
*** ACCA INTERNAL AUDIT BULLETIN ***
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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 160 countries. The ACCA's headquarters are in London and it has staffed offices in 35 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. We want to hear your news, views and comment.

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NEWS

IIA Revises its Standards for the Professional Practice of Internal Auditing

In December 2000, the Institute of Internal Auditors' Internal Auditing Standards Board approved the issuance of new standards, in the first major revision since they were introduced a quarter of a century ago. The mandatory implementation date for the new standards is January 1, 2002.

For more information, please see the new Standards at:
http://www3.theiia.org/ecm/guide-frame.cfm?doc_id=1499 and an accompanying cover letter from the

Chair of the Internal Auditing Standards Board at:
http://www3.theiia.org/ecm/guide-frame.cfm?doc_id=1503

The new Standards will be available in Spanish and French in the near future. For copies of the current standards and guidance in languages other than English, please see translations at:
http://www3.theiia.org/ecm/guide-stand.cfm?doc_id=1326

Securities and Exchange Commission relents on internal audit work

The Securities and Exchange Commission in the United States has backed down on its proposed ban on external auditors carrying out internal audit work at the same company. A company's external auditors will now be able to do 40% of larger clients' internal auditing, or the entire internal audit for a client with assets of less than \$200 million.

'Unacceptable' Errors in EU Accounts

Late last year, the European Court of Auditors reported an 'unacceptable' number of errors in the accounts of the European Union for 1999, as in previous years. Its reports says as a result it 'cannot provide assurances the transactions underlying the financial statements are legal and regular except as regards own resources, the commitments and the institutions' staff expenditure.' The Court goes on to warn against interpreting these errors as indications of widespread fraud, saying mistakes were 'mainly those of inadequate financial management'.

Details of the European Court of Auditors can be found at: <http://www.eca.eu.int/>

Kinnock Issues Rules for Internal Audit of the European Commission

In March 1999 all 20 members of the European Commission quit under a torrent of allegations over their complacent, incompetent and crony-friendly management of the European Union's £60 billion budget. As part of the response to these allegations, detailed guidelines for the operation of the European Commission's new internal audit procedures were published by its vice-president Neil Kinnock last year. The Internal Audit Charter was published on 31 October 2000.

Groups of internal audit officials will be responsible for monitoring their own Directorate Generals (DGs). These Internal Audit Capabilities will 'advise the Director-General on the quality of the internal control systems operating within their DG and the risks under which it operates, and recommend improvements as necessary. The Director-General remains ultimately responsible for deciding whether or not to accept audit findings and recommendations'.

The Commission's central Internal Audit Service will be responsible for 'contributing to an effective and rigorous management of the resources of the European Commission' by:

- controlling risks
- safeguarding assets
- monitoring compliance with rules
- producing accurate management information
- improving the quality of management, control and internal audit systems
and
- improving the efficiency and effectiveness of Commission operations

Former Ernst & Young executive regional partner, Jules Muis, the man responsible for revamping the audit and financial control system at the World Bank has been appointed head of the European Commission's Internal Audit Service.

Overseeing these two layers of Internal Audit will be the Audit Progress Committee (APC). This will consist of four EU Commissioners and an independent Internal Auditor from outside the Commission. The role of

the APC will be to ensure that Internal Audit recommendations are implemented effectively and that it remains independent.

Vice-President Kinnock said: 'With the implementation of these measures, the Commission will have at its disposal a coherent network of internal auditors, working according to internationally recognised standards.' He also published a timetable for rolling out this system, which should be completed by December 2002.

The Gambia Demonstrates Limits to Audit Independence

In August 1994, Ms Fatoumata Jallow was appointed as the Auditor-General of The Gambia, a small country in West Africa. Over the next six years, the Auditor-General's Office developed into an effective supreme audit institution with assistance from the Department for International Development (UK). Audits were undertaken at all ministries, departments, local authorities and, with assistance from private sector audit firms, the public enterprises. Reports were produced as a result of each of these audits and, where possible, agreed with the relevant Accounting Officer.

Later the Auditor-General produced a summary report of this work for the Finance and Public Accounts Committee of the National Assembly. This report provided a comprehensive summary of all the main findings and weaknesses that had previously been included in the individual audit reports.

The Auditor-General's report and the Finance and Public Accounts Committee report were published. As a result, a Commission of Enquiry was established to investigate the problems that had been uncovered and cases where senior officials had not responded adequately to the individual audit reports.

However, things then started to go wrong. Ms Jallow has been suspended without pay. The Commission of Enquiry's report is not expected to be published and the National Intelligence Agency is now running the Auditor-General's Office.

NAO in Bid to Widen Powers

The National Audit Office (UK) has told Lord Sharman's review of central government audit and accountability that it must be allowed to audit government owned private companies such as the Millennium Dome. The NAO currently has no automatic rights of access to an estimated 150 government companies. In a report last year, the Public Accounts Committee noted that at least £3billion of public money was not audited by the NAO, which reports to parliament, but by private sector auditors reporting to government ministers.

The National Audit Office and information about its role, including copies of its value for money reports, can be found at: <http://www.nao.gov.uk>

UK Home Office IT System Slammed

The Home Office in the UK is to scrap a £118m probation service computer system after its agreement with French IT company Bull was labelled 'unlawful' by a National Audit Office report. According to the NAO, the Home Office and Bull did not agree service level agreements until 1998, four years after the contract was signed, and even then 'performance was not systematically monitored'. By the end of the year, the systems are expected to have cost £118m, 70% more than was originally budgeted for by the Home Office, plus an addition £16m already spent on Y2K prevention and £10m on maintenance. The report also attacked the project management team at the Home Office. In the last seven years, seven different programme directors have managed major IT projects, only two of whom, the NAO claims, had significant experience of managing major IT projects. See: <http://www.accountancyage.com/News/1116237>

Millennium Dome Report: Catalogue of Financial Mismanagement

The National Audit Office (UK) issued a damning report on the Millennium Dome's finances in November. The report includes a list of crucial factors that combined to create acute difficulties for the attraction, including 'a failure to establish sufficiently robust financial management'.

The report concluded that the visitor target involved significant risk, and yet there was no agreement on contingency plans. Sir John Bourn, Comptroller and Auditor General, said: 'The targets were highly ambitious and inherently risky leading to a significant degree of financial exposure on the project. In addition, the task of managing the project has been complicated by the complex organisational arrangements put in place from the outset, and by the failure to establish sufficiently robust financial management'.

David Davis, Chair of the parliamentary Public Accounts Committee, said the report 'is a serious indictment of those involved with this ill-fated project'.

Ministry of Defence (UK) Reforms Bring Costs Under Control

Weapon procurement reforms have brought Ministry of Defence costs under control but are yet to reduce delays, the National Audit Office (UK) reported in November. The report's revelation that three Royal Navy Type 45 destroyers will be pushed into service without essential sonar systems to meet new procurement rules sparked widespread criticism from defence experts.

The MoD has shaken-up the way it organises and goes about purchasing new equipment under its Smart Procurement programme, which the NAO report said had begun to improve performance. Baroness Symons, defence procurement minister, said: 'It will take time for our new working methods to be translated into improvement in the NAO's headline figures. 'Nearly two-thirds of the delay is on projects that have either now entered service or been cancelled, and one quarter is previously reported delay on current projects'.

UK Home Security Service (MI5) Advertises for a Senior Internal Auditor

In some countries internal audit is not allowed to cover the armed forces or the security services. In November 2000 the UK Security Service, more usually known as MI5, was seeking a Senior Auditor to join its 'small internal audit section'. The main duties were described as being 'required to:

- provide audit assurances, opinions and recommendations
- deliver an assigned element of the audit plan to agreed performance and quality standards, including the audit of developing systems
- provide clear and concise advice to all levels of management on risk and control issues
and
- contribute to the formation, development and improvement of the audit service through input to the audit section's policies, strategies, techniques and methodologies'

Potential candidates were warned that they would not be able to rush into this job. 'Because of the sensitive nature of our work, we must be satisfied about the character and integrity of our staff. All members of the Security Service are required to hold Developed Vetting security clearance. Therefore, the recruitment process, including vetting, can take up to six months'.

Malawi President Fires Cabinet Amid Graft Charges

Malawian President Bakili Muluzi dissolved his cabinet in November following criticism of government ministers and officials implicated in a major graft scandal. "The cabinet is dissolved. Functions of government departments revert to the office of the President", Muluzi said.

In September, a parliamentary committee reported that a syndicate comprising cabinet ministers and senior civil servants had swindled the government out of millions of dollars in payment for contracts that did

not exist or had not been completed. In a further report in December, it was reported that at least 100 million Malawi Kwacha had been lost from the Education Ministry in dubious contracts.

In November, whilst in Zambia on a tour of Africa to promote good governance, British International Development Minister Clare Short urged African leaders to follow Malawi's lead in fighting corruption. Short said the President had inherited systems that were prone to corruption when he won elections in 1994. Nevertheless, Muluzi had shown strong leadership especially on corruption.

South African President Excludes Anti-Corruption Unit from Arms Deal Investigation

South African President Thabo Mbeki has decided to exclude the country's anti-corruption unit from an investigation into a controversial arms procurement deal. President Mbeki's decision flies in the face of a specific parliamentary recommendation and immense public pressure to include the unit. Mr Mbeki's office said the decision was made because the constitutional court recently ruled that the unit was unconstitutional. Ever since South Africa's Auditor General recommended a forensic probe into the \$5.5 billion arms procurement package, the issue has been clouded in controversy. In a special television address in mid-January, President Mbeki said he wanted to deal with the matter openly and honestly. He also insisted that the government was determined to deal with corruption.

World Bank Fires Three Staffers for Alleged Corruption

The World Bank said in December that it had fired three employees for allegedly taking bribes from Swedish companies in exchange for awarding them contracts. An internal investigation revealed that the three staff members had 'engaged in corrupt activities in connection with funds administered by the Bank' and had taken bribes from 'two separate groups of Swedish companies'.

The World Bank was tipped off by a call to its hot line. This was set up in 1998 as part of a push to stamp out corruption. The subsequent investigation discovered that the Bank employees allegedly took undisclosed kickbacks to grant contracts worth about \$600,000 and also awarded the companies other contracts worth about \$300,000 for ineligible activities.

IT Security: Top 10 Checklist

Internet security firm NTA Monitor has produced a list of the top 10 security myths that may be of use to improve protection of organisations' computer systems from attack or misuse from outside:

- 'As good as a firewall' syndrome - in-house firewall options may not be the best route.
- Systems outside the firewall - once breached, a system just outside the corporate firewalls can be used to intercept all traffic in and out of a company.
- Out of date software - keep checking that your systems are up-to-date.
- Spam vulnerable - take proper care of your own mail server to ensure it is not used to relay e-mail messages.
- 'Who left the back door open?' - some groups are open to attacks via links to shared central organisational networks or supplier sites which have insecure Internet connections.
- 'We trust our security supplier' - trust is important, but you must check the quality of their work.
- Hosted web server risks - off-site servers need the same security considerations as in-house ones.
- Insecure Web applications - using an external supplier for applications could involve security risks.
- Dial-In services - remote staff may well be able to access their e-mail and other material, but remember that using passwords for a service is dangerous.
- Inadequate virus checking - not enough organisations have security checking at the Internet perimeter of their site.

For more details, read the article by Deri Jones at: <http://www.nta-monitor.com/news/top-10.htm>

BBC Accounting System Under Fire

A six-year project to install a finance computer system at the British Broadcasting Corporation (BBC) was criticised in November by staff who feel training for the multimillion-pound project has been inadequate. BBC finance director John Smith said 'everyone knows what SAP is like to introduce: very difficult. But I have absolutely no hesitation that it's the right thing to do'.

OECD Action Programme to Deter Bribery

OECD member states announced in December that they have agreed on an action programme to deter bribery in government-supported export credit transactions. The export credit and export credit insurance agencies of OECD countries will now demand written statements from all companies applying for coverage, stating they have not, and will not, engage in bribery. If bribery is established, the agency will deny coverage or reject claims for indemnification and will refer the case to the judicial authorities.

In the past, many private sector companies became involved in corrupt projects in developing and transition countries because they enjoyed the full support of their countries' export credit agencies. 'This will now be a thing of the past. Transparency International will be actively monitoring the OECD countries to see if these words are put into action', said a spokesperson for Transparency International. Further details: <http://www.transparency.org/documents/press-releases/2000/2000.12.06.exportcredit.html>

Fraud and its Deterrence

The IIA Research Foundation is conducting a global survey to find out how fraud and related issues are addressed by internal auditors and their respective organisations. The final product will enable an understanding of how country, industry, organisation size, corporate culture, governance structure, and most of all, specific organisation policies might affect fraud awareness, fraud investigation, and fraud deterrence. See: <http://www3.theiia.org/>

Moroccan Premier Pledges to Support Whistleblowers in Fight Against Corruption

The Prime Minister of Morocco, Adberrahmane el Youssoufi, reaffirmed in December his commitment to the fight against corruption. Meeting with representatives of Transparency International in Berlin, he said that his government was studying legislative proposals to protect the rights of individuals who demonstrate the courage to expose corruption. During the meeting, he stated: 'We want to encourage Moroccans to expose instances of corruption, but they are not speaking out'.

Further details: <http://www.transparency.org/documents/press-releases/2000/2000.12.06.marocprime.html>

First Anti-Corruption Project Launched in Three Yugoslav Cities

Four weeks after the toppling of the Milosevic regime, Transparency International's partner organisation in Yugoslavia has launched an anti-corruption programme in the cities of Nis, Kikinda and Cukarica. The project is to increase the transparency of budgeting and public procurement at the local government level and has started on 8 November. Against the background of the wide-spread corruption in the Milosevic's administration, Transparency International (TI), the international anti-corruption organisation, also called on the new administration to ensure the highest standards of transparency in public life nation-wide.

'The new government faces the challenging task of reforming the system and keeping the citizens' trust', says TI Chair Peter Eigen. He adds: 'It was civil society that ultimately overthrew the Milosevic regime. It is now civil society that can monitor and guarantee the much-needed reforms'. Further details at:

<http://www.transparency.org/documents/press-releases/2000/2000.11.09.yugoslavia.html>

Buckingham Palace Finance Director to Face the Public Accounts Committee

Buckingham Palace's finance director faced a grilling by the Public Accounts Committee in December over why £14m had been deposited into the Queen's Royal Collection Trust. A further cause of disagreement

was why staff members were still entitled to subsidised rents and why more properties outside the royal security cordon were not rented commercially. The finance director maintained that the Royal Household is 'probably the most heavily audited organisation in the world' and that the cost to the taxpayer had been come down by 55% in real terms over the last 10 years. See: <http://www.accountancyage.com/News/1115668>

Russian Cabinet Says Yes to Corporate Governance

At the end of November, the Russian government gave its support to the creation of a single, uniform corporate governance code, thus addressing one of the major concerns of foreign investors in Russia, reports the Moscow Times. A code is needed to improve transparency in management, defend minority shareholders' rights and prevent companies from diluting shares by emitting additional shares of subsidiaries, according to the Federal Securities Commission, which has been lobbying for it.

The Russian Cabinet asked the commission and others to come up with a list of measures for improving the standards of corporate governance by 1 February 2001. The Securities Commission then has until 1 March to propose regulations to put such a code into force.

High Level Meeting on Governance in China

In December, ACCA funded a high level meeting on Governance in China. Several experts addressed the meeting in Cardiff, Wales.

There has been considerably decentralisation of economic activity in terms of ownership and decision making in China. Ownership patterns have changed dramatically. The state owned enterprises, which had a near monopoly position as recently as the 1980's, have been overshadowed by the growth of township and village enterprises, foreign owned enterprises and joint ventures.

Such changes have profound implications for corporate and organisational governance in China. The growth of private ownership and shareholding means that new regulatory mechanisms are necessary for adequate accountability.

Poland Makes Virtue out of Corporate Vice

The Manus Puris (literally, 'A Hand to the Clean') campaign is an unprecedented effort to curb corruption in Polish commerce. The program, launched in December, asks participating companies to amend their internal procedures to forbid the giving or taking of bribes. Companies then inform their clients and suppliers they are participating and display the Manus Puris logo, a palm outstretched, in a prominent place.

In taking on Poland's culture of bribery, the initiative is adding to the debate on what is arguably eastern and central Europe's most pressing business issue. However, although there is still much room for improvement, the Polish economy has changed over the past five years, bribery has fallen, according to a World Bank survey of businesspeople last year. Poland ranks far above Russia and Ukraine, but it is worse than Slovenia or Hungary. A separate report by the Bank cited widespread corruption in Polish public procurement, privatisation and Parliament, where, according to one source, laws can be 'bought' for \$3 million apiece.

Approaches to Corporate Governance in the Public Sector

The UK Chartered Institute of Public Finance Accountants (CIPFA) is publishing this new report on behalf of Fédération des Experts Comptables Européens (FEE), the federation of the European accountancy profession. It draws upon work undertaken by CIPFA, which is a UK member of FEE. It sets out a series of corporate governance principles and standards and allows the reader to set these in any particular institutional or cultural context.

To order copies, see details in the *Publications and Resources* section below.

IFAC Releases Exposure Draft on Bank Auditing

IFAC's International Auditing Practices Committee has released an exposure draft of a proposed International Auditing Practice Statement on bank auditing, *The Audit of International Commercial Banks*. This exposure draft covers the various stages of the bank auditing process and provides detailed guidance on reviewing internal controls and assessing risk. The appendices provide examples of checklists for assessing bank operations; financial ratios commonly used for analysing financial condition and performance; and exposures and other considerations in securities operations, private-sector banking, and management of financial holdings. A final appendix provides auditors with some potential indicators of fraud in banking operations. This publication is available from: <http://www.ifac.org>

In its response to the exposure draft, ACCA welcomed the proposed IAPS as a timely update of the existing IAPS issued in 1990. The inclusion of new material on risk management in advance of changes to International Standards on Auditing was hailed as a bold and successful step and ACCA particularly welcomed the inclusion of new material on fraud. However, ACCA expressed concern that, as the public interest in banks is very much focused on their financial stability, the proposed IAPS gave very little guidance on the assessment of going concern. ACCA also suggested that it would be appropriate for the proposed IAPS to recognise the importance of independence issues for auditors of banks and to provide specific guidance on this and other matters to be considered for communication to those charged with governance.

Resources: Ford Foundation Offers Study Fellowships

People in developing countries may get graduate training in the social sciences through the Ford Foundation. The fellowships are valuable and substantial. The program aims to develop world-class leadership skills and will involve 350 scholars over the next 10 years. The foundation was originally set up by the bequest of Henry Ford, the founder of the Ford Automobile Company. It is now an independent NGO with social justice aims. See: <http://www.fordfound.org>

YOUR IDEAS

If you want us to cover any aspect of internal audit then let us know. If you have a favourite tip please send it to us. If you have any comments or questions about the contents of the Bulletin send them to us at: bulletin@accanet.com or info@accaglobal.com

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 the ACCA Internal Audit Bulletin.

AUDITING IN THE NEW MILLENNIUM **GOVERNANCE, CONTROL AND ASSURANCE - CONSTRUCTION PROJECTS**

Gursharan Singh M.I.I.A. (Retired Audit Officer)
Presently giving lectures and in-house training and audit on the subject of Construction Contracts and Technical Consultants' Agreements.

1.0 INTRODUCTION

1.1 The Construction industry is one of the main components responsible for economic growth in Malaysia. Furthermore it enables other sectors of the economy to grow. The infrastructure constructed enables the transport of labour and building materials, which are used in the construction of office and industrial buildings that house the industries and factories which manufacture the goods. The Construction industry is also responsible for building the townships which house the workers and management that also

implements and services all the constructed works. In short, it can be said that the Construction industry contributes to every other aspect of economic growth in the country.

1.2 The importance of the Construction industry is of special interest to the Government which uses it to generate economic growth of other sectors. This was aptly demonstrated in the recent [1997-1998] economic downturn. In addition to other measures by the Government like capital controls, fixed Forex rates and lowering of finance costs, the Construction industry was very effectively used. Contracts valued in excess of RM46.66 billion and RM21.22 billion were awarded in 1997 and 1998 respectively. The Gross Value of Output for the Construction industry for the years 1997, 1998 and 1999 was reported to be in excess of RM42b, RM34b and RM31b respectively. The total number of persons directly engaged in the Construction industry during the last three years have been in excess of 800,000 at any one time. The number of contractors registered with CIDB is in excess of 40,000 of which over 1,400 [including 62 foreign contractors] can undertake contracts with unlimited value. Thus the need for comprehensive management controls in respect of construction projects cannot be over-emphasised.

2.0 AUDIT COMMITTEES IN COMPANIES LISTED ON KLSE

2.1 The Kuala Lumpur Stock Exchange (KLSE) as the Regulatory Authority, has made it obligatory for listed Companies to appoint Audit Committees that should be composed of a majority of non-executive directors. In addition, certain statutory functions have also been prescribed. The stated objective is to ensure that the companies comply with the specified financial standards and disclosure policies developed and administered by the KLSE and are consistent with the Exchange's commitment to encourage high standard of corporate disclosures.

2.2 KLSE has 32 Construction and 76 Property Development companies listed on the Main Board. However, most of these companies, and companies listed under other sectors, are also involved in construction projects through subsidiary/associate companies that number in hundreds. These companies have complied with the letter of the requirements of KLSE Section 344A. However, it cannot be ascertained whether the intent of the requirement is complied with, as there is no such indication from the Audit Committee [or KLSE or Securities Commission] in the published Annual Reports or the Annual Financial Statements sent to the shareholders and discussed and approved at the AGM.

2.3 The membership of the Audit Committees is composed of people who are very knowledgeable and experienced. However, not many of them may have the specialised expertise that is relevant to the Construction industry. As such they are generally dependent on the Internal Auditors. Thus GOVERNANCE is weak.

3.0 INTERNAL AUDITOR

3.1 The Internal Audit Department has been entrusted with a very heavy responsibility and an important control function in all the companies where it has been established. However, the effectiveness of the IAD is substantially reduced due to three main deficiencies. These deficiencies are: lack of sufficient qualified and relevantly experienced manpower, insufficient budget and facilities and, most important of all, lack of total management support. Consequently, the IAD would not be able to play its role to properly advise the Audit Committee. Only if these three deficiencies are rectified can the IAD play its role effectively i.e. properly advise the Audit Committee and implement its audit programs that are relevant to the various multi-million Ringgit (Malaysia's currency) costing components that constitute the Construction projects that could involve several billion Ringgit.

3.2 The other main deficiency the IAD faces is the lack of management support that does not provide sufficient budget to enable the IAD to be staffed with sufficient number of people with relevant expertise and to continuously upgrade itself with the latest techniques of Construction project audit. While the Construction companies are involved in Construction projects involving hundreds of millions of Ringgit, the IAD strength, in most cases, is grossly inadequate to do any meaningful audit. As the IAD is also responsible for financial compliance audit that is obligatory and generally and easily understood by the management, attention is paid more to it. This financial compliance audit further reduces available resources for the audit of Construction projects. This situation has been confirmed to be prevalent even in the developed countries including USA where a survey showed that only 20% of IAD resources were utilised on Construction projects that involved over 80% of the financial resources of the companies.

3.3 The IAD is handicapped in the field of audit of Construction projects due to lack of reference materials, manuals, guides, notes and other training facilities that are tailored to the specific needs of the

Construction audit. A visit to any public or professional organisation library, bookstore or the latest source, the Internet, will confirm this sad situation. There is extensive information on audit, finance, computers, technical disciplines, contract and project management, etc., but very little on audit of Construction projects. ABSENCE OF EFFECTIVE CONTROLS WILL RESULT IN INEFFECTIVE AUDIT.

4.0 RECOMMENDATIONS

4.1 It is suggested that management should review its policies if it wants to ensure that Construction projects are planned, implemented and supervised properly to ensure that the company obtain optimum benefits from its substantial financial resources. For this objective to be achieved, it must provide total support to its IAD in the form of sufficient budget and manpower that has the relevant expertise. This expertise must be upgraded continuously, expanded as necessary and, where appropriate, specific aspects of Construction project audit should be outsourced.

4.2 The audit of Construction projects is not perceived to be a prestige discipline. This is substantiated by the low rewards when compared with those professionals involved in other glamorous disciplines such as IT, finance, banking, insurance, etc. Thus it could be a contributory factor to the lack of interest among practicing auditors towards Construction project audit. The Management of Construction companies should provide attractive rewards and opportunities to the outstanding auditors of Construction projects. The auditors themselves should also acquire the relevant expertise and add value to their services to justify the rewards that should be provided. It is a two-way street.

4.3 The IAD should ensure that it is staffed with persons who are not only academically qualified but also possess qualifications that are relevant to the Construction industry. They need to constantly upgrade their knowledge pertaining to the varied technical aspects of the construction contracts and the services of the many disciplines of technical consultants. The financial aspects and the fraud possibilities that are inherent in construction projects - including budgeting, planning, contractual terms and conditions, implementation, supervision and post construction phase - need to be identified, investigated and remedial action proposed. It is acceptable for IAD to accept the decisions and opinions of the various experts for the purely technical disciplines in which these professionals have the expertise but the IAD should seek clarifications for those aspects that have fraud possibilities and financial implications.

5.0 CONCLUSION

5.1 Almost every profession has an organisation that looks after the interest of its members. The Internal Auditors have IIA. It also caters to specific sections such as Taxation, Banking, Insurance, etc. However, it appears that Construction Project audit is very low on the priority list. Until such time this neglected sector is given its due attention, the Construction project audit will not gain its rightful place in the profession. It is not the intention to down play the importance of other sectors that are also in the 'mega bucks' category but to suggest that due attention be focussed also on this equally important, but neglected, sector.

5.2 IIA and the management of companies involved in construction projects, either as owners or contractors, can follow the example of national audit organisations of various countries [including Malaysia] which have specialised departments to audit public sector construction projects. They have prepared audit manuals, guides, questionnaires, checklists and notes which have specific relevance to construction projects. They continuously upgrade their expertise with training seminars, both at local and international level, attachment training of staff to other countries and visits to project construction sites, etc. Value is added to their audit services on a continuous basis. The ball is at the feet of IIA and it is up to IIA to take up the challenge and rectify this neglected multi-billion Ringgit sector.

INTERNAL AUDITORS SHOULD FULFIL THEIR OBJECTIVE BY IMPROVING GOVERNANCE, CONTROLS AND ASSURANCE IN THE CONSTRUCTION INDUSTRY

[Sources:- Statistical information: MBAM & CIDB Directory and Newsletters.]
- Audit Committee: Sec.344A of KLSE listing requirements

THE INTERNAL AUDITOR AND THE RISK MANAGER - ONE MAN'S VIEW

By Paul Batchelor

I was going to call this article 'The Auditor and Mr Turnbull', mainly because I liked the ring of it. Then I realised that it might be more productive to stop pretending that the Turnbull Report invented operational risk management – so many of us imply just that in our everyday activities, mainly because it suits us. To be fair, those of us working mainly in the UK have used the Turnbull Report during the last year or so to open doors in our crusade to spread the word on the benefits of active operational risk management. The fact is that the latter makes very good business sense, with or without Turnbull, and whilst I will spend a little time discussing the differences the Report may have made to the internal auditor's role, the main thrust of the article will be to explore the relationship between internal audit and risk management, irrespective of Turnbull.

Operational Risk

Firstly, let us look at what we mean by 'operational risk'. A few months ago, I spent what seemed like an eternity reading numerous papers on operational risk in the banking sector and wound up feeling confused (or possibly, smug) because it appeared that the experts could not agree amongst themselves on a single definition. I suppose the most appropriate, and simplest, was 'everything except market and credit risk'. That should work for most financial services organisations, presumably, but whether or not it would for other industries is likely to depend upon the significance of market or credit risk to their businesses. At the end of the day, it does not matter how risks are defined or packaged, so long as they are all managed correctly. It is vitally important to differentiate between symmetrical risks (i.e. those that give rise to opportunities as well as threats) and negative or downside risks, when formulating a risk policy. Whilst this statement might appear obvious, it is worth dwelling on, as it can be the cause of some friction between line management and the internal auditor. The latter is often believed to be insensitive to commercial pressures and unable to add value to the business, and, to be fair, internal auditors are naturally more risk averse than their colleagues. Businesses gain competitive advantage and increase their profits by exploiting symmetrical risks, and the switched-on internal auditor will need to demonstrate recognition of this fact in their reports, bearing it in mind when recommending additional controls in business areas.

Turnbull

Now, let us turn to the Turnbull Report. I have read one or two articles in recent months which spelt out gloom and despondency, or at least relegation in the organisational pecking order, for internal auditors who did not 'grasp the Turnbull nettle', embracing risk management as their discipline and reinforcing their own importance as a result. I don't share this view. I have no problem with the concept of moving from internal audit into risk management as a career move – that makes good sense to me, as I have always argued that internal auditors have many of the skills required of a good risk manager (incidentally, this is a claim also made by other professionals, such as Treasurers, probably with equal validity). My position is that it is fundamentally wrong to encompass risk management within internal audit by design (or stealth) and that internal auditors should understand this and plan their strategies accordingly. If you accept the above argument, it seems to me that all Turnbull really has to say about internal audit is that directors should be able to rely on it as an independent monitor of the internal control system and should review its effectiveness on an annual basis. I should have thought that this would have been automatic in most well run organisations and, if this is the case, the only big difference is the requirement placed on those organisations without an internal audit function to review the need for one on an annual basis.

Separation

So, there you have it, I say that internal audit and risk management should be quite separate and I imagine that some of you will be asking 'Why?' whilst others may be asking 'How?' Taking the first question I have posed, I will start by repeating a maxim I have always tried to work by; that if internal audit were removed, the day-to-day running of the business would not be affected, in other words, internal audit has no part to play in running the business. (Zealots should bear in mind that this principle is best aired sparingly during periods of cost reduction and downsizing.) Clearly, risk management is an essential part of running any business, which fact should exclude internal audit from holding those particular reins. There will be some persistent and knowledgeable readers of this article who will express the view that the risk manager is merely a facilitator who has no part in running the business - the real managers of risk being the business managers themselves. This is a seductive argument, but it really only applies to those organisations large enough to have clearly defined structures and mature risk management processes. If pushed on the point, however, I would fall back on my view that the risk management function, like any other, should be reviewed by internal audit periodically and cannot, therefore, be carried out by internal audit.

Those readers whose organisations have already set up risk management functions within their internal audit departments may well ask the second question, 'How?' In order to answer this question, we need to examine why the structure came about in the first place. It may be that the organisation is so small that the internal auditor is the only person capable of performing the risk management role. In such an organisation, there are likely to be many scenarios where full separation of duties is not achieved and, with the best will in the world, there is little that can, or will, be done to improve matters unless external pressure is applied. The second scenario occurs where internal audit has moved towards a risk-based audit methodology (probably over the course of the last five years), which has meant that the internal auditor has acquired a modicum of knowledge in the subjects of risk identification and risk assessment. This is likely to have happened where no operational risk management function existed, and in such an environment, the auditor has developed his own risk databases and has used them to highlight those areas requiring more, or less, internal audit attention. He has also been able to demonstrate the need for more, or less, resources within internal audit. In short, he has become regarded as the risk expert within the organisation and may have concluded that risk management represents a useful power base in his dealings with the line. Under such circumstances, senior management, having discovered it has an expert (at no extra cost) is understandably more than happy to confirm the status quo.

So, whatever the reason for the situation, if the organisation has internal audit and risk management as one department, the functions should be separated.

But, how can this be achieved? Well, as indicated above, if the organisation is so small that there simply is not enough resource, it will be difficult. In such a situation, it may be necessary to consider radical changes, such as the outsourcing of one of the functions, leaving the most important, in business terms, in-house.

Where the audit/risk function is not a 'one-man band' the way forward is, in my view, straightforward – split the department into two, removing the management of the risk database from internal audit. A benefit that should accrue from this change, given time, is that risks will be looked at as opportunities, as well as threats, in a well-trained risk management department. Of course, it remains essential that the internal audit department should use the central risk database for audit planning purposes and you would expect the auditor to comment upon the extent to which the right risks have been identified and properly assessed in each area audited. Internal audit needs to work closely with the risk manager in this regard, but must not resort to using its own risk database – there must be only one in the organisation.

Conclusion

In conclusion, the ideal situation is where operational risks are identified and assessed by senior management under the watchful eye of the risk manager, who acts as co-assessor, ensuring a consistent approach throughout the business. The internal auditor uses the risk database for audit planning purposes, incorporating a review of the risks for each area into his work. The internal auditor also includes the risk management function in his audit universe and reviews the methodologies in use from time to time.

In short, I submit that the internal auditor and the risk manager are two quite different animals that are required to co-exist in close proximity for their mutual benefit and that of their environment.

Paul Batchelor FCCA is a director of Professional Interim Management Services Limited. He was a member of ACCA's Financial Services Society Committee for 10 years, serving as Chairman for 3 years. He would welcome comments on this article via e-mail address to: paulbatchelor@tinyworld.co.uk

We would also welcome any comment on the above two articles for future Bulletins.

INTERNAL AUDIT PROGRESS IN UGANDA

Richard Gudoj Gid'Agui Institute of Internal Auditors - Uganda Chapter

Internal Auditing in Uganda has been conservatively going on with a minimum of few qualified professionals. Most Internal Auditing in this country is done by semi-qualified, if not unqualified, staff. They may also be unethical and can be submissive to respective managers for fear of victimisation, loss of jobs etc.

We, in the IIA Chapter, have tried to bring to the attention of the few qualified Ugandan accountants the need to pursue and attain either CIA or MIIA certificates. Already a good number of them have responded and six sat for CIA exams last May.

Our major concern has been to promote CIA/MIIA certifications. However, we have noted that most potential members would need some kind of sponsorship simply because Ugandans believe that ACCA/CIMA/CA/ or CPA are the only qualifications suitable for an Internal Auditor.

Here in Uganda, Internal auditors are seen as fault finders and not as partners in the promotion of good governance and the provision of specialist aspects of consultancy.

PAYROLL AND EXPENSES - AN INTERNAL AUDIT GUIDE

Payroll is an essential expenditure stream in almost all organisations. For this reason, it will often be a significant area for Internal Audit review. Below we provide a guide to auditing this important area. We would welcome comments on this guide and suggestions for other guides for publication in future issues of this Bulletin.

System Objective: Current employees are paid accurately and promptly

1 Control objective: Permanent and temporary variations to payroll input data are accurate and undertaken promptly

KEY CONTROLS:

- 1.1 *All starter and leaver records are created by staff in a personnel section that is separate from the payroll section.* Staff responsible for authorising the creation of new employee records should have no involvement in the routine processing of the payroll. Payroll staff should receive a copy of the appointment letter and the new starter form and details should be checked for consistency. Personnel staff should check all leavers are stopped promptly on the correct date
- 1.2 *All changes to payroll input data is checked and authorised.* Staff responsible for authorisation of the following changes should be formally agreed:
 - (a) amendments to standing data (e.g. salary scales, tax rates)
 - (b) amendments to local permanent data (e.g. staff salary levels)
 - (c) transaction data (e.g. overtime, expenses)(b) and (c) should only be submitted for processing if the relevant documents (e.g. starters/leavers forms, overtime records) are properly authorised by the appropriate persons (copies of whose signatures are held by the payroll section). All tax and pay scales that are held in the computer should be checked for accurate input, at least on a sample basis, to prime documents e.g. official notification of pay increases or tax rates
- 1.3 *Spot checks are made on payroll items to ensure that input data is accurate.* Items within output reports should be checked (on sample basis) in comparison with the authorised data submitted and prime documentation, including spot checks by staff independent of the original preparation of data for submission
- 1.4 *Access to the computer payroll system is suitably controlled.* Only authorised staff should have access to the payroll system. Use is made of suitable password protection and user profiles, i.e. staff should only have access to those aspects of the system that they need to undertake their work. Passwords (at least six digits and not common words) 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
- 1.5 *All relevant staff have access to suitable payroll procedure notes.* These should be sufficiently detailed to be used for training and reference by new staff and should cover all aspects of the payroll function and be updated as necessary with new guidance and regulations. Staff should have access to suitable detailed guidance on e.g. taxation issues. This may be written guidance

or access to suitably qualified and experienced advisors. Suitable details are included in Financial Regulations

2 Control objective: All payroll data is accurately processed, net pay is properly calculated

KEY CONTROLS:

- 2.1 *There is clear segregation of duties between staff who account for payroll and those who make the payments.* Staff responsible for handling manpower/payroll data and calculating gross/net pay are not required or allowed to handle cash or cheques (including those returned un-cleared) and are not involved in automatic payment systems
- 2.2 *Each payroll statement is authorised by a senior officer who is not directly involved in its preparation.* Authorisation of payroll payments (the production of the cheques, automatic payment systems) is restricted to an appropriate number of senior staff independent of the production of the payroll itself
- 2.3 *A check is made on changes to the number of staff on the payroll compared with the last period.* On each payroll/section of payroll the number of staff paid is reconciled with the previous month (or week) and the changes included within authorised data input. In smaller organisations this may be reduced to an annual check. Each head of department should be asked about the staff employed and their salaries/grades and the cost code for each member of staff
- 2.4 *Checks are made to ensure that individual and total payroll payments do not exceed an agreed amount and unusual payments are investigated.* Appropriate payment limits are established for individual cheques/POs and automatic payment systems totals. Exception reports are produced showing for example: negative net pay; gross greater than given percentage of basic pay; gross pay greater than £2k; net pay greater than 20% more than previous period; salary exceeding the grade maximum; overtime greater than £x; allowances greater than £y; cash payments greater than £z
- 2.5 *Control accounts are regularly reviewed.* The output from payroll is reconciled to the input totals in the general ledger through the use of suitable control accounts. The total debits/credits to the payroll system is compared to those posted to the general ledger. If the control account does not balance this is investigated and suitable action taken to ensure that this is corrected. The reconciliation is promptly reviewed. Preparers and reviewers should initial and date each reconciliation

3 Control objective: All deductions from gross pay and employers' contributions are properly calculated, accounted for and paid over to the appropriate body

KEY CONTROLS:

- 3.1 *Checks are made to ensure that income tax / National Insurance is paid accurately and promptly each month.* Income tax is deducted where appropriate, paid to the Inland Revenue by the required date and properly accounted for
- 3.2 *Appropriate arrangements are made for the deduction of pension contributions.* Staff agree in writing to join and employee and employer contributions are sent to / transferred to the relevant pension fund by the required date
- 3.3 *Voluntary deductions from pay are authorised in writing by the employee*
- 3.4 *Other deductions have appropriate written authorisation e.g. Court Orders, maintenance payments etc.*
- 3.5 *Control accounts are used to ensure deductions are paid accurately.* These are reviewed and cleared/balanced each month as necessary. All payroll suspense accounts (if used) are cleared each month

4 Control objective: Suitable management information and statutory returns are completed as required

KEY CONTROLS:

- 4.1 *Variances from revenue and manpower budgets are reported with suitable explanations*
- 4.2 *A suitably authorised staffing establishment is maintained independently of the payroll section. This includes salary scales. The payroll is periodically checked to the payroll establishment*
- 4.3 *Checks are made to ensure that statutory payroll forms are produced and distributed as required each month/year*

5 Control objective: Appropriate expenses are paid accurately and promptly

KEY CONTROLS:

- 5.1 *Rates for expenses are reviewed and agreed each year. Suitable rates for expenses (e.g. Inland Revenue fixed profit mileage rates) are agreed and reviewed each year and adequately recorded. These are formally agreed by the finance committee etc. Unless otherwise documented in staff contracts, expenses should only be for specific costs that have been incurred and, where possible, be backed up with receipts*
- 5.2 *Expenses are only allowed if they are claimed promptly. All expenses are claimed on official forms within two months of the end of the month in which they were incurred. The forms are authorised by approved supervisors. Expenses are paid through payroll*
- 5.3 *The total expenses paid to each member of staff is reviewed each year. A tabulation should be produced of the total value of expenses claimed by each member of staff each year and this should be reviewed for reasonableness by their head of department. Any potential anomalies should be checked carefully*
- 5.4 *All foreign travel should be reviewed by members each year and the cost compared to likely benefits. All foreign travel is coded separately and the total for each member of staff is reported to members each year*

ACCA UK MEMBERS SURVEY: FRAUD AND THE SMALLER COMPANY

Statement of Auditing Standards (SAS) 110, 'Fraud and Error', issued in 1995, sets out the current responsibilities of external auditors in the UK for detecting fraud. The Auditing Practices Board (APB) conducted research into whether, and how, SAS 110 and related Auditing Standards should be revised, which culminated in the publication of the discussion paper 'Fraud and audit: choices for society' in 1998.

The key findings of APB's work were that:

- most material frauds invariably involve directors and/or senior management
- the majority of frauds involve misstated reports to the market but do not involve diversion of funds from the company
and
- management fraud, particularly if it also involves collusion with third parties, was unlikely to be detected as part of the statutory audit of financial statements

As part of its continuing commitment to the fight against fraud, and to maintaining an understanding of how fraud affects small entities in particular, ACCA has undertaken research into the issue of fraud and the smaller company in the UK. As part of this research, ACCA sent out a survey to its members, which was distributed to 1,250 different UK accountancy firms in late 2000.

The key findings of this survey were that:

- 59% of respondents claimed to have experienced, or suspected, fraud affecting their clients.
- 75% of respondents noted that the cases which they had encountered involved owner-managers only.
- 45% claim that the fraud was detected by the auditor.

- 123 encounters with fraud involving the falsification or alteration of accounting and/or computer records in order to suppress / remove transactions were reported by members.
- 58% of fraud experienced by respondents had been motivated by personal gain.
- 75% noted that 0–5% of turnover was involved.
- 76% noted that 0–5% of capital employed (net assets) was involved.
- 88% perceived the level of fraud to be the same over the last five years.
- 87% were not aware of any change in fraud levels caused by e-commerce.
- 34% of respondents claim that instinct had led them to be suspicious of fraud.
- 42% noted that management override of controls enabled the fraud to be perpetrated.

For a full copy of the report, please visit the ACCA website: http://www.accaglobal.com/tech_dev.html

PUBLICATIONS AND RESOURCES

AuditNet - <http://www.auditnet.org>

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 world-wide. 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. Pointers via the Internet connect some of those spokes while some spokes are islands unto themselves. A listing of those electronic resources is updated and distributed monthly via the Internet. AuditNet includes Jobs for Auditors and an inventory of Audit Work Programs.

Newly Added Resources:

IS Audit and Security Review Kits are now located at: <http://af.gallaudet.edu/audit/kits.html>

Review Information Network is at: <http://www.tbs-sct.gc.ca/ia/index.htm>

Sick Leave Management Audit Guide is at: <http://www.tbs-sct.gc.ca/ia/Resources/guide/APPEND.e.html>

Training Function Audit Guide is at: <http://www.tbs-sct.gc.ca/ia/Resources/guide/GUIDE307.e.html>

Internal Auditing Qualification

To date, nearly 25,000 individuals have attained The Institute of Internal Auditors' Certified Internal Auditor qualification. Now in its 36th year, the CIA designation is recognised in countries across the world, with a significant growing interest in Europe, Africa and Asia. The CIA is offered at more than 200 sites throughout the world in May and November each year. Examinations are offered in Chinese, English, French, German, Hebrew, Italian, Japanese, Spanish and Thai. For more information or to register, contact The IIA's Customer Service Centre: e-mail: custserv@theiia.org or Fax: +1-407-831-5171 Tel: +1 407-830-7600. Website: <http://www.theiia.org>

Those considering sitting for the CIA exam and wanting to get a feel for the types of questions and the set-up of the exam - it's easy! Just log on to The IIA's website, select the Certification heading, then click on the Interactive Sample Exam. The sample CIA exam consists of 12 questions for each part, and a total of 48 questions for the entire exam. The site also includes complete details on the certification and exam, and an application form.

In the UK *Management Audit* arrange three-day CIA review courses in March and October led by professors Andrew Chambers and Jeffrey Ridley. Details of these courses are available from:

<http://www.management-audit.com>

Internal control in banks

The Bank for International Settlements has a range of documents - available from <http://www.bis.org/publ/index.htm> - of interest to internal auditors working for banks this includes *Framework For Internal Control Systems In Banking Organisations* [Basle Committee on Banking Supervision, September 1998].

Internal Audit Books Available on the Internet - <http://www.cipfa.org.uk/publications>

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.

The Southern African Institute of Government Auditors

The Southern African Institute of Government Auditors was founded in 1988. The objectives of the Institute are broadly defined and encompass the promotion and advancement of accountability and auditing. Since the principles of government auditing are based on the generic principles of auditing, the Institute strives to promote auditing in its wider context.

Unlike most accounting Institutes, the Southern African Institute of Government Auditors is not a trade association, but it focuses on the advancement of the disciplines of accountability and auditing.

Its website (at <http://www.saiga.co.za/default.htm>) includes a range of information including: news releases & communication; publications; standards & guidelines; members courses; Public Finance Management Academy; PFMA Discussion Forum; contact details; & links.

Internal Audit Research: The First Half Century

(Gerald Vinten 1996)

A review of the contribution that internal audit research has made in the last 50 years. It focuses on the research work of the Institute of Internal Auditors which has helped to propel internal audit from a semi-professional to professional status.

Order by email from: info@accaglobal.com

ACCA Communities

ACCA Communities is a free Internet service for ACCA members and students and their business contacts. They can use the service to set up or take part in virtual interest groups, to provide secure virtual workspaces for collaboration on projects or business deals or to support self-help study. Each virtual group has its own document area, database, group mailing list, calendar and voting mechanism.

Since the launch, communities have been created to discuss tax and audit issues, ACCA's practice support tool, Business Navigator and its lifelong learning proposals. To find out more visit:

<http://www.accacommunities.com>

Please let us know if you have found any references on the Internet which you think other internal auditors would find useful. We can then include the information in the Bulletin.

BOOK REVIEWS

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.

ACCA INTERNAL AUDIT SUB-COMMITTEE

The Internal Audit Sub-committee is a sub-committee of ACCA's Auditing Committee. The terms of reference of the sub-committee are:

1. To promote, in co-operation with other relevant professional bodies, the development and best practice of internal audit
2. To bring to the attention of the Auditing Committee developments in internal audit practice which are considered to be relevant to the ACCA and its members
3. To consider and comment on any significant internal audit issues
4. To keep under review developments and any policies, procedures or regulations relating to corporate governance so far as these concern internal auditors
5. To consider whether there are additional services in the form of newsletters, networking facilities or training which ACCA could usefully and practically offer to its members who are internal auditors
6. To consider whether there are topics for research on internal audit which should be referred through Auditing Committee to the Research Sub-committee
7. To monitor the output of other professional bodies and authoritative groupings in regard to internal audit matters
and
8. To be aware of and, through Auditing Committee, to liaise with the External Affairs Committee on the public relations potential of the Sub-committee's work

The Chairman of the Sub-committee is Richard Nelson, Controller of Audit at The Lattice Group. The other members are senior internal auditors or internal audit specialists covering the public and private sectors. The Internal Audit Bulletin editor, Andy Wynne, is a member of the Sub-committee.

PASS ON DETAILS OF THE BULLETIN TO OTHERS

Please pass on information contained in this Bulletin to anyone in your organisation or any other internal auditors. Your internal audit colleagues can register to receive future Bulletins by sending contact details including telephone number by e-mail to: info@accaglobal.com putting the word '**regbull**' in the subject line.

If you no longer wish to receive the Bulletin or if you change your e-mail address, again please contact us at the above e-mail address putting '**debull**' or '**changebull**' respectively in the subject line.

Please include your full name, clearly state the type of organisation that you work for and whether you are a member of the ACCA. This will enable us to update our records and ensure that the Bulletin contains information that is of interest to its readers. The service is open and free to all internal auditors across the world, regardless of whether or not they are members of the ACCA. We will not pass on your details to any third party.

Best wishes

Andy Wynne, Editor

The End