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CHALLENGES FACING INTERNAL AUDIT FUNCTION THE CASE OF OROMIA
PUBLIC ENTERPRISES

BY

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RESEARCH PROJECT SUBMITTED TO DEPARTEMENT OF ACCOUNTING AND
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ADDIS ABABA

Declaration

I, Emire Regassa declare that, this paper prepared for the partial fulfillment of the requirements for MSC. Degree in Accounting and Auditing entitled “challenges facing internal audit function the case of oromia public enterprises” is prepared with my own effort. I have made it independently with the close advice and guidance of my advisor. All materials and sources used are duly acknowledged.

Emire Regassa

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Date _____

Certification

This is to certify that Emire Regassa has carried out this research work on the topic entitled “challenges facing internal audit function the case of oromia public enterprises” under my supervision. This work is original in nature and it is sufficient for submission for the partial fulfillment for the award of MSc. in Accounting and Auditing

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ACRONYMS

CAE: Chief Audit Executive

CEO: Chief Executive Officer

CFO: Chief Finance Officer

IA: Internal Auditor

IAF: Internal Audit Function

IIA: Institute of Internal Auditor

ISPPIA: International Standards for Professional Practice of Internal Auditors

MOFED: Ministry Of Finance And Economic Development

ABSTRACT

The main objective of this research was to investigate challenges facing the internal audit function that influence the oromia public Enterprises to tail their internal audit activities. The research was conducted on nine public Enterprises at head office level. Twenty internal auditors were used as data source who were selected using convenience sampling techniques. To obtain the required information open- ended and closed ended questionnaires was used as data gathering tools. Then quantitative and qualitative approaches were employed to analyze and interpret the filled in data. The findings related to challenges delaying adequacy of internal auditing revealed lack of independence, inadequacy of internal control system, inadequate skills among internal auditors, inadequate facilities at the internal audit department, inadequate funds to carry out internal audit, inadequate cooperation among role players, external auditors reluctance on works of internal audit, the lack of an audit action monitoring processes, inadequacy on segregation and appointments of duties as well as lack of commitment from management staffs were critical factors influencing internal audit functions of the respective public enterprises. To alleviate those problems, it is recommended that management, audit committee and the audit process owner of the respective public enterprises has to work jointly to improve the IAF of their respective public enterprises as per rules, regulations and requirements of international standards

CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

Currently, several forces have led to a quiet revolution in internal audit. Democracy requires government to be accountable in its use of public money and in providing effective, efficient, and economical service delivery. Ever larger and more complex systems require greater competencies, thus internal audit has had to become ever more professional. (Van Gansberghe, 2003.)

Reporting relationships of internal auditing has changed and developed together with the progress of internal auditing. At the beginning reporting lines of internal auditors went to the accounting level and external auditors, who saw internal auditors mainly as assistant in financial audits.

Accordingly as functions and roles of internal auditing expanded, changed and shifted more to management oriented matters than accounting matters, the challenge they facing have also been transformed and currently in many countries internal audit activities have also been transformed. Internal audit process can be ideally classified in to administrative and functional; the chief audit executive is functionally responsible to the board or audit committee and administratively to the chief executive officer of the organization. (Rolandas , 2005.)

In addition, the development in internal audit profession brings change in the scope and functional relationships with internal audit customers. Initially the major role of internal auditing focused on an accounting oriented function that has been gradually transformed into management oriented profession. Previously internal auditors were seen just as an assistant of accountants and an external auditor but recently internal audit is certainly considered an independent profession, which is playing a significant role in the management of organizations.

Besides, Independence of auditors have always been a sensitive issue, especially for internal auditor in which the internal auditor is expected to be independent, while he/she is the employee of the organization, above all, not clearly organized structural line make the problem more complicated.

Moreover, the emergence of the concept corporate governance and audit committee brings change in the professional relationship of internal auditors. In many countries internal audit required to works are functionally to audit committee and it is also play key role to assist the board and/or its audit committee in discharging their governance responsibility. The main purpose of this project is to conduct a survey study through analyzing the challenges of internal audit, and identify the correlation of internal audit scope, independency, good governance and audit committee with internal audit functional relationship in relevant with Oromia Public Enterprises and make recommendations on this particular concern.

1.2. The Development of Internal Audit in Ethiopia

An Internal Auditing function has existed for quite a long time in Ethiopia; however, it got legal recognition in late 1980s. The internal Auditing function started in the budgetary public sector as part of internal control. However the latter part of the 1940s witnessed the establishment of Internal Audit functions in the Ministry of National Defense, Ministry of Education, and Ministry of Finance. It was also at this time that the Internal Auditing units began to grow in non-budgetary public sector (Public enterprise) like Ethiopian Highway Authority, Ethiopian Airlines, Ethiopian Telecommunication, and financial sector that formed the modern layer of the National Economy (Lemma , Dec 2000)

Internal Auditing in Ethiopia obtained legal recognition for the first time in 1987 through Proclamation No. 13/1987. This proclamation empowered Office of Auditor General (O.A.G) to direct the Internal Auditors of Government Offices and Public Enterprises in three aspects that are whether accounting records are properly maintained and reliable, whether the assets of the ministries and enterprises are adequately safeguarded and properly maintained; and whether

policies and procedures laid down by top officials/management are complied with that implies less attention was given to operational audit as a service to management.(Lemma , Dec 2000)

In 1994 the civil service reform program organized a task team that was formed by Prime Minister to assess and review the performance of Civil Service and come with the following: absence of Internal Audit functions in some of the Ministries and Public enterprises, internal auditors devoted most of their times and efforts on pre-audit, internal auditors neither have the skills needed nor working manuals.

On July 1, 1997 the Financial Administration Regulations No. 17/1997 was issued in which the responsibility of internal audit function was transferred from the Office of the Auditor General to the Ministry of Regulation set out the responsibilities of the Minister of Finance to develop and maintain appropriate standards of work and conduct for application throughout all the public bodies. Internal audit function and after this financial regulations almost all public bodies established Internal Audit Services; almost all public bodies discontinued pre-audit or pre-checking. (Wolderuphael , 2000)

In 1998 the Ministry of Finance issued an Operational Audit Manual to strength the Audit function in the Public bodies. According to this manual internal audit services are made to report to the top persons of the organizations.

In May 2007 policy directive was issued to further strengthen the Internal Audit service function in the public bodies, however, the legal basis laid down by both in the Regulations of Council of Ministers and the Ministry of Finance Directive is applicable only to internal auditing under the auspices of Public bodies and does not apply to public enterprises and the private sector, but recently Public Enterprises Supervising Authority has issued policy directive for establishment of audit committees in all public enterprises and an audit manual to maintain uniformity of audit work in all public enterprises

Generally, the history of internal auditing in Ethiopia dated back to the 1940s just about the time the profession was also evolving in Europe and in the United States. Although, the prologue of internal auditing in our country counts half a century and all the above endeavors has made to the

development of internal audit in Ethiopia there are challenges that hinders or slows the speedy growth of internal audit. (Lemma , Dec 2000.)

In this chapter we try to analysis the reporting structure of internal audit, looking in to the relationship between reporting relationship and internal audit scope explain how independency could be impeded by reporting relationship, elucidate the relationship between corporate governance and reporting relationship, and finally discuss internal audit relationship with audit committee.

1.3. Statement of the Problem

Several business administrations are rapidly assuming complexity resulting to notable confidence/reliance/ to internal audit and management as a broader range area of control.

In spite of the existence of internal audit departments in organizations, it is often argued that the rate of fraud and misdeeds is still on the increase, particularly in the public Enterprises. Some people argue that the internal auditors are creating more problems than they are solving, others see it as tools for compliant and therefore sees them as unnecessary criminal.

The internal audit in Oromia public Enterprises may be insufficient based on some confusion:-

- Lack of proper segregation and proper assignment of duties as well as shortage of qualified staff and experience to carry out internal audit and accounting duties;
- Lack of implementation of audit report by appropriate authorities;
- Inadequacy of internal control system leading to improper investigation;
- Inadequacies in obedience to internal audit standards and quality assurance;
- Inadequate cooperation;
- Lack of proper communication among stakeholders/concerned party;

The above reasons greatly affect the effectiveness of internal audit in the public Enterprises. This gives the researcher the push for undertaking a study on this with a view coming up with solution of those challenges.

1.4. Objectives of the Study

The objective of this research is to outline the specific task to be set out towards achieving the purpose of a research problem. However, appears to be inhibiting the proper discharge of the challenges facing internal audit function the case of oromia public enterprises due to the necessity for public Accountability. Many people do not know why internal audit department should exist and it should be part of internal control in public organization.

This study is expected to achieve the following specific objectives:

- To evaluate the overall internal control system and ascertain the existence of proper segregation and assignment of duties;
- To assess whether there is sufficient number of staffs to carry out audit work;
- To ascertain that there is proper implementation of routine audit report by appropriate authorities;
- To assess independence of internal audit department from the management;
- To answer whether there is adequate resource allocation for the audit department;
- To assess whether there is Management support.

1.4.1. Research Questions

The following are the various research questions. They are as follows:

1. Are there challenges of internal audit function in the Oromia public sector?
2. Are the impacts of Oromia public sectors on the internal audit function?
3. Does public Enterprises management do with an internal audit function?
4. How is the educational qualification and professional experiences of internal auditors?
5. Are the internal auditors satisfied with the management response for audit findings?
6. What are the major challenges of Oromia public enterprises internal auditors?

1.5. Significance of the Study

The project intended to bring to light the challenges of internal audits department in the Oromia public Enterprises with a view of coming up with possible ways to overcome such challenges.

The research work will be of vital importance to the government, bringing to light the challenges hampering the efficiency of the internal audit and how these challenges can be tackled.

The research work will also be of significance to the management or to the supervisory authority, Boards and other government organizations. So as to see the importance of effective internal control system and the discharge of their responsibilities to the internal auditors as a yardstick to improve organizational performance. It is also necessary for the internal auditors to understand their loopholes so that necessary adjustments could be made to enhance their efficiency.

1.6. Scope of the Study

The scopes of this research work in the Oromia Enterprises as a whole specifically the internal audit department, with particular interest in the Oromia public Enterprises.

1.7. Limitation of the Study

The limitation to this research work is the lack of adequate information from the senior staff of the Enterprises considering such information as “Top Secret”. In ability to have access to vital documents in the Enterprise considering such document as confidential.

1.8. Organization of the Paper

The paper is organized in five chapters; chapter one include back ground of the study, statement of the problems, objectives, significance of the study, and scope (delimitation) and limitation of the study; chapter two contains reviews of related literature; chapter three of the paper has research methodology; chapter four data analysis and interpretation and the last chapter, contains conclusions and recommendations.

1.9. Definition of Terms

In every study, there are some terms that are frequently used; also in the course of this study the following terms relating to the subject matter will frequently be used.

FRAUD: This is defined as criminal deception in an act of acquiring other people money kept in one's possession deceitfully.

INTERNAL AUDIT: A.H. Mill champ defined internal audit as “an independent appraisal function within an organization for the review system of control and quality of performance as a service to the organization”. The objective is to examine, evaluate and report on the adequacy of internal control as a contribution to the proper economic efficient and effective use of resources.

INTERNAL CONTROL: Internal control is the whole system of control, financial and otherwise, established by management in order to carry on with the business to an enterprise in an orderly manner, ensure adherence to management policies, safeguard its asset and secure as far as possible the completeness, accuracy and reliability of books and other records.

INTERNAL CHECK: Internal check is the aggregate of the check and balance imposed on the day to day transactions in an organization where by the work of one person is verified independently by or is complementary to the work of one another.

PUBLIC ENTERPRISE: are the regional enterprises that are responsible for the Oromia Public Enterprises supervisory authority.

PUBLIC SECTOR: consist of all organization whose control lies in the hands of the public and whose objective involves the provision of services where profit is not the primary motive.

CHAPTER TWO

LITERATURE REVIEW

2.1. Evolution of Auditing

The history of auditing started as man's awareness of the need to safeguard state and personal property that has been inferred from the records of a Mesopotamian civilization going back as early as 3500 BC. These records, involving financial transactions displayed various markings, which may be construed as a system of verification, internal controls and separation of duties. (Van Gansberghe, 2003).

Ancient Rome employed the "hearing of accounts", where one official would compare his records with those of another, entails an application of both separation of duties and verification practice, hearing of accounts, which gave rise to the term "audit", from the Latin "Audire", to listen.

In the medieval period, Industrial Revolution in Europe, changed the role of auditing that went beyond hearing of accounts to include verification of accounting records and associated supporting documentation. Since Second World War internal audit, has evolved rapidly from the primarily function, which is concerned with financial and accounting matters to the one that addresses the entire range of operation activities.

Internal audit profession has advanced primarily as consequences of the increase size and decentralization of organization, the greater complexity of their operations, and the resulting need for means of monitoring their numerous activities, various government organizations are expected to have an internal auditing function and an audit committee composed of non-management directors. (Irvin , 2000)

2.2. Roles of Internal Audit Department

Consistent with its mission, the Internal Audit Department provides management with information, appraisals, recommendations, and counsel regarding the activities examined and other significant issues.

The department executes an approved audit plan and will perform the following tasks in accordance with its overall strategy:

- Verify the existence of assets and recommend proper safeguards for their protection;
- Evaluate the adequacy of the system of internal controls;
- Recommend improvements in controls;
- Assess compliance with policies and procedures and sound business practices;
- Assess compliance with state and federal laws and contractual obligations;
- Review operations/programs/to ascertain whether results are consistent with established objectives and whether the operations/programs/ are being carried out as planned;
- Investigate reported occurrences of fraud, embezzlement, theft, waste, etc. (Chartered Institute of Internal Auditors, 2012) The main role of internal audit as: independent appraisal of internal control system, independent review of the efficient operation of the organization, proper safeguarding of asset and preventing and detecting fraud and errors (Ho & Hutchinson).

As far as internal auditing is one of the cornerstones of corporate governance, along with the board of directors, senior management, and external auditing. management often calls upon internal auditors to help provide them with assurance that:

- (a) Risks are effectively identified and monitored;
- (b) Organizational processes are effectively controlled and
- (c) Organizational processes are efficient or effective.

In other words, internal audit has played an active role in implementing effective governance and controls while being asked to assess the effectiveness of management's control practices. To strengthen this active role, internal auditors shall report directly to the audit committee, not to senior management there by ensuring Audit committee's preminent role in monitoring and reporting on the effectiveness of corporate governance.

Additionally, in the governance context, the key activity with respect to risk (the probability that an event or action, or inaction, may adversely affect the organization or activity under review) is to monitor it, including all the subsidiary steps of identifying risk, assessing the potential effect

of the risk on the organization, determining a strategy to address the risks, and then monitoring the environment for new risks as well as monitoring the existing risk strategy.

To do this effectively, an internal audit activity must have adequate resources, professionally staffed, and follow the internationally recognized framework for internal auditing. Besides, audit committee members must play an active role to ensure that it has enough resources to provide the appropriate level and quality of information and to support the independence of internal auditing and. This independence that can be seen from the angles of:

- **Independence in Mind.** The stage of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing individuals to act with integrity and exercise objectivity and professional skepticism. (Bethlehem ,2009)
- **Independence in Appearance.** The avoidance of facts and circumstances that a reasonable and informed third party having knowledge of all relevant information, including safeguards as applied would reasonably conceal member of audit team integrity, objectivity and professional skepticism.(Bethlehem , 2006)

Nevertheless, internal audit independence is increasingly being strengthened by the endorsement of regulators or statute. Internal auditing is thereby virtually mandatory in central and local government, state financed agencies, banks, building societies and some other financial societies.

The support the professional internal auditor receives from his or her professional body is also important. The professional body is a watch dog over many of the factors which contribute to independence and a buttress against treats to that independence (Andrew, 1992).

However, during the past 50 years, organizations worldwide in the private, public service and voluntary sectors have established internal auditing functions to improve their monitoring activities. In the early days of its development most internal audit work related to internal accounting control and security over assets. Few internal auditors were involved in operating systems or the achievement of organization objectives and strategic issues at board or governing body level (Kenneth , 2007).

2.3. Value of Internal Auditors to the Organization

Internal auditors deal with issues that are fundamentally important to the survival and prosperity of any organization. Unlike external auditors, they look beyond financial risks and statements to consider wider issues such as the organization's reputation, growth, its impact on the environment and the way it treats its employees. In sum, internal auditors help organizations to succeed. We do this through a combination of assurance and consulting. The assurance part of our work involves telling managers and governors how well the systems and processes designed to keep the organization on track are working. Then, we offer consulting help to improve those systems and processes where necessary (Chartered institute of internal auditors, 2012)

2.4. Types of Audits Performed by Internal Auditors

A variety of audits are performed in the review of campus programs and resources. These audits include:

2.4.1. Operations Audits: These audits examine the use of resources to determine if resources are being used in the most effective and efficient manner to fulfill the organization's mission and objectives.

2.4.2. Financial Audits: These audits review accounting and financial transactions to determine if commitments, authorizations, and receipt and disbursement of funds are properly and accurately recorded and reported. This type of audit also determines if there are sufficient controls over cash and other assets and that adequate process controls exist over the acquisition and use of existing resources.

2.4.3. Compliance Audits: These audits determine if entities are complying with applicable laws, regulations, policies and procedures. Examples include federal and state laws, and Trustee policies and regulations.

2.4.4. Information Systems Audits: These audits review the internal control environment of automated information processing systems and how people use these systems. The audits usually evaluate system input, output; processing controls; backup and recovery plans; system security; and computer facilities.

2.4.5. Internal Control Reviews: These audits focus on the components of the major business activities, such as payroll and benefits, cash handling, inventory and equipment, physical security, grants and contracts, and financial reporting.

2.4.6. Performance Audit: Performance audit refers to an independent examination of a program, function, operation or the management systems and procedures of a governmental or non-profit entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources.

2.5. Internal Audit Effectiveness

Different authors were defined the term “effectiveness” as follows; for instance, Arena and Azzone (2009) defined effectiveness as “the capacity to obtain results that are consistent with targets”. Dittenhofer (2001) “Effectiveness is the achievement of internal auditing goals and objectives using the factor measures provided for determining such factors”. In Mihret and Yismaw, (2007) internal audit effectiveness is defined as “the extent to which an internal audit office meets its supposed objective or the extent to which it meets the intended outcome”.

All the three authors defined effectiveness in terms of achieving the IA goals and objectives, though interpreted in different ways. Mihret and Yismaw (2007) described the characteristics of effective internal audit unit from the internal audit point of view. Effective Internal Audit (IA):

- Undertakes an independent evaluation of financial and operating systems and procedures;
- Contributes to the achievement of organizational goals;
- Needs management’s commitment to implement recommendations;
- Provides useful recommendations for improvements as necessary;
- Affected negatively by lack of attention from management which in turn adversely affects the audit attributes; and
- Management support is a natural quid pro quo for effective internal audit.

While, Sarens and Beelde (2006) point out the contribution and roles of internal audit in organizations or corporate governance from the senior management’s expectation point of view.

Senior management expects internal audit:

- To compensate for management's loss of control resulting from increased Organizational complexity,
- To be the safeguard of corporate culture through personal contacts with people in the field,
- To be a supportive functions in the monitoring and improvement of the risk management and internal control system,
- To be laid a training ground for future managers, and
- To collaborate actively with the external auditors to increase total audit coverage.

This indicates that internal audit and management is the interdependent unit that should be collaborated to achieve organizational goals. While doing their activities, there is some value that internal audit unit seeks from management (such as management support, commitment, expectation, etc.) and that the management wants from the internal audit like adding value in decision making by providing sufficient information and reducing information asymmetry, monitoring and improvement of the risk management and internal control system.

2.6. Challenges of Internal Audit Practices

Theoretically, the Chief Audit Executive should present audit report functionally to the board or audit committee and administratively to the chief executive officer of the organization and functional reporting line for the internal audit function is the ultimate source of independence and authority (Rolandas, 2005).

Audit report functionally means that the principal authority would approve the overall charter of the internal audit function, approve the internal audit risk assessment and related audit plan, receive communication from the chief Audit on the results of the internal audit activities or other matters that the Chief Audit Executive determines are necessary, private meeting with the Chief Audit Executive without management present, approve all decisions regarding the appointment or the removal of the Chief Audit Executive, approve the annual compensation and salary adjustment of the Chief Audit Executive, and make appropriate inquiries of the management and

the Chief Audit Executive to determine whether there are scopes or budgetary limitation that impede the internal audit function to execute its responsibility.

On the other hand administrative reporting is the reporting relationship within the organization's management structure that facilitates the day-to-day operation of the internal audit function it is typically includes, budgeting and management accounting, human resource administration including personal evaluations and composition, internal communication and information flow, administration of the organization's internal policies and procedures (Irvin , 2002).

However, a different research result shows the challenging issue that theoretical approach usually is not always implemented practically. For instance as the survey of the chief audit executives made by the IIA for 2003 shows, functional reporting lines of the internal audit activity sometimes deviate from the ideal or theoretical reporting relationship and audit opinions are not implemented.

2.7. International Internal Auditing Standards

The Institute of Internal Auditors promulgates standards and guidelines for internal auditors in a publication titled the International Standards for the Professional Practice of Internal Auditing (ISPPIA), Code of Ethics, and The International Professional Practices Framework (IPPF). These standards are designed for all types of internal audits.

The standards are principle-focused and provide a framework for performing and promoting internal auditing. The Standards are mandatory requirements consisting of statements of basic requirements for the professional practice of internal auditing and for evaluating the effectiveness of its performance. The requirements are internationally applicable at organizational and individual levels. Hence, it is necessary to consider both the statements and their interpretations to understand and apply the Standards correctly. The standards employ terms that have been given specific meanings and are included in the glossary .Hence, it is necessary to consider the specific meanings from the glossary to understand and apply the Standards correctly.

The purpose of the Standards is to:

1. Delineate basic principles that represent the practice of internal auditing.
2. Provide a framework for performing and promoting a broad range of value-added internal auditing.
3. Establish the basis for the evaluation of internal audit performance.
4. Foster improved organizational processes and operations.

2.8. Empirical Review

As the main aim of this research is to assess the challenges and practices of internal audit in the public business sector enterprise, different authors and researcher's idea and recommendations regarding the related topic of internal audit are analyzed and presented. Although the prologue of internal audit in Ethiopia are dated in the 1940s the time also the united states and most European countries are adapted; the duets of internal audit in the public sector are challenged because of the factors that hinder the development of IA. For the ease of presenting the literature those studies regarding the main determinants/factors/ that challenge the duets of internal audit in the public business enterprise sector; such as the formal mandate, unrestricted access, sufficient funding, competent leadership, management support and professional audit standards. Perceptions of the management, organizational independence of internal auditors, adequate competent of IA staff and the presence of IA charter reviewed from different researchers are included in these literature.

2.8.1 Organizational Independence

MOFED (2004), Ethiopian Government Auditing Standards (EGAS, 2006) and IIA (2006) states that organizational independence allows the audit function to conduct work without interference by the entity under audit. EGAS (2006) placed emphasis that in all matters related to their audit work, audit offices and individual auditors must have independence from the legislature, executive and the management of the audited entities.

Independence has no single meaning and interpretation across the people; hence the concept is subject to ambiguity and uncertainty (Wines, 2012). However, for the purpose of the case study independent refers to the concept of being free from any management influence while internal auditors perform audit activities and issue audit report (Ahmad & Taylor, 2009; Belay, 2007; MoFED, 2004). Independence is fundamental to the reliability of auditor's reports. Those reports would not be credible, and investors and creditors would have little confidence in them, if auditors were not independent both in fact and appearance. The assurance services provided by auditors derive their value and credibility from the fundamental assumptions of independence of mind and independence in appearance (Wines, 2012; Stewart and Subramanian, 2010).

While the internal audit typically the whole management process, to maintain objectivity, to increase the reliability of information, to be free from unacceptable risk of material bias, and to issue reasonable and credible audit opinion, it is required to be independent (IIA,2001). However, due to an often strong direct or indirect relationship between IA and the Chief Executive Officer (CEO) and/or chief Finance Officer (CFO), it is reasonable to expect that senior management is in a position to exert a significance influence over IA (Sarens and Beelde, 2006; Van Peurse, 2005).

Independence in fact exists when auditors are actually able to act with objectivity, integrity, impartiality and free from any conflict of interest. While the concept of independence in appearance is the auditor should be perceived by others (the public or other third party) to be independent. In this case, conflict of interest will also exist when a reasonable person, with full knowledge of all relevant facts and circumstances, would conclude that the auditor, or a professional member of the audit team, is not capable of exercising objective and impartial judgment in relation to the conduct of the audit of the audited body.

Auditors should be sufficiently independent from those they are required to audit in order to conduct their work without interference. Coupled with objectivity, organizational independence contributes to the accuracy of the auditor's work and gives employers confidence that they can rely on the results and the reports (Cohen & Sayag, 2010). However, Hellman N. (2011) suggested that CFOs seek to influence audit planning, particularly with regard to internal

controls and the selection and scope of entities subject to audit; and this in return impairs the independence of internal auditors.

In order to maintain their independence internal auditor's organizational status and position is also critical which is related to management perception. This is because it enables them to exercise their tasks independently and act objectively. As Stewart and Subramaniam (2010) review under organizational status the IAF should be given the appropriate status in the organization to enable the function to exercise organizational independence and individual internal auditors to act objectively since internal auditors found in a unique position as employees of an organization with responsibility to assess and monitor decisions made by management and also to the management.

Furthermore, many auditors have been argued that in order to achieve audit objectives and become effective organizational independence is very important. For instance, the independence of internal audit department and the level of authority to which the internal audit staff report are the important criteria influencing the objectivity of its work, and added that organizational independence is more crucial to the effectiveness of the internal auditors, as it protects the auditor from pressure or intimidation, and increases the objectivity of the auditing work (Cohen & Sayag, 2010; Van Peurse, 2005; Boa- Read, 2000).

2.8.2. Management Support

Internal auditors have a close relationship with organization's management in their day to day activities. They need good support and perception from their management to be more effective and to achieve the audit objectives. Management support is expressed in terms of supporting the auditing process by fulfilling the necessary resources, finance, transport if required, providing training, introducing auditors with new technology and procedures, budgeting funds for certification and other facilities that facilitate the internal auditing works.

Dessaegn and Aderajew (2007), their Ethiopian higher education case study result shows that management support to IA is considered as one of the determinants of IA's attributes. The institute in relation to support stated that the legitimacy of the audit function and its mission

should be understood and supported by a broad range of elected and appointed government officials, as well as the media and involved citizens (IIA, 2006).

Management support has a far-reaching consequence on IA effectiveness in organizations. For example, Mihret and Yismaw (2007) in their case study of IA effectiveness on public sector shows that the component of management support consists of the response to audit finding and the commitment to strength internal audit which has significance influence on IA effectiveness.

Given the fact that internal audit activities are performed in dynamic management process and more supportive environment, internal auditor expects senior management to take the first steps to support the IA process. Because, Sarens and Beelde (2006) argue that the overall acceptance and appreciation of IA within the company is strongly dependent upon the support they receive from senior management. Internal audit actively seeks management support with resources, commitment to promote and communicate their added value.

The management support is almost crucial to the operation and internal audit; because all other determinants of IA effectiveness derive from the support of top management, given that hiring proficient IA staff, developing career channels for IA staff, and providing organizational independence for IA work are the results of decisions made by top management (Cohen & Sayag, 2010). This means it is the interest of management to maintain a strong internal audit department (Adams, 1994; Mihret and Yismaw, 2007).

In addition implementation of audit recommendations is highly relevant to IA effectiveness (Sarens and Beelde, 2006; van Gansberghe, 2005) which is the component of management support (Mihret and Yismaw, 2007). The management of an organization is viewed as the customer receiving IA services. As a result, management's commitment to use audit recommendations and its support in strengthening internal audit is vital to IA effectiveness.

MOFED (2004), states that heads of internal audit should co-ordinate internal audit plans and activities with the management, other internal auditors, external auditors, and other review agencies to ensure the most effective audit coverage is achieved and duplication of the effort is minimized. In line with this thought, Van Gansberghe (2005) noted that the IA function should work closely together with operational managers to improve the organization's evaluation of

risks and determine its risk appetite to improve its systems, regulations, procedures and the ethical environment.

Therefore, audit finding and recommendations would not serve much purpose unless management is committed to implement them. Furthermore, Belay, (2007) find that to curb corruption and inefficiency in the public sector of Ethiopia, it is mandatory to have effective internal audit function (IAF) that in turn needs appropriate governance structure, mobilizing sufficient and appropriate resource and competent personnel

2.8.3. Management's Perception of IA's Value

Perception is the process of attaining awareness or understanding of sensory information or it is the mental image or intuitive recognition of experience when aware of the elements of the environment (Woodard III, 2002). To function effectively, internal auditors and the customers of audit services should possess a similar understanding of what makes internal auditing a value added activity. The failure to reach this understanding could result in the perception that internal audit is simply an obstacle to achieving production objectives. This can result in underutilized audit services and ignored audit recommendations (Flesher and Zanzig, 2000) which adversely influence the effectiveness of IA (Arena and Azzone, 2009).

When employees at all levels perceive that the top management assigns importance to the function of IA, they will cooperate and support these processes (Cohen & Sayag, 2010). This implies that internal audit staffs are more motivated and encouraged to perform audit activities given good management's awareness of IA values. Sarens and Beelde (2006) used a case study approach of five Belgian firms to explore the expectations and perception of both senior management and internal auditors with respect to the relationship between these two parties. They find that, when internal audit operates primarily in a management support role, there is a lack of perceived objectivity and the relationship the audit committee is weak. However, senior management's expectations significantly influence internal audit and that the perception of senior management is critical to the acceptance and appreciation, to promote value added and to the maturity of internal audit function with the organization.

2.8.4 Adequate and competent Internal Audit Staff

Adequate staffing is essential for a system to its full capability. Weakness in staffing can lead to mismanagement, error and abuse, which can negate the effect of other controls (MoFED, 2004). The size of IA staff and the competency of internal audit are the critical characteristics of IA quality that can't be separated. This means at the absence of one dimension the other cannot contribute to the quality of internal auditors.

The empirical findings by Al-Twajjry et al. (2004), based on questionnaire and interview responses from internal and external auditors, working in Saudi Arabia, suggests that the external auditors believes that IAF size is an important indicator of its quality. In addition, large size of IA staff has many benefits for internal operations of IA unit. For instant, larger sized functional units, there will be more opportunity and flexibility to have a staff rotation schedule that can also influence IA effectiveness by promoting a more healthy relationship and resulting in more objective audit investigations. Furthermore, Zain et al. (2006) argue that a larger size internal audit is likely to be better resourced, including having a broader work scope, higher organizational status and wider staff talent than a smaller unit. Likewise, the quality of IA work is likely to be higher in internal audit units with a larger proportion of staff with audit experience than those with a lower proportion of audit experience.

Appropriate staffing of an internal audit department and good management of that staff are keys to the effective operation of an internal audit. An audit requires a professional staff that collectively has the necessary education, training, experience and professional qualifications to conduct the full range of audits required by its mandate (Al-Twajjry et al, 2004). Auditors must comply with minimum continuing education requirements and professional standards published by their relevant professional organizations (IIA, 2001).

The IIA's standard 1210, on proficiency of the auditor require that the internal auditors should possess the knowledge, skill and other competencies need to perform their responsibilities (IIA, 2001). Additionally, the critical dimensions of IAF is the quality of its internal auditing staff measured in terms of internal auditors skill (Seol et al, 2011; Leung and Cooper, 2009; Seol and Sarkis, 2006). As part of this, Competency Framework for Internal Auditing (CFIA) focuses on the skills needed by an individual person to be an efficient internal auditor.

The literature review specifically conducted on the communication skills (Smith, 2005) stated that the development of effective communication skills (such as listening, interpersonal, written and oral communication skills) is an important part of internal auditor's advancement potential. Internal auditors must possess highly developed communication level skills to become a successful professional. The development of these skills is not only enhances the auditor's potential, but will also improve the quality of audits produced.

In addition to the above dimension of IA quality, the competence of internal auditors can be measured in terms of academic level, experience and the efforts of staff for continuous professional development and compliance with audit standards. Both the quantity of audit effort and the quality of professional care exercised will determine the overall quality of the internal audit work (Cohen & Sayag, 2010; Leung and Cooper, 2009; Belay 2007). Arena and Azzone, (2009) also stated that IA effectiveness increase in particular when the ratio between the number of skilled internal auditors and employees grows. This shows that sufficiently large number of skilled professionals enables the IA to do its duties.

2.8.5. The Approved Internal Audit Charter

Internal audit charter is defined by the IIA as “a formal written document that defines the activity's purpose, authority and responsibility. The charter should be (a) establish the internal audit activity's position within the organization; (b) authorize access to records, personnel and physical properties relevant to the performance of managements; and (c) defined the scope of internal audit activities” (IIA, 2001).

Additionally, an internal audit charter typically includes the responsibilities of the IA in broad terms, the standards followed by the IA; and the relationship between the IA and the audit committee. It may also defines access to the information (documents, records, systems, and personnel) necessary to perform and reach conclusions on the work, and it is a vehicle for asserting that there are no unreasonable limitations on the scope of the auditor work. The charter should clearly identify and record any limitations and alter to actual or potential changes on internal and external conditions that affect its ability to provide internal control assurance from a forward looking perspective (O. Regan, 2002).

Different authors have been explained the presence of defined audit charter in organizations will helps auditors to be effective. For instance, O. Regan (2002) concludes that a well drafted charter is an important ingredient for the IA effectiveness. It helps to direct the efforts of audit staff and defines what the board can expect on the assurance it required on internal control from an IA. Van Peurseem (2005) added that the presence of a strong charter adds an official and respected layer of authority to the position of IA in the company. It is also an important feature of insuring success in achieving the independent status of an IA. Furthermore, the existence of audit charter in organization influences senior management to flow the recommendations of the internal auditor (Van Peurseem, 2005) which in turn affects IA effectiveness.

2.8.6. Formal Mandate/Existence of Audit Charter

The interpretation of attribute standard 1000 states that the internal audit charter is a formal document that defines the internal audit activity's purpose, authority and responsibility. In line with this notion, Common wealth of Australia (2007), in its better practice guide states that the charter should define the scope of internal audit, that is, the programs, activities, processes, systems and organizations that are subject to internal audit review.

In addition it states that the charter should also specify the requirement for an internal audit strategic business plan and annual work plan. In a similar manner, Hock and Burch (2011) stated that the internal audit charter provides the Internal Audit Activity (IAA) with a formal mandate to do its work.

2.8.7 Unrestricted Access

Audits should be conducted with complete and unrestricted access to employees, property and records (IIA, 2006). In relation to this, encyclopedia of business indicates that internal auditors have unrestricted access to whatever they might need to make an objective assessment. It includes unrestricted access to plans, forecasts, people, data, products, facilities and records necessary to perform their independent evaluations (<http://www.referenceforbusiness.com/index.html>.)

2.8.8. Sufficient Funding

The audit function must have sufficient funding relative to the size of its audit responsibilities. This important element should not be left under the control of the organization under audit, because the budget affects the audit function's capacity to carry out its duties (IIA, 2006).

2.8.9. Competent Leadership

The head of the audit function must be able to effectively recruit, retain and manage highly skilled staff. Moreover, the chief audit executive should be an articulate public spokesperson for the audit function (IIA, 2006). The Ministry of Finance and Economic Development of Ethiopia defines the minimum level of skill, knowledge and experience required of the internal auditor and the Head of the Internal Audit. It also states the Head of Internal Audit should be qualified and have a wide experience of management.

2.8.10. Professional Audit Standards

The institute stated that professional audit standards support the implementation of the previous (above) elements and provide a framework to promote quality audit work that is systematic, objective and based on evidence (IIA, 2006).

Internal auditing is conducted in diverse legal and cultural environments; within organizations that vary in purpose, size, complexity and structure and by persons within or outside the organization. While differences may affect the practice of internal auditing in each environment, conformance with the IIA's International Standards for the professional Practice of Internal Auditing (Standards) is essential in meeting the responsibilities of internal auditors and the internal audit activity (IIA , 2010).

Over all, it can be seen from the literature that there is inadequate empirical prior studies which examine to what extent risk management, control and governance process role of internal audit function relates to organizational independence, formal mandate, unrestricted access, sufficient funding, competent leadership, competent staff, management support and professional audit standards in developing nations and in Ethiopia case in general and also in Oromia public Enterprise in particular.

2.8.11 Obtain Buy-In

Stakeholders want to see potential results before they agree to change. Internal audit must prove the business case for allocating resources to improvement audits. In addition, stakeholders' commitment to change rises when they are part of the solution, such as when audit and management work together to address deficiencies and implement recommendations resulting from improvement audits. Such collaborative work also fosters trust that can yield new opportunities to improve the business. (Patrick D, *et-al* 2011).

2.8.12. Internal Audit Tools

In today's business world, internal auditor needs some new ways through which companies could enhance quick discovery of errors, stand out of frauds and can improve corporation audit efficiency. Computerize Technology is one of the undeniable fact in competition world. This technology in corporation can do a number of other jobs; searching for duplicate check numbers to find photocopies of company checks; searching for vendors with post office boxes for addresses; analyzing the sequence of all transactions to identify missing checks or invoices; identifying vendors with more than one vendor code or more than one mailing address; finding several vendors with the same mailing address; and sorting payments by amount to identify transactions that fall just under financial control on contract limits. The Computer Assisted Audit Tools and Techniques is one of the important tool through which auditors can detect frauds and omissions.

Through job rotations and through the involvement of new bloods in the audit department could also enhance the company efficiency. It is observed that through the use of auditing tools like advance computer technology internal auditors can improve their efficiency. In all of the public Enterprises of Oromia the internal audit work is done through the use of manual way.

2.8.13. Rules and Regulations

The internal auditors are interested to follow the rules and regulations and standards during an audit. These standards and rules and regulation are connected to the objectives of an Enterprises or organization. The internal auditors are properly trained to contribute a lot in goal achievement and to check the compliance with rules and regulations

CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

RESEARCH APPROACH

To obtain the advantage of both the qualitative and quantitative research approach and at the same time to overcome their limitation, the mixed approach has been used.

3.1 Data Type and Source

Both primary and secondary data have been used. Primary data is the major source of data for the research as there are no research works done on the challenges facing internal audit function in Oromia public enterprises both empirically and theoretically. Self-administered questionnaire as well as the overall observation of the researcher was used as the main source of information as regard with the primary data.

3.2 Target Population

The target population of the study which was purposively selected all Oromia public enterprises internal audit departments. In Oromia there are **eight** public Enterprises which includes: Oromia Seed, Forest & wild life, Water works & construction, Road construction, Drilling, Water works design & supervision, Agricultural output market & Industry parks development Enterprise

3.3 Sample Size and Sampling Techniques

The use of purposive sampling enables the researcher to generate meaningful insights that help to gain a deeper understanding of the research phenomena by selecting the most informative participants that is satisfactory to the researcher's specific needs, on the other hand in rare cases where non informant internal auditors Purposive or non-probability sampling method involves purposive or deliberate selection of particular units of the enterprises for constituting a sample which represents the enterprise. When populations elements are selected for inclusion in the sample based on the ease of access (Kothari, 2004).

3.4. Method of Data Collection

In this research self-administered questionnaires were used to collect primary data. The self-administered questionnaires have been used to get detail information & distributed to the all Audit staff and accountants/very few/. The secondary sources document analysis and observation was also undertaken as intended.

3.5. Methods of Data Analysis

The researcher used a quantitative and qualitative research design using descriptive statistics such as frequency counts, percentage, means values and cross tabulation tables for structured items and interpreted according to the finding and finally triangulated data obtained both in questionnaire and interview.

CHAPTER FOUR

4.1. Data Presentation, Analysis and Interpretation

This chapter deals with the presentation analysis and interpretation of the quantitative and qualitative data collected using diverse instruments. The analysis was done as follows: The quantitative data collected through questionnaire were tabulated, and frequency counts and percentage were used for analysis. The qualitative data collected using interview and observation were transcribed and interpreted. Finally, the quantitative and qualitative data were triangulated where appropriate.

4.2. Analysis of the Questionnaire and Perceptions behind Internal Audit

A survey has been carried out with the objective of challenges of internal audit in Oromia public enterprises. Structured questionnaires were distributed to 23 internal auditors at different positions as shown in table 1 below, 87% of them have responded.

NO	Public Enterprises	Struct ured Box	Number of auditors assigned to the department	Sample population	Respo nd
1	Oromia Seed Enterprise, ,	3	2	2	2
2	Oromia Forest & wild life Enterprise	5	1	1	1
3	Oromia Water works & construction Enterprise	7	6	6	4
4	Oromia Road construction Enterprise	7	5	5	4
5	Oromia Drilling Enterprise	5	3	3	2
6	Oromia water works design &supervision Enterprise	4	4	4	4
7	Oromia Agricultural output market Enterprise	2	1	1	1
				1 Accountant	1
8	Oromia Industry parks development Enterprise	3	1	1	1
Total		33	23	23	20
Total response rate				87%	

4.3. Capability of the Internal Auditors

The aspect of capability includes experience of the staff, sufficient number of the staff, and the skills they possess.

4.3.1. Experience of the Staff

It was also important to study the work experience of staff audit function in order to relate with their ability to accomplish and understand their role. The researcher established that out of 4 respondent 1(6%) of the respondent has over 10yrs experience in the field, 7(47%) have more than 5yrs and 7(47%) have experience of less than 5yrs.

The situation above shows that, all of respondents had somewhat satisfactory work experience which means that their ability to perform audit responsibilities is almost satisfactory.

4.3.2. The skills of Audit Staff

This study intended to establish the level of education of the respondents and their ability to perform their audit function in a best way to accomplish organizational goal or enhance corporate governance. The greater the professional qualifications of the internal auditors in a given department, defined by the length of their professional training and educational level, the greater the effectiveness of this department (Albrecht et al. 1988; Ratliff, 1996)

Having examined the level of education of practitioners in IA Function at these public enterprises, the researcher established that 2(11%) of the IA staff had masters degree and 15(79%) had bachelor degree. With these finding the researcher establish that with high level of education of practitioners, IA is performed in a more professional way. In the role of best practice, the IA function need to have been equipped with multidisciplinary professionals such as legal knowledge, procurement skills and etc.

An audit requires a professional staff that collectively has the necessary education, training, experience and professional qualifications to conduct the full range of audits required by its mandate (Al-Twajry, Brierley and Gwillian, 2003) Multidisciplinary skills would make them handle the audit in a more diligent way.

The researcher found out that Oromia public enterprises has educated internal auditors but with single profession, thus this indicate that their ability to audit is not as good as expected in different field like Agronomy, marketing or supplies management, Geology, Forest management, engineering and training matters.

4.3.3. Sufficient Number of Staff

Oromia public enterprises internal audit is structurally composed of 33 boxes, where only 23 (70%) of it occupied. One is the process owner and the others are auditors. They are responsible of auditing the enterprise at head quarter, the branch and district offices which are located across the region of Oromia. Appropriate staffing of an internal audit department and good management of that staff are keys to the effective operation of an internal audit. Best practices of recent internal audit theory states that the chief audit executive must ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the plan.

The researcher found out that as a challenge faced by internal audit departments is simply the number of the staff. Audit departments are historically understaffed, and the problem has become increasingly worse in today's economic environment. Staffs are being downsized or insufficiency of internal control system leading to improper investigation.

4.4. Empirical Results and Discussion

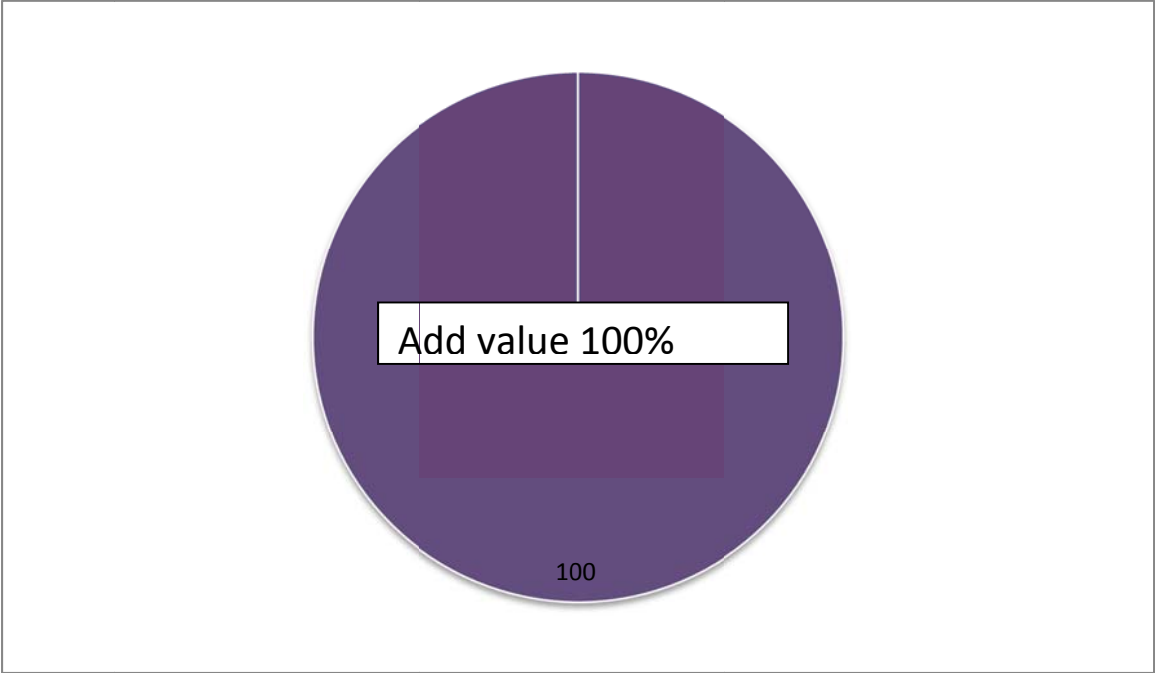
4.4.1. Value Addition of Internal Audit

Latest approaches show that governments which strive for democracy demonstrate some degree of accountability in the use of public money and increase their efficiency for delivery of services. Larger and more complex systems demand greater competency and professionalism from internal auditing, and scarce resources must be deployed more efficiently to minimize and manage risk (Samuel, 2008)

Internal audit departments of all selected Oromia public enterprises, were established with the primary purpose of adding value to the organizations or established by governments' imposition bylaw.

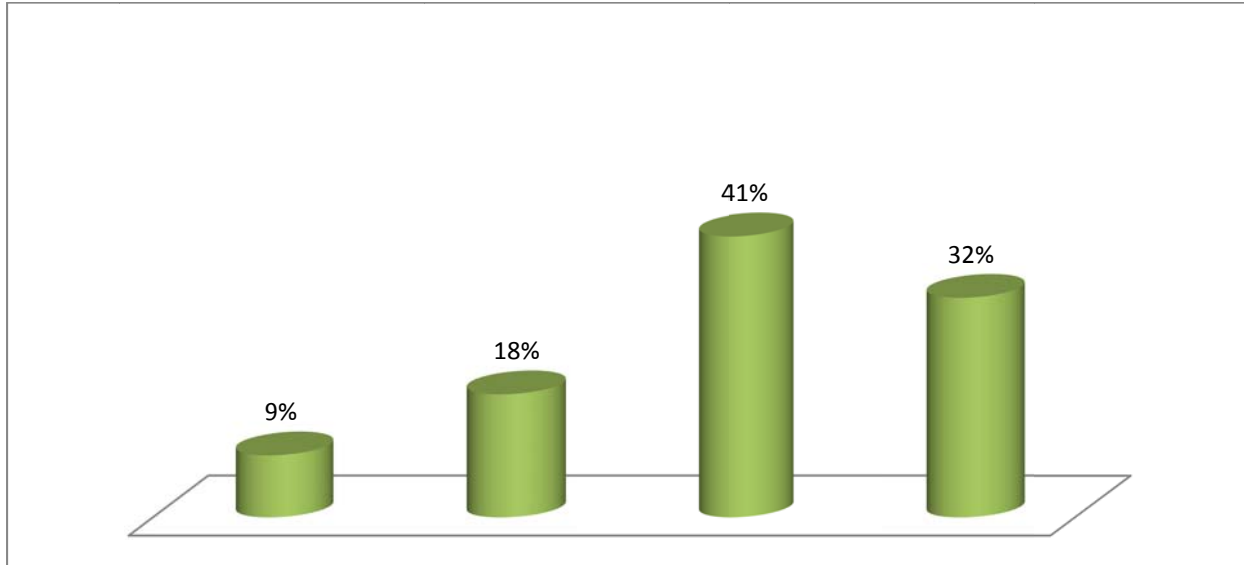
As shown in the following chart, 100% of the respondents believe that internal audit adds value to the organization that they work for.

Figure 4.1: The reason for the existence of internal audit function



All the respondents agree internal audit adds value to the Enterprise. Although, internal audit is expected to meet the above mentioned objectives, it is facing challenges 2(9%) of the respondents believe as lack of audit committee commitment and business knowledge, the lacking bridge between governing policy and the needs of technology, 9(41%) of the respondent suggested that lack of implementation of audit opinion and the external auditor's reluctance to rely on the work of internal audit , 4(18%) agreed inadequacy of internal control system and 7(32%) of the respondent responded as all of the them exist as described in graph 1,

Graph 4.1: The major challenges of internal audit



Above all, to meet its responsibilities, as mentioned earlier in the literature review part, Oromia public Enterprises supervisory authority, Board and managements should have a clearly defined action plan to normalize the challenges fostering internal audit.

4.4.2. The Scope of Internal Audit

According to Standard 1000 –the internal audit activity’s purpose, authority, and responsibility must be formally defined in the internal audit charter. The CAE is responsible for periodically reviewing the charter and presenting it to senior management and the board for approval.

Researchers review indicates that the scope of internal audit is very big and it has direct relationship with organizational status. Similarly, for the question raised on the scope of internal audit the result indicates that 13(20%) claimed as verification of financial statement, 5(8%) as assessing & promoting the adequacy of corporate governance, 13(20%) of them reacted as assessment of internal control, 9(14%) as evaluation of projects, 6(9%) as operational audit,

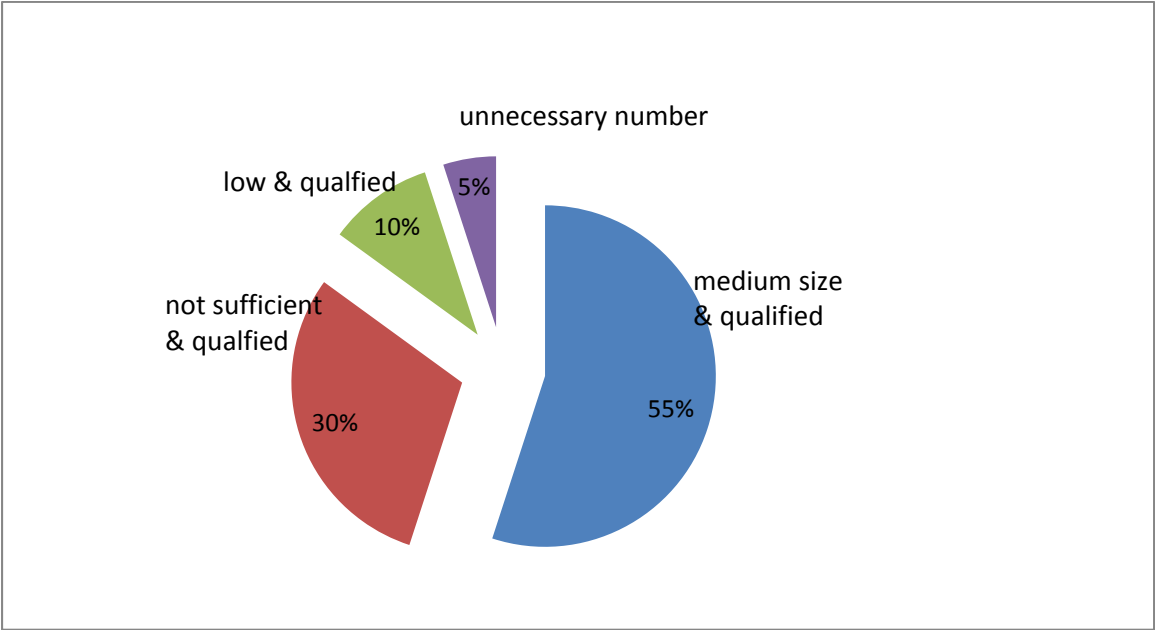
6(9%) as compliance audit, 4(6%) suggested assessment of organizational wise risk, 8(12%) replied on fraud investigation & 1(2%) of them on information system audit.

International Standards for Professional Practice of Internal Auditors (ISPPA) 2110 states the internal audit activity should assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems. Also properly stated on the audit manual prepared by regional public Enterprises supervisory authority. Based on the provided data, it can be concluded that the majority of the respondents in this study were lacks clarity on internal audit scope. It is a big assignment of the enterprises management to shift and capacitate the skills of internal auditors to the desired level.

4.4.3. Size and Quality of Internal Audit

To mitigate the scope of internal audit, the internal audit department should be strengthened in terms of size and quality. For the question raised regarding size and quality, 11(55%) of the respondents reply that unnecessary number of staff and unqualified and other 1(5%) believe unnecessary number of staff and un qualified as indicated in the chart below:

Figure 4.2: Size and quality of internal audit



Even though a close look at the above table depict many respondents believe that the medium size and qualified promises the possibility of mitigating internal audit. The numbers of the respondents, which are stated in line of unnecessary number and unqualified, low and qualified and not sufficient and qualified, are significant number is not something to be ignored. According to ISPPIA No.1210, internal auditors should possess the knowledge, skills and other competencies needed to perform their individual responsibilities. Hence it can be concluded that the challenges towards staffing plan is so material an adjustment on the matter has to be not overlooked.

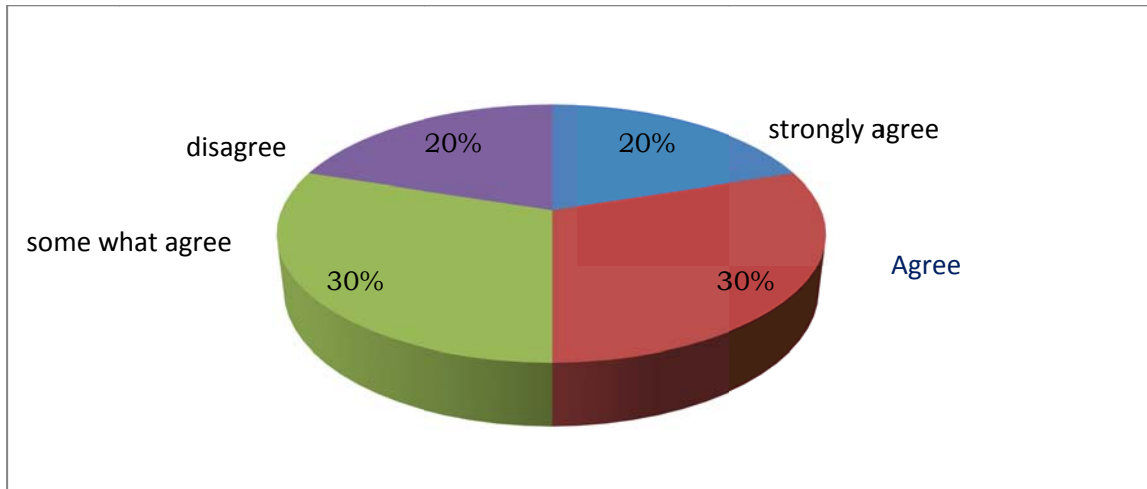
4.4.4. Internal Audit Plan & Quality Assessment/Assurance/Program

Appropriate risk based planning and quality assurances are the basic to be included in the internal audit program. On the other hand ISPPIA No.2010, the chief audit executive should establish risk-based plans which are supported by the implementation standard No. 2010.A1 that requires the internal audit activity's plan to be based on a risk assessment, undertaken at least annually.

4(20%) of the respondents strongly agreed that the plan for their internal audit activity is based on their respective organizations/enterprises risk profile. 6(30%) of the respondents agreed for undertake of risk based audit plan.

Another 6(30%) of the respondents somewhat agreed for existence of risk based audit plan in their IAF. The remaining 4(20%) disagreed for implementing the risk based audit plan in their audit department.

Figure 4:3 Risk based internal audit plan

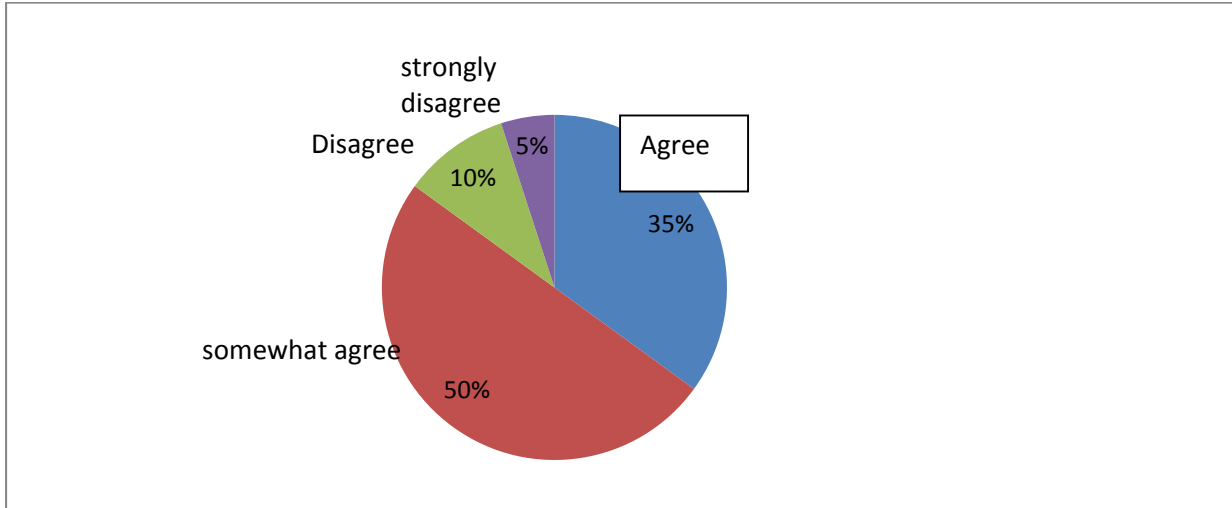


For quality assurance program, ISPPIA No.1300 states the chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. And the international standards and code of ethics. ISPPIA No.1310 requires the internal audit activity should adopt a process to monitor and assess the overall effectiveness of the quality program. The process should include both internal and external assessments. Where ISPPIA No.1311 and ISPPIA No.1312 categorizes this assessment process into internal or self-assessment and external assessment at least once every five years by independent reviewer which is an outsider, respectively. Finally, ISPPIA No.1320 even sets the responsibility of CAE to communicate the results of external assessment to the board.

In fact, all respondents responded that there is no quality assurances program in their enterprise, no external quality assessment every five years and hence, no recent quality assessment results communicated by CAE.

Concerning the completion of what is planned, 7(35%) of the respondents agreed that they have satisfactorily accomplished their yearly plan. 10(50%) of the respondents somewhat agreed that their yearly internal audit plan activity accomplishment as per the plan is somewhat satisfactory, 2(10%) disagreed and the other 1(5%) also replied strongly disagreed.

Figure 4.4: Annual audit plan accomplishment



4.4.5. Internal Audit Reporting Structure

ISPPIA No. 2060 –The chief audit executive must report periodically to senior management and the board on the internal audit activity’s purpose, authority, responsibility, and performance relative to its plan and on its conformance with the Code of Ethics and the Standards. Reporting must also include significant risk and control issues, including fraud risks, governance issues, and other matters that require the attention of senior management and/or the board

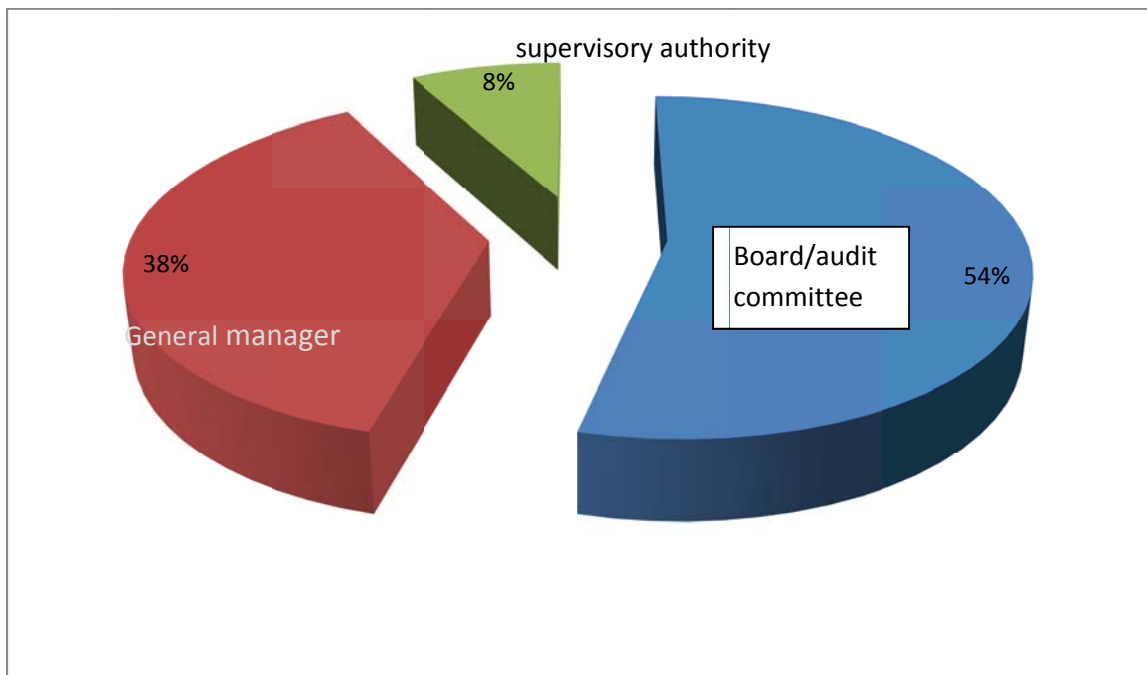
ISPPIA No. 1320 – Reporting on the Quality Assurance and Improvement Program lists the requirements of the CAE’s communication to senior management and the board, including that this reporting must occur as the assessments are completed. However, the results of ongoing monitoring of the internal audit activity’s performance, which is part of the internal assessment process, must be reported at least annually.

Theoretically, the Chief Audit Executive should report functionally to the board or audit committee and administratively to the chief executive officer of the organization and functional reporting line for the internal audit function is the ultimate source of independence and authority

(Rolandas, 2005). Report functionally means that the governing authority would approve the overall charter of the internal audit function, approve the internal audit risk assessment and related audit plan, receive communication from the C.A.E on the results of the internal audit activities or other matters'. On the other hand administrative reporting is the reporting relationship within the organization's management structure that facilitates the day-to-day operation of the internal audit function it is typically includes, budgeting and management accounting, human resource administration including personal evaluations and composition, internal communication and information flow, administration of the organization's internal policies and procedures (Irvin , 2002).

Accordingly, the respondents stated that 14(54%) reported to the board/audit committee/, 10(38%) reflected as reported to general manager and 2(8%) indicated as they reported to the public Enterprises supervisory authority as shown in the chart below.

Figure 4.5: Reporting responsibilities



From the above data even though the majority of the respondent 54% responded the reporting responsibility is to the Board/audit committee, the number of respondents responded as to the

general manager 38% are significant that has not been overlooked. In which reports to the general manager of the enterprise that forced them to lose their independence.

4.4.6. Presence of Audit Charter

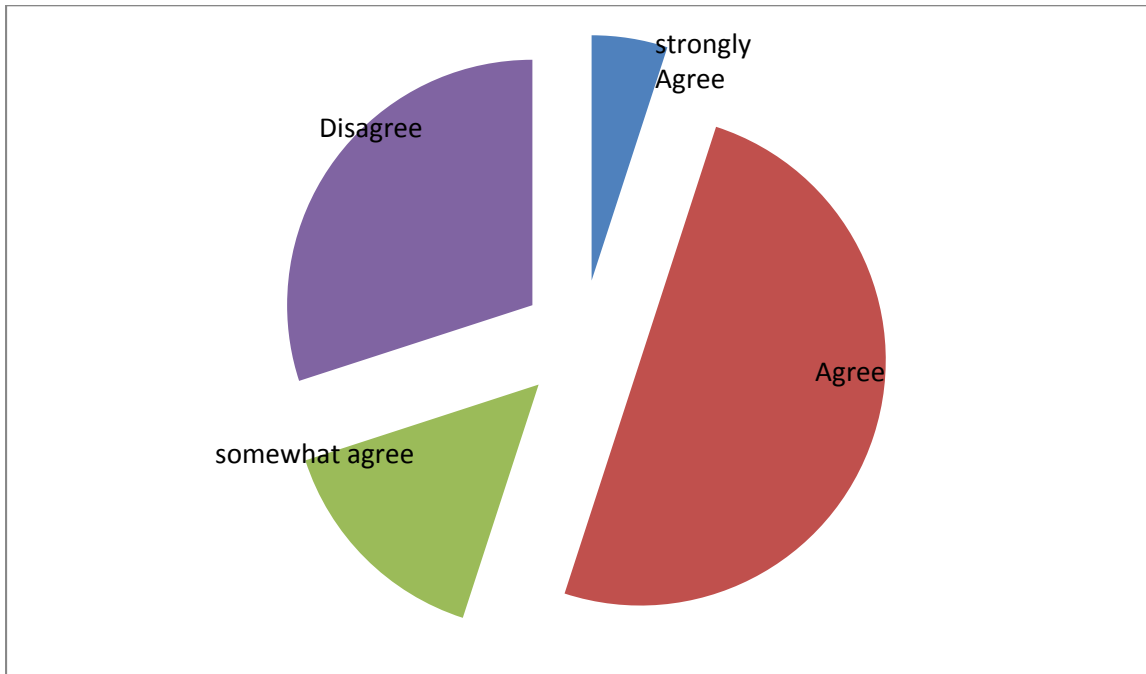
The attribute ISPPIA No. 1000 as per the IIA states that the purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the standards, and approved by the board. Besides, the implementation standard 1000.A1 states that the nature of assurance services provided to the organization should be defined in the audit charter. Again, implementation standard 1000.c1 states that the nature of consulting services should be defined in the audit charter. (Bethlehem 2008)

Basically one of the very crucial segments of internal auditing, audit charter needs to be available and apparently understood by the people in line of operation. In other words, the audit charter's purpose, authority and responsibility of the internal audit activity, should be clearly defined and properly communicated. However, 6(30%) of the respondents reply that they strongly agree, 7(35%) agreed, 4(20%) somewhat agreed and 3(15%) responded as disagreed that they have no information about the availability of audit charter in their Enterprises. From this one can safely analyze that, even though it exist, it is not effectively communicated in those Enterprise

4.4.7. Roles of Internal Auditors and Audit Committee as well

55% of the response confirms that the current structure of internal audit has sufficiently playing its role for their organization as it was expected. However, 15% somewhat agreed and 25% of the respondents disagree with this, as shown in the chart below.

Figure 4.6: Internal auditors' role

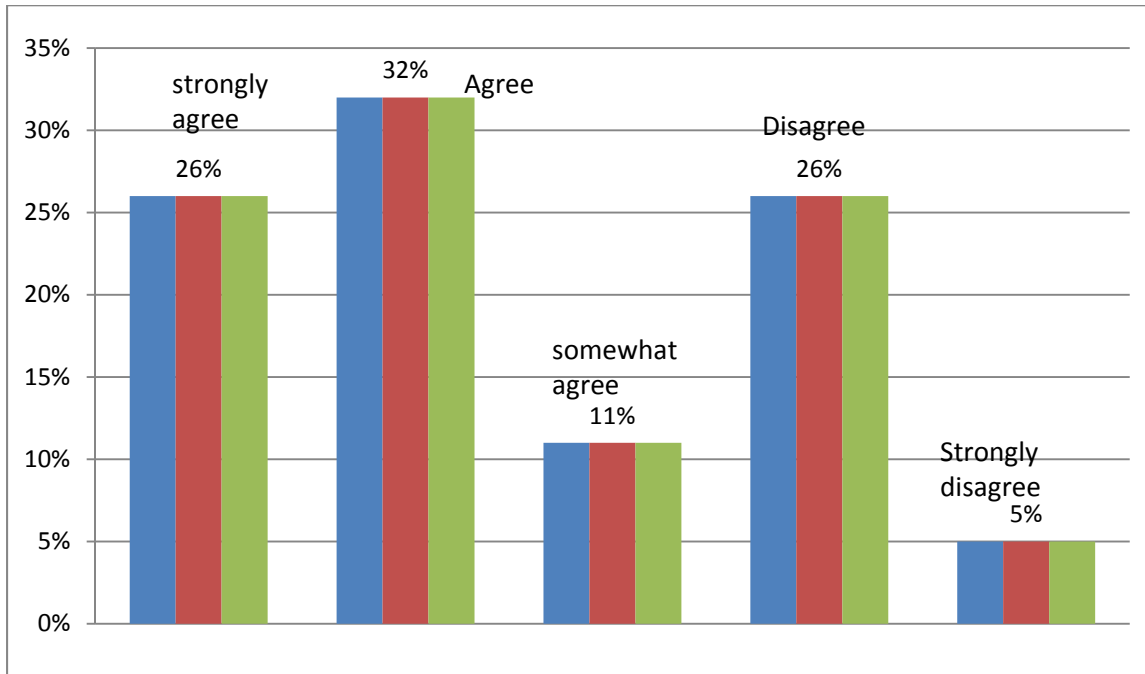


From the above chart the overall data shows almost 40% of the respondents opposed the current structure of internal audit.

The governing body should give attention to strengthen and support the internal audit function to bring the expected result. Or the board members and /or audit committee should support internal auditors to discharge their role.

However, 58% of the response asserts that the current board and/or audit committee has sufficiently playing its role for the organization as it was expected. However, 11% somewhat agreed, 26% and 5% of the respondents think that the boards and/or audit committees are contributing at a low so disagree and strongly disagree respectively as shown in the following graph.

Graph 4.2: Board and/or audit committee role



4.4.8. Internal Audit Role in Risk Management and Corporate Governance

In case of ISPPIA No.2120. All the internal audit activity must evaluate risk exposures' relating to the organization's governance, operations, and information systems as reviewed in chapter two, internal auditors' role is immense in supporting the corporate governance responsibility of management to the key activities of risk identification and monitoring as well as the effectiveness and efficiency of the whole organizational processes and associated controls.

35% of the respondents states that they are moderately involved in improving the corporate governance of their respective enterprises in areas of compliance to governmental rules and regulations, especially through management performance audit team and 65% of the respondents stated that their contribution to effectiveness of the corporate governance of their organizations is very low.

4.4.9. The Internal Audit Function and the Effectiveness of the Audit Committee

A positive relation between the internal audit function and a stronger audit committee can be expected because of their closely intertwined goals (Scarborough et al., 1998, p. 53). An effective

audit committee can strengthen the internal audit function position (Braiotta, 1999) whereas a powerful internal audit function can result in enhancing the audit committee's effectiveness (Bishop et al., 2000).

Despite this, however, in the real situation 4(21%) of the respondent are strongly agreed, 5(26%) agreed, 4(21%) of respondent somewhat agreed, 4(21%) disagreed, and 2(11%) strongly disagreed with it and 1 respondent (0.05%) was not responded. This means majority of the respondents have a sort of disagreement. So it can be safely concluded that majority (53%) of respondents asserted that there is no a positive relation between the qualities of the internal audit function and the effectiveness of the audit committee.

4.4.10. Management Examines & Uses an Internal Audit Opinion as an Input

External auditing standards (Such as: AUS, 402 and ISA, 400) shows that the control environment can be strengthen by using effective internal audit function by:

- Review of the internal control structure of a firm,
- On behalf of the management; monitoring different operations regarding the information system and control procedures (AUS 402 19-d)

In order to exercise good Institutional governance both the management and employees shall understand and use the work of internal audit.

Despite the fact that 5(25%) of respondent somewhat agreed, 5(25%) disagreed, and 1(5%) strongly disagreed on management uses an internal audit opinion as an input. On the focal group discussion undertaken with management and audit committee member they respond "it is lack of business knowledge and giving attention to strengthen and support the internal audit function to bring about good governance."

The main reason for this is that whenever the internal audit finds out corrective actions, the management involves directly or indirectly and then the report goes to this management unit as well. The corrective action, therefore, falls in danger so that the findings may be filtered by management.

4.4.11. Inadequate Tools

According to ISPPIA No.1220. A2– In exercising due professional care internal auditors must consider the use of technology-based audit and other data analysis techniques. Oromia public enterprises Internal auditors are faced by the challenge of inadequate tools to meet the modern pace of technology. Even though a slight beginning almost all enterprises not use computerized system of managing data thus making it hard for internal auditors' to get information, and to get all the required data for better audit.

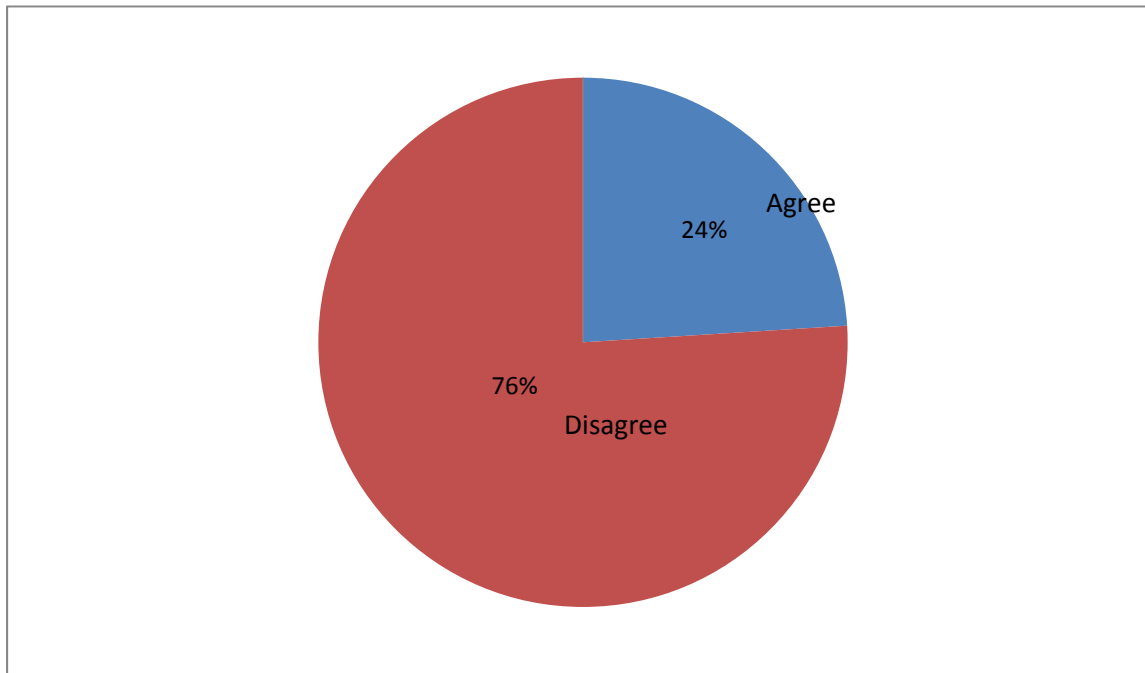
An audit department does not have some of the critical tools required to perform comprehensive, advanced audits. New software tools that enable data mining and other computer-assisted audit capabilities may not be available in an underfunded audit department. An understaffed department without the technology to compensate for the lack of personnel is not unusual, but often delivers incomplete or ineffective audits

4.4.12. Resource Allocation and Continuing Professional Development

According to ISPPIA No.2230 Internal auditors must determine appropriate and sufficient resources to achieve engagement objectives based on an evaluation of the nature and complexity of each engagement, time constraints, and available resources. As reviewed in literature part, the board or audit committee to whom the Chief Audit Executive functionally report makes appropriate inquiries of the management and the C.A.E to determine whether there are scopes or budgetary limitation that impede the internal audit function to execute its responsibility.

Accordingly, 24% of the respondents agreed as the existence of sufficient resource to undertake their reasonable assurance and consulting activities. However, the remaining 76% assured that their department is not sufficiently resourced that seriously challenges the internal audit function /IAF/.

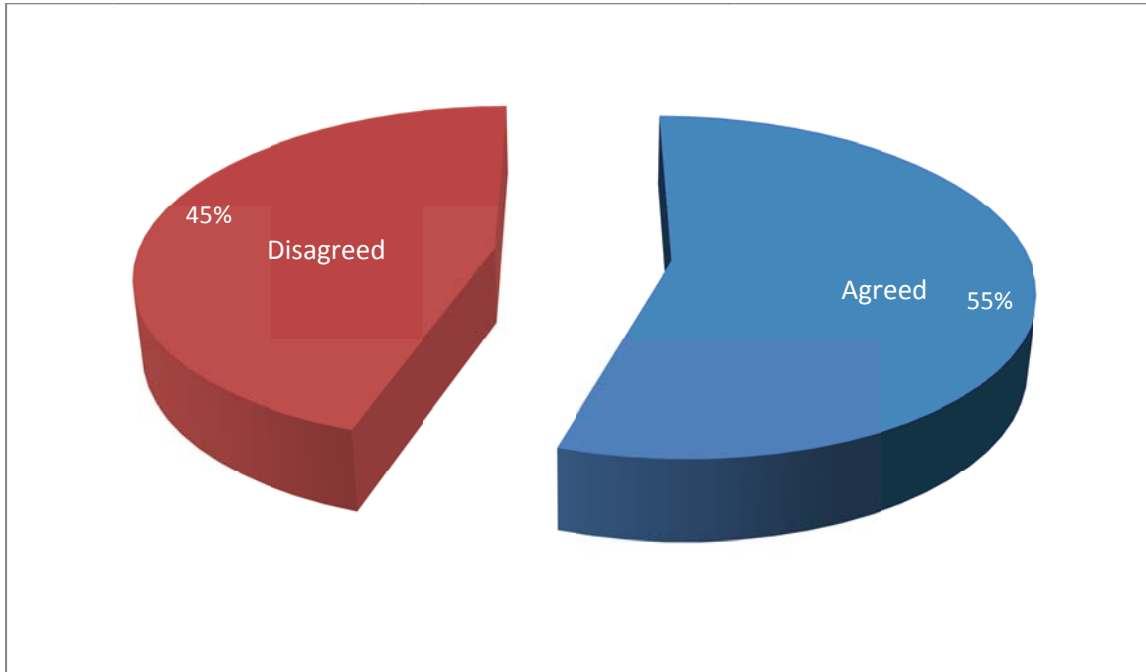
Figure 4.7: Resource Allocation



Concerning the internal auditors' professional development programs, ISPPIA No.1230 and IIA's Code of Ethics principle No.4 requires for development of the proficiency of internal auditors through continuing professional development to enhance their competency.

Accordingly 55% of the respondents agreed progress of their audit department in terms of number of qualified staff to undertake their reasonable assurance and consulting activities. However, the other 45% believed that their department is not sufficiently progressed in terms of number of qualified staff that affects the quality of the audit service from their department, collectively.

Figure 4.8: Development programs of internal audit



4.4.13. Segregation and Assignment of Duties for Internal Auditors

As it has a bearing on the sufficient number and competence of staff to prevent occupational fraud in the form of asset misappropriation and intentional financial misstatement experience in proper Segregation and assignment of duties for internal auditors is an important factor. Ideally segregation of duties /SOD/ is that no employee or group of employees should be in a position both to perpetrate and to conceal errors or fraud in the normal course of their duties.

Accordingly 45% of the respondents agreed as there is proper Segregation and assignment of duties of internal auditors. Even though staff size prohibits mitigating controls can be not only used to save money, but also allows auditors to focus on more high-risk areas. However, 55% believed that there is no proper Segregation and assignment of duties of internal auditors in their department, collectively. These show those enterprises Lack, proper segregation and assignment of duties as well as shortage of qualified staff to carry out internal audit and accounting works as intended.

4.4.14 Audit Action Monitoring Processes /Follow-up Process

According to ISPPIA No.2500.A1 the chief audit executive must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

The audit committee participant views audit action monitoring processes as a remedial exercise to ensure that corrective action is taken on issues identified by the internal auditors.

Accordingly 73% of the respondents disagreed on internal Audit perform a follow-up review to verify the resolution of the report findings. The audit committee had the following to say in this regard: “How long has it taken to resolve some of these issues? Then we can monitor it and say “how can we identify things sitting there for long /periods/ because they haven't been addressed by management.” That has been a challenge in management sometimes, resolving those things.

In order to monitor the implementation of audit findings and recommendations, the audit committee requires the internal audit to compile a formal findings register that would indicate corrective actions taken and list the unresolved findings. This could also assist the audit committee in overseeing how management is responding to the recommendations made by internal auditors. It may also assist the audit committee to affect accountability and to follow up on critical audit recommendations.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

The main concern of this study was to analyze the challenges facing internal audit function the case of Oromia public enterprises. The study marked at identifying the extent to which internal audit directives, manuals and standards are followed, as well as find out how best the challenges can be addressed. Accordingly the following conclusions were drawn.

- The findings on the extent to which internal audit standards are obeyed to the enterprises revealed there are inadequacies in obedience to internal audit standards. This was indicated by the majority of respondents who disagreed to the statements that internal audit carried out their job as planned, adequate experience, internal audit charter availability and reports were communicated to stakeholders, internal auditors had the right qualifications against discipline as well as internal audit reporting line. Moreover, the majority of the respondents were uncertain as to whether there is transparency and accountability of audit committee and their business knowledge, adequacy of staffing plan, clearly defined action plan and audit scope, proper segregation and assignment of auditors, Audit action monitoring processes /Follow-up process/, internal auditing carried out at minimum possible costs, as well as the bridging between governing policy and the use of proper auditing software.

However, the literature review indicates that the internal audit function remains a key component of governance for providing valuable guidance on issues relating to control and risk as of the stated standard in the public sector. Interviewees and respondents views show less than enthusiastic endorsement of the internal audit function's output and effectiveness, the remaining activities that should be played by the concerned party that are stated in the standard are not played.

- The findings related to challenges delaying adequacy of internal auditing revealed lack of independence, inadequacy of strong internal control system, inadequate skills among internal auditors, inadequate facilities at the internal audit department, inadequate funds

to carry out internal audit, inadequate cooperation among role players, external auditors reluctance on works of internal audit, the lack of an audit action monitoring processes, limited transparency and openness of the role players, as well as lack of commitment from management staffs are the major challenges.

- Despite of whatever the work done by the internal audit department, the perception of the role players about the internal auditor was not impressive. Majority of the Oromia public enterprises had a negative perception toward internal auditing function and this to a large extent challenges the attainment of the objectives of the internal auditing function.
- All of the respondents reply that they are facing tremendous challenge because of management's poor attention to IAF in terms of implementing the opinion of the internal auditors and resource commitment. Hence, the management of respective enterprises is obliged to be committed to the effectiveness of internal audit practice.
- It is important to recognize that internal audit is not a substitute for effective controls. The executive management should establish an internal audit function to contribute to internal control, corporate governance and risk management of the respective enterprise by examining, evaluating and reporting to management on its effectiveness and the way in which internal audit activity achieves its objective.
- The chief audit executive of these public enterprises did not develop and maintain a quality assurance programs that covers all aspects of the internal audit activity even though the standard of the professional practice of internal auditing obliges to do so. In addition to this in the public enterprises almost there is no internal and external assessment.

5.2. Recommendations

After concluding the research study the following suggested recommendations are recommended which can be useful for these enterprises in improving their internal audit operations in order to achieve audit objectives.

- The number, discipline and experience of audit staff can affect the results of an audit, assigning different responsibilities to one person causes inefficiency in operations. Top management support not only improves auditor efficiency but also encourage their involvement in risk prevention. The internal audit can be used as a base to assure the management about the conformity of the enterprises rules and regulations but also to contribute and assure its goals.
- The fact that there are inadequacies in obedience to internal audit standards requires that proper measures should be immediately taken to address the situation since the effectiveness in internal auditing is very crucial in ensuring good governance, accountability and sound fiscal health on any organization.
- In particular, lack of independence and autonomy from the employer are notable bottlenecks, and these are common problems in many organizations. There is a need to ensure objectivity through ensuring autonomy of the internal auditors.
- Recruitment of qualified internal auditors, regular internal auditing, prioritizing in staff training and development, allocating more funds for internal auditing, improving the working environment, updating hardware, software and working tools, ensuring transparency and openness, intensify efforts against higher officials business knowledge, as well as cooperation during the process of auditing has to put in to effect.
- As of the challenge reported that the external auditors do not rely on the work of internal audit, it is important that both internal auditors and external auditors enter into open dialogue.
- In the light of the finding regarding the lack of audit action monitoring processes, it is recommended that formal audit action monitoring processes should be introduced in the Oromia public enterprises, which will require management to commit themselves to respond swiftly to internal audit's recommendations.

- Public enterprises must focus on improving interaction with audit committee, in order to improve the overall effectiveness of internal auditing in managing business risk in the enterprises.
- Internal auditors must spend time in explaining to their clients what the internal audit is expected to achieve and how important contributions from the client are to that process.
- To undertake the full functions of internal audit as required by the public at large: organizational independence should exist through maintaining appropriate reporting line.
- Top managements should support and appreciate internal auditors through accepting the value adding role of their functions and through timely implementation of audit findings and recommendations. Internal audit departments should have clearly stated audit charters.
- Based on the perceptions of the audit committee participant, senior managers should set the tone required to increase the standing of the internal audit function in the public sector. The internal audit function's standing could be improved by involving them at the strategic level and by seriously and effectively considering their recommendations. Such conduct could prevent management sending out the wrong signal.

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APPENDIX 1

Addis Ababa University
Faculty of Business and Economics
Department of Accounting and Finance

Dear respondents, your response is crucial for the success of this study and I would kindly like to ask you to fill these questionnaires. The purpose of these questionnaires is to perform the master's thesis entitled challenges facing internal audit function the case of Oromia Public Enterprises. The study is purely an academic work

All your responses are confidentially kept and used only for the research purpose. Please fill out free and respond to all the questionnaires and kindly supply more information relevant to the system.

You may even attach additional sheet of paper or use the back of this questionnaire by indicating question number, it is possible to reply in “afaanoromoo”. Thank You in Advance for Your Earnest Work and Honest Cooperation.

Part one .General Background

I. Name of your Enterprise

II. Your position in the organization

III. Educational background A. MSC and above in accounting B. BA in accounting C, Diploma in accounting D. Below diploma in accounting E. Certified like CIA (Certified internal auditor), ACCA, others F. Other than accounting qualification: please specify

.....

IV. Work experience as an internal auditor year(s)

V. Age A. 20-25 B. 26-30 C. 31-40 D. 41-50 E. Above 50

VI. Sex A. male B. Female

VII. Marital status A. Married B. Single

Part Two. Assessing internal audit activity

1. Why the internal audit function exists in your Enterprise?

A. Add value to the Enterprise B. Imposed by the government /low/

2. What are the major challenges observed so far in the internal audit functions in your Enterprise?

a. Audit Committees (ACs) commitments to fulfill their duties and obligations.

b. The lacking bridge between governing policy and the needs of an IT department

c. Lack of implementation of audit opinion by appropriate authorities.

d. Inadequacy of internal control system leading to improper investigation. E. all of them

3. The scope of work of internal audit can be represented in which of the following in your Enterprise? (Please circle each choice as much as it is applicable) a. Verification of financial transaction (Financial audit) b. Assessing and promoting the adequacy of corporate governance c. Assessment of internal control d. Evaluates projects/ programs accomplishments (effectiveness) e. Operational audit f. Compliance audit g. Assessment of organizational /Enterprise wise risk h. Fraud investigation i. Information system audit

j. Other areas if any.....

4. The Enterprise audit department/division/unit/ has structured in terms of:-

A. necessary number of staff & highly qualified B. unnecessary number of staff & unqualified

C. not sufficient number of staff and qualified D. medium number of staff and qualified E. very low number of staff & qualified

5) Does your Enterprise internal auditing department/division/unit/ have a quality assurance program? a. Yes b. No

6) The Standard recommends undergoing an external quality assessment every five years; does your Enterprise internal audit have a plan to undertake?

a. Yes b. No

7) To whom does the internal audit department report in your Enterprise?

a. Board / Audit committee b. General Manger c. President d. Finance Department Head
Other, please specify

Part Three. Individual and Job Factors

Please indicate the extent to which you agree with each statement below by putting a “□”mark in the appropriate box.

No	Statements	Strongly agree	Agree	Neutral	Disagree	Strongly Disagree
1	The internal audit department/division/unit/ of our Enterprise have audit manual & charter.					
2	The internal audit department/division/unit/ of our Enterprise is playing sufficient role to address the purpose for which it is established					
3	The scope of internal audit brings change.					
4	The internal audit activities of our Enterprise comply with the IIA’s Standards.					
5	The internal audit position in our Enterprise is structured at sufficiently high level and sufficiently detached from functional areas to guarantee its independence?					
6	The internal audit plan of our Enterprise is based on risk profile.					
7	The internal audit department/division/unit completes/achieves/ its plan timely.					
8	The reporting responsibility of the internal audit to the audit committee increases its value.					
9	When internal auditors report to both the audit committee and various levels of management there					

	may be inherent conflicts.					
10	Audit committee plays an active role in supporting the independence of internal auditing.					
11	There is a positive relation between the qualities of the internal audit function and the effectiveness of the audit committee.					
12	The management of our Enterprise has a commitment to add value to the internal audit function.					
13	Management of the Enterprise have time to examine the internal audit activity and performance & using an internal audit opinion as an input.					
14	Internal auditors of our enterprise equipped with right kind of talents.					
15	The skills of internal audit personnel in our Enterprise matches with needs and demands of the Enterprise.					
16	Tremendous Corporate wrong doings and risk failures have addressed by internal auditors.					
17	As an Enterprise management we all do with an internal audit function.					
18	There is a proper segregation and assignment of duties for internal auditors.					
19	Internal Audit perform a follow-up review to verify the resolution of the report findings					
20	Internal auditing is one of the elements that makes your quality management system (QMS) complete					
21	With increasing technology, market volatility and complexity, internal audit is being expected to deliver deeper insights.					
22	Internal auditors involved in auditing the effectiveness of the governance structure of the Enterprise.					

Part Four – Independence vs challenges

1) What kinds of safeguards are built into the internal audit practices to ensure that internal audit to meet its external governance responsibilities?

2) What are the challenges you face from management side in your internal audit activities?
