Internal auditing standards and its practice the case of East Arsi Zone, Ethiopia

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Abstract
The purpose of the study was to investigate how major internal audit standards are applied in the internal audit departments of selected public enterprises in East Arsi Zone, Ethiopia. Accordingly competency, compliance, Independency, Risk management and quality assurance has been taken as major parameters for comparison. 36 Questionnaires were distributed for the target population. Questionnaires were designed to measure the level of agreement of the respondents on the applicability of each parameter. The result shows competency in terms of educational level, background and experience is in line with the standards. Though majority of the respondents are agreed that they are working as per internal auditing standards, a number of auditors don’t agree on the compliance. Auditors also responded that their independency is impaired because most of the time they are attached with internal functional areas.

Keywords: IIA (Institute of Internal auditing), Internal auditing standard, internal audit practices

INTRODUCTION

The issuance of Ministry of Finance directives in 1942, which focused on public sector fund utilization, marked the development of modern auditing in Ethiopia (Kinfu, 1990). The formation of the Office of the Auditor General in 1961 (Government of Ethiopia, 1961) with subsequent refinements of duties and responsibilities in 1979 (Government of Ethiopia, 1979) and 1987 (Government of Ethiopia, 1987) was another significant development in public sector auditing in the country.

The Office of the Auditor General undertakes external audits of government ministries and their respective offices to ensure accountability. Public sector organizations are also required to have internal audit functions to support effective management. The Ministry of Finance and Economic Development has the authority to issue internal audit manuals for use by all organizations that are wholly or partially financed by the government budget (Government of Ethiopia, 1996). The Ministry has issued a manual that contains a code of ethics for internal auditors and procedural guidance on the conduct of audits (Ministry of Finance and Economic Development, 2004).

Internal audit standards of the Ethiopian Government, specified in the manual, closely match those published by the IIA.

As a result of changes in organizational needs, technology and complexity of organizations’ activities and systems, the nature of the services sought from the internal auditors has been transforming over the years from an emphasis on traditional/compliance audit where independence has been the core paradigm, to a value-adding role where partnering with management is
accorded greater significance (Desalegn and Getachew, 2008).

In recent years, researchers and practitioners have widely discussed the need for internal auditors of adding more value to their companies’ operations, and contributing to the achievement of corporate objectives. This new perspective has focused increasing attention on issues such as performance evaluation and effectiveness of internal auditing. Several parties advocated the need to assess internal auditing (IA) effectiveness, though, at present, there is not a shared framework of reference to this scope. Recently, (Sarens 2009) have raised the question “when can we talk about an effective IA function?” in his editorial about future perspectives of IA research. Looking at the existing literature, there are many possible answers to this question. Different authors have related IA effectiveness to different issues, focusing on IA processes, outputs and outcomes (Marika and Giovanni, 2004).

According to the Institute of Internal Auditors (IIA), internal auditing reviews the reliability and integrity of information, compliance with policies and regulations, the safeguarding of assets, the economic and efficient use of resources, and established operational goals and objectives. Internal audits encompass financial activities and operations including systems, production, engineering, marketing and human resources (Rupsys, 2005). In addition, the internal audit service is currently being considered as a good contributor to corporate governance. Recently, in developing countries, there has been increased interest and more emphasis is placed on the IAF (Internal Audit Function) as one tool to crisis prevention and enhancing good governance system of the public sector (Zeleke, 2007).

In 1991, OAG conducted a brief survey of internal auditing in ministries, commissions, agencies, and public enterprises. Established internal audit units were found in more than 70 percent of the budgetary institutions and 90 percent of public enterprises surveyed. The survey also revealed that most internal audit functions considered their responsibilities in broad terms. Internal auditors wanted to help the organization safeguard its financial assets and property from embezzlement, theft, and other losses, and they saw the need to perform additional functions outside those traditional responsibilities (Welde-Ruphael, 1998).

Following this, the aim of this study is to conduct an assessment on the internal audit practices with special emphasis on reporting relationships, role of the internal audit function in corporate governance, the scope and independence of internal audit function (service), the challenges, the internal audit practice faced and recommends suitable solutions to the problems.

Review of related literature

In the past, internal auditing was defined as an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization. This statement is more an introduction than a definition. It tells little about what internal auditors are responsible for.

We will have to look further for a definition that embodies the broad, unrestricted scope of professional internal auditing (Lawrence B. Sawyer, 1988).

Accordingly, the new Institute of Internal Auditors (IIA) definition of internal audit is as follows: Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

This definition states that scope of internal auditors is assurance and consulting activity. Assurance services involve the internal auditor’s objective assessment of evidence to provide an independent opinion or conclusions regarding an entity, operation, function, process, system or other subject matter. The nature and scope of the assurance engagement are determined by the internal auditor. Consulting services are advisory in nature, and are generally performed at the specific request of an engagement client. The nature and scope of the consulting engagement are subject to agreement with the engagement client. When performing consulting services the internal auditor should maintain objectivity and not assume management responsibility. However, the work of the auditor is so much bounded up with the detection of fraud with the minimum of delay is a matter of great importance, the efficiency of an internal audit department, however, is sometimes judged by the number of defalcation it uncovers (Waldron, 1980).

Internal audit is a long-standing function and an effective tool of management in many organizations. It has been a recognized component of organizations in both the public and private sectors and in most industries for many years. Internal auditing is often seen as an overall monitoring activity with responsibility to management for assessing the effectiveness of control procedures which are the responsibility of other functional managers. The internal audit function is not limited to the operation of any particular function within an organization. Rather, it is all-embracing and accordingly
is structured in the organization as a separate entity responsible only to a high level of management.

Internal auditing which is often seen as constituting a large and significant aspect of an organization’s financial control system is a vehicle to success and survival. According to Rittenberg and Schwieger (1997) internal auditing is taking on increased importance in many of today’s global organizations by assisting management in evaluating controls and operations and thereby providing an important element of global control. Venables and Impey (1991) also recognized the control role of internal auditing when they stated: It is generally recognized that the proper organization, staffing and methodology of internal audit presents the board with the best means of focusing on its obligation to ensure proper controls in the business. However, the need for an internal audit function will vary depending on company specific factors.

**History of internal auditing in Ethiopia**

Internal auditing’s importance in Ethiopia was formally recognized in the early 1930s by the country’s first Constitution. This document referred to the proper collection of state revenue and the necessity for procedures to control expenditures. In 1944, another milestone occurred when a proclamation established the Commission for Audit, charged with auditing the Ministry of Finance accounts. The development of state budget practices, an emphasis on fraud deterrence, and growth in trade and industry subsequently added impetus to the growth of the profession (Welde-Ruphael, 1998).

As to Lemma Argaw, the ministry of education, ministry of national defense and the ministry of finance were pioneers in implementing the internal audit practice in Ethiopia. He revealed this fact as follows. ‘An Internal Auditing function has existed for quite a long time in Ethiopia; however, it got legal recognition in late 1980s. The internal auditing function started in the budgetary public sector as part of internal control. However, the latter part of the 1940s witnessed the establishment of Internal Audit functions in the Ministry of National Defense, Ministry of Education, and Ministry of Finance. It was also at this time that the Internal Auditing units began to sprout in non-budgetary public sector (public enterprises) like Ethiopian Highway Authority, Ethiopian Airlines, Ethiopian Telecommunications, and financial sector that formed the modern layer of the National Economy’ (Lemma, 2000). Perhaps the most direct impact on the current status of internal auditing in Ethiopia came from another important document issued in 1987, Proclamation No.13 (Welde-Ruphael, 1998).

Moreover, Proclamation No. 68/1997 requires that, the Federal Democratic Republic of Ethiopia’s (FDRE) new economic policy be supported by a modern and reliable audit system in order to ascertain proper implementation through effective monitoring of administrative, developmental and service rendering institutions in the Federal Public Sector (Zeleke, 2007).

Generally, the history of internal auditing in Ethiopia dated back to the 1940s just about the time the profession was also evolving in Europe and in the United States (Lemma, 2000).

**RESEARCH METHODOLOGY**

**Research design**

To enable the researchers address the objectives of the study, a descriptive research was the preferred choice since it was meant to present a picture of the specific details of a business setting among other things. Since the focus is on an assessment of internal auditing practice in East Arsi zone public enterprises the data collection was restricted to employees of public enterprises in East Arsi zone.

**Data sources and method of data collection**

There are six public enterprises in Arsi Zone; namely The Arsi Zone Agricultural Development Enterprise (AADE), The Asella Mat Factory (AMF), Commercial Bank of Ethiopia - Asella Branch (CBE), The Upper Awash Agro Industry (UAII), The Ethiopian Insurance Corporation, The Ethiopian Electric Power Corporation (EEPCO), and the Ethiopian Telecommunications corporation (ETC). However, the internal auditing in the ETC and EEPCO is conducted at regional levels and the district offices in Asella simply send documents to the head office and the Upper Awash Agro Industry (UAII) becomes privatized. Since then, by excluding these three from the target population 36 questioners are distributed for all target groups. Among the respondents 3 of them were top level managers, 27 Accounts officers, and 6 internal auditors.

**Data analysis**

Descriptive statistical analyses were employed. The processed data was analyzed by using Excel and statistical package for social sciences (SPSS) Version 16.

**RESULT AND DISCUSSION**

**Competency**

According to ISPPIA No.1210, internal auditors should possess the knowledge, skills and other competencies needed to perform their individual responsibilities.

Accordingly, the study revealed that 1 (2.8 percent) of
The respondents was post graduate, 30 (83.0 percent) of the total respondents had a first degree, and 5 (14.2 percent) of them held college diploma qualifications. The majority of respondents were accounting graduates 31 (86.1 percent), which is followed by both management and economics degree 3 (8.3 percent) each and other field of study 2 (5.6 percent) qualifications. A majority of auditors 32 (88 percent) served for 4-7 years and 4 (12 percent) were served 1-3 years as an internal auditor in the enterprises. From the educational level, background and experiences of the respondents it can be conclude that majority of the respondents have attained the required quality of competency.

Compliance

Respondents were asked their level of agreement whether the internal auditing activates in their organization comply with IIAs standards. Of the total respondents 2 (5.6 percent) were strongly disagree, 32 (8 percent), were agree, 2 (5.6 percent), were strongly agree. The above analysis indicated the internal audit activity comply with institute of internal audits. This is show by the graph belloew. Figure 1.

Independency

Respondents were asked to level their agreement about the detachment of internal auditing in their organization from functional areas to guarantee its independence 2(5.6 percent), of the total respondents were neutral, 27(75 percent), were disagreed, 7(19.4 percent), were strongly disagreed. The study revealed the selected public enterprise’s internal auditing is not detached from functional area to guarantee its independence, but according to the standard 1110.A1 - The internal audit activity must be free from interference in determining the scope of internal auditing, performing work, and communicating results. Figure 2.

Risk management

ISPPIA No.2110 requires IAF to extend to enterprise wide risk assessment to result in effective risk management and control systems. The study indicated that the selected public enterprises were plan the internal audit based on the enterprise’s risk profile in order to eliminate or minimize the existing risk in the enterprise.

Quality assurance

According to ISPPA 1300, this program is designed to enable an evaluation of the internal audit activity’s conformance with the Definition of Internal Auditing and the Standards and an evaluation of whether internal
auditors apply the Code of Ethics. The program also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunists for improvement. The responses were asked to level their agreement about the availability of quality assurance. 25 (69.4 percent) were disagree, 9 (25.0 percent) were strongly disagree, 2 (5.6 percent) were neutral. The above analysis indicates that in the enterprises internal auditing has no quality assurance program.

CONCLUSION

In selected public enterprises the Internal Auditing practice has been seen from compliance, independency, and competency risk management and quality assurance points.

All staffs in the internal auditing department of selected public enterprises found to be competent in terms of educational background, qualification and experience. But the size of the IA staff is small due to the wrong perceptions that they are enough for financial and compliance audits. But ideally they are not sufficient.

The scope of the internal audit function in the enterprises surveyed did not yet go far from the traditional practices and much time is devoted in performing financial and compliance audits.

Regarding quality assurance program, none of the respective public enterprises ’audit department has quality assurance programs. Thus, CAE should be able to develop quality assurance programs.

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