
* ACCA INTERNAL AUDIT BULLETIN *
* ISSUE 4 - MAY 2000 *

Information from the ACCA to internal auditors across the world.

The Association of Chartered Certified Accountants (ACCA) is the largest global professional accountancy body, with over 250,000 members and students in more than 140 countries. ACCA's headquarters are in London and it has staffed offices in 25 countries.

This bulletin aims to provide up-to-date news, information and comment from and to internal auditors across the world. The success of the bulletin depends on your contributions. *A set of audit programmes for reviewing financial systems will be sent to all contributors to the next edition.* So please contact us:

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NEWS

Nigeria: Senate passes anti-corruption bill

The Upper House of the Nigerian federal legislature, has passed the anti-corruption bill proposed to it in June 1999 by President Olusegun Obasanjo. However, the version of the bill, which was finally approved by the Senate, contained several significant amendments, including amendments previously made by the Lower House, the House of Representatives in late 1999. In August 1999, Human Rights Law Service (HURILAWS) in collaboration with civil society organisations convened public hearings in Lagos to examine the draft anti-corruption bill. Participating stakeholders from civil society and the legislature identified various defects and lacunae in the bill and generated recommendations to strengthen it. These recommendations were presented to the

National Assembly and were the crux of the HURILAWS testimony at the Senate Judiciary Committee hearings on the anti-corruption bill in November 1999.

Pakistani Experts To Devise Islamic Financial System

Pakistan's military government was expected to appoint a high-powered commission of experts in January to advise on changes needed to make the country's financial system comply with Islamic concepts. The commission would be the first tangible step since the supreme court ordered the government to prepare for removing interest-based transactions, which are considered illegitimate in Islam.

Newly appointed central bank governor Ishrat Hussain said at that the functioning of the country's financial system would remain intact, and that any changes would take place smoothly. "Nothing will change in the year 2001. Then we are going to have the recommendations of the commission, which will lay the ground for future changes," he is quoted as saying.

He said the court ruling carried many aspects which in fact would help Pakistan establish new financial instruments, such as leasing or types of equity participation by depositors known as "musharika", which Islam allows.

South Africa: Firms rank low in corrupt practices

South African companies have scored well in international directors' perceptions of corrupt business practices, according to a 1999 survey by the Industrial Research Bureau. Directors of American and European firms were asked about their perception of the compliance of companies in various countries with non-corrupt practices in securing and commencing business transactions. On the four-point scale, South Africa was given a 2.6 indicating that it has "a generally high standard of compliance with only occasional lapses". The survey also showed that corruption was the single biggest deterrent to investors seeking opportunities offshore. Of the directors surveyed 39 % said corruption had stopped them from engaging in otherwise attractive foreign investment opportunities. John Bray, principal research consultant, attributed the increased sensitivity to corruption to intensified media coverage. "Companies are well aware that a local scandal can affect their reputation", he said. Regarding "grease payments", however, the survey found that companies were less sensitive. While 38% of European companies condoned them, nearly a quarter of US companies does not forbid them.

UK to review the audit and accountability of government

Former KPMG partner Lord Colin Sharman is to head the review of the audit and accountability arrangements for central government, Treasury minister Andrew Smith announced at the end of April. Sharman will look at the audit of performance measures, how they compare to European directives, and the modernising Government agenda.

Smith said: "I am pleased to confirm that Lord Sharman, a former senior partner at KPMG International, has been appointed to lead the review. "This is a great opportunity for Parliament and Government to work together to make sure transparency and accountability go hand in hand with the modernising Government agenda. I look forward to seeing the results of the review later this year."

Financial Times has current series on risk management

The UK based newspaper, the Financial Times, is currently running a 10 part series on risk management. The series aims to provide a comprehensive overview of the subject. It explains the techniques used to identify and measure risk, methods of managing financial and non-financial risk, and investigates emerging areas of risk such as e-commerce and reputation management. The supplements are appearing each Tuesday until 27 June 2000. Summaries of each article and several articles of further reading are posted weekly on www.ftmastering.com/risk

NAO catalogues problems with MOD accounts

The Ministry of Defence accounts (UK) show evidence of misappropriation of funds, overspending and the loss of nearly 30m pounds, according to the annual report from the National Audit Office. As a result Sir John Bourne, head of the NAO, has given a qualified audit opinion.

ACCA strengthens international links with SA Auditor-General

The South African Office of the Auditor-General is poised to begin training staff members towards ACCA qualification, following the recent agreement to set up an Approved Training Scheme. Jan van Schalkwyk, Centre Manager: Training Development in the Office of the Auditor-General, explained that ACCA's status as a global qualification was of great value to the Auditor-General's office. "When we consider the international audits that we carry out such as that on the World Health Organisation and our recent appointment to audit the United Nations, we need individuals who hold international qualifications, those who are able to speak the right 'language' to financial professionals across the globe."

Consultation on Internal Audit in UK Local Government

CIPFA are consulting on the Code of Practice for Internal Audit in Local Government. The Code has been produced in recognition that the original CIPFA publication of 1993 is now in need of updating to reflect the many changes to the organisational world in which internal audit operates. The draft code is available from:

<http://www.cipfa.org.uk/pt/consultations.html>

If you have any comments on this draft to share with other readers please send them to the Bulletin Editor.

Ernst & Young anti-fraud squad guides CBI campaign

Big Five accountancy firm Ernst & Young has joined forces with police and the Confederation of British Industry to combat corporate fraud. The firm's fraud investigations group released a practical guide, "[Fraud: Risk and Prevention](#)", as part of its work with the CBI's "[Partners Against Crime](#)" anti-fraud campaign, which was launched on Friday 24 March by Home Secretary Jack Straw.

The most radical proposal will be for the Metropolitan and City of London police forces to subcontract fraud investigations to "approved organisations" - such as the forensic accounting departments of Big Five firms. The scheme is due to begin on 1 April. Accredited investigators will have to prove they are competent to investigate complex fraud cases, and sign a contract with the police for every individual case they investigate.

The Home Secretary took pains to emphasise that the anti-fraud initiative was not a case of the police contracting-out of investigating fraud cases, nor was it a privatisation of the police by the back-door. Perry Nove, Commissioner of the City of London Police, said: "The difficulties of investigating corporate fraud in ways which are both timely and effective are well rehearsed. The initiative is neither a panacea nor an abrogation of police responsibility, but my judgement is that it will make a beneficial difference in a number of cases and in turn there will be a wider public benefit as the police will be able to move more cases more quickly." The E&Y guide covers practical measures companies can take to protect themselves from fraud, but also emphasises the importance of creating a corporate culture which does not tolerate fraud and encourages the reporting of suspicions.

Fraud: A Significant Business Risk

The European Confederation of Institutes of Internal Auditing (ECIIA) launched a landmark position paper, "The Internal Auditor's Role in the Prevention of Fraud," during its conference at the end of last year.

The position paper sets out the expectations of internal audit and the means by which boards and governing bodies can utilize the audit resource in the fight against fraud and other irregularities. Starting from the premise that fraud is just one of many risks that organizations need to recognize and evaluate, ECIIA promotes a proactive involvement from directors in undertaking an effective risk management process, ensuring that internal control mitigates these risks where appropriate and in using all the resources of the organization to combat fraudulent activity.

According to the ECIIA Chairman Jean-Pierre Garitte, CIA, "Internal auditing is one of the resources which, when deployed effectively, has a pivotal role to play in giving boards assurance that its policies and procedures are being followed. No body or individual can guarantee that fraud will never happen, but the ECIIA strongly believes that internal auditing can make a significant contribution to fraud prevention. It can do this by providing opinions to management on internal control effectiveness and information on leading-edge techniques for fraud detection and risk assessment."

For more information, contact ECIIA Director General Neil Cowan at neilcowan@controlandaudit.demon.co.uk. tel +32-3-232-1782, or fax +1-32-3-226-6802.

Bribery continues due to poor public sector salaries

Corruption among public officials continues to thrive according to a survey released in January this year. The results of the survey, published in January by Transparency International, found that only a quarter of the 779

multinational executives who were surveyed thought that corruption in their country of residence had fallen in the past five years. Thirty-three percent said corruption was rising; the rest said there has been no change or that they were undecided.

The practice of gaining large business contracts through bribery in developing-world markets is most deeply ingrained in the construction, defence, and power industries, where poorly paid public officials have it in their power to make or break many a deal, the survey found. Sixty-five percent of executives interviewed believed that low public sector salaries were the prime cause of corruption. Sixty-three percent said immunity from prosecution also played a part.

Moreover, the story says, corruption may be growing just as international institutions have recognized the damage it does to struggling economies and have sought to combat it. The anti-bribery convention adopted last year by the OECD has had little impact; the survey found that 38 percent of executives had never heard of the pact, and only 19 percent had any sense that international companies were doing anything to spread the word.

The TI report on the survey included a section on "unfair trade practices"-the most frequently mentioned being diplomatic or political pressure. The US, France, and Japan-in that order-were most associated with using tactics such as having their foreign embassies' commercial departments to pursue contracts.

"We are not making a value judgment because a lot of these 'unfair practices' are not illegal," said Frank Vogl of TI. "What we are deeply concerned about is that the perception that the US uses strong diplomatic pressure may be used by other OECD countries to go slow on anti-bribery legislation."

Kenya publishes corruption 'list of shame'.

Kenya's Parliament has published an unprecedented name-and-shame list of corrupt politicians, linking some of President Daniel Arap Moi's closest aides and relatives to graft and scandal, reports Reuters. The report names dozens of the country's leading politicians and civil servants as being responsible for corruption, which has cost the country hundreds of millions of dollars.

Kenya is consistently near the top of international corruption tables, says the story, noting that the IMF and the World Bank suspended aid three years ago because of graft.

Much of the information in the 937 page report is not new, but it is the first time that a parliamentary committee-made up of opposition politicians and ruling party members-has so fully investigated corruption in Kenya. The report goes further in attempting to analyse the causes of high-level corruption and makes recommendations on dealing with individual cases.

It also says all presidential appointees, senior civil servants, judges and members of parliament should be legally obliged to declare their wealth. A final recommendation is that a partial amnesty and pardon be offered to officials who own up to corruption within the next year and pay back stolen money.

Indonesia may fire central bank chief

In January the Indonesian President Abdurrahman Wahid was reported as considering firing central bank governor Sjahril Sabirin, following the release of an audit suggesting that Bank Indonesia may be technically bankrupt. "Considering the current situation in Bank Indonesia, the president has proposed that the [central bank] governor be replaced," Akbar Tanjung, speaker of the lower house of Parliament, was quoted as saying.

The move comes amid growing speculation that Wahid is planning a cabinet reshuffle and an overhaul of the bureaucracy to clean out figures implicated in corrupt business dealings under the past government, the story says. Any attempt to fire Sabirin will also be the first significant test of the central bank since it was transformed into an independent monetary institution last May.

World bank wants good governance in Indonesian

In May the World Bank again called on Indonesian President Abdurrahman Wahid's administration to pursue good governance and anticorruption measures to improve confidence in public institutions and development programs, reports the Jakarta Post. The Bank's country director for Indonesia, Mark Baird, said at a seminar yesterday that the new government was committed to fighting corruption. "But progress has been painfully slow," he said.

Weeding Out Corruption Not A Lost Cause

The cause of corporate governance in Asia received a big boost from the financial meltdown of 1998. Yet with growth in the Asia-Pacific region back to a pre-crisis six percent last year, the reformist momentum has waned.

While better governance was a condition of IMF and World Bank financial support for troubled countries, there are doubts about implementation and enforcement, says World Bank country director for South Korea Sri-Ram Aiyer. But corporate governance in Asia is not a lost cause. The Fund and the Bank have helped bring about improved companies legislation, better listing agreements, higher quality accountancy and new bankruptcy laws.

AnCorR Web

The OECD has developed a comprehensive world-wide information resource on corruption and bribery. This includes information and data, research and analysis, in-depth diagnosis and policy dialogue. It also includes listings of references on related topics for countries and regions across the world.

This resource is available on-line at: <http://oecd.org/daf/nocorruptionweb/index.htm>

Internal Audit Books Available On The Internet

The Chartered Institute of Public Finance (CIPFA) in the UK publishes a range of books on public finance and internal audit. These are available for purchase by credit card on-line at: <http://www.cipfa.org.uk/publications>

AuditNet

AuditNet is a conceptual model developed by Jim Kaplan. The original concept was for a central electronic resource for the audit community that would provide a link for auditors worldwide. The initial concept has evolved into a network of resources available for auditors. The AuditNet concept now has the auditor as the hub of a wheel. The spokes of that wheel represent resources available for professional auditors. Some of those spokes are connected by pointers via the Internet while some spokes are islands unto themselves. A listing of those electronic resources is updated and distributed monthly via the Internet. The AuditNet Home Page at <http://www.auditnet.org> and the hypertext version of the Kaplan's AuditNet Resource List (KARL) now operate as the hub of the wheel for the Auditors Network on the Internet.

AuditNet includes Jobs for Auditors and an inventory of Audit Work Programs.

New additions to the AuditNet Work Programs Inventory include:

- Budget Control
- Construction Contractor Audit Program
- Credit Control Audit Program
- Currency Swap Audit Program
- Foreign Corrupt Practices Act Audit Program
- HP-UX Audit Program
- Tandem Audit Program
- Warehouse Management

YOUR IDEAS

If you want us to cover some aspect of internal audit then please let us know. Or if you want to submit your favorite tip then please send it to us. If you have any comments about this bulletin then please let us know.

Please email us at: bulletin@accanet.com or elenid.davies@acca.org.uk

We can't guarantee to solve your problems or to pass on your tips, but we will try our best.

We also welcome non-commercial announcements for inclusion in ACCA Internal Audit Bulletin.

CHECKLIST ON WRITTEN PROCEDURES

Grant Gooding of Duncan Lawrie Ltd provided the following checklist on written procedures. Duncan Lawrie Ltd is a small private bank based in London, Isle of Man and Cyprus. He has been with them for two years now. His previous employers include Colonial Financial Services and Legal & General.

Features of written procedures

- Objectives - These will help to give the reader an overview of the subject.
- Policy - This will explain the parameters set by management. It may be combined with the objectives.
- Process narrative - A step by step guide with each step should have one action only. The aim is to write the text within two lines. This should be clear, concise and using plain English and active words. Any jargon and abbreviations should be clearly defined using a glossary of terms. Block capitals should be avoided unless something important needs to be emphasised. Too complex a process may indicate that there is something wrong with it or the way in which it is being documented is inefficient. Headers and footers of the document should show the running title, the electronic location of the document, the page / section, date of amendment and any other information considered necessary (e.g. author).
- Key controls - This will to help the reader understand what is important about the work they are undertaking.

Optional features

Sometimes it is beneficial to have:

- References - These should adequately explain where to locate additional information, forms and schedules.
- Checklists - These are useful to ensure completeness and consistency of a process.
- Examples - This will show what happens in practice and reinforce the theory.
- Process flowcharts - These help the reader understand complex sequence of events, branching processes or where there are decisions to be made.
- Illustrations - These may show what you mean more quickly than text.

Creation and revision

- Write them, revise them, and then give them to someone else who is not familiar with the process to carry out the job.
- Written procedures should be produced by someone who has a good knowledge of the process.
- Written procedures should then be reviewed by both someone who operates the process and someone completely outside the process.
- All written procedures should be passed to the Compliance Department and / or Internal Audit for review.
- All persons who need to know about the new procedures or amended procedures should be informed.

Location

- Store the electronic version in a suitable location.
- Use sensible file names and directory names.
- Keep the current and previous version at least.
- Windows Explorer allows different levels of directories to be created. However the system is far from ideal as there is too much scope to delete or move files.
- Use of a standard document system will enable appropriate filing arrangements to be maintained.

Amendment and timing

- Produce written procedures before the process is implemented.
- Keep written procedures up to date as processes change. Out of date procedures are useless.

Advantages of written procedures

- Ensure key controls and procedures are adhered to.
- Ensure consistency of action.
- Ensure processes are carried out in an efficient and effective manner.

- Act as reference point.
- Assist the training of staff.
- Ensure that knowledge is retained in the company.
- Make it easier to identify problem areas.
- Give a good opportunity to review the control, efficiency and effectiveness of the current processes.

Disadvantages of written procedures

- Need to be regularly reviewed.
- Can be expensive in time to create.

Control

- Care must be taken when designing processes to avoid compromising security or control.

USA GENERAL ACCOUNTING OFFICE

The General Accounting Office is the investigative arm of the US Congress. GAO's mission is to help the Congress oversee federal programs and operations to assure accountability to the American people. GAO's evaluators, auditors, lawyers, economists, public policy analysts, information technology specialists, and other multi-disciplinary professionals seek to enhance the economy, efficiency, effectiveness, and credibility of the federal government both in fact and in the eyes of the American people. GAO accomplishes its mission through a variety of activities including financial audits, program reviews, investigations, legal support, and policy/program analyses. GAO is dedicated to good government through its commitment to the values of accountability, integrity, and reliability. Its web site is: <http://www.gao.gov>

Government Auditing Standards (The Yellow Book) contains standards for audits of government organizations, programs, activities, and functions, and of government assistance received by contractors, nonprofit organizations, and other nongovernment organizations. These standards, often referred to as generally accepted government auditing standards (GAGAS), are to be followed by auditors and audit organizations when required by law, regulation, agreement, contract, or policy. These standards pertain to auditors' professional qualifications, the quality of audit effort, and the characteristics of professional and meaningful audit reports.

ACCA STUDY INTO ACCOUNTING AND AUDITING IN TANZANIA

Last year the ACCA undertook a study for the World Bank on *The status of accounting and auditing functions in Tanzania and harmonisation with international and regional standards.*

At the project workshop on 21 September 1999, the Deputy Minister of Finance, Professor Crispin Hauli, confirmed that it is the policy of the Government of Tanzania to fight corruption until it is eradicated. He said corrupt practices cut across professions, but that the accounting profession, due to non-adherence to professional ethics has fuelled or propelled corruptive practices in one way or the other. Nonetheless in his view, it is uncontested that accountants can play a significant role in fighting fraud and corruption in Tanzania.

The Minister listed a number of practices which accountants should be aware of:

- Mismatch (in value terms) between original and copy receipts
- Non banking of cash or banking at lower sums
- Duplicating and printing receipts carrying the same serial numbers
- Refund against fictitious receipts
- Un-vouched and improperly vouched expenditures
- Non-recording on ledger goods delivered
- Falsification of payroll
- Issuance of open or duplicate cheques
- Forging of signatures
- Improper spacing of figures in cheques.

This list provides a useful checklist for practices to look out for.

What steps do your internal auditors take to ensure that suitable controls are in place to minimise the occurrence of fraud and corruption? Please share them with readers of this bulletin.

TRANSPARENCY INTERNATIONAL

website: www.transparency.org

Transparency International (TI) is a non-governmental organisation dedicated to increasing government accountability and curbing both international and national corruption. It defines corruption as the abuse of public power for public gain.

The movement has multiple concerns:

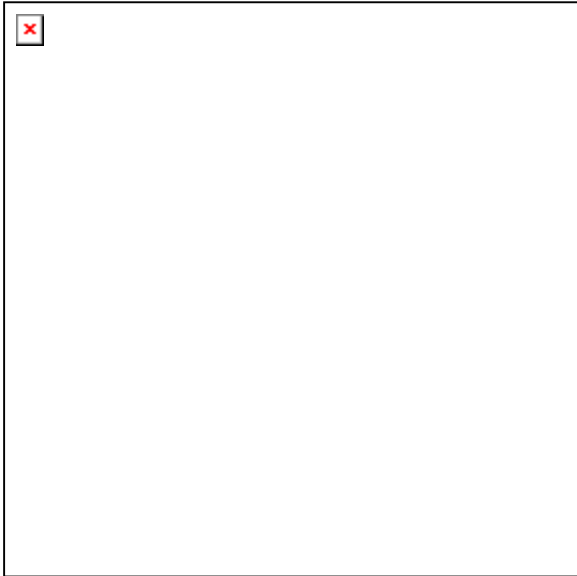
- humanitarian, as corruption undermines and distorts development and leads to increasing levels of human rights abuse;
- democratic, as corruption undermines democracies and in particular the achievements of many developing countries and countries in transition;
- ethical, as corruption undermines a society's integrity; and
- practical, as corruption distorts the operations of markets and deprives ordinary people of the benefits which should flow from them.

One aspect of Transparency International's work is the publication of Corruption Indexes and Surveys.

The [TI Bribe Payers' Survey](#) is a comprehensive study on bribe-paying in international trade. It looks at key factors influencing corruption, covers unfair business practices, assesses the readiness of the private sector for the new ban on bribing foreign public officials and includes the Industrial Sector Ranking. The TI Bribe Payers Index ranks the leading exporting countries in terms of the degree to which their companies are perceived to be paying bribes abroad.

The [TI Corruption Perceptions Index \(CPI\)](#) ranks countries in terms of the degree to which corruption is perceived to exist among public officials and politicians.

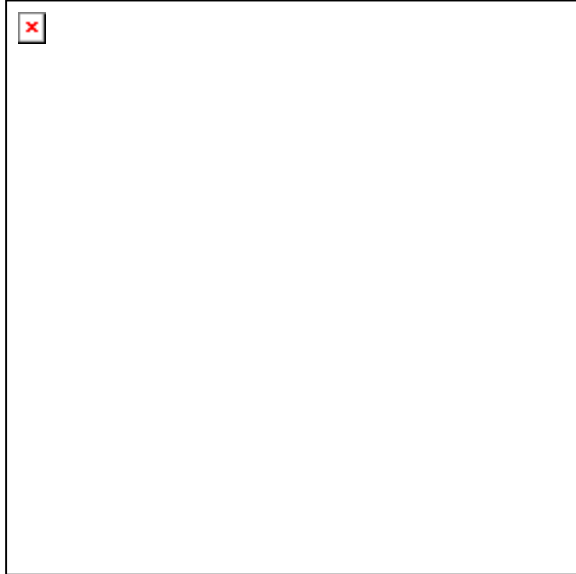
Transparency International takes an holistic view of building [National Integrity Systems](#). Simply strengthening prosecution and judicial powers cannot by itself curtail corruption. Their National Integrity [Source Book](#) provides a framework. A standard reference point for reformers, it describes practical steps that can be taken in each sector of society and contains a vast array of best practice documentation.



TI is based on the following guiding principles:

- TI recognises the shared responsibility of actors in all regions for corruption, and its emphasis is on prevention and on reforming systems, not on exposing individual cases;
- TI considers that the movement against corruption is global and transcends social, political, economic and cultural systems;

- Internally, TI observes the [principles](#) of participation, decentralisation, diversity, accountability and transparency;
- TI is politically non-partisan; and
- TI recognises that there are strong practical as well as ethical reasons for containing corruption.



How TI achieves its purpose

- TI builds national, regional and global coalitions, embracing the state, civil society and the private sector, in order to fight domestic and international corruption;
- TI co-ordinates and supports [National Chapters](#) to implement our mission;
- TI assists in the design and the implementation of effective integrity systems; and
- TI collects, analyses and disseminates information and raises public awareness on the damaging impact of corruption (especially in low-income countries) on human and economic development.

If you have worked with your local chapter of TI, or used their guidance in your audit work, then why not tell other readers of this bulletin about your experience?

INTERNAL AUDIT IN SOUTH AFRICA

Internal audit in South Africa's central and provincial government departments - a developing function

By **Andy Wynne** – andywynne@lineone.net

The author would welcome any comments on this article. Articles describing internal audit practice in other parts of the world would also be welcome for future editions of this bulletin.

Introduction

Internal audit is an essentially new function in South Africa in both Central and Provincial Government Departments. Internal audit sections have been established or at the very least fundamentally re-engineered since 1994. This has both its negative and positive aspects. On the one hand internal audit continues to struggle to receive the necessary resources in competition with much needed front line services such as housing and education. On the other hand modern world class internal audit functions are being established without the baggage of old fashioned working practices. Through books, journals and the Internet these new internal audit sections are in contact with leading edge internal audit practitioners across the world. As a result they have been able to adopt modern internal audit techniques and practises as soon as they are formed.

This article aims to provide a snapshot of these internal audit services as they are developing. It is based on a questionnaire developed by the author that was distributed and collected in June and July 1998 by Marianne Brown

of the Institute for Public Finance and Auditing. Additional material has been taken from a survey of existing internal audit practices undertaken by a consortium of three independent accounting firms (KPMG, ABD&T and KMMT Brey Inc 1998) in April to June 1998.

The questionnaire was developed as part of a wider research project into internal audit in Government Departments across Africa. It was sent to each of the 35 Central Government Departments and the nine Provincial Governments in South Africa. Replies were received from nine Government Departments and internal audit sections with five of the Provincial Governments.

A new Service

When Nelson Mandela came to power in 1994 a new nation was created with the task of developing a unified state and overcoming years of divisiveness and international isolation. Internal audit departments have been and are being developed at national and provincial levels within this context. Under the previous administration the internal audit functions in the 'homelands' were decentralised. They were also more akin to inspection than a professional audit service (Van Wyk, Anton et al. 1998).

Out of the nine central departments responding to the questionnaire, two had yet to establish an internal audit service (one small and one large department) and two had been established in the last year. In the KPMG survey (KPMG, ABD&T and KMMT Brey Inc 1998) five of the 18 departments were to develop an internal audit department in 1998/99. At the provincial level two of the five provinces responding had yet to establish an operational internal audit service.

In recognition of their newly established status all the seven internal audit services completing the questionnaire recognised that they could improve. Two of the national sections had yet to develop annual or strategic audit plans and four others had developed annual plans but not strategic plans.

National Guidance

In November 1995 the Department of State Expenditure issued the "Manual of Public Sector Auditing" (Department of State Expenditure 1995). This provided guidelines for the establishment of internal audit sections and is currently being revised. A year later regulations issued under the Exchequer Act No 66 of 1975 made it compulsory for the Director-General (accounting officer) of each central and provincial department to establish an internal audit service.

This includes the responsibility to form an audit committee whose role, at least in part, should be to monitor the effectiveness of the internal audit service. Five of the eight government departments that completed the questionnaire had an audit committee and two more were establishing one. Three of the five provincial departments had an audit committee.

In 1999 the Public Finance Management Act was passed (Department of Finance 1999). Amongst other aspects, this requires all national and provincial government departments to have and maintain:

"effective, efficient and transparent systems of financial and risk management and internal control;

a system of internal audit under the control and direction of an audit committee complying with and operating in accordance with regulations and instructions prescribed".

Regulations that will provide detailed guidance to be followed are to be issued for public consultation in the near future.

This is an example of best practise being implemented from the start. In the UK audit committees were rare until the Cadbury Committee (Cadbury 1992) reported and nearly half of local authorities have still to establish one. In South Africa the King Report (King 1994) established the importance of audit committees only two years after the Cadbury Report. Now they are already the norm or are in the process of being established across the South African public sector.

Budgetary Constraints

Resources devoted to internal audit are tight. The KPMG survey (KPMG, ABD&T and KMMT Brey Inc 1998) found that, for the departments where the information was available, half had an internal audit budget that was less

than the external audit fees. Even worse, a third had internal audit budgets of less than half of the external audit fees.

By comparison, in the UK, public sector internal audit budgets are often several times as much as the organisation's external audit fees. In central government, for example, there are approximately 900 internal auditors whilst the National Audit Office (the external auditors) have only around 600 staff.

As a result many of the internal audit sections across the South African public sector are very small. Only two of the national departments, and none of the provinces, answering the questionnaire had an internal audit section with more than five staff. In the KPMG survey (KPMG, ABD&T and KMMT Brey Inc 1998) less than half the departments issued more than ten internal audit reports in 1997/98 thus showing a low level of activity or a very small section.

These budgetary constraints appear to be having an adverse effect on the scope of internal audit. In the KPMG (KPMG, ABD&T and KMMT Brey Inc 1998) survey nearly a third of internal audit time was spent on fraud and only one audit section estimated that it was reviewing more than 50% of potential internal audit areas.

In this situation it is probably advisable to establish dedicated fraud investigation sections. This will avoid the situation where internal audit work is sacrificed to fraud investigations. In addition, internal auditors do not necessarily have the skills to undertake effective fraud investigations. Thus it is encouraging that one national departmental internal audit section that answered the questionnaire was not responsible for undertaking fraud investigations.

Contact with World Class Advice

Internal audit sections at national and provincial levels are in contact with world class advice and many are adopting this as soon as they establish their service. Five of the seven national departmental audit sections answering the questionnaire received the American journal *Internal Auditor*. The same number of sections had purchased internal audit textbooks in the last year and three had Sawyer's standard work on internal audit from the US. Two of the provincial internal audit sections also had this publication.

At least two of the national departmental audit sections and one of the provincial sections who completed the questionnaire had access to guidance available from the Internet. A number of these sections are also gaining advice from consultants or international accounting firms.

This access to best practice means that many South African internal audit sections are adopting practices that are only now being introduced by internal sections in both America and Europe. For example, as already stated, audit committees are standard in South Africa and most internal audit sections expect to issue annual reports. Only one departmental and one provincial section answering the questionnaire did not produce an annual report.

South Africa has a national governmental audit manual that is being revised and all but two of the audit sections had documented their own procedures. The KPMG survey (KPMG, ABD&T and KMMT Brey Inc 1998) found that a third of departmental internal audit sections had formally approved procedure manuals. In addition, an Internal Audit Forum has been established by the Institute for Public Finance and Auditing where internal auditors can share their experience and pass on best practices to each other.

Education and Training

The KPMG survey (KPMG, ABD&T and KMMT Brey Inc 1998) identified that internal audit staff in national government departments were relatively well qualified. Less than a quarter of staff were only qualified to matric level and over a quarter were qualified to graduate level or above. More than two thirds of the sections said that a proper training and development programme was in place for their staff.

This was backed up by responses to the questionnaire, which suggest that nearly two thirds of internal audit staff have formal internal audit or accounting qualifications. In addition, staff at almost all the responding sections had received training in the last year. This included a course on internal control provided by the Department of State Expenditure; IIA - South Africa courses; and more general courses from the South African Management Development Institute.

Most of the provincial internal audit staff were formally qualified or were training to become so. Only one of these three sections indicated that staff had received no training in the last year.

Some internal audit sections are staffed with people that were previously undertaking inspections rather than internal audit. This emphasises the need for continued effective training for all internal auditors. This should help to ensure that this change in role is completed successfully and internal audit staff develop constructive co-operative working relationships with their internal audit clients.

Internal Audit Co-operation with Auditor General Staff

The general report of the Auditor-General on the accounts of the National Government for the 1996/97 financial year stated that in many instances internal audit did not exist, and if it did that internal audit is often understaffed or does not operate effectively.

The questionnaire and the KPMG survey (KPMG, ABD&T and KMMT Brey Inc 1998) indicate that this situation, whilst still not perfect, has improved. However, co-operation between internal audit and the Auditor-General still requires substantial improvement. The survey indicates that less than half of internal audit sections met regularly with their external auditors and that the external auditors only rely on the work of a third of the internal audit sections.

The questionnaire indicates that internal audit sections are reviewed by the Auditor-General at least once every three years, although the Auditor-General indicated that this is happening every year. Only about a third of the respondents at national or provincial level stated that internal audit was helping the Auditor-General with their work. The same low number of internal audit sections said that the Auditor-General had recently helped to improve the quality of their work.

The Deputy Auditor-General believes that: "The Office of the Auditor-General has a vital role to play in developing public sector accounting and auditing standards" (Fakie 1998). The results of the survey and the questionnaire indicate that the full potential of this role has yet been realised.

Conclusions

It is now generally accepted, across the world, that effective internal audit has an important role to play in improving and maintaining the quality of an organisation's internal control system, helping it achieve its objectives more efficiently and is an important means of helping to achieve effective corporate governance. It is also widely accepted that major change usually has a detrimental effect on internal control. Given the extent of change at national and provincial level in South Africa, after the achievement of black majority rule, it is not surprising that the KPMG survey (KPMG, ABD&T and KMMT Brey Inc 1998) found that: "None of the officials interviewed were of the opinion that risks were effectively controlled in their departments." It is also not surprising that nearly half of them felt that their department's internal control system was ineffective or had major deficiencies.

In this situation it is important that internal sections within South African government departments continue to develop and improve. The results of recent research out-lined in this article are only acceptable if this process of internal audit development continues. Otherwise, the objective of the government to provide at least basic services to all its citizens will be much less likely to succeed.

Most internal audit sections in government departments are still young. They need continued help to develop effective planning systems and an efficient approach to modern internal audit techniques. The strengths identified in education and training need to be maintained to ensure that the process of continual improvement is sustained and the staff do not become cynical and loose their critical edge. The work of the Department of State Expenditure; the Institute for Public Finance and Auditing; the Institute of Internal Auditors - South Africa; and others in supporting the development of professional internal audit sections needs to be continued.

Initiatives such as the Internal Audit Forum are needed to enable governmental internal auditors to share ideas and exchange best practices. Finally the Auditor-General's staff and internal audit need to further develop an effective partnership where each supports improvements in the work of the other, co-operation becomes the order of the day and the work of each is made more efficient through greater mutual reliance.

This article first appeared in the latest edition of *Auditing SA* published by the Southern African Institute of Government Auditors. More details are available from the editor Prof Herman de Jager on hdejager@hakuna.up.ac.za

A GUIDE TO THE INTERNAL AUDIT OF ACCOUNTING SYSTEMS

Internal auditors should not just review financial systems. However, financial audit remains an important part of our work. Below we outline an internal audit guide to the audit of a general ledger or main accounting system. We would welcome any comments our readers may have on this guide.

This guide has been produced a part of a set of nine covering all the common financial systems. The full set will be sent to all contributors to our next bulletin.

Accounting Systems

System Objective: The financial transactions of the organisation are recorded accurately, completely and held with integrity. The financial data forms a suitable basis for the preparation of management accounts, final accounts and financial returns

1 Control objective: data input is complete, accurate and secure

- 1.1 *A suitable chart of accounts is available to all relevant staff.* An up to date authorised chart of accounts or coding structure exists relevant to the user's requirements. This is made available to all staff who code financial transactions. It should be reviewed at least annually by a senior finance officer to ensure that all amendments are necessary and any redundant codes are removed or de-activated. The chart should be as simple as possible balanced with appropriate analysis of income and expenditure
- 1.2 *Suitable checking of transaction coding is undertaken.* Coding of transactions is checked at least on a sample basis. All income and expenditure is coded by the most appropriate staff. All coding queries and potential mistakes are promptly resolved and corrections/action taken to prevent it happening again
- 1.3 *There is adequate segregation of duties.* Functions, a, b and c below are undertaken by different people (including during staff absence for holidays, sickness etc):
- the daily processing of transactions a
 - the clearance of suspense or rejected entries a
 - posting journal entries b
 - bank and control account reconciliations b
 - authorisation of journal entries c
 - review of reconciliations c
- 1.4 *Batch control totals are used for data input.* The total value of all transactions input (batch control total) is compared to the value calculated by the computer. Exception reporting is used to identify "strange" (too large or small) items or those that have not been processed correctly
- 1.5 *Control accounts are regularly reviewed.* The output from each feeder system (payroll, sundry debtors, creditors etc) is reconciled to the input totals in the general ledger through the use of suitable control accounts. The person who undertakes the reconciliation should not have access to any of the feeder systems. If the control account does not balance this is investigated and suitable action taken to ensure that this is corrected. There is a monthly check that the general ledger balances in total. That is that the total credits are equal to the total debits. There is an annual check that the opening balances are brought forward to the appropriate accounts and that the amounts are accurate

2 Control objective: the general ledger is adequately and accurately maintained

- 2.1 *Bank account reconciliations are undertaken regularly.* The balance on each of the organisation's bank accounts according to the bank statement is independently reconciled (compared) to the figure expected from the financial records at least monthly. If the figures do not balance this should be investigated until a suitable explanation is found. Even small differences may hide larger figures that balance each other out at least partly. Bank accounts that only have a few transactions may be reconciled quarterly or even annually. The person who reconciles the accounts should not have access to cash, cheques etc or the accounting records.

- 2.2 *All reconciliations are promptly reviewed.* Control and bank account reconciliations are promptly, formally and independently reviewed and documented as such ie the reviewer initials and dates the reconciliation. The reviewer should check that each reconciliation is done accurately and promptly. Any balancing figures should be queried and all the figures should be checked on a sample basis to the original sources. It is particularly important that this is done effectively if the processing of transactions and reconciliations is undertaken by the same person.
- 2.3.1 *All journal entries are documented and authorised.* All journal entries (including write-offs and adjustments to control accounts) should be:
- appropriately documented (codes Dr & Cr; serial number; initials and date of preparer)
 - recorded in the system
 - clearly state the purpose of the journal
 - be authorised in writing with date (by someone other the person who inputs it)
 - subject to sequential number checks, check all journal are present by checking that there are no missing numbers
- 2.4 *Suspense accounts are regularly checked and cleared.* Appropriate use is made of separate suspense accounts for income and expenditure. All suspense accounts should be cleared each month and appropriate authorised journal postings made
- 2.5 *Suitable computer access controls are used.* Passwords (at least six digits and not common words) and user profiles (each person can undertake certain functions on specified computer systems) are used to control access to information on the general ledger (passwords are changed regularly - at least every 3 months). Each member of staff has their own password and has been clearly instructed not to give their passwords to any other person. The computer system administrator (the person who sets up new staff, changes profiles etc) should not use the system or have access to any of the finance systems

3 Control objective: periodic financial reports are produced promptly, accurately, and are distributed appropriately

- 3.1 *Relevant staff have access to suitable procedure notes.* All input, processing and output from the financial ledger is covered by suitable procedure notes. These include staff roles and responsibilities; the authorised signatories; and performance standards. A timetable of duties and responsibilities is drawn up and agreed in advance and senior finance staff should monitor progress against timetables (to include monthly and annual close down; production and issue of management accounts to budget holders; annual accounts and backing schedules and financial returns). Finance staff should hold suitable financial qualifications and have suitable training each year. The finance section should have access to qualified accountants for advice if none of the staff are qualified. Suitable financial regulations are maintained.
- 3.2 *Management accounts are produced promptly.* Management accounts are produced monthly. They need to be comprehensive, but eg do not need to have full accruals. A balance needs to be made between accuracy and speed of production. These are reviewed by senior management. They are issued to the relevant budget holders within 10 working days of the end of the month. The accounts should include commitments ie orders placed, but invoices not received or paid. Contingency arrangements have been formalised in case of system failure
- 3.3 *Management accounts are regularly reported to the highest level within the organisation.* At least quarterly the financial performance of the organisation is reviewed by the senior management team, the chief executive and/or members. These accounts include an income and expenditure statement, balance sheet and rolling one year cash flow statement. In addition, suitable comments should explain the financial position of the organisation, any significant differences to the financial plans/budgets and suggestions for action to be taken to address any problems
- 3.4 *Budget managers are consulted regularly about the layout of financial information.* Financial reports are periodically and formally reviewed to ensure that all the information produced is required and is in the most appropriate format so that it can be understood and used by all. A balance needs to be made between the levels of detail and users needs. Budgets managers need suitable financial training
- 3.5 *All financial returns are monitored.* Managers check that all financial returns are issued promptly and that they appear to be reasonable and accurate. A checklist is maintained of all the returns that are necessary and their due dates. Action is taken as necessary to address problems if returns are sent out late

BOOK REVIEW

THE INTERNAL AUDITING HANDBOOK

K H Spencer Pickett

ISBN 0-471-96911-7

Hardback

Published by Wiley

1997

636 pages and computer disk

£60

The foreword of this book, written by a leading internal audit academic, claims the work is a "labour of love". Certainly its length is impressive and enables the publication to do justice to its wide scope, ranging comprehensively over the professional practice of internal audit.

The book is split in to four parts: the theoretical framework; audit techniques; management of internal audit; and specialist auditing.

Part One starts with definitions of internal audit rather than with internal control (which is not covered until the last chapter of this section) and its role in risk management. This weakens the theoretical framework for the book and the central role of systems auditing in audit practice is not made consistently clear. However the book does make the useful distinction between systems audit and any other work that internal audit may be required to undertake - this is consultancy. "All things are possible under the consultancy role of internal audit so long as this does not interfere with the planned systems reviews that should run side-by-side with consultancy services".

The second chapter of part one includes a potted history of internal audit. This charts its development from an extension of external audit when "vast numbers of transactions were double checked to provide assurances that they were correct and properly authorised". The distinction is clearly made between the roles of internal and external audit and the importance of systems audit is underlined. It is then suggested that internal audit's highest plane of development will be social auditing although this concept is not explained in any detail.

The book says that "Internal Auditing is a developing or quasi-profession that still has some way to go". This may explain some of the theoretical weaknesses the book contains. The major one being the confusion between the five main objectives of internal control and the key analytical tool in systems auditing, control objectives.

The scope of internal audit is recognised as reviewing managerial controls over:

- management information systems
- compliance with laws, policies, procedures and regulations
- safeguarding assets and interests
- the economy and efficiency with which resources are applied
- the accomplishment or organisational goals and objectives.

However, it is then claimed that these are control objectives that should form the basis of each systems audit review. In fact specific control objectives should be developed for each systems audit undertaken. These control objectives should be developed as a more detailed analysis of the system's objective. Each systems audit should review the extent that internal controls will ensure that each control objective, and thus the system's objective, is achieved. The control objectives form the framework for the audit and should be developed in consultation with the managers responsible for the system.

Section One also includes a major chapter on the behavioural aspects of auditing. This includes much sound advice, which if followed should ensure that significant progress is made in bridging the expectations gap that often occurs between auditors and the managers of our organisations.

The introduction to Part Two on audit techniques signals an emphasis on systems auditing, but this is undermined later on in the section with too great an emphasis on testing; the claim that: "All auditors need knowledge of statistical sampling"; and a failure to integrate the chapters on risk and audit planning.

This section also includes a comprehensive chapter on audit reporting, written and through presentations. However, this chapter failed to make a clear link to what I thought was the most informative aspect of this book. This is the frequent use of graphs, block diagrams and other figures to break up the text and summarise the points

being outlined. It is standard practice for books on internal audit to recommend the use of such techniques, but very few consistently show how this can be done.

Part Three includes much useful reading for new or aspiring audit managers or heads of internal audit. This includes major chapters on human resource management and internal audit units; audit information systems; and training and development. This section ends with a useful chapter providing an introduction to change management and the role that internal audit can play. This is an important topic and one that all internal audit departments need to address if they are to remain effective in a fast changing world.

The final section consists of two long chapters; one on managing computer audit and the other on investigating fraud.

The book has an accompanying computer diskette which includes much supplementary information; a set of blank internal audit working papers; information on establishing an audit section; and a formal fraud investigation procedure.

All in all this publication provides a useful handbook on internal audit passing on professional knowledge that will be useful to auditors at all levels of experience.

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If you have read a book recently that you think would be of interest to readers of ACCA Internal Audit Bulletin then please send its details with your comments. . A full set of nine guides to auditing financial systems will be sent to any contributors who submit a book review for our next bulletin.

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Best wishes

Andy Wynne, Editor

* The End *
