

The Effect of Internal Audit Department Function on the Performance of the Internal Control System of a Public Hospital in Uganda

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Abstract: *This study set out to examine the effect of the internal audit department function on the performance of the internal control system in a not-profit making hospital. It focuses on Mengo Hospital in Uganda. The research was based on the premise that the hospital sector in Uganda has witnessed modest growth over the last decade with numerous financial challenges that culminated into a significant decline in service delivery. One strategy that can work to ameliorate the situation is having in place a system of internal controls that this study examines. A survey questionnaire approach was used for data collection from the different departments of the hospital. The study reveals that internal audit function has significant influence on the performance of the internal control system in public hospitals through the following; (1) management and reporting of financial information ($\beta = .648, t = 7.508, p < 0.001$); (2) compliance with hospital laws and regulations ($\beta = .311, t = 2.894, p < 0.005$); (3) adhering to accounting procedures ($\beta = .600, t = 6.626, p < 0.001$); and (4) hospital professional finance management practice ($\beta = .567, t = 6.072, p < 0.001$). It was concluded therefore that for public hospitals that are not-for profit, there is an urgent need for the governing bodies and top management to ensure that the internal audit function is not only independent as a department but also that such a department is empowered to monitor, verify and control the use of funds so that all the other departments are able to sagaciously carryout their responsibilities and obligations so as to influence the general service delivery and fulfil the mission that is geared towards patient care.*

Keywords: Internal Audit, performance, internal controls, public hospitals and accounting procedures

1. Introduction

As the quest for improved hospital service delivery in Uganda increase momentum, there is need for research on how the existing old hospitals that were established by the missionaries very many decades ago continue to perform. One such hospital is Mengo Hospital in Uganda which founded in 1897 and has survived for more than 100yrs. This study was therefore premised on the assumption that one of the key controllers of performance that should perform effectively and efficiently in the hospital is the internal audit department. Hence, the internal audit department that is charged with monitoring and overseeing the performance of the internal control system was the focus of this study.

It is expressed by Farkas (2006), that in the financial management literature, the internal audit function is viewed as an independent and objective assurance activity designed to add value and improve the organisation's operations. It helps an organisation like Hospital to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.

According Steinhoff (2005), internal control is conceptualized as a process affected by an agency's Board of Directors,

Chief Executive Officer, Senior Management and other employees, designed to provide reasonable assurance regarding the achievement of the Agency's objectives. This definition covers both the financial and operational objectives of Agencies and thus addresses the following; 1) the reliability of financial and non- financial reporting; 2) compliance with applicable laws and regulations; and 3) the effectiveness and efficiency of operations including safeguarding assets and compliance with internal policies and procedures. Some of these aspects were investigated in the present study.

Consequently, Cuomo (2005) adds that internal controls are systems of policies and procedures that protect the assets of an organization, create reliable financial reporting, promote compliance with laws and regulations and achieve effective and efficient operations. It is therefore concluded by Cuomo (2005) that these systems are only related to accounting and reporting but also relate to the organisation's communication processes, internally and externally, including procedures for (1) handling funds received and expensed by the organization, (2) preparing appropriate and timely financial reporting to board members and officers, (3) conducting the annual audit of the organisation's financial statements, (4) evaluating staff and programs, (5) maintaining inventory records of real and

personal property and their whereabouts, and (6) implementing personnel and conflicts of interest policies.

Moreover, Steinhoff (2005) also observed that internal control represents an organisation's plans, methods and procedures used to meet its missions, goals and objectives and serves as the first line of defence in safeguarding assets, preventing and detecting errors, fraud, waste, abuse and mismanagement.

Mengo hospital like any other organization is expected to have several controls including: controls over procurement; controls over stock issues and distribution of supplies from the stores; controls over salaries and ways; controls over cash; controls over fixed assets; controls over debtors; controls over the use and running of vehicles; controls in regard to decentralized and self-accounting departments and land over controls.

2. Literature Review

The challenges concerning the performance of the internal control systems and the role of internal audit therein are not unique to Uganda alone. Several scholars and practitioners world over recognize the importance placed on internal controls in the achievement of an organization's objectives and the role played by internal audit in ensuring their performance. For example the Common-Wealth of Australia (1998) observed that the role of internal audit is changing as a result of the demands on all organizations to do more with less, to add value and to strengthen internal governance. It was noted that these demands have led to a significant shift in management expectations of internal audits' role within the organization. The argument here is that the current situation in Hospitals expects internal audit to assist executive, senior and line management to fulfill their obligations and to assist the organization in meeting its corporate objectives. This is achieved through establishing and ensuring the performance of internal control systems.

Besides, the internal audit function also comprises a fundamental element of corporate governance structures and processes within most organizations and it operates primarily to provide assurance, in conjunction with other activities, to executive management and any governing body that is if the internal control structure of the organization remains effective. Imperative to note is that the role of internal audit may vary considerably between organizations and over time within an organization (ACCA, 2007). Broadening the scope of internal audit to include economy, efficiency and effectiveness has been an integral part of advanced internal audit policies. By moving beyond traditional auditing of compliance, internal auditors stand greater chance of contributing to improvements in organizational performance and accountability (Schwartz and Sulitzeanu-Kenan, 2002). The Common Wealth of Australia (1998) contend that today, it is recognized that a purely 'cyclical' approach to determining internal audit coverage is unlikely to be as effective as one predicted on identification of risks and the prioritization of internal audit activity based on an assessment

of these risks. Researchers have also observed that conceptual models of internal audit propose are a link between internal audit, internal controls and risk management (ACCA, 2007; Schwartz et al., 2002). However, these models do not specify how internal audit contributes to the performance of internal controls nor do they present empirical supportive evidence.

According to Ali et al (2013), there is need for frugality in executing the audit function in the public sector in that it promotes accountability and improves government performance. In this regard therefore, policy measures on internal audit that are examined in this paper include; requiring the establishment of internal audit units, establishment of standards for the professional conduct of internal audit work; training' resource allocation; expanding reporting arrangements and broadening mandates to make auditors responsible for performance assessments and understanding internal control as an import tools of accountability.

Therefore, Zwaan and Stewart (2011) conclude that internal auditors should assist both management and the audit committee in their risk management responsibilities and oversight roles by examining, evaluating, reporting and recommending improvements on the adequacy and effectiveness of management's risk processes.

3. Methodology

The study population comprised all members of staff in the different departments of Mengo Hospital and 15 board committee members. Purposive sampling was used to select individual respondents who would constitute the sample. This sampling technique was used because it enables the selection of only those respondents considered as key informants (Meyer, 1999). It was therefore used to select only those respondents who are key and resourceful in eliciting the required data. In the final analysis, a sample size of 118 respondents was used.

The self administrative questionnaire was used with a Likert scale in which respondents reported the degree to which they agree with various statements i.e. 5 = Strongly Agree to 1 = Strongly Disagree. Items comprised the extent to which the internal audit department demonstrates independence, integrity, communication, compliance with laws and regulations and ensuring that there is practice of internal control on a daily basis.

The data collected was processed before the actual analysis and this involved checking the completed questionnaires to check for any errors that might have been committed. This process involved editing the data, coding the data, entering the data in the computer and summarizing the data. Analysis was based on both descriptive and inferential statistical tools using SPSS version 20.

The performance of the internal control system which is the dependent variable in this research examined the extent to

which the hospital adheres to the policies and procedures developed by management to manage risk and provide reasonable assurance that the hospital would achieve its objective. It is hypothesized that the more the internal control system is adhered to the easier and the more reliable the financial reporting, its efficiency, effectiveness as well as its compliance with laws and regulations. The department that can ensure that the policies and procedures are followed is the internal audit department. An organization without proper control system would normally suffer a lot of problems such as a rise of cost and loss of cash.

The reliability of the questionnaire was ascertained using Cronbach's Alpha coefficient. The coefficient for this questionnaire was 0.867 which demonstrated that the questionnaire was reliable for use.

4. Data Analysis

4.1 Analyzing descriptive statistics on management and reporting of financial information

Before conducting the regression analysis, descriptive statistics was first analyzed. Table 1 indicates that most of the respondents (97.5%) agreed that there are established procedures for ensuring that grants and contributions are properly recorded, accessing (62.5%) and inputting (79%) of electronic data, changing electronic data (80.2%) that can ensure that detailed daily records are utilized. The analysis also reveals that 85% of the respondents agreed that the assets register is periodically updated and monitored and also that internal audit department periodically reviews established controls over hospital assets whilst making necessary and relevant recommendations on weak areas. This partially explains why Mengo Hospital has been able to stay in the health care business for a long time.

Table 1: Responses on the management and reporting of financial information

Item	Responses		
	SA & A %	N %	D & SD %
There are established procedures for ensuring that grants and contributions received are properly recorded	97.5	2.5	0.00
There are established procedures for accessing electronic data maintained by the hospital	62.5	17.5	20
There are established procedures for inputting electronic data maintained by the hospital	79	2.5	18.5
There are established procedures for changing electronic data maintained by the hospital	80.2	2.5	17.6
Detailed properly records are maintained for all significant assets owned by the hospital.	65	17.5	17.5
Updating and monitoring the existing assets register	85	8.75	6.25
Internal audit department periodically	85	8.75	6.25

reviews controls established over hospital assets and makes necessary and relevant recommendations on weak areas.			
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SA; Strongly Agree; A: Agree; N: Neutral; D: Disagree; SD: Strongly Disagree

Testing the effect of internal control on the management and reporting of financial information

In order to determine the effect of internal control on the management and reporting of financial information, a regression analysis was performed and the results are indicated in table 2.

Table 2: Regression of the four (4) independent variables

Variable	Predicted sign	β	t-value	p-value
Management and reporting of financial information	+	.648	7.508	0.00
Compliance	+	.311	2.894	.005
Accounting procedures	+	.600	6.626	.000
Hospital professional finance management practice	+	.567	6.072	.000

As indicated in table 2, the regression results support the hypothesis that there is a significant effect of internal control on the management and reporting of financial information ($\beta = .658, t = 7.508, p < 0.0001$). This implies that internal control system is a strong predictor in the management and reporting of financial information.

4.2 Analyzing descriptive statistics on hospital compliance with laws and regulations

The analysis of descriptive statistics in table 2 shows that 88.8% of the respondents agreed that the hospital has established procedures which can help the hospital to ensure compliance with regulations and reporting requirements. Similarly, 82.5% of the respondents agreed that there are periodical reviews of the existing laws to suit external regulations. In addition, the hospital has systems in place that can ensure that policies, plans, procedures, laws and regulations are reinforced (73.75%), and 75% also agreed that the recommendations of the internal audit department are always implemented by management as expected.

Table 3: Compliance with the laws and regulations

Item	Responses		
	SA & A %	N %	D & SD %
There are established procedures to ensure compliance with the hospital and other reporting requirements.	88.8	0.00	11.3
The internal audit department reviews compliance with laws and other external regulations.	82.5	8.75	8.75
There are systems in place to ensure compliance with those policies, plans, procedures, laws and regulations.	73.75	26.25	0
Compliance/non compliance with established policies, plans,	73.75	26.25	0

procedures, laws and regulations has an impact on hospital operations and reports			
The recommendations made by the internal audit department on the system of compliance are always implemented by management	75	17.5	7.5

Testing the effect of internal control on hospital compliance with laws and regulations

As indicated in table 2, the regression results support the hypothesis that there is a significant effect of internal control function in ensuring compliance with laws and regulations ($\beta = .311, t = 2.894, p < 0.05$). This implies that internal control function is a strong predictor of compliance with laws and regulations in the organization.

4.3 Analyzing descriptive statistics on adherence to accounting procedures

Analysis of the descriptive statistics in table 4 below reveals that there are accounting policies and procedures manual describing all financial and other controls (91.3%). Similarly, most of the respondents (91.3%) agreed that the internal audit department conducts special investigations in matters such as suspected fraud. It was also revealed that there are established procedures for ensuring that timely and appropriate financial reports are prepared and distributed to all key stakeholders (93.8%). The table also reveals that procedures are established for; reporting to audit committee for allegations of fraud or financial improprieties (81.25%), approving contracts to which the hospital is a party (73.75%), initiating (57.5%), approving (58.75%) and authorizing (60%) capital assets transactions. The internal audit department also periodically reviews the effectiveness and efficiency of these financial reporting procedures (93.75%) which has enhanced effectiveness in the hospital service delivery.

Table 4: Responses on adherence to accounting procedures

Item	Responses		
	SA & A	N	D & SD
	%	%	%
There are accounting policies and procedures manual describing all the financial and other controls.	91.3	0.00	8.8
Internal audit department conducts special investigations (e.g. into suspected fraud).	91.3	0.00	8.8
There are established procedures for providing for regular oversight by the internal audit department	56.3	35.0	8.8
There are established procedures for ensuring that timely and appropriate financial reports are prepared and distributed to all key stakeholders.	93.8	6.3	0
There established procedures for reporting to audit committee of allegations of fraud or financial improprieties	81.25	8.75	10
There are established procedures for approving contracts, to which the hospital is a party, including securing competitive bids from vendors	73.75	11.25	15

The internal audit department periodically reviews the effectiveness and efficiency of these financial reporting procedures	93.75	6.25	0.00
There are established procedures for initiating capital asset transactions	57.5	42.5	0.00
There are established procedures for approving capital asset transactions	58.75	35.0	6.25
There are established procedures for authorising capital asset transactions	60	28.75	11.25

SA; Strongly Agree; A: Agree; N: Neutral; D: Disagree; SD: Strongly Disagree

Testing the effect of internal control on adherence to international accounting procedures

As indicated in table 2 above, the regression results support the hypothesis that there is a significant effect of internal control function on adherence to international accounting procedure compliance with laws and regulations ($\beta = .311, t = 2.894, p < 0.05$). This implies that internal control function is a strong predictor of compliance with laws and regulations in the hospital setting as well.

Analyzing descriptive analysis concerning hospital professional finance management practice

It can be deduced from in table 5 that most of the respondents (67.5%) agreed that there is an audit committee in place to ensure good corporate governance with sufficient and well trained professional staff (97.5%) and that management displays integrity (66.3%) and demonstrates a commitment to having well trained staff (93.8%). The findings also reveal that the hospital has an organization structure identifying authority levels and employees' responsibilities (91.3%) and hence the audit department is charged with overseeing the hospital's risk management activities (65%). Similarly, 67.6% of the respondents agreed that the internal audit department uses a formal framework for identifying and assessing business risks, and regularly receives management requests for assistance and advice (88.8%). Finally, it was agreed that the communication process used for financial reporting in Mengo Hospital is effective (82.5%). This implies that in a hospital setting, perhaps more than any other organization, the zeal to recruit qualified professionals such as medical doctors and nurses, who treat patients, should be the same for other departments in the hospital such as the internal audit department.

Table 5: Responses on hospital professional finance management practice

Item	Responses		
	SA/ A	N	D / SD
	%	%	%
A high degree of importance is placed on internal controls.	67.6	6.3	26.3
Management displays integrity and has developed ethical rules which have been implemented throughout.	66.3	17.5	16.3
An audit committee is in place to ensure good corporate governance	67.5	0.00	32.5
Management demonstrates commitment to having trained staff	93.8	0.00	6.3

with right skills and experience.			
The hospital has an organization structure, with clear authority levels and responsibilities.	91.3	6.3	2.5
The internal audit department has sufficient and well-trained professional audit staff.	97.5	2.5	0.00
The internal audit is charged with overseeing the hospital's risk management activities.	65	8.8	26.25
The risk management techniques adopted are appropriate.	47.5	17.5	35.0
Internal audit department uses a formal framework is for identifying and assessing business risks.	67.6	6.3%	26.3
Internal audit department regularly receives line management requests for assistance and advice.	88.8	2.5	8.8
The communication process used for financial reporting is effective.	82.5	17.5	0.00

SA; Strongly Agree; A: Agree; N: Neutral; D: Disagree; SD: Strongly Disagree

Testing the effect of internal control on hospital auditors' professional practice

As indicated in table 2, the regression results support the hypothesis that there is a significant effect of internal control function on hospital professional practice ($\beta = .311$, $t = 2.894$, $p < 0.05$). This implies that internal control function is a strong predictor of routine practicing of internal control in the hospital setting as well ($\beta = .567$, $t = 6072$, $p > 0.0001$).

5. Discussion and Implication

The research by Munro and Stewart, (2011) showed the internal audit function has a significant role to play in the functioning of other departments as well as assessing risks therein. The internal audit function therefore helps members of the organization to improve the performance of the activities (Ali et al, 2012). The study here adds that the audit function in the hospital is to; (1) assess the extent to which the hospital assets are properly managed for the efficient and day to day effectiveness of the hospital operations; (2) examine and evaluate existing procedures for initiating transactions; and (3) approve transactions and that detailed records are maintained in the management of patients and all the assets and liabilities of the hospital. The Audit function also requires that money and other assets are not only kept properly but also accounted for in terms of use and expenditure. Moreover, it is the responsibility of the internal audit department to periodically review controls and make relevant recommendations on the weak areas and for management to ensure that they implemented. This study therefore analysed the effect of internal audit department function on the four (4) variables of the internal control system which included; management and reporting of financial information, compliance with the laws and regulations, adhering to accounting procedures and hospital professional finance management practice. The findings here stress the importance of the audit department in a hospital and

how it can work to not only to ensure continuity but also one way to stop the public outcry of the poor performance of public hospital in a developing country like Uganda. An important element to this end is having in place a well established system of internal controls to provide reasonable assurance that the hospital objectives are achieved through; 1) effective and efficient operations, 2) reliable financial reporting; and 3) compliance with laws and regulations. To ensure their reliability, and effectiveness, there must be in place an independent and objective internal audit department to constantly review and report on their reliability and effectiveness as structures become more complex. This role must be complemented by the establishment of an audit committee to play its 'oversight; assessment and review roles of other departments and systems within the hospital.

6. Conclusion

In conclusion, it is not only the sophisticated hospital medical equipment and qualified doctors that have propelled hospital performance but it is also the control function of the financial resources and other assets that can guarantee continuity and quality service. The research implication here is that public hospitals can easily continue to witness poor service delivery and continuous complaint by medical personnel and other workers if focus is on placed on the internal control of the resources therein which can guarantee that such valuable human capital are paid so as to deliver their services promptly. Therefore, the internal audit department is fundamental in the performance of the internal control systems of public hospitals.

Everything considered, there is an urgent need for the governing bodies and top management to ensure that the internal audit function is not only independent as a department but also that this department is empowered to monitor, verify and control the use of funds so that all the other departments are able to sagaciously carryout their responsibilities and obligations so as to influence the general service delivery and fulfil the mission that is geared towards patient care.

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