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The Role of Internal Audit Quality to the Sustainability and Success of Microfinance Program

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ABSTRACT

Microfinance institutions are the main source of finance for the poor and the women in many country, therefore the sustainability of these companies is a concern, but that cannot be achieved without proper internal control mechanism to detect any attempt frauds that could harm the operations of microfinance institutions. The research will used literature review method by digging into previous researches to see the main courses of the failure of many microfinance institutions. The research found out that most of the microfinance institution failed due to inadequate control in place to detect malfunctions or fraud at the earlier stages that can safeguard the operations of microfinance institutions.

Keywords*: Internal, Audit, Sustainability, Microfinance, Loan Programs*

INTRODUCTION

In the overall framework of risk management, internal audit is a very important feature. Internal audit services can be divided into three groups, referring to three broad internal control objectives: financial control, compliance and operational control.(The SEEP Network 2011). The Institute of Internal Auditors (IIA), the international regulatory body for internal auditors, offers internal audit functions with a degree of uniformity and continuity. The Institute of Internal Auditors (IIA) sets out general guidelines for the conduct of internal audits and acts as an instructional and information source. Both internal audits are carried out in conjunction with the International Auditing Practices of private organizations, such as savings and loan firms (IAS). The history of the IIA is closely connected with the establishment, growth, and evolution of today's internal auditing profession.

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The internal audit profession appears primed for continued dynamic development for the last sixty (60) years and aims to become a profession for the twenty-first (21st) century. Over the last 60 years, this global expansion, continued importance and growing presence and acknowledgement of the IIA and the internal auditing profession reflects remarkable growth and development. Auditing, whether external or internal audit, provides independent checks to eliminate record keeping mistakes, asset misappropriation and business fraud, and this function of audit goes back to times scarcely less remote than that of accounting (Obeng 2016). It must also be remembered, however, that while internal audit is a vital function and an essential risk management department, it is not enough to have the internal audit department handle all risks alone. Many MFIs have this misplaced perception that one has handled the majority of its risk by getting an internal audit department. For all the debates, however, I want to completely understand that this is not true and risk management or overall internal control is a much larger job and internal Audits are only a part of it. Nonetheless, it is not necessary to create an internal audit role in MFIs, but internal audit functions should be successful to the degree that they contribute to achieving the overall organizational objective. Internal auditing does not only act as the main and initial objective of the oversight of internal and financial control structures and making management recommendations to management as its primary and initial focus but should be effective to contribute to the achievement of organizational profitability.

An internal audit is an independent verification of the MFI's results. The definitions of 'independent' are very important to comprehend here. Internal audit must be a fully autonomous, operational-free feature. Freedom is assured by providing a completely independent team of workers and the department reporting directly to either the board of directors or the head of the company. It is necessary to keep the audit department autonomous for an impartial evaluation of the company. Therefore, freedom and objectivity are keys to this feature. The concept behind Internal Audit is not just to catch fraud or malpractice, but more proactive, i.e. by minimizing the possibilities of malpractice, to add value and effectiveness inside the company. Internal Audit is done by a specialized Internal Audit team who should be very well versed with the organization’s policies and procedures.

Magnitude of other workers involved in it to recognize any fraud or misappropriation regardless of its scale. To recognize any employee malpractice, collusion or behavior that is against the organizational policies/culture or may cause the institution to disagree. To see if all levels are adhered to operational policies/processes and to identify anomalies To check unethical employee conduct and to get a sense of organizational image as viewed by customers To verify the accuracy of reports, MIS and Accounting, the accuracy of records kept by checking evidence such as receipts, including records retained at customer level in the form of passbook. Providing feedback/opinion on organizational threats, such as employee discontent, inadequate strategies for competitiveness or areas of possible conflict. The significance of internal audit in the sustainability of microfinance by providing the historical context of both. Traditionally, commercial banks lend to medium and large companies that are judged to be creditworthy.

Since the associated costs and risks are perceived to be comparatively high, they avoid doing business with the poor and their micro enterprises. Consequently, microfinance institutions (MFIs) have been the primary source of financing for micro-enterprises in Africa and other developing regions. The goal of this study is to evaluate the role of internal audit in microfinance's success. The purpose of this study will be to collect and review various literature that would provide a basis for the development of appropriate control policy, regulatory and supervisory structures for MFI operations and to identify the important role of quality internal audit in these institutions. Training and development should be continued by the management of microfinance institutions, especially privately owned ones, so that these internal auditors are regularly trained by experts within their workplace. Internal auditing is a catalyst for improving the structure of corporate governance, risk control and management by offering input and feedback based on research and assessments of previous literatures and business processes.

LITERATURE REVIEW

2.1 Definition and Relevance of Internal Audit

An overarching concept of internal audit has been provided by the Institute of Internal Auditors (IIA), which influences the organizational prominence of internal audit. IIA (2011) describes internal audit as "Internal auditing is an independent, objective assurance and consulting activity aimed at adding value and enhancing the operations of an organization." By bringing a structured, disciplined approach to evaluating and enhancing the efficacy of risk management, control and governance systems, it helps an organization achieve its goals. This concept has extended the role and responsibility of internal audit in the value creation process of an organization. Recently, the importance of internal audit roles in organizational environments cannot be overlooked. The pace of organizational expansion, coupled with the growth of internal control system complexity, has made it necessary for organizations to develop internal audit functions. Prawitt, Smith, and Wood (2009), recognize the fact that the internal audit functions have gained impressive recognition as an important contributor to efficient corporate governance and financial reporting as a result of the rise in accounting scandals in recent years, as a high-quality internal audit feature focused on enhancing financial reporting by ensuring compliance with standards. In light of this, several internal audit study studies were performed until recently when the Institute of Internal Auditors (IIA) caused a paradigm shift in the value of the internal audit role by defining the audit efficiency and achievement of organizational objectives.

2.2 Effectiveness of Internal Audit

Many research studies on the factors influencing audit performance and how audit effectiveness contributes to the achievement of organizational goals, especially in the public sector, have led to this new phase of internal audit functions. BADARA and SAIDIN (2013), According to this fact, the importance of internal audit in an organizational environment, in particular with regard to organizational goal achievement, enables different researchers to continue to display concern about its functioning. BADARA and SAIDIN (2013) Risk management, an efficient internal control structure, audit expertise, collaboration between internal and external auditors and performance management are proposed as factors affecting the efficacy of internal audits. They concluded that the reasons or histories they proposed had a substantial impact on the internal audit effectiveness of local governments in Nigeria. Despite the fact that their studies have contributed to awareness in the field of internal audit effectiveness, it is not possible to generalize their results in any company to be the same. Their results are restricted only to the world of the public sector, that is, local government, and cannot be extended in the sense of the private sector.

According to Hung and Han (1998), An empirical study was also conducted on the effectiveness of the internal auditor in Taiwan, generating three factors affecting the effectiveness of the internal audit: management perception of the internal audit function; factors affecting the perception of the head of the auditing department regarding the effectiveness of the internal audit; and the latter being factors affecting the progress of the annual audit plan. They concluded that the factors that affect the perception of internal audit effectiveness are the management attitude, the attitude of the controller, and the possibility of promotion of the internal auditor, the execution of performance assessment, the establishment of job description, and the preparation and technical skills of the internal auditor. Internal auditor's technical skills, the combination of organizational formalization and professional skills are the factors that affect the understanding of internal audit efficacy by the head of the auditing department, and a combination of all these factors will also affect the success of the annual audit plan. Another empirical study was conducted by Ramachandran Asst Professor, Subramanian, and John Kisoka 2012, Muhammed 2018). The results were that the risk management and corporate governance of internal auditors' related activities were merely integrated as contractual responsibilities and did not provide stakeholders with added value. They also provided findings that provide a strong understanding of the theory of the organization, which clarifies the relationship between the owner and the agent by emphasizing the degree of the degree of independence the internal auditors must have in Tanzanian commercial banks. They noted that the low independence of internal auditors in Tanzanian commercial banks is a challenge to the relationship between the owner and the agency. The low response received from the Tanzanian commercial banks was the constraint of this report. They admitted that the results may have altered a broader response.

According to Ibironke and Elewor (2020) it explores the role of internal auditing in Nigeria's financial institutions. In her study, she described the importance of internal audit in financial institutions and the degree to which the function of internal audit has contributed to the overall success of organizations. Analyzing the information obtained from both primary and secondary sources, they found that the internal audit department performs different roles, which consist primarily of ensuring that staff generate accurate and reliable reports, limiting organizational inefficiency, and preventing misappropriation of funds. The researcher was also of the opinion that, if the internal audit of the financial organization is defined, By eliminating fraud and extravagant use of funds and inducing staff to provide full and reliable information, this will contribute enormously to the overall success of these organizations.

RESEARCH METHOD

Centered on a conceptual analysis approach, this paper is qualitative in nature. Conceptual research is called a research technique in which research is carried out by the study and interpretation of data already available on a specific subject (Kothari, 2002). Conceptual analysis doesn't even include any realistic tests being reviewed. It has to do with concepts and ideas which are abstract. In order to formulate new ideas or view current theories in a different way, philosophers have long been using philosophical analysis.

In order to compare and contrast the findings of these publications in a holistic way, data is obtained from different research journals and idea papers from different journals.

A conceptual research methodology gives researchers the best idea of how to do the research and interpret the data gained from previous research papers (Blumberg, Cooper, and Schindler 2011). The goals set out in the preceding sections of this concept paper are directly related to the methods of study outlined in this section. The approach for this paper is condensed and summarized in order to serve as a general context for the methods to be used.

DISCUSSION

In this chapter, I will address previous studies conducted specifically in sub-Saharan Africa on this similar topic. According to Pavković, Mlinarić, and Dolinar (2014), Over the last two decades, bank and financial failures and widespread losses have increased the value of successful risk management and internal audit of the formal financial sector worldwide. To predict and explain the efficacy of internal auditing, a number of individual theories have been developed, including communication theory, structuring theory, institutional theory and agency theory Narkchai and Fadzil (2017). The theory of communication suggests that the efficiency of the internal audit depends primarily on the communication skills possessed by internal auditors. The theory of structuring suggests that the key structural properties required to understand the relationships between social behaviors, including accounting and auditing, are culture, power and morality. Institutional theory assumes that internal audit practices are ultimately established by institutional standards, which, in turn, describe the institutional improvements necessary to strengthen current internal audit practices. The theory of the department, which has been widely used to justify the efficacy and motivate the internal audit mechanism for an efficient risk management role (OKARO et al. 2017). Bank collapse, for example, rose to 200 percent in the United States of America in 1980 due to both fraud and mismanagement. The literature demonstrates that, according to Musah, Gapketor, and Anokye (2019) Internal auditing was carried out in a rudimentary way in both private and state-owned institutions prior to the 1980s. As referenced in OKARO et al. (2017) It argues that internal audits have largely been focused on compliance, along with institutional financial rules, protocols and vindicating the existence of physical properties, also in private entities. Dittenhofer (2001)and Getie Mihret, James, and Mula (2010)as cited in Coram, Ferguson, and Moroney (2008) It claimed that internal auditing in both the private and public sectors is emerging as an essential component of management and a governance mechanism. However, Mustika (2015) It stated that the reliability of the internal audit function is significantly important, particularly for private organizations, as most stakeholders are the most reliable. World Economic Forum (WEF) et al.(2018) and Tazilah and Hussain (2015), Internal audits of organizations are severely intertwined with the corporate leadership systems used to manage, organize and guide the institution's everyday business or relations.

The internal audit role is an autonomous, objective assurance and consultancy practice designed to add value and enhance the effectiveness and protection of the activities of an MFI (The SEEP Network 2011). The mindset of the agency being audited is closely connected to the performance or failure of the internal audit. However, very few variables had major impacts on the perception of results by the audited department manager. All businesses must also review their performance appraisal metrics, the content and strategies of using job descriptions, and education and training.(Hung and Han 1998).

CONCLUSION

The purpose of the analysis is to test the degree of impact of the factors influencing the efficacy of the internal audit on fraud detection in microfinance institutions. Internal audit effectiveness is influenced by the technical competence and independence of the internal auditor, which in turn affects the proper control structure. In collecting data from various studies, literature from several previous studies was used in gathering data from different research work. The results indicate that in the prevention and identification of fraud in microfinance institutions, the professional competence and independence of the internal auditor have a significant impact. The findings of many studies indicate from the study that the greater the internal audit, the better the fraud detection or prevention by microfinance institutions. The study suggested that MFIs should develop the technical skills and independence of their internal audit workers by arranging, within a defined period of time, training programmers and providing them with access to information whenever they need it. In order to improve audit expertise and turn over internal auditors, MFIs should do well to retain their internal audit personnel for a longer time. The organizational climate suggests that with top-level management, the internal auditor is in a higher hierarchy; thus, resources should be allocated to the internal audit department to cater for the auditor's work more effectively.

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