

**INTERNAL AUDIT AND INTERNAL CONTROL IN  
RURAL/COMMUNITY BANKS, CHALLENGES  
AND THE WAY FORWARD**

**CASE: SEKYERE RURAL BANK LTD**

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## ABSTRACT

Internal Audit and Internal Controls Systems have become very crucial and indispensable in Business Organizations due to their fundamental roles in the achievement of organizational objectives. On the contrary, Rural and Community Banks (RCBs) are characterised by inadequate and unsound internal controls and ineffective internal audit units as evidenced by rampant cases of frauds, irregularities and at worse, collapse of some RCBs. Instituting effective internal audit and internal controls in RCBs is a very challenging one due to a number of reasons.

This research work is aimed to unearth the challenges that confront internal audit and internal controls in RCBs that have rendered them ineffective and recommend ways of making them work more effective.

The population for the purpose of this work was made up of Internal Auditors, Management members, Audit Committee members and other Operational Staff of Sekyere Rural Bank. A total sample size of Thirty One was selected using the random sampling procedure. Data were collected from both primary and secondary sources. Questionnaire and interviews were used to collect data from the primary source. The secondary sources included books, training manuals, journals and articles on internal audit and internal control.

Some of the findings on challenges confronting Internal Auditors of RCBs included lack of support from Board and Management, inadequate training to Internal Auditors, lack of independence, non-existence of policy and operational manuals and poor placement and recognition of the Internal Auditors. Override of internal controls by Board and Management, resistance to change, non-appreciation of relevance of internal controls and human factor were found to be the challenges confronting internal controls. It also came to light that lack of independence is the paramount among the challenges confronting Internal Auditors of RCBs and non-existence of policy manuals been the least. Override of internal controls by Board and Management was ranked to be the paramount challenge confronting internal controls and ranked least is non-appreciation of internal controls by management and staff.

It was recommended that effective operational policies on all operational areas should be put in place. These policies should be made know to every member of staff to ensure adherence to them.

Another recommendation was that Board and Management of RCBs should endeavour to avoid interference in the work of Internal Auditors for the Auditor to be independent.

The study further recommended that Board and Management should lead exemplary lives by adhering to internal control systems. This will scare other staff members from flouting internal controls since they are aware of the importance placed on internal controls by Board and Management. This will help strengthen internal controls.

Internal Auditors should also be given adequate training to equip them enough to handle more effectively the internal audit functions.

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# CHAPTER ONE

## INTRODUCTION

### 1.1 Background of the Study

Rural/Community Banks (RCBs) are established and registered under the Banking Act, 2004, (Act 673) to undertake a mix of microfinance and commercial banking activities structured to satisfy the needs of the rural areas. They provide banking services by way of funds mobilization and credit to cottage industry operators, farmers, fishermen and regular salaried workers-employees.

FINSAP was implemented during 1989-1990 to liberalize and improve the soundness of the banking system in Ghana, and as a result, ARB Apex Bank Limited was established to supervise and regulate the rural and community banks. Meanwhile, RCBs are to institute on their own an internal audit function and internal control systems to ensure smooth running of their organizations.

Internal auditing is an independent appraisal function established by management to examine and evaluate the organisation's systems of internal control and make recommendations for the achievement of the organisation's objectives. Internal control system, as defined by the Auditing standards is "The whole system of controls, financial and otherwise, established by management in order to carry on business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the completeness and accuracy of the records".

Therefore, internal auditors of Rural and Community Banks (RCBs) are responsible for advising and assisting the board and management in establishing an effective and adequate internal control system that seeks to ensure that resources are safeguarded, records are accurate and reliable and work is done efficiently and orderly.

On the contrary, almost all RCBs operated for several years without internal audit units and effective and sound internal control systems and as result are characterised by



financial improprieties, inefficient utilization of assets, poor corporate governance and management. Majority of RCBs have been performing poorly, experiencing low growth rate and collapsed due to these negative practices. The Bank of Ghana later made it a requirement for all RCBs to create internal audit departments to ensure that internal control policies are been adhered to and are sound and effective.

Internal auditors in executing their roles face various challenges that render them ineffective and hence could not live up to task. This is due to the fact that the whole concept of internal auditing and internal control is not widely understood by board of directors, management and staff of RCBs. It may sound unbelievable but remains a fact that some RCBs as of date operate without internal auditors. In spite all these, there has not been any conscious effort by authorities of RCBs to deal with those hindrances so as to empower internal auditors to effectively carry out their roles.

It will therefore be of great importance and timely to identify and analyse these main challenges and the recommended ways of curbing them so as to make the work of internal auditors of Rural Banks more effective and strengthen internal control systems.

## **1.2 Problem Statement**

Many RCBs have been in existence in Ghana over a decade. However, common problem to RCBs irrespective of age or viability is the issue of unsound and inadequate internal controls due to the fact that internal auditors of RCBs have not been effective enough as a result of various challenges confronting them. It will sound unbelievable but remains a fact that some RCBs presently are without internal auditors for various reasons. As a result some RCBs over the years have been experiencing financial mismanagement, inefficient utilization of assets, poor corporate governance and management. These negative practices are undoubtedly responsible for the collapse, poor performance and low growth rate of majority of RCBs. Realization of organisational objectives becomes practically impossible as far as these practices continue to exist.

Not until challenges confronting internal audit and internal controls are identified and appropriate actions taken to curb them, the problem of unsound and inadequate internal control system and their resultant effects will forever exist.

Therefore, in order to make the work of internal auditors of RCBs challenge free and to conscientise RCBs on the purpose of and the need for effective internal audit and internal control systems for the attainment of corporate objectives, the preparation of this report is very crucial.

### **1.3 Objectives of the Study**

The following are the objectives of this study.

- The **primary objective** for the preparation of this document is to make the internal audit profession in RCBs and internal controls as effective and efficient as possible towards the achievement of organisational objectives.

To achieve the above primary objective, the following **secondary objectives** will first have to be achieved.

- To identify and analyse the challenges facing internal auditors and internal control systems.
- To come out with pragmatic recommendations as to how such challenges can be alleviated or eliminated to enable internal auditors of RCBs carry out their duties and responsibilities without any hindrances.

### **1.4 Research Questions**

This research work poses the following questions:

- Are internal auditors of RCBs effective, efficient and equipped adequately enough to execute their duties as expected of them?
- Are there sound, adequate and effective systems of internal controls in RCBs?
- If the answers to the above questions are no, which is obvious, then what factors account for such deficiencies and how can those factors be identified and dealt with?

## **1.5 Expected Outcome**

At the end of this document it is expected that:

- Challenges confronting internal auditors and internal control systems of RCBs are identified and analysed.
- Readers will come to comprehend why internal auditors of RCBs have been less effective and efficient.
- Users of this document will know why there still exist inadequate and ineffective internal control systems and for that matter frequent cases of fraud and other irregularities in almost all RCBs in Ghana.
- Some of the reasons why RCBs have been experiencing low growth rate in their operations.
- Authorities of various RCBs will strive to make internal auditors more dynamic, effective, efficient and professional in discharging their duties to the utmost benefit of their banks.
- The preparation of this document is also expected to deepen my knowledge in internal audit and internal control in RCBs.

## **1.6 Organization of Chapters**

This research work has been organised and presented in an orderly manner such that it will be easy for users to read and follow. It has been organized in five chapters.

Chapter one contains the introductory aspect whiles chapter two reviews existing literature on the topic. Methods and approaches to data collection and their sources were all considered in chapter three. Chapter four reports the findings and analyses them whereas the fifth chapter concludes the whole work and recommends ways of curbing the challenges.

# CHAPTER TWO

## LITERATURE REVIEW

### 2.1.0 Internal Auditing

#### 2.1.1. Historical Perspective of Internal Auditing

Auditing has its origin in Africa, Egypt where it was practiced in the Pharaoh's Council.

At that time, the objectives of auditing were the following:

- to ascertain or check the correctness of all monies received and the amount disbursed out of all receipts into Pharaoh's treasury and then the resultant balance;
- to ascertain the amount of commodities received into the royal warehouse, issues made out of stock and the stock balance;
- to ensure that all cash disbursements or expenses and, issues of food items from stock were supported by official order of the kind;
- to check accuracy of entries made in records books (Adu-Gyamfi, 2006).

From Egypt auditing was introduced into Persia where it was called "The King's Eyes and Ears". From Persia it spread to Rome. The English people adopted the practice when they defeated the Romans in the 15<sup>th</sup> Century. From English auditing was introduced by British Accounting firms into the USA, precisely in 1879 at the request of investors who wanted to protect their invested capital. The practice was further introduced into Canada in 1879 and incorporated in 1902 in that country as a legal requirement in business transaction (Adu-Gyamfi, 2006).

Although accounting and auditing has not been practiced in Ghana, it was the passing of the Companies Code Act 179, 1963 which gave legal recognition to them in the country.

### **2.1.2 Definition and Nature of Internal Auditing**

Internal auditing as defined by the Institute of Internal Auditors (IAA) is “an independent, objective assurance and consulting activity designed to add value and improve the operations of organizations”.

It is defined as “an independent appraisal activity within an organization for the review of operations as a service to management”, (Okai, 1996,)

As also defined by Adu-Gyamfi, (2006) “it is an independent activity established by management to examine and evaluate an organization’s risk management process and systems of operational control”

Internal audit is an element of internal control established by management to ensure adherence to internal control policies procedures established by management towards the achievement of organizational goals and objectives. Internal audit objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources. It helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.

### **2.1.3 Objectives of Internal Audit**

The objectives of internal audit as outlined in ARB Apex Bank, (2004), Internal Control and Internal Audit for Rural and Community Banks, Operational manual, “is to assist members of the organization in the effective discharge of their responsibilities by furnishing them with analyzes appraisals, recommendations, counsel and information concerning the activities”.

### **2.1.4 Qualities of an Internal Auditor**

Legal cases before courts in the past have brought some qualities which is desirable in an Internal Auditor. The following summarises some of these cases:-

- He must exhibit honesty and integrity in its duties. Thus, “he must not certify what he does not believe to be true”

(In re London and General Bank Ltd, 1985)

- The Auditor must be conscientious in that, if he even has in one instance, fallen short of the strict duty of his, he cannot be excused merely because in general he has displayed the highest degree of care and skill.

(In re the City Equitable Fire Insurance Company Limited, 1924)

- The Auditor must not be unduly suspicious in his work. This means that the Auditor is not bound to assume when he is dealing with fraudulent and dishonest people. Thus, he is not to approach his work with or mind set a suspicion that there is wrong. (In London Oil Storage Company Limited VRS Sear, Hasluck and Company, 1904)

- He must be objective throughout his work. Thus, he must avoid subjectivity or biases.

- The Internal Auditor must be able to work independently without depending on others for ideas and direction at all times.

- He must be qualified academically and professionally.

- He must resist offers and hospitalities which will make him compromise the quality of his work.

- An Internal Auditor must be confident and be able to work without fear particularly with issues in which he/she is sure that the right thing is being done.

(FINSEC Consult, 2008)

### **2.1.5 Responsibilities of the Internal Auditor**

The internal auditor of RCBs is responsible for advising and assisting the board and management of his bank in establishing an effective and adequate internal control system

that seeks that resources are safeguarded, records are accurate and reliable and work is done efficiently and orderly.

According to Apex Bank, (2004), Internal Control and Internal Audit for Rural and Community Banks, Operational manual, for the internal auditor to cope with this responsibility, the following key functions shall be performed:

- Ensure adherence to policies and procedures established by board and management.
- Ensure compliance with the provisions of the Banking Law, the Companies Code, 1963 (ACT 179), as well as the directives and procedures established by Bank of Ghana and ARB Apex Bank.
- Review and appraise, from time to time, the effectiveness of internal controls in place and propose new controls for consideration and adoption by Board and management.
- Educate staff on the importance and the need for compliance with internal control policies.
- Assist in building the capacity of staff so that they can work satisfactory by drawing the attention of management to weaknesses of staff.
- Conduct follow-up to ensure that anomalies that were detected during the course of earlier audit have been rectified by Auditees.
- Help create a control environment that will prevent, detect and minimize fraud.

It can be realized from the above that the role of the internal auditor is key to the achievement of organizational goals and objectives.

### **2.1.6 Problems Faced by Internal Auditors**

Internal auditors face a lot of problems. Some of the general problems faced by internal auditors at all levels include:

1. Management, Boards, Councils of most institutions do not place internal auditors in a proper managerial position and give them the recognition which they deserve by nature of their jobs; in most cases there is a big question mark on the internal auditor's independence;

2. politicization and personalization associated with internal audit functions make it difficult for internal auditors perform their jobs the way the profession requires of them;
3. poor relationship with operational staff due to poor perception which some CEOs, spending officers and other operational staff have for internal audit that it is a “witch hunting” activity affect internal auditors effectiveness;
4. the changing nature of internal audit is such that it is moving away from the traditional check- and- tick approach to risk -based and consultancy approach which bring a lot of challenges to current breed of internal auditors; there are always skills and expectation gaps to be filled (Adu-Gyamfi, 2006).

### **2.1.7 The Principles of Independence and Confidentiality in Internal Auditing**

Two principles which pose major problems to Internal Auditors are independence and confidentiality. Independence is an essential ingredient in determining the effectiveness and efficiency or otherwise of an internal auditor. By independence, it means that the internal auditor should be free from interference in determining the scope of internal auditing, performing work and reporting (Daily Graphic, March 6, 2008). Therefore, to ensure the independence of the internal auditor, he must occupy management position and report to the Audit Committee on the board. However, the independence of the internal auditor may be compromised if, for instance, it is directly involved in operational process.

The principle of confidentiality says that an Internal Auditor should not disclose any information, facts, figures, data etc. which comes to his notice in the course of his work without authority. The Internal Auditor has unrestricted access to any information within the work place and it is possible he will come across confidential issues such as information on staff file, Bank of Ghana Inspection report, etc. It is unethical and a breach of confidentiality to disclose any of such information and trust in him may be lost; he cannot collect reliable, adequate, relevant audit evidence, and may be taken on by the Board of Directors.



## 2.2.0. Internal Control

### 2.2.1 Definition and Nature of Internal Control

The Auditing standards defines an internal control system as “The whole system of controls, financial and otherwise, established by management in order to carry on business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure as far as possible the completeness and accuracy of the records”.

Internal controls are procedures and directives which management uses to guide workers behaviour and performance so as to avoid frauds, irregularities, errors, misappropriations, embezzlements and other negative acts of staff members.

The Statement of Auditing Standards (SAS) 30 classifies internal controls into **control environment** and **control procedures**. Control environment is the over-all management philosophy, attitude, awareness values and actions regarding the importance of prevention, detection, and deterrence of frauds, irregularities and embezzlement.

Control procedures consist of rules, regulations, methods, instructions, directives, policies and decisions established by management over various transactions of the entity.

### 2.2.2 Types of Internal Control

As outlined in ARB Apex Bank, Internal Control and Internal Audit for Rural and Community Banks; Operational Manual, the following are the various types of internal control.

- The organization
- Segregation of duties
- Physical controls
- Physical controls
- Authorization and approval controls
- Arithmetic and accounting controls

- Personnel controls
- Supervisory controls (internal checks)
- Documentary controls
- Budgetary controls
- Management controls

### **2.2.3. Usefulness of Internal Controls**

Internal control is useful to RCBs because:

1. They ensure efficiency in operations.
2. They ensure that work is done in an orderly manner.
3. They safeguard Rural Bank assets.
4. They ensure adherence to management policies.
5. They minimize errors and recurrent fraud.
6. They ensure the efficiency and reliability of records.

The above usefulness is also the objectives of internal control.

### **2.2.4 Importance of Internal Controls to the Internal Auditor**

The Internal Auditor's key objective is to review the organization's system of Internal Control and to provide assurance that the corporate governance requirements are met. They have to make decisions on the extent of reliance on control to manage risks therefore the level of testing to be carried out.

Internal audit should be able to provide Board with assurance regarding the effectiveness of the system of internal control. To provide such assurance, the Internal Auditor need to check that the controls in place are adequate to guard against the risks identified and that the controls are operating effectively.

The adequacies of controls are therefore important so that the Internal Auditor need not to check only for sufficient controls but also for over-control and inefficiencies. (FINSEC Consult, 2008)

### **2.2.5 Limitations to Internal Control**

Although internal controls are important they have their own limitations. No internal control however elaborate and comprehensive can by itself guarantee efficient administration and reliability of records nor can be a proof against fraudulent collusion especially on the part of those holding positions of authority or trust.

Internal controls which depend on separation of duties can be avoided or defeated by collusion of those involved. Authorizations controls can be abused by the person say a senior official in whom authority is vested. Other factors likely to undermine effective operation of controls are: .

- Fatigue
- Distraction; can easily be controlled through experience
- Carelessness
- Misunderstanding
- Errors of judgment and/or interpretation

### **2.2.6 Making Internal Control Systems Effective**

For internal control system to achieve its desired objective it must be effective and reliable. In an In-House training program facilitated by Bank Watch Limited for Sekyere Rural Bank; dubbed “Emerging Concepts of Fraud Prevention and Internal Control”, the following were outlined as the ways of supporting internal control systems so as function effectively.

### **[A] Procedural Manual**

Organization staff, without exception must be guided by unit/departmental based operating manual as well as overall mission and policy direction for business objectives. This may contain operational controls and provides some sort of guidance, direction and creates awareness to all staff.

### **[B] Inspection and Audit Report**

Employees to meet transparent business culture requirements, must access internal audit reports and act on them accordingly. This will make employees more responsible in taking initiatives that will reduce operational errors and fraud.

### **[C] Circulars and Memos on Designed Programs**

Internal circulars and memos that relate to corrections and update of business systems controls should be made handy and understandable to employees in order to solicit their commitment for attainment of designed work objectives.

### **[D] Leadership Skills**

A confident and inspiring leadership skill in work supervision is no doubt a rare control asset. The presence of employees with good job knowledge and leadership skills sometimes threatens both internal and external fraudsters who might not be aware of the existing readiness to foil their fraudulent attempts.

### **[E] Management Support**

Management support to internal control stimuli in an organization is a prerequisite for making internal control system. Management's support must be made known to all members of staff and punitive decisions should be taken against flouters of internal control policies.

## **2.2.7 Features of a Successful Control Environment**

A good and successful control environment exhibits certain attributes. They include:

- Commitment to truth and fair dealing

- Commitment to quality and competence
- Leadership in control by example
- Communication of ethical values
- An appropriate organization structure
- Independence, integrity and openness at Board level
- A professional approach to financial reporting.

(Finsec Consult, 2008)

### **2.3 Summary**

It can be inferred from the above review that for every entity to succeed in achieving its goals and objectives it should have in place effective internal control systems, and an effective and efficient internal auditor. Thus, the objectives of a company are in a way embodied in that of internal control and internal audit.

Therefore, the objectives of internal control and internal audit and for that matter, a company will be defeated if there exist weak and inadequate internal control systems and ineffective internal auditor all as a result of challenges or limitations faced with. Hence, it will be of great importance to companies to ensure that there is some acceptable degree of perfection in internal control systems and internal auditing.

## **CHAPTER THREE**

### **RESEARCH METHODOLOGY**

#### **3.1 Profile of Sekyere Rural Bank Ltd.**

The idea for the establishment of Sekyere Rural Bank was proposed by Captain (Rtd.) Osei Ntem. The Bank was set up and commissioned in 1983 to play an intermediary role between surplus fund holders and those in need of funds for their projects within the Jamasi Traditional Area in the Ashanti Region of Ghana. The Bank is registered under the Ghana's Companies Code 1963 (Act 179) and operates under the Banking Law, 2004 (Act 73).

The vision of the bank is "to be a foremost rural financial services provider and at the forefront of micro and rural finance industry in the country".

It has its mission to be "a unique microfinance intermediary in Ghana, through the provision of unequalled financial services propelled by a well-motivated workforce, customized products and superior customer service than our competitors, sustaining the payment of satisfactory returns to our shareholders as well as being seen as a vehicle for rural development in the community we serve". The bank at present has six branches and headquartered in Jamasi, off Kumasi-Mampong road.

#### **3.2 Population and Sampling Procedure**

The population from which sampling was made included internal auditors of RCBs, Audit Committee members on the board, management members and operational staff.

As a matter of fact, the Internal Auditors were very important members in the population since they are actually practicing the internal audit profession in RCBs and are very much aware of the various challenges being faced with. The Audit Committee members were among the population because, ideally internal auditors are suppose to report to them and are responsible for issues concerning internal auditing within the institution. Management

members are responsible for implementation of internal control policies and this accounted for their inclusion in the population.

A total sample size of Thirty One (31) was selected and was made up of Seven (7) Internal Auditors, Twelve (12) Management members, Two (2) Audit Committee members and Ten (10) Operational staff.

✓ The random sampling procedure was adopted in determining the sample size. This procedure was used because each member within the population ought to have equal chance of being selected. Secondary, this criterion was assumed to give a fair representation of the population.

However, the internal auditors were given priority over other members within the population since they were the main target group and indispensable as far as this research work is concerned. Undoubtedly, data collected from them and their contributions were crucial to the successful completion of this document

### **3.3 Data Collection Methods/Instruments**

To enhance comprehensive and quality research work, three main methods were employed to collect data. They include questionnaire, interview and documentary review.

#### **3.3.1 Questionnaire**

Appropriate questionnaire which featured both open-ended and closed type questions were designed. More open-ended questions were included than closed questions because the researcher wanted to give the respondents the chance to express their answers according to their understanding. Secondary, everyone had his or her own perception and understanding about what is a challenge and what is not a challenge.

The questionnaires were well answered and it received a remarkable response rate of 100%.

### **3.3.2 Interview**

Interview could not be left out considering the busy schedule of some of the targeted members. Thus, it was more convenient to engage some of them in interview other than leaving a questionnaire with them.

Conversational semi- structured interviews were conducted with all the interviewees at their less busy times in office. Each interview began by asking the question “are there any challenges facing internal auditors and internal controls at all”, after a brief comment about the purpose of the study. In order to remain focused, the questionnaire was used as a guide in each of the interviews. However, in most cases to tap the full knowledge and understanding of the interviewee about the topic, the interview sometimes went beyond the guide. Major points and facts raised were noted and put together thereafter.

### **3.3.3 Documentary Review**

Data were also collected from existing documents and materials on the topic. Among these documents include books on internal audit, training materials on internal audit and internal control of RCBs, operational manuals, news papers and other journals to the extent to which they were relevant to the topic.

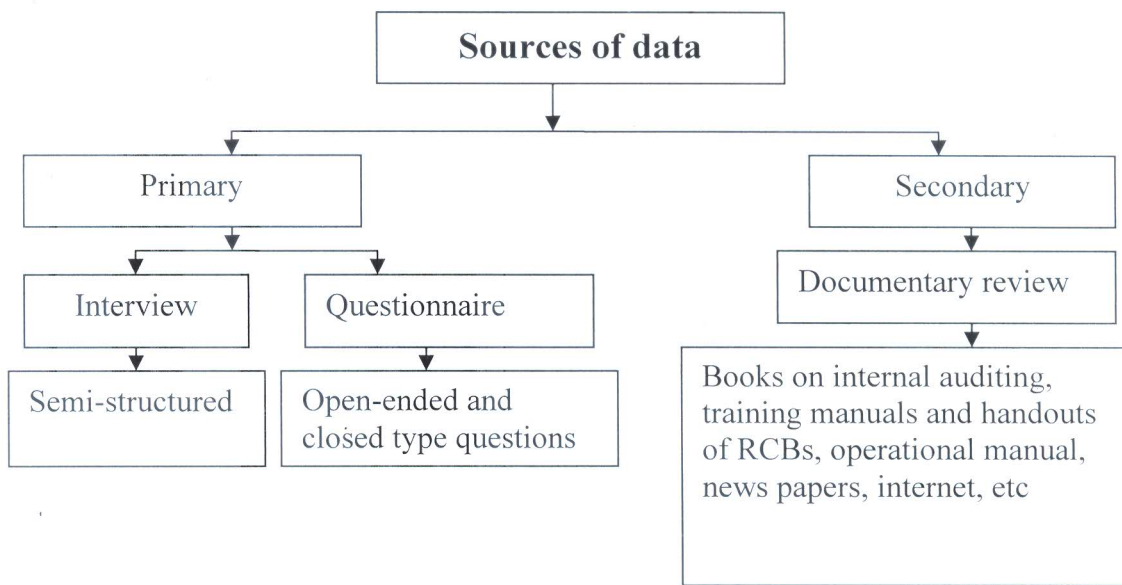
### **3.4 Sources of Data**

Collection of data was made from two main sources. These are primary and secondary sources.

The primary sources include interview and questionnaire whereas the secondary sources include books on internal auditing, training materials and handouts of RCBs on internal audit and internal control, operational manual of Rural Banks, news papers such as the Daily Graphics, Business and financial times and the internet.



**Figure 3.1 (A diagram showing sources of data)**



### **3.5 Data Analysis**

Data gathered were analysed with percentages, ratios, tables, graphs, pie charts and other illustrative instruments necessary to comprehensively analyse the data.

### **3.6 Limitations**

The basic limitation to this research work was time. Time in the first instance has to do with the short duration for the preparation of this work.

This to some extent limited the extensive nature of the work. Secondary, the researcher was limited by time in the sense that greater percentage of my time is spent at the work place. It became more difficult when I had to go to work on Saturdays.

Another problem was unavailability of the internal audit staff. It was quite difficult getting them for interviews and respond to questionnaires due to the busy nature of their work. Some of the internal auditors were also unwilling to divulge other informations they deemed sensitive since they thought it behoves them to observe secrecy and be confidential with any information in their possession as internal auditors.

## CHAPTER FOUR

### FINDINGS AND DISCUSSIONS

#### 4.1 Introduction

In pursuance of the objectives in chapter one, questionnaires were developed and distributed to targeted members within the population. Interviews were also conducted with some members. Summarised in the table below is the responds rate of various category of members interviewed that were given questionnaire.

**Table 4.1 (summary of respond rate to questionnaire)**

Category of members	No. given Questionnaire	No. responded	Respond rate
Internal Auditors	7	7	100%
Management	12	9	75%
Audit Committee members (Board)	2	1	50%
Operational staff	10	7	70%
<b>TOTAL</b>	<b>31</b>	<b>24</b>	<b>77%</b>

It can be inferred from table 4.1 above that the respond rate was well above average. It must also be emphasised that interviews were conducted as explained in chapter three.

#### 4.2 Challenges Confronting Internal Auditors of RCBs

One of objectives of the research work is to identify and analyse the main challenges confronting Internal Auditors of RCBs. In the quest by the research to identify these challenges, the following responds were given by respondents.

**Table 4.2 (a tabular presentation of response and response rate on challenges confronting Internal Auditors of RCBs)**

<b>Challenge</b>	<b>Percentage (%) of Respondents</b>
Lack of support from Board and Management	70
Lack of independence	58
Inadequate training	48
Hostile environment	25
Non existence of policy manual	64
Poor placement and recognition of Internal Auditor	29

Discussed and analysed below are the results and findings gathered on challenges confronting internal auditors.

#### **4.2.1 Lack of Support from Board and Management**

For internal auditor to be vibrant and effective, he needs guaranteed support in diverse ways from the entire Board of Directors and management. However, this vital element is conspicuously missing in Rural Banks. They rather sabotage the internal auditor by denying him certain benefits he deserves, deliberately refusing to consider and implement his recommendations, mention but a few.

The rationale for the above might be that the internal auditor is seen as a big threat and to minimize the threat is to revoke the needed support that could make him more effective. Another cause for the above is that some members of Board of Directors and some senior management members would always want to illicitly protect the interest of their close relations and favourites. Therefore, any internal audit report concerning the work of any of those people is taken very personal by some members of the Board and management.

#### **4.2.2 Lack of Independence**

It came out from the research that between 70-80% of internal auditors of RCBs have their independence unduly influenced. Even though, internal auditors by principle do not have total independence since they are servants or employees of their companies or institutions, but in the case of RCBs, the Internal Auditor's work is excessively interfered by Board of Directors, Management members and other staff members as far as they could.

Consequently, the internal auditor is always in a dilemma either to protect his job or report fraudulent but important and influential officer. Obviously, the internal auditor would love to secure his job and in most cases will compromise his independence which adversely affects his output.

#### **4.2.3 Inadequate Training**

RCBs do not offer adequate training to sharpen the skills and competencies of their internal auditors. Irrespective of ones educational background, it is prudent to be exposed to contemporary internal audit and internal control related training programmes. This research work brings to light that about 60% of the Internal Auditors are put on their jobs as soon as they are employed. The best some RCBs could do is to attach their newly recruited Internal Auditors to that of sister rural banks for a maximum of one month, and comes back to assume duties without any formal training on and introduction to the ethics, practices and principles of internal auditing as well as the systems and operations of the rural bank concerned.

It must be emphasised that the auditor once recruited have two issues to deal with, the full and vivid understanding of the operations and systems of the RCB concerned and basic knowledge of the principles, practices and ethics of internal auditing. These issues if not properly addressed, as in the case of RCBs, will negatively affect the overall competency and delivery of the Internal Auditor. Unfortunately, RCBs only rely on training programmes of ARB Apex Bank which is woefully inadequate.

Summary of findings on the number of times Internal Auditors have attended internal audit and internal control related training programmes including in-house training is presented below.

**Figure 4.1 (Number of training programmes attended by Internal Audit Staff of RCBs)**

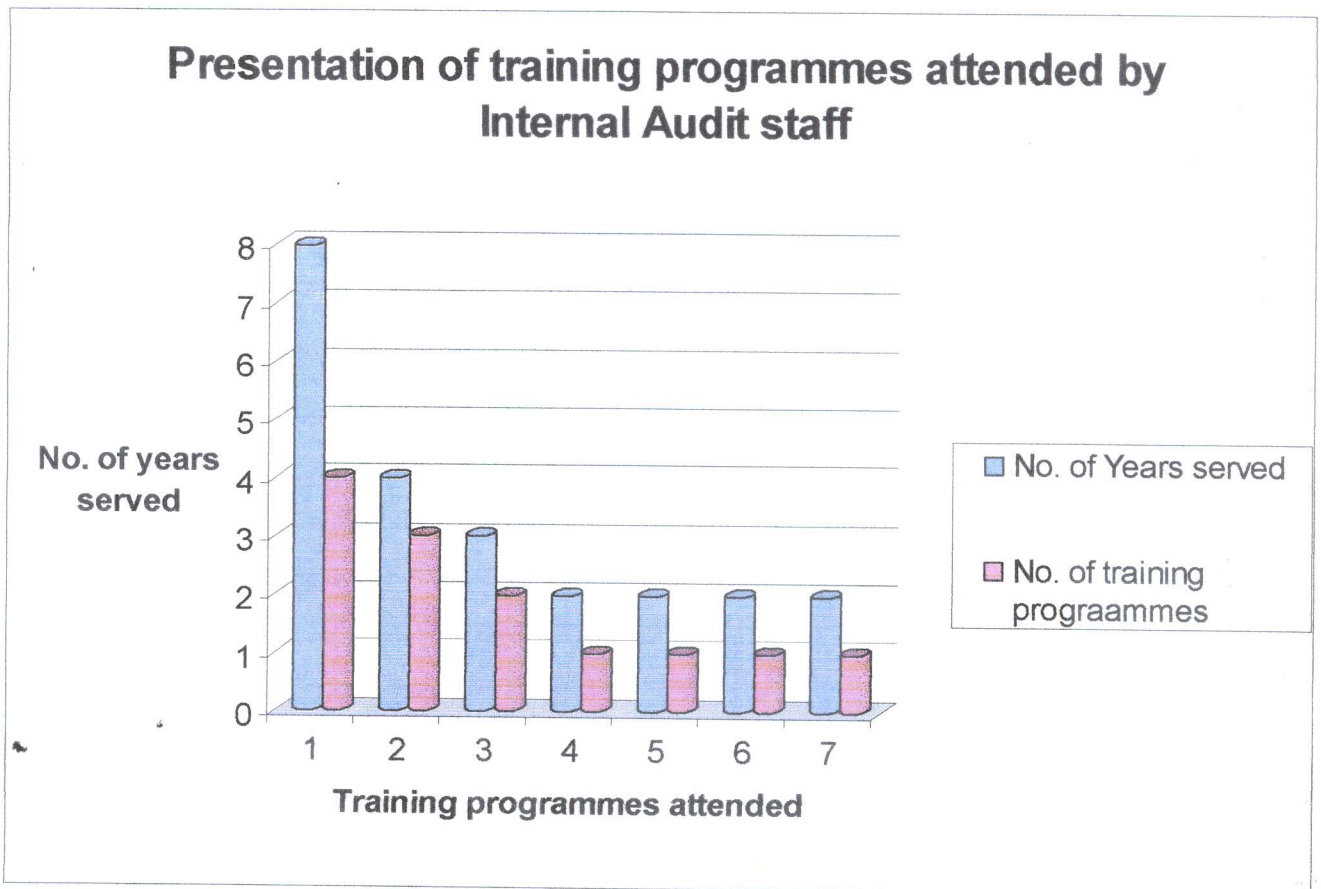


Figure 4.1 above indicates that Internal Auditors attend training programmes not more than twice a year on average which is woefully inadequate.

#### 4.2.4 Hostile Environment

Internal auditors of RCBs work in a very unfriendly environment. Every member in the organization, staff, management and Board of Directors see the Internal Auditor as a “policeman” and automatically becomes his/her enemy. This perception stems from the fact that the concept of internal auditing is not well understood by Board of Directors,

management and the entire staff of rural banks. Management, Board and Audit Committee members nurture and glorify this hostility by humiliating, embarrassing and threatening the Internal Auditor for issuing an Audit Report sometimes before staff members.

There has always been dichotomy, conflicts and misunderstanding between Internal Auditors and operational staff. Internal Auditors have been receiving unpleasant words and insults from operational staff just because the auditor reports on their works. This unprofessional practice has the tendency of demoralising the internal auditor to work assiduously to the utmost benefit of their banks.

#### **4.2.5 Non Existence of Policy Manuals**

RCBs are characterised by non existence of well documented policy manuals and internal controls whose operation the Internal Auditor is to appraise. The Internal Auditor is professionally required to ensure compliance to internal control policies established by management, therefore, where they are not in existence or are not well known to all staff, virtually there is nothing there for him to enforce. This constitutes lack of tools for the auditor and therefore ends up not being able to defend his position and changes because there is no basis to the changes he recommends. This challenge also accounts for disparity in operations of various branches of the bank. Thus, every Branch Manager operates his/her branch the way he/she deems favourable.

#### **4.2.6 Poor Placement and Recognition of the Internal Auditor**

The internal auditor's position is supposed to be a senior management position. In a situation where the internal auditor is not properly placed and given the required recognition which they deserve by the nature of their jobs, there is always a big question mark on their independence.

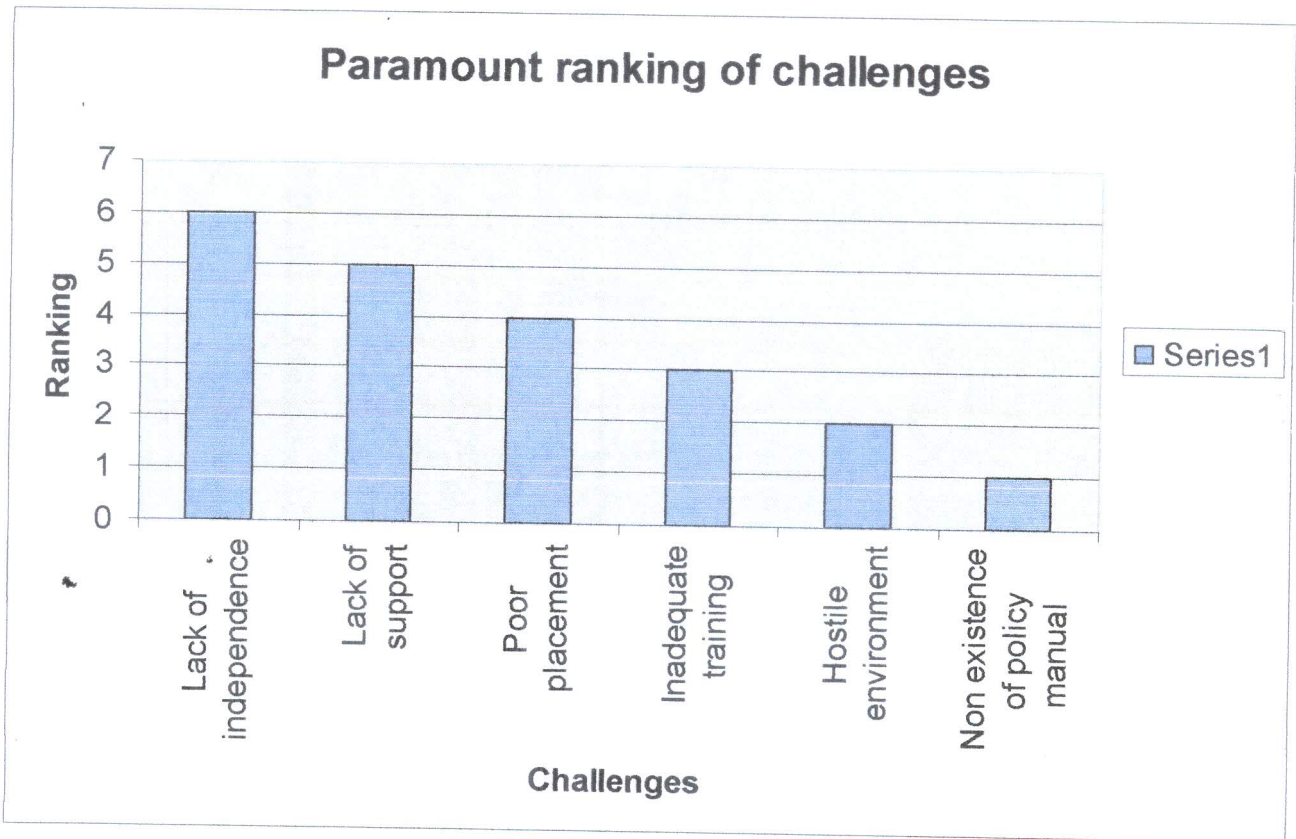
In most cases, RCBs place their internal audit staff with the exception of the head, on a lower or junior staff rank and as a result are not recognised and regarded by the Board, Management, Branch Managers, other senior staff, and even other junior staff who are on

a higher rank than the Internal Auditor. As a result, his recommendations and advice are not seriously taken.

### 4.3 Other Relevant Findings and Analysis

In the quest by the study to rank the challenges in their order of paramount, the following results were obtained.

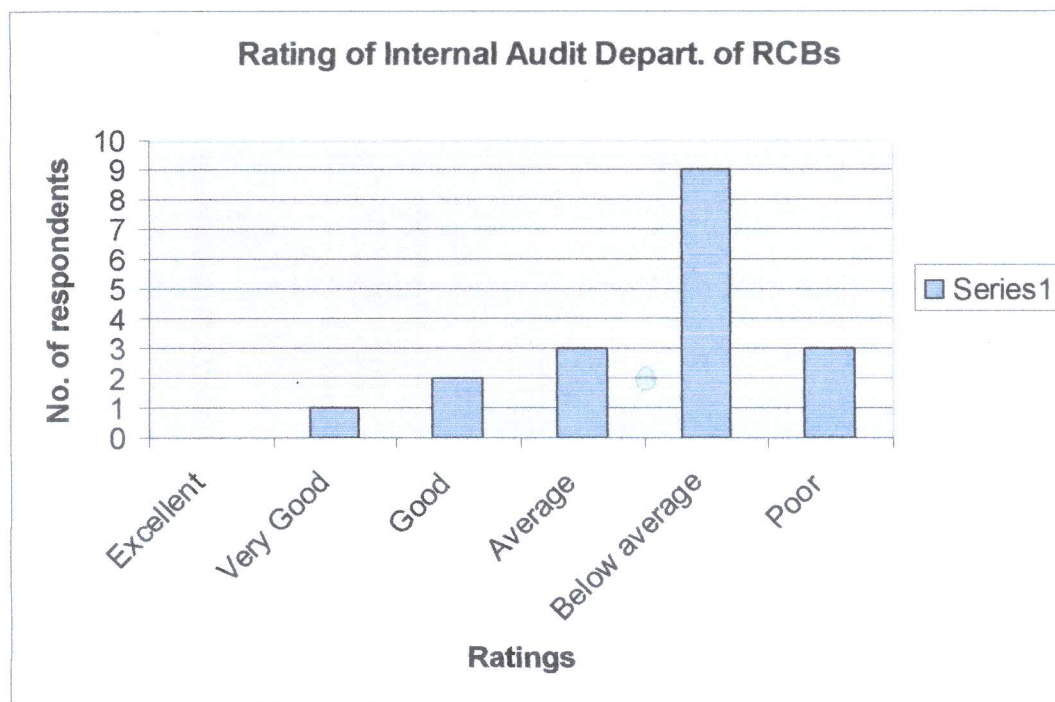
Fig. 4.2 (a graph presenting paramount ranking of challenges facing Internal Auditors of RCBs)



The above graph gives an indication that the most paramount challenge that confront Internal Auditors in lack of independence and the being non existence of policies.

In testing the overall effectiveness and performance of the internal audit departments of RCBs, respondents were asked to rate effectiveness and performance of the internal audit departments. The result is presented in a graph below.

Fig. 4.3 (a bar graph showing rating of effectiveness and performance of internal audit departments)



From Fig. 4.3 above, a conclusion is drawn that the performance and the effectiveness of internal audit units of RCBs is rated below average.

Further more, 100% of the Internal Auditors who were interviewed and given questionnaire confessed that they strongly wish to be transferred from the department and that they will resign if circumstances tend to worse. 80% of non Internal Auditors also responded that they would never want to work in internal audit units of RCB and that they will resign if circumstances tend to be worse.

#### 4.4 Challenges Confronting Internal Controls

Relentless effort by the researcher to find out challenges confronting internal controls of RCBs, the table below presents the findings obtained.



**Table 4.3 (a table outlining response on challenges to internal controls of RCBs)**

<b>Challenge</b>	<b>Percentage (%) of Respondents</b>
Override of internal control by Board and Mgt.	80
Resistance to change	22
Non appreciation of relevance of internal controls	22
Human factor	61

The identified challenges to internal control systems have been analysed and discussed below.

#### **4.4.1 Override of Internal Controls by Board and Management**

Internal control systems as established are expected to be adhered to by members of Board, all staff and even to ensure that customers are guided to adhere. Board and management, having instituted these controls are expected to observe them strictly so as to serve as an example to all and sundry within the organization. This is not so with RCBs where Board and Management continually flout internal control systems. For instance, major contracts for construction of buildings and renovations awarded are not covered by sufficient documents. Other staff members therefore find it more comfortable violating internal controls since those in authorities have been doing the same.

This practice does not augur well for maintenance of effective internal control systems because the purpose for establishing these control systems becomes defeated. Consequently, cases of fraud and irregularities become rampant in the organization.

#### **4.4.2 Resistance to Change**

Internal controls in order to counter, more effectively, the growing dimension of fraud risk that faces traditional internal controls, it is necessary to re-look the business systems culture and build proactive response initiatives of employees against fraud signals. In other words, for internal control systems to effectively deal with current trend of fraud should be modified regularly to feature more proactive elements by management, sometimes based on Internal Auditor's recommendations.

However, for unexplained reasons about 85% of staffs and management of RCBs find it very difficult to adjust to any changes that seek to strengthen internal control systems. Thus, members of RCBs are not receptive to change, so that they will embrace new effective control elements. Instead, they find it more convenient and comfortable in the old systems of operation, which in most cases are outmoded. Good business culture, values and behaviour of staff also add strength to systems of internal controls; however, it is almost impossible to change the business environment, culture, values and behaviour of staff of RCBs. These therefore, leave internal control systems porous and weak, hence could not achieve its intended purpose.

#### **4.4.3 Non Appreciation of Relevance of Internal Controls**

Internal control systems, however comprehensive they are, must also be handled by people who really understand and appreciate their relevance. On the contrary, this research has proved that about 85% of staff, management, Audit Committee members and Board of RCBs lack or has insufficient knowledge and appreciation of the relevance of internal control systems, audit operations and rather see controls as impediments. Consequently, internal controls, even though may be strong in itself, might not be effectual due to the calibre of personnel who operate them.

#### **4.4.4 Human Factor**

No internal control system however elaborate and comprehensive can by itself guarantee efficient administration and reliability of records, or can it be a proof against fraudulent collusion on the part of those holding positions of authority or trust. For instance, internal controls which depend on separation of duties can be avoided or defeated by collusion of those involved. Authorisations controls can also be abused by the person say a senior official in whom authority is vested. All these are human factors or elements that limit the effectiveness of internal controls. These factors are indeed difficult to deal with since they involve changing of ones moral behaviour and attitude.

#### 4.5 Ranking of Internal Control Limitations/ Challenges

Challenges on internal control systems were ranked in order of paramount by respondents. The results have been presented in the diagram below.

**Fig. 4.4 (a pyramid depicting ranking of internal control challenges of RCBs on order of supremacy)**

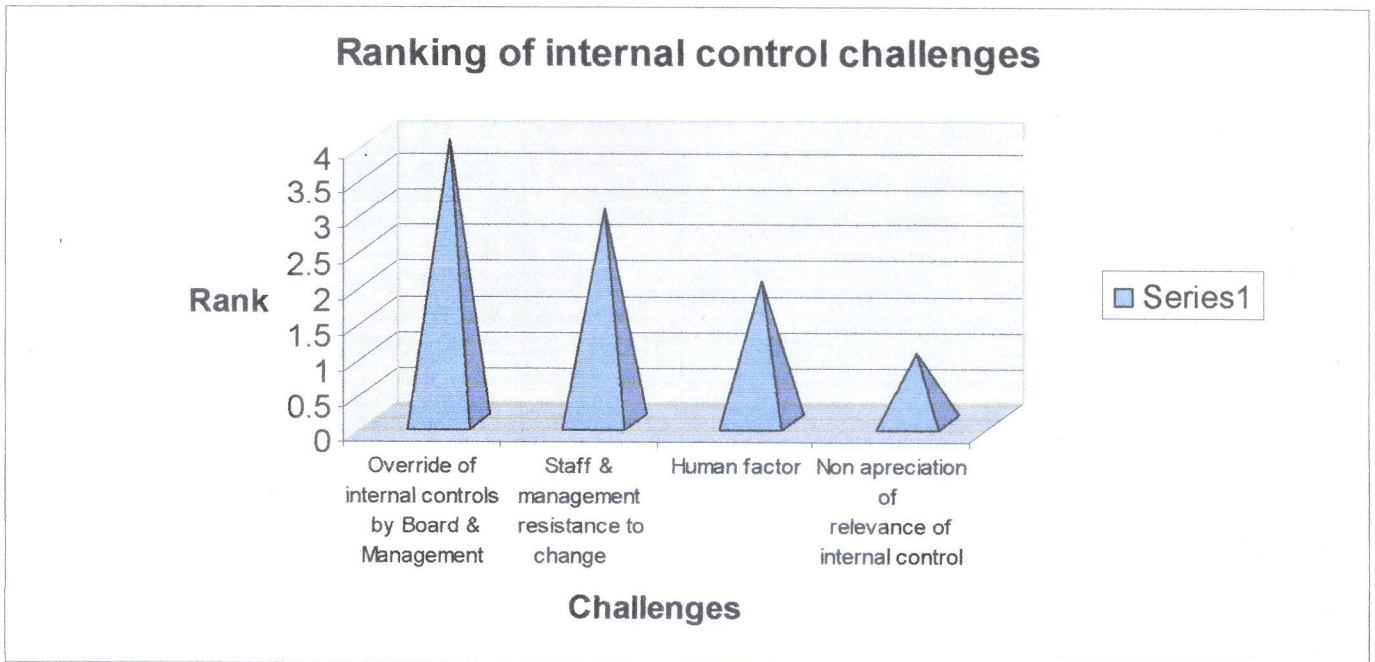
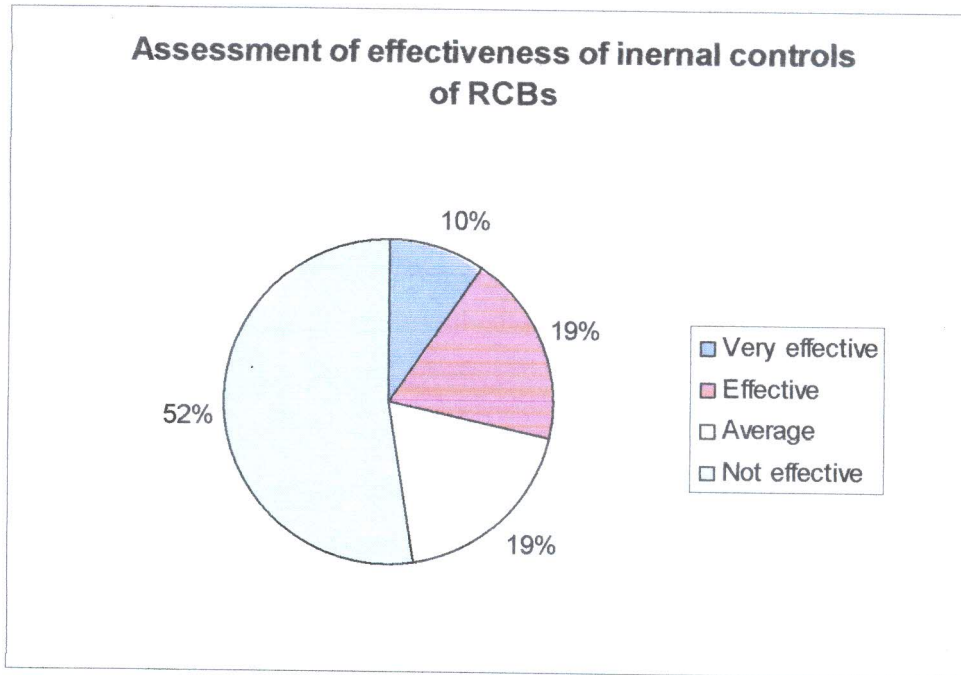


Fig. 4.4 indicates that override of internal controls by Board and Management ranks supreme to the other challenges and non appreciation of relevance of internal control systems being the least.

Respondents view on the soundness and adequacy of internal controls of RCBs are presented in the diagram below.

Fig. 4.5 (a pie chart showing the assessment of effectiveness and soundness of internal controls)



Internal control systems of RCBs were adjudged to be ineffective as indicated in Fig. 4.5 above.

## **CHAPTER FIVE**

### **SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

#### **5.1 Summary of Findings**

The objectives of the study as outlined in chapter one, is to make the internal audit profession in RCBs and internal controls as effective and efficient as possible towards the achievement of organisational objectives by identifying the main challenges confronting internal audit and internal control, analyse them and recommend ways of making internal auditing and internal control work effectively and efficiently.

From the findings and discussions in chapter four above, it is indisputably evident that internal auditors of RCBs are faced with various degrees of challenges. Among the challenges, lack of independence was ranked the most paramount and non existence of operational policies (Fig.4.2). Limitations / challenges were also identified to be confronting internal control systems. Override of internal controls by Board and Management was graded the most supreme (Fig.4.4).

The overall effectiveness and performance of internal audit departments of RCBs was rated below average (Fig. 4.3). This is due to the encumbrances in their ways as detailed in chapter four. Internal control systems of RCBs were also adjudged ineffective (Fig. 4.5).

#### **5.2 Conclusions**

Internal Audit and internal control are very much important as far as effective and efficient running of a company and safeguarding of assets are concerned. RCBs are characterised by relative small asset base, low competency level and poor calibre of majority of staff, poor attitude towards work, corporate governance system and other challenges faced by them. They therefore need adequate, sound and effective internal control systems and internal audit function for quality assurance. Failure to have these systems instituted undoubtedly calls for misappropriation of cash, inefficient use of

assets, frauds and other irregularities. These practices have been responsible for the collapse and low growth rate of RCBs.

I will therefore conclude base on the findings that internal audit and internal control in RCBs had not been adequate, sound and effective enough to cope with current dynamic and challenging Rural Banking environment. This is accounted for by Internal Auditors inability to assess the effectiveness and soundness of internal control and recommend better ways of strengthening internal controls as a result of challenges faced by them. Board of Directors and Management should therefore endeavour to make the work of Internal Auditors challenge free by implementing the recommendations below.

### **5.3 Recommendations**

One of the objectives of this study is to recommend possible ways of curbing the challenges and making internal auditing and internal controls work effective and efficient. The following recommendations are therefore made to help revamp internal audit function in RCBs when implemented.

RCBs should have on their board more qualified and competent members with knowledge and experience in Accounting, Banking and Finance, Management, Economics etc., by co-opting members who are not executives. This does not allow for cross-fertilization of ideas.

The Board should also put in place an effective policy to cover all operations of their banks. Additionally, these policies must be made handy to all members of staff for effective adherence.

Internal audit departments must be independent in their operations. Board and Management of RCBs should endeavour to avoid interference in the work of Internal Auditors unduly.

Internal audit staff should be trained on basic principles and practices of internal auditing in RCBs and in line with the bank's corporate objectives. Education on best Banking practices should also be given them. Management should not be left out as far as training on internal audit and internal controls are concerned. The training should also equip them on best are effective Banking practices.

Board of Directors should act decisively on internal audit reports. They should be fair and dispassionate in the implementation of recommendations of Internal Auditors.

Board and Management should establish sanctions for control breaches and must be communicated to all staff. Moreover, these sanctions must not just remain on paper but must be firmly implemented on anyone who flouts internal control without exception. This will deter other staff from committing similar offences.

Staff recruitment should emphasis on competence other than favouritism. Recruitment procedures should be strengthened to select the best candidate in terms of competency, moral character, and other relevant factors.

In order to strengthen internal control systems, Board and Management should lead exemplary life by adhering to internal controls. This will send a strong signal to staff on the importance placed on adherence to internal controls by them.

Management and Staff should be trained to adapt to changes as a learning process. The habit of resisting change should be distilled from Staff and Management through training so as to embrace changes to internal controls smoothly.

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**APPENDIX**

**CHRISTIAN SERVICE UNIVERSITY COLLEGE, KUMASI  
QUESTIONNAIRE**

**Prepared By: Michael Aidoo**

This questionnaire is designed to collect data or information for academic research work on the topic “Internal Audit and Internal Control, Challenges and the way forward”. Case study of Sekyere Rural Bank

You are assured that whatever information to be provided will be treated **highly confidential**, and this accounts for exclusion of personal details of respondents. Therefore, respondents are requested to willingly provide information that reflects the true situation on ground. Questions 2 and 3 should not be responded by non- internal audit staff.

(1) How many years of rural banking experience do you have? .....

(2) How many years have you worked with the internal audit department?  
.....

(3) What are your job duties as an Internal Auditor of a Rural Bank? [Please be brief]  
.....  
.....  
.....  
.....

(4) What are the challenges that confront internal auditors of RCBs.?

Please tick as appropriate

- i. Inadequate training [    ]
- ii. Non existence of operational policies [    ]
- iii. Lack of support from Board and Management [    ]
- iv. Lack of independence [    ]

Others [Please specify]

- v.....
- vi.....
- vii.....

(5) Please rank the challenges stated above in order of magnitude with one (1) being the most serious and in that order.

- 1.....
- 2.....
- 3.....
- 4.....
- 5.....
- 6.....
- 7.....

(6) What do you suggest can be done to mitigate or eliminate these challenges?

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(7) How would you rate the overall effectiveness / performance of the internal audit department?

- (a) Excellent [    ]
- (b) Very Good [    ]
- (C) Good [    ]
- (d) Average [    ]
- (e) Below Average [    ]
- (f) Poor [    ]
- (g) Other [Please specify] .....

(8) Are there internal controls in existence at all? Yes [    ]      No [    ]

(9) How would you assess the soundness and effectiveness of the internal control systems? *(Please tick.)*

- (a) Very effective [    ]
- (b) Effective [    ]
- (c) Average [    ]
- (d) Not effective [    ]
- (e) Other [Please specify] .....

(10) How would you rate adherence to internal controls systems out of 100%? .....

(11) What are the limitations to / challenges facing internal control systems?

- 1. Resistance to change [    ]
- 2. Override of internal controls by Board and Management [    ]
- 3. Human factor [    ]

Others [Please specify]

- 4.....
- 5.....
- 6.....

(12) How would you rank the above challenges according to their magnitude with one being the highest?

- 1.....

- 2.....
- 3.....
- 4.....
- 5.....
- 6.....

(13) What do you suggest could be done to enhance effective internal control?

- 1. Operational policies and manuals must be in place and be made handy [    ]
- 2. Adequate training on internal controls must be given to members of staff [    ]
- 3. Internal controls must be observed by Board and Management [    ]

Others [Please specify]

- 4.....
- 5.....
- 6.....

(14) Any further comments.

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