) to carry out internal audit responsibilities in an unbiased manner. Independence permits internal auditors to render the impartial and unbiased judgments essential to the proper conduct of engagements.

Internal audit, through audit of revenues and expenditures and performances audit, has greatly contributed to safeguarding the financial and economic order, facilitating protection and appreciation of state owned property, improving operating management and economic returns, strengthening an honest government, and enhancing internal self-discipline (Zhang Fa, (1997).

The perceived strength or otherwise of the internal audit function is itself an important tool in symbolising organisational competence to handle and properly "account" for entrusted resources (Durden & Pech, 2006). In this respect auditing acted as a legitimating tool and when it was perceived to be adequate it enhanced organisational legitimacy (Goddard & Assad, 2006; Fiador, 2013). The speed, frequency and intensity of accounting reporting reflects the significance which organisations accord to different stakeholders. The more significant the stakeholder the more influential they are in determining the legitimacy status of organisations and the more accounting activity appeared to be directed to them (Sikka, 2010).

Likewise, IIA (2006), stresses that the internal audit function should be given the appropriate status in the organization to enable the function to exercise organizational independence and individual internal auditors to act objectively. This is necessary because internal auditors are in a unique position as employees of an organization with responsibility to assess and monitor decisions made by management and also to advise management on the adequacy and effectiveness of internal controls (Sarens and de Beelde, 2006a). It is thus no surprise that internal auditors can face considerable familiarity and social pressure threats stemming from their relationship with management. In more recent years, audit committees have undertaken an important governance role in coordinating and overseeing the communications between management, internal auditors, and external auditors. Gramling et al. (2004, p.148) highlight that "a quality relationship between the IAF (internal audit function) and the audit committee also works towards providing the IAF with an appropriate environment and support system for carrying out its own governance related activities (e.g. risk assessment, control assurance and compliance work).

Similarly, governance role played by audit committees in enhancing the relationships between management, external auditors and internal auditors (Blue Ribbon Committee, 1999; Smith Committee, 2003). As such, audit committees can be viewed as a key safeguard mechanism for internal auditors in managing their professional objectivity and independence.

The importance of internal auditing in NGOs has been established, particularly with respect to legitimacy and accountability. However, the complexity of the NGO context and the multiplicity of stakeholders have also been recognised. What is missing is a deeper empirical understanding of how accounting is used in this setting and the purposes it serves (Goddard & Assad, 2006).

Internal auditing will always operate within the dynamic contradiction of, on the one hand being a part of the organisation, and on the other hand trying to remain independent and objective (KPMG, 2003: 2-3; Crowe Chizek, 2006: 3). The independence of the IAF and the objectivity of the internal auditor can be enhanced by various factors, the most important being the reporting lines. According to the IIA (IIA, 2006:41-44) and reports issued by other major role players (IOD, 2002: 186; KPMG, 2005: 26-32; ECIIA, 2005: 28; Crowe Chizek, 2006: 2; Marx, 2008: 291; IOD, 2009: 96), operationally or functionally the CAE should report to the audit committee, while administrative reporting should be to the CEO. Legislation, codes and other standards (IIA 2006:100- 101; Companies Act 2008: S94; IOD 2009: 56) highlight the independence of the audit committee, making this line of reporting the ideal route to follow for internal auditing.

The majority of prior studies relating to the organizational status of internal audit have focused on internal audit's relation with the audit committee. Most of these studies involve surveys or interviews of internal auditors. An exception is the study by Carcello *et al.* (2002) which examined audit committee charters and reports of 150 US companies. Part of this study looks at disclosures relating to auditor oversight. The authors found that disclosures relating to external audit were much more prevalent than those relating to internal audit, with less than 50% of companies in their sample reporting that the audit committee held private meetings with internal audit.

Leung *et al.* (2004) explored the role of internal audit in corporate governance and management in Australia using both an on-line survey and in-depth interviews of CAEs. They report that, while a majority of CAEs had reporting responsibilities to the audit, Christopher *et al.* (2009) examined the independence of the internal audit function in a sample of 34 Australian companies through the function's relationship with both management and the audit committee.

Other surveys have examined whether the composition of the audit committee is associated with the strength of the relationship between the internal audit function and the audit committee. Raghunandan *et al.* (2001), in a survey of US chief internal auditors4, assessed the joint effect of audit committee independence and expertise on the committee's interaction with internal audit. They found that independent committees with at least one member with accounting or finance expertise had longer meetings and more private meetings with the chief internal auditor.

Goodwin and Yeo (2001) surveyed chief internal auditors in Singapore and found that audit committees comprised solely of independent directors had more frequent meetings and more private meetings with the chief internal auditor.

Goodwin (2003) obtained similar results in a survey of chief internal auditors from Australia and New Zealand. In contrast, however, O'Leary and Stewart (2007), in a study of Australian internal auditors' ethical decision making, found that the existence of an effective audit committee had little impact on internal auditors' perceptions of their willingness to act objectively. Whereas the debates conclude that independence of the internal auditing function enhances accountability, the findings were obtained from developed economies. In addition, it is a new debate that has no final conclusion. With all these gaps, it is imperative that this debate is extended to the accountability of NGOs in Uganda.

This Therefore, Lends to the Following Hypotheses

H1: Internal audit independence and accountability are positively related in NGOs.

H2: Reporting lines and accountability are positively related in NGOs.

Study Design and Methodology

This study took cross-sectional and quantitative research designs to address the formulated hypotheses. Data was collected through a self-administered questionnaire of 97 Child funded NGOs out of which 84 responded. The sample size of 97 firms was covered and the number was arrived at by adopting Krejie and Morgan (1973) sample selection approach. Simple random sampling was applied for sample selection. The selection procedure involved picking of pieces of paper in box without replacement until 97 firms were selected. The survey unit of analysis composed of Child funded NGOs whose Chief internal auditor or Internal audit staff were the units of inquiry. However, out of 97 MFIs, 84 NGOs responded, hence giving a response rate of 86.5% percent. Internal audit was measured using adequate freedom, segregation of internal auditing from other responsibilities, Reporting Relationship and Legislative Requirements (Ahmad and Taylor, 2009), Whereas accountability was measured disclosure and transparency (Bracci, 2014; Doig & Wilson, 1999; Dellaportas et al., 2012; Mwesigwa et al., 2014).

Questionnaires earlier developed and tested by Bontis (1998) and Svei by (1997) were adapted to match the Ugandan study context. All items were anchored on a five-point Likert-type scale ranging from 5 (strongly agree) to 1 (strongly disagree).

The questionnaire was validated through expert interviews and a panel of practitioners. All the variables registered content validity index of greater than 0.80. We further tested the reliability of the instrument (using internal consistency approach) to find out whether it consistently measured the study variables on the scales used (Anastasi, 1982; Nunnally, 1978). Item-total reliability (a measure of internal consistency) and Cronbach alpha coefficients of study variables were computed. The Cronbach alpha coefficient results of independence of the internal audit function and its elements together with accountability were all above 0.75 respectively signify that the scales used were reliable.

We addressed the common methods bias in order to reduce the measurement error (random and systematic errors) which normally threatens the validity and conclusions about the relationships between measures (Podsakoff et al., 2003). We endeavored to reduce the potential effects of response pattern biases by incorporating negatively worded or reversed-coded items on the questionnaires (Hinkin, 1995). According to Hinkin (1995) the logic is that reversed-coded items are like cognitive "speed bumps" that require respondents to engage in a more controlled, as opposed to automatically cognitive processing.

Data were checked; recorded, cleaned and negatively worded scale items were reversed-coded. Data were aggregated to a firm level.

Completed questionnaires were further checked for missing values and inconsistencies in responses given by the respondents. Simple frequency runs were made to screen the data so as to identify missing values using series of means value replacement method (Field, 2006; Vanatta, 2002). The data screening exercise aimed at establishing the distribution of data to assess whether the assumptions of parametric data were tenable. Specific assumptions tested included normality of the distribution of the data, homogeneity of variance, linearity of the data independence of errors.We carried out a correlation analysis to establish the direction and strength of the association of study variables and a hierarchical regression to determine the variance in the dependent variable that is explained by independent variables.

Analysis And Findings

Out of the 84 respondents, more than half (57.1%) of the respondents were female, and 42.9% were males. A question on position held by the respondent was asked and the results were as follows, 45.2% of the respondents were Chief internal auditors, 25% staff 21.4% (managers), and lastly 8.3% (internal auditors). Regarding the qualifications attained, 47.6% had a diploma, and lastly 44% who have attained a degree. Concerning the experience, More than half (54.8%) of the respondents have spent more than five years at the organization, followed by those who have spent there between one to five years accounting for 41.7%.

Results indicate that more than three quarters of the respondents believe that their organizations have over 10 employees (91.7%), followed by 8.3% of the respondents who believe the number of employees is in the range of five to ten. In order to initially discern the relationship between the independence of the internal audit function and accountability, the Pearson (r) correlation coefficient was employed to execute this as shown below;

Table1. *Correlation Results*

Correlations								
	1	2	3	4	5	6	7	8
Internal audit independence	1.000							
Adequate freedom	.744**	1.000						
Segregation	.808**	.566**	1.000					
Reporting relationship	.789**	.566**	.636**	1.000				
Legislative requirement	.818**	.428**	.467**	.433**	1.000			
Accountability	.378**	.238*	.295**	.431**	.258*	1.000		
Disclosure	.274*	.181	.208	.373**	.152	.911**	1.000	
Transparency	.413**	.254*	.328**	.421**	.311**	.941**	.719**	1.000
**. Correlation is significant at the 0.01 level (2-tailed).								
*. Correlation is significant at the 0.05 level (2-tailed).								

Source: *Primary data*

Findings in table 1 revealed that there was a significant positive relationship between internal audit independence and accountability (r = .378**, P≤.01). Likewise , the same results holds between adequate freedom and accountability (r = .744**, P≤.01)segregation of duties and accountability, (r = .808**, P≤.01), reporting relationship (r = .789**, P≤.01) and legislative requirement (r = .818**, P≤.01). This implies that the level of internal audit independence is directly associated with the level of accountability, in respect to disclosure and transparency.

Table2. *Regression Results*

Coefficients[a]							
Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	1.934	.566		3.417	.001		
Adequate freedom	-.057	.192	-.039	-.295	.769	.590	1.694
Segregation	.022	.164	.019	.137	.891	.508	1.969
Reporting relationship	.478	.167	.400	2.863	.005	.523	1.912
Legislative requirement	.065	.084	.092	.777	.439	.728	1.373

Model	R	R Square	Adjusted R Square	Model	R	F statistics	
1	.439[a]	.193	.152	1	.439[a]	47.11	

b. Predictors: (Constant), legislative requirement, adequate freedom, reporting relationship, segregation
a. Dependent Variable: accountability
The regression model summarized in table 2 indicates that of the four measures of internal audit independent variables in the multiple regression model of accountability, only reporting relationship (beta = .400, p<.01) had a significant positive effect on accountability.
The results also indicate that internal audit independence account for 15.2% variation in accountability (Adjusted R Square = .152) and in the same vein only reporting relationship was the appropriate predictor of accountability since the model was found to be well specified (F Statistic = 47.110, p<0.01).

DISCUSSIONS

Arising from the study results, it is clear that other than Reporting relationship, other elements of internal Audit independence (adequate freedom, segregation of duties, legislative requirement) are insignificantly associated with accountability in the Child funded NGOs. These results indicate that increases in the reporting relationship is associated with better accountability in Child funded NGOs.

Findings further reveal that there was a significant relationship between internal audit practices and accountability. This is consistent with Faudziah (2005), who found out that performance of audit work and audit reporting of the internal auditing practices positively influence the control activities aspect of the quality of accountability in terms of disclosure and transparency. This is also in agreement with Bierstaker and Wright (2004), who posted that accountability, depends on how effective the internal audit function is performed particularly and how it is managed generally. Sharma (2006), also supports this finding that accountability results from audit practices. He argues that it is the management competences can therefore be used as a means to explain these differences. Bou-Raad (2000), also in support of the above finding 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. The IIA, the American Institute of Certified Public Accountants (AICPA) and others have likewise identified organisational independence as crucial to the viability of the internal audit function (Brown 1983).

CONCLUSION

Ensuing from the foregoing discussion, the study confirms that, reporting relationship with the exception of adequate freedom, segregation of duties, legislative requirement is a significant predictor of accountability in the Child funded NGOs in Uganda. Of the four internal audit independence elements, reporting relationship has the highest predicting power and, therefore, is more important in influencing accountability in the Child funded NGOs. Altogether, internal audit independence elements account for 34% of the quality of the services provided by the MFI.

Fundamentally, human capital has been found to be an engine of intellectual capital as depicted by factor analysis results in Table 1 and multiple regression results. Therefore, in the microfinance institutions' business context, the development of human capital resources is one of the most significant intellectual capital elements of economic success.

RECOMMENDATIONS TO MANAGEMENT AND RESEARCHERS

To boost the Accountability of NGOs in Uganda, managers should use a suitable internal audit functions blend that increases Responsibility. Since the results of this study clearly show that reporting relationship is the most important internal audit function, NGOs should Establish an agreed upon format and frequency for reporting that considers the organization's size, nature, and governance structure. In addition, establish a periodic review of such monitoring and reporting to ensure relevance, efficiency, and effectiveness as well as using the results of reporting to shape and guide internal audit activities. In effect, the NGOs should place greater emphasis to Align internal audit activities to the defined measures of internal audit effectiveness and efficiency.

LIMITATIONS OF THE STUDY

This research is not without its limitations. First, data had not been collected from the beneficiaries especially on accountability. Nonetheless, the study has used secondary sources to measure Accountability.

Second, although the constructs have been defined as precisely as possible by drawing on relevant literature and being validated by practitioners, they can realistically only be substitutes for the fundamental underlying phenomenon that is itself not fully measurable.

Finally, only a single research methodological approach was used, and future research through interviews could be undertaken to triangulate.

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