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MANAGEMENT AUDIT IN THE NATIONAL BANK OF ETHIOPIA: CHALLENGES AND PROSPECTS

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MASTERS OF BUSINESS ADMINISTRATION

BY
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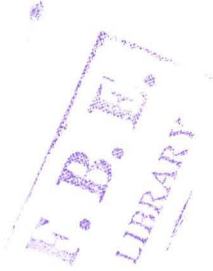
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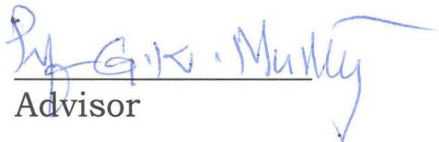
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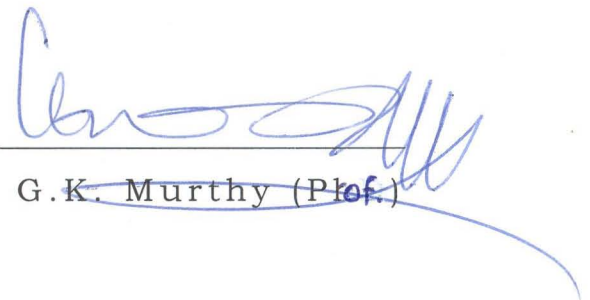
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Statement of Approval

This is to certify that Ato Sefialm Liben has completed a research paper entitled **“Management Audit in the National Bank of Ethiopia: Challenges and Prospects”** under my guidance. I also approve that his work is appropriate enough to be submitted in partial fulfillment of the degree in Masters of Business Administration.



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Declaration

I hereby assert that this study entitled "**Management Audit in the National Bank of Ethiopia: Challenges and Prospects**" is my own original work and has not been presented by anybody; for any degree or diploma in any other university and all materials used for the project work have been duly acknowledged.

Seji-Alem Liben  March 19, 2007
Name of Candidate Signature Date

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Abbreviations

| | |
|-------|--|
| ACCA | Association of Chartered Certified Accountant |
| Basel | Basel Committee of Bank Supervision |
| BoD | Board of Directors of the National Bank of Ethiopia |
| CIA | Certified Internal Auditor |
| CRS | Comprehensive Restructuring Study |
| EAL | Ethiopian Airlines |
| IAD | International Standards for Professional Practice of Internal Auditing |
| IAD | Internal Audit Department of the National Bank of Ethiopia |
| OFAG | Office of the Federal Auditors' General |
| NBE | National Bank of Ethiopia |
| VFM | Value For Money |

KPMG 1
IIA -SI
IIS -SI

Abstract

This research attempted to look into the current management audit practice of the National Bank of Ethiopia to assess its organization and performance thereby find out major challenges and prospects of management audit in light of recent developments and best practices in the field. In the project, primary data was collected using a survey of two target groups. Secondary data was also collected from two local best management audit practicing institutions. It was explored that inappropriate reporting relationship, absence of approved internal audit charter, lack of training, staff composition, absence of bank-wide risk management body and inadequate position classification and salary structure were the major problems to execute management audit in the NBE. On the contrary, the transformation has brought many benefits including providing objective assurance on whether resources are used optimally and operations are performed in efficient, effective and economical manner; and has contributed its part to improve overall institutional performance of the bank by measuring actual performances of plans against strategic goals and objectives.



CHAPTER ONE

INTRODUCTION

1.1 Background

The internal auditing profession has been in existence for decades in the National Bank of Ethiopia. The role of internal auditors has limited to checking the validity of transactions, expressing opinion on financial statements. Such kind of auditing practice could not provide on how effectively, efficiently and economically are operations being performed. Increased public expenditure, the need for more rational and informed decision making in the use of resources and growing demand for public accountability of those who manage public resources necessitate for a new type of audit- management audit. Accordingly, the National Bank of Ethiopia has introduced management auditing practice in 2004 based on the comprehensive restructuring study conducted by an international firm called KPMG. The new function was organized as a subset of the new professional internal audit function. Based on the recommendations of the study the traditional audit functions have been transferred to departments to be handled as part of the operation process. Hence, the new Department was provided with new redefined roles compatible with the modern day audit trends and requirements.

The mission of the department is "To provide independent, objective assurance and consulting services to the Bank to improve its operational efficiency, the effectiveness of risk management, control

and governance process.” As part of the new audit function, the Management Audit has entrusted with the responsibilities of providing independent, objective assurance and consultation for the management and Board of the Bank designed to add value and improve the Bank’s operation.

More specifically, the role of management audit is to give independent assurance on:

- application and effectiveness of risk assessment procedures and risk assessment methodologies;
- effectiveness, efficiency and economy of operations; and
- adequacy and effectiveness of the internal control system.

To implement management audit in the Bank’s endeavor, the comprehensive restructuring study put mandatory preconditions. The major preconditions were to structure the audit directly reporting the Audit Committee of the Board of Directors, train the auditors with techniques of risk assessment, performance auditing, governance auditing, etc. However, the Internal Audit was organized under the Governor of the Bank, and staffs assigned to the department has not given adequate training on technical auditing skill in the areas such as performance auditing, governance auditing, risk management, etc.

1.2 Significance of the study

In view of the situation prevailing in global auditing environment and recent development in the public financial institutions, the scope of the ‘transaction based’ auditing system focusing on checking and

validation, is practically incapable to provide independent objective assurance on efficient, effective and economy of operations.

The internal auditing profession has been in existence for more than 100 years. In those older days, the role of internal auditors has limited to checking the validity of transactions, expressing opinion on financial statements. In recent years, the need for reorganization of the internal audit within organizational setup, and of all redefinition of its role has been a top agenda among auditing institutions. In fact, the institute of Internal Auditors has redefined internal auditing as 'Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objective by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance process'.

In the Ethiopian context, different governmental institutions, including the Office of the Federal Auditor General of Ethiopia and Ethiopian Airlines have been exercising management audit calling the function in different synonymous naming as Performance audit or value for money Audit. The practice in these organizations indicate that management audit can play a significant role in providing objective assurance to stakeholders on one hand and advising the Board of Directors and management on audit and risk management issues on the other. The contribution that can be derived from the management audit services, however, depends on the degree of freedom and qualification that the unit has.

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The Internal Audit Department (where management Audit function is the most important part) is not directly reporting to the Board of Directors of the Bank; and staffed with 'management auditors' with inadequate training on the field. These issues make the study particularly important. In the study therefore the existing practice will be assessed against best practices; and potential challenges and prospects will be addressed.

1.3 Need for the Study (Problem Statement)

The National Bank of Ethiopia has practiced auditing for decades instituting the function within its formal structure. The traditional internal audit of the Bank was not value adding task focusing on verification of transactions, compliance checking, financial controlling, and reliability checking on financial statements, and complementing the task of external auditor works. Today, in view of the interests of its varied stakeholders, and to meet the demands of the broader environment, the Bank has reorganized its auditing functions in such a way that it could deliver value through being operationally focused.

Implementing management audit in the NBE pose the following challenges.

- Management commitment to ensure organizational independence
- Mitigation of the auditing skills shortage
- Lack of performance auditing experience to conduct risk based auditing.
- high expectations for quick result among the stakeholders

This research will try to examine the challenges that will restrict the implementation of management audit and potential benefits that management audit will provide to the Bank.

Thus, the purpose of this research is to assess the current organization and performance of the management audit of the bank and address the challenges that might face and future prospects of management audit in the Bank.

1.4 The Research Question

In view of the problem stated above, the research will address the following questions. These are:

- How is the management audit practiced in the National Bank of Ethiopia?
- How is management audit organized and exercised in best practicing institutions?
- What kind of Management audit structure, manpower, system, and training are required to enhance the existing management audit practice?

1.5 Hypothesis of the study

The following hypothesis is developed based on the notion that an independent and qualified management audit service will help the Board and management to get independent assurance and consulting service in risk management and governance.

The alternative hypothesis of the study is,

When is H₀?
Promoting independent and qualified Management Audit will be a vital tool to meet the high expectations and quick result demand of the executive management on objective assurance and consulting services risk management, governance and efficient, effective and economy of operations.

1.6 Objective of the Study

The main purpose of the study is to make early stage assessment on the practice of management audit and identify prospects and potential challenges. The specific objectives are:

- to examine the current practice of the management audit function of the NBE.
- to review best practicing institution in internal auditing in light of the experiences of their institutions.
- to analyze the prospects and challenges of management auditing in the Bank in view of international internal auditing standards and best practices.
- to recommend actions for improvement

1.7 Scope of the Study

The research will be confined to study the internal audit function of the National Bank of Ethiopia in general while focusing on the current

management audit practice and present and potential problems that might hinder to meet its intended objectives.

1.8 Limitation

Although the practice of management audit is not new to the Ethiopian situation, it was introduced in the NBE very recently, which may pose certain problem in the data collection stage. Thus, the study was mainly constrained by the limited years of experience. Further, absence of adequate literature specially books on the subject restricted the research to focus on internet, journals, magazines, and internal audit standards.

1.9 Methodology and Data Design

1.9.1 Research Design

The population of the study was categorized into three groups, management of the Bank, employees of the IAD, and two selected public institutions. The research employed survey of the whole population. The first target group includes the management group constitutes executive and senior management team members of the CRS of the bank. The second target group includes internal auditors of the IAD. Accordingly, all members of the executive and senior management who were worked in the 'Steering Committee' or 'Accounting & internal Audit Technical Committee' of the CRS of the bank were interviewed. From the second category too data are collected from all internal auditors of the IAD. Further, structured interview technique was used to obtain information from two 'best

*Text does not go with table
and do not mention questionnaire as instrument*

practicing' public institutions. To this effect, interview was conducted with the performance audit and program audit division heads of the OFAG; and with the manager of the corporate audit of the EAL. Thus, to a large extent, it is a census study except with regard to secondary category respondents.

| Type of Data | Source of Data | Techniques of Data Collection | Instrument |
|---|--|-------------------------------|----------------------|
| Restructuring objectives, plans, procedures, implementation and expected result | Executive and Senior Management Team members | Questionnaire | Questionnaire |
| Facts and opinions on structure, plans, skill & experience, professional mix, salary, and problems | All employee including Internal Audit management members | Questionnaire | Questionnaire |
| Data on their respective structure, reporting relationship, plan & budget approval, education & training, performances and challenges | Office of the Federal Auditor General of Ethiopia | Focus group discussion | Structured questions |

Table1:- data Type, sources and data collection techniques

1.9.2 Data Source

The study employed both primary and secondary data sources. As primary data collection technique two distinctive questionnaires were prepared and distributed, one for the CRS steering and technical committees' members and another for the internal auditors of the bank. Interview questions was also be designed to collect data on the practice of management audit from the Office of the Federal Auditor General and the Ethiopian Airlines.

The secondary data collection process included referring of documents and reports. Accordingly, the CRS report, different books, internal audit journals, internal audit standards by the Institute of Internal Auditors (IIA), different web-sites, and related materials were reviewed.

1.9.3 Data Analysis

The data collected through both methods was organized and presented in a meaningful manner using tabulation and frequency distribution method to see the spread; and compiled using Ms excel and Ms word application software.

Data collected and presented in the above methods will be summarized and analyzed using measures of central tendency such as the mean and percentile.

CHAPTER TWO

REVIEW OF LITERATURE

2.1 Definitions of Internal and Management Audits

2.1.1 Definition of Internal Audit

The Institute of Internal Auditors IIA defined internal auditing as ‘an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.’

Internal audit activities are performed 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, compliance with the International Standards for the Professional Practice of Internal Auditing is essential if the responsibilities of internal auditors are to be met. If internal auditors are prohibited by laws or regulations from complying with certain parts of the Standards, they should comply with all other parts of the Standards and make appropriate disclosures. In a broader view, the services of internal audit falls under two categories, namely, assurance and consultancy.

Assurance services involve the internal auditor's objective assessment of evidence to provide an independent opinion or conclusions regarding a process, system or other subject matter. The nature and scope of the assurance engagement are determined by the internal auditor. There are generally three parties involved in assurance services: (1) the person or group directly involved with the process, system or other subject matter – the process owner, (2) the person or group making the assessment – the internal auditor, and (3) the person or group using the assessment - the user.

Consulting services are advisory in nature, and are generally performed at the specific request of an engagement client. The nature and scope of the consulting engagement are subject to agreement with the engagement client. Consulting services generally involve two parties: (1) the person or group offering the advice – the internal auditor, and (2) the person or group seeking and receiving the advice – the engagement client. When performing consulting services the internal auditor should maintain objectivity and not assume management responsibility.

2.1.2 Definition of Management, Performance and Value for Money Audits

In many countries, the term management audit, performance audit and value for money (VFM) audit are used to describe the same thing in different countries. In many countries, and especially in the UK, value for money (VFM) audit is used as a term instead of performance audit (Pollitt 1999). In other countries such as Canada and Bangladesh Performance Audit is commonly used to refer the same thing. In this paper too management audit is in synonymous with

performance audit or Value for money (VFM), and I prefer to use performance audit more frequently.

Reference is frequently made to “Management audit”, “value for money audit” and “performance audit” in relation to examinations of the use of resources by public sector organizations. Different terms are used in various parts of the world. Although management audit and performance audit can sometimes be interpreted as extending beyond clear VFM issues (to include, for example, quality and technical matters), the terms are used inter-changeably by many auditors. As in the Institute of Internal Auditors (IIA) Auditing Standards, the formal term “performance audit” has been adopted in this paper.

Although performance audit can be very wide-ranging, in broad terms, it can be applied to:

- those activities involving a considerable level of resources
- projects that are at risk of failing in their objectives
- issues which are of concern to Parliament or the PAC.

The Government of Auditing Standards of Bangladesh defines performance audit, a performance audit “is an objective and systematic examination of a public sector organization’s programme, activity, function or management systems and procedures to provide an assessment of whether the entity, in the pursuit of predetermined goals, has achieved economy, efficiency and effectiveness in the utilization of its resources”.

Management audit is a more recent concept focuses on result, evaluating the effectiveness and suitability of controls by challenging underlying rules, procedures and method (**Dennis R.Arter**). He

further explained that management audit, which are generally performed internally, are compliance plus case-and-effect analysis, when performed appropriately they are potentially the most useful of the evaluation techniques as it resulted in change.

Performance audit, therefore, involves an independent assessment of whether economy, efficiency and effectiveness have been achieved by the organizations concerned. These three key elements of VFM can be defined in various ways, as follows:

Economy: Economy is concerned with minimizing the cost of resources used (staff, materials and equipment) for an activity in the pursuit of its objectives and whether they are in accordance with sound administrative principles and practices and management policies. An economical organization acquires its input resources, of the appropriate quality and quantity, at the lowest cost. In summary, economy means minimizing the cost of resources used for an activity, having regard to quality i.e. spending economically, whilst maintaining quality.

Efficiency: Efficiency is concerned with the relationship between goods and services produced (the outputs) and the resources used to produce them (the inputs). An efficient entity produces the maximum output from any given set of inputs. Alternatively, it may require minimum inputs to achieve a given quantity and quality of output. This will be reflected in increased productivity and lower unit costs. In summary, efficiency means ensuring that maximum output of goods and services has been gained from the resources used in their production i.e. spending well.

Effectiveness: Effectiveness is concerned with achieving predetermined objectives (specific planned achievements) or goals and with the actual impact (the output achieved) compared with the intended impact (the objectives). Using a range of performance measures and indicators, it is possible to assess an entity's effectiveness. In summary, effectiveness means ensuring that the desired results, objectives, targets or policies have been successfully achieved i.e. spending wisely.

2.2 International Standards for the Professional Practice of Internal Auditing

The Standards consist of Attribute Standards, Performance Standards, and Implementation Standards. The Attribute Standards address the characteristics of organizations and parties performing internal audit activities. The Performance Standards describe the nature of internal audit activities and provide quality criteria against which the performance of these services can be evaluated. While the Attribute and Performance Standards apply to all internal audit services, the Implementation Standards apply to specific types of engagements.

There is one set of Attribute and Performance Standards, however, there are multiple sets of Implementation Standards: a set for each of the major types of internal audit activity. The Implementation Standards have been established for assurance (A) and consulting (C) activities.

The Standards are part of the Professional Practices Framework. The Professional Practices Framework includes the Definition of Internal Auditing, the Code of Ethics, the *Standards*, and other guidance. Guidance regarding how the Standards might be applied is included in Practice Advisories that are issued by the Professional Issues Committee.

The purpose of the Standards is to:

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

Of all the standards, standards relevant for the project are presented here below.

1000 – Purpose, Authority, and Responsibility

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.

1000.A1 - The nature of assurance services provided to the organization should be defined in the audit charter. If assurances are to be provided to parties outside the organization, the nature of these assurances should also be defined in the charter.

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1000.C1 - The nature of consulting services should be defined in the audit charter.

1100 – Independence and Objectivity

The internal audit activity should be independent, and internal auditors should be objective in performing their work.

1110 – Organizational Independence

The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities.

1110.A1 - The internal audit activity should be free from interference in determining the scope of internal auditing, performing work, and communicating results.

1200 – Proficiency and Due Professional Care

Engagements should be performed with proficiency and due professional care.

1210 – Proficiency

Internal auditors should possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should.

1230 – Continuing Professional Development

Internal auditors should enhance their knowledge, skills, and other competencies through continuing professional development.

1300 – Quality Assurance and Improvement Program

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. This program includes periodic internal and external quality assessments and ongoing internal monitoring. Each part of the program should be designed to help the internal auditing activity add value and improve the organization's operations and to provide assurance that the internal audit activity is in conformity with the Standards and the Code of Ethics.

2000 – Managing the Internal Audit Activity

The chief audit executive should effectively manage the internal audit activity to ensure it adds value to the organization.

2010 – Planning

The chief audit executive should establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization's goals.

2010.A1 - The internal audit activity's plan of engagements should be based on a risk assessment, undertaken at least annually. The input of senior management and the board should be considered in this process.

2010.C1 - The chief audit executive should consider accepting proposed consulting engagements based on the engagement's potential to improve management of risks, add value, and improve the

organization's operations. Those engagements that have been accepted should be included in the plan.

2020 – Communication and Approval

The chief audit executive should communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and to the board for review and approval. The chief audit executive should also communicate the impact of resource limitations.

2030 – Resource Management

The chief audit executive should ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan.

2040 – Policies and Procedures

The chief audit executive should establish policies and procedures to guide the internal audit activity.

2060 – Reporting to the Board and Senior Management

The chief audit executive should report periodically to the board and senior management on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan. Reporting should also include significant risk exposures and control issues, corporate governance issues, and other matters needed or requested by the board and senior management.

2110.A2 - The internal audit activity should evaluate risk exposures relating to the organization's governance, operations, and information

systems regarding the reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets; and compliance with laws, regulations, and contracts.

2120 - Control

The internal audit activity should assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement.

2120.A1 - Based on the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of controls encompassing the organization's governance, operations, and information systems. This should include: reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets; and compliance with laws, regulations, and contracts.

2120.A2 - Internal auditors should ascertain the extent to which operating and program goals and objectives have been established and conform to those of the organization.

2120.A3 - Internal auditors should review operations and programs to ascertain the extent to which results are consistent with established goals and objectives to determine whether operations and programs are being implemented or performed as intended.

2120.A4 - Adequate criteria are needed to evaluate controls. Internal auditors should ascertain the extent to which management has established adequate criteria to determine whether objectives and

goals have been accomplished. If adequate, internal auditors should use such criteria in their evaluation. If inadequate, internal auditors should work with management to develop appropriate evaluation criteria.

2130 – Governance

The internal audit activity should assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives:

- Promoting appropriate ethics and values within the organization.
- Ensuring effective organizational performance management and accountability.
- Effectively communicating risk and control information to appropriate areas of the organization.
- Effectively coordinating the activities of and communicating information among the board, external and internal auditors and management.

2130.A1 – The internal audit activity should evaluate the design, implementation, and effectiveness of the organization's ethics-related objectives, programs and activities.

2130.C1 – Consulting engagement objectives should be consistent with the overall values and goals of the organization.

2.3 The Need for Management Audit

The internal auditing profession has been in existence for more than 100 years. In those older days, the role of internal auditors has limited to checking the validity of transactions, expressing opinion on financial statements. In recent years, the need for reorganization of the internal audit within organizational setup, and of all redefinition of its role has been a top agenda among auditing institutions. In fact, the institute of Internal Auditors has redefined internal auditing as 'Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objective by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance process'.

The role of public auditor traditionally has been limited to expressing opinions of financial statements and related issues of legality, regularity and fraud. This involves assessment of whether transaction was properly controlled, whether care was taken in the collection and custody of revenues, and whether expenditures were properly incurred. One of the shortcomings of the traditional internal audit is that it is often too internally focused (within the department) and as a result, the organization does not fully benefited from the experience, knowledge and intelligence gathered during the performance of their duties. Internal audit often performs extensive analysis and research (on the organization's environment, risks, operations, results, etc.) in the process of developing an internal audit plan (KPMG 2003). Such kind of auditing practice does not provide on how effectively, efficiently and economically are operations being performed. Increased

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public expenditure, the need for more rational and informed decision making in the use of resources and growing demand for public accountability of those who manage public resources necessitate for a new type of audit- management or performance or value for money audit.

Internal audit institutions in developed world and a good number of developing countries are moving from financial audit to management or VFM audit. This shift can be seen as moving from the role of an observer to a more proactive role as an improver. In the public sector, management or VFM audit provides relevant feedback to managers, legislators, and citizens on the efficiency and effectiveness of measured activities. In the case of public banks, for example, the management audit enables the three groups (managers, legislators, citizens) to evaluate whether the banks are prudent enough in managing public funds and lending.

The exception is an expectation for performance audits to recognize and report good performance along with poor performance. This departs from the tradition in performance auditing, which is to focus on and report on poor performance. It is important to recognize the positive impact of regular oversight (provide by performance audit). Not only would poor performance be identified and ended, but previously unpublished success stories would become a part of the public record, allowing state managers and workers to establish credibility with voters, something that today is severely lacking (Washington Policy Center).

In many public sector reforms during the 1980s and 1990s, decentralization has been one key ingredient. Along with the delegation of authority, decisions and management of financial funds, performance measurement and performance auditing are often developed and control systems centralized (Pollitt and Bouckaert, 2000). Many audit practices have grown out from changes in public sector management with ideals such as quality, governance and accountability. In fact, there has been an explosion of audits in many different fields of society (Power, 1997).

However, the efficacy of audits is seldom documented and debated. Power argued that audit, despite its role in assessing and verifying the performance of other organizations, has put itself beyond empirical knowledge about its own effects in favour of a constant programmatic affirmation of its potential. Paradoxically, performance auditing, which presumably is more complex and ambiguous than financial auditing, is probably more important in public sector organizations than in firms even though performance in the public sector is more difficult to verify.

Until the mid-1980s research in public sector auditing was seriously neglected (Lapsley, 1988). There has now been some research on public management and performance auditing in central government (Hatherly and Parker, 1988; Gupta 1994; Roberts and Pollitt, 1994; Keen, 1999; Dirsmith 2000). Accountability occurs when both Parliament and the public at large are assured that public funds are being spent efficiently and economically on programs that are effective. Performance audit assists this process by reporting on management's performance in the democratic environment. (A.K.M.)

Jashim, 2003). The Performance or VFM audit deals with the results of operating decisions by top management. A well-performed and reported management audit serves as an essential instrument for developing and promoting good governance by improving public sector management. The absence of good governance along with the lack of transparency and accountability are the major predicaments in failure to achieve the desired goals. Performance audit can play a pivotal role in establishing good governance through ensuring accountability and transparency in dealing with public funds.

2.4 Common Challenges in Management Auditing

Management (Performance) Audit offices face a common set of challenges in conducting performance audits. These challenges include: organizational structure, staff quantity and quality, staff salaries, training, strategic plan and audit selection, and reporting model, and Audit Charter and Guidelines. These concerns pertain to the profession as a whole, as well as to audit offices just getting started.

2.4.1 Organization Structure

The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. To meet the organizational independence requirement, Audit Committees, with in the Board, should be established to review audit reports and provide over all guidance. Functionally, depending on its size, performance audit offices tend to organize around subject areas or functions with a manager responsible for each area or function. Some specialization by subject

matter or special expertise is common in small as well as large audit offices. Large offices have field locations.

2.4.2 Staffing

Disciplines- The general practice in performance auditing is to recruit professionals with a college degree, but not from a single discipline. The U.S. Government Accountability Office hires from a mix of disciplines with an emphasis on advanced degrees for its performance audit staff. The general practice of federal inspectors general is to hire accountants, but some recruit from other disciplines. State auditors conducting performance audits generally hire from a mix of disciplines, as do local government audit offices.

Number- No formula has been devised to establish how many performance auditors an organization of a given size should have. Staffing at public institution audit offices conducting performance auditing is relatively low, from five to around 45, with an exceptional high of 380 in one state.

2.4.3 Training

Training is critical to an audit office's success. No college or university program specifically trains students to be performance auditors. As a consequence, audit organizations either hire auditors from other audit offices or develop their own. The "development" of professionals into performance auditors is achieved through a combination of formal and on-the-job training, coupled with experience doing performance audits. The success of this development process is heavily dependent on good training. The importance of training is recognized by the profession. Performance auditors in most government audit

institutions are required by their respective auditing standards to obtain continuing professional education.

Such Auditing Standards require each auditor to obtain 80 hours of continuing professional education every two years with at least 20 hours obtained in one of the years. Auditors obtain the necessary training in a wide variety of ways, to include training from professional audit training organizations.

2.4.4 Salary

It is difficult to recruit and retain highly competent, energetic, experienced staff. High turnover is one result as private sector firms and other government organizations with a higher salary scale seek to recruit experienced government auditors. In government, salary rates and scales are generally determined centrally. Salaries are often based on degreed professions (accounting, computer science, etc.) or some recognized technical skill. Performance auditing is not a “degreed” profession. Hence, a given government entity may not have a position description and salary structure established for performance auditing. As an expedient, some apply the salary structure for accounting and/or auditing, meaning financial statement auditing, a widely recognized profession.

The range in salary rates for performance auditors across governments is significant. As a general rule, the salaries for government auditors— financial and performance—are below that in the private sector. This is particularly true for accountants and persons with advanced degrees. To compensate, government performance audit offices commonly have special authority to grant

pay increases at six-month intervals or to promise rapid advancement for the first two years or so. Federal audit offices commonly promise “new college graduates” with limited experience a promotion within two to three years. They also emphasize the good health benefits and a true pension program. When hiring professionals with experience, individual audit offices may not have flexibility to offer a salary competitive to the private sector, or with those for other positions in government.

2.4.5 Strategic Plan

The value of following a strategic plan is widely acknowledged in both the private and public sectors, and is required by many, if not most, government entities. Beyond a few generally recognized items, such as a vision statement, mission statement, an explanation of how the mission is to be achieved, and measures of performance, organizations are free to decide the form and content for their strategic plans. For performance audit offices, one unique, and important strategic planning item is audit selection—the method and rationale for selecting subjects for audit.

To have a full degree of independence, performance audit offices need authority to select subjects for audit without approval of the legislature, governor or some other oversight body. Most, if not all, federal and local government auditors have such authority. The methods used to select subjects for audit vary among performance audit offices. Many conduct risk assessments, some using the COSO framework that involves constructing an audit universe, prioritizing areas in accordance with risk level, getting validation from a group of advisors, and auditing the highest risk areas first, each year. Others

receive legislative or executive branch requests; some act on issues uncovered by investigative and financial audit teams. In preparing annual audit plans, many audit offices seek input from the officials of the entity they report to.

The following criteria were chosen to guide selection of specific topics for audit: expectations from citizens; ideas and suggestions from frontline public employees; opinions and recommendations of policymakers, interested organizations and the government entities themselves; ideas generated by the governor's performance-based initiatives; auditor's own research including analysis of best practices; auditor's own judgment from knowledge and long experience in conducting financial and compliance audits of state and local governments; expectation of identifying significant efficiencies and cost savings

2.4.6 Performance Management and Measurement

In recent years the federal government, and many state and local governments, have enacted laws requiring establishment of measures of performance and for use of those measures in managing. These laws generally require that executive branch agencies engage in strategic planning to include the development of an agency mission statement, measurable goals for applicable aspects of output and outcome performance, and performance measures indicating the relative success in achieving program goals. Some have a requirement for use of performance measures in budgeting, generically referred to as performance-based budgeting.

2.4.7 Reporting

The tradition in performance auditing is to issue written audit reports. Performance audit report formats are as varied as the topics themselves. Some audit offices prefer a short, terse style that resembles the narrative sections of financial audit reports. Others take a broader approach, incorporating graphics, photographs and special fonts intended to make the reports more readable. Each report is unique. It is common practice for public sector audit offices to make their reports available to the public and to post the reports on their websites.

2.4.8 Audit Charter and Guidelines

Organizations should have internal audit charter and management or performance audit guidelines, approved by the board, in conformity with IIA standards. The Charter defines the purpose, authority, and responsibility of the internal audit offices; and the guidelines detailed the procedures to be followed on day to day auditing activities.

2.5 Current Practice of Management Audit in the Ethiopian Public Institutions

Management Audit is a recent growing field. Although its application was not wide until in the past, at present many instantiations transform their traditional audit practices into risk-based auditing making management audit their focal function. Among the institutions practicing management audit in Ethiopia, the current practice of the Office of the Federal Auditors General of Ethiopia and Ethiopian Airlines were assessed.

2.5.1 Office of the Federal Auditor General of Ethiopia

The management audit function in the Office of the Federal Auditors General (OFAG) which is named as 'Performance Audit' has been functioning for more than 15 years. The function is organized at a department level. Under the department there are two divisions, namely, Common Services Audit and programs & project audit divisions. The Performance Audit Department reports to the Auditor's General, who is answerable to the Parliament. Thus, the budget of the department, along with the budget of all other work unit of the OFAG, is to be approved by the Parliament.

Recognizing the differentiated and complex nature of audits that the auditors face while investigating varied audit issues in different auditable institutions (units), the staff of the performance audit of the OFAG follows a multi-disciplinary approach. As a result, the auditors were recruited from different professional back ground including management, accounting, economics, engineering, biology, political science& international relations, and environmental science. The audit may also use, depending on the nature of the audit project, outsourced professionals in the audit team. From a combination of all the above mentioned professions, there are fifty auditors in the department.

The department uses job classification system to make the grading of the auditors. Accordingly, the performance audit classified the audit positions under the department manager into eight levels which include, from the lowest to the highest, Junior Auditor, Auditor, Team Leader I, Team Leader II, Team Leader III, Senior Auditor I, Senior Auditor II, and division head. This is made to differentiate jobs based

on the complexity and other requirements in the one hand and give development opportunities for the audit staff on the other.

The entry-level educational requirement of performance audit is first degree in the above listed professions. However, most of the audit staffs have their ACCA and the others are following same.

At the initial stage of the establishment of the department, the auditors were made to be trained abroad for three months and provided with technical assistance by foreign expert for about six months. But, at present, the department uses internal resource to train new entry auditors. Thus, upon joining the department, intensive in-house training program is to be arranged so as to make the auditor ready for practical audit field, as part of the team attached with the experienced auditors. The training policy covers not only new staff but the existing staff is also required to pass through a minimum of 40 hours training program per annum to reorient the auditors with audit standards and current trends. In addition to the class-room based training the department creates opportunities for continuous staff development through assigning the auditors at different audit projects on job rotation basis.

The approving authority of annual plan is within the discretion of the OFAG itself. The department, taking the cost and other considerations, has also full authority to determine the scope of the audit. The audit reports are to be sent to audited institutions upon completion of each audit for necessary action; and the summarized plan progress report to the Parliament quarterly and annually. As of

June 30, 2006, about 42 performance audits were conducted by the OFAG.

In exercising performance audit, the OFAG has encountered different challenges. Although it has been trying to disseminate performance audit related information through its media 'Lisane Auditors', lack of awareness on the purpose of performance among auditable institutions remain as a major hindrance. Traditional way of documents and records management system existing in all institutions is making the audit data collection task difficult and time consuming. Lack of cooperation from the auditees is also one of the problems contributing for the delay of audit projects.

The current trend in relation with the government policy to introduce performance audit in all public institutions is considered by the OFAG as an opportunity to develop the profession and there by to implement effective performance audit projects.

2.5.2 Ethiopian Airlines

The Ethiopian Airlines has started the exercise of management audit, in the form of performance audit, was started in 1995. The structure and scale of operations of the internal audit has been changed at different times. Currently, the internal audit function of the Airline is organized at a Vice-President level and reports to the Board of Director; and to the Chief Executive Director (CEO) administratively. The Board of Directors has also finalized the draft proposal to establish an audit committee, within the Board, to deal with internal audit matters.

Under the V/President of the internal audit, there are three directorates, namely, Corporate and Operations Audit Director, IT and Systems Audit Director, and Corporate Quality Audit Director. The Corporate and Operations Audit, where in which the management audit is the major part, constitutes two managers, i.e., the managers of the Corporate Audit and Operations Audit.

The Number of staff of the Corporate and Operations Audit is 10. Concerning the educational requirement, there exist multi-disciplinary composition from the fields of accounting, management, economics and other social science professions. Depending on the audit issue, the audit may use specialized services such as from engineers and other fields. The entry level educational requirement is 1st degree in social science fields. The present profile of the auditors indicates that, apart from the minimum requirement, all auditors acquire professional certificate of internal auditing from the Institute of Internal Auditors (IIA); and are following other advanced internal auditing certificate programs of the IIA.

The plan and budget for the audit is approved by the Board. Based on the approved plan, the department determines the scope of the audit. The audit reports are to be sent to auditee institutions upon completion of each audit for necessary action; and the summarized plan progress report to the Chief Executive officer and the Board on a quarterly basis.

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CHAPTER THREE

MANAGEMENT AUDIT IN THE NATIONAL BANK OF ETHIOPIA- A SURVEY

3.1 Descriptions of the Population

Description of personal data of the respondents of the questionnaires are presented below (table 2 & 3)

| Job Position | No. | Sex | | Education Level | | Service Year in the Bank | | | |
|-------------------------|-----------|-----------|---|-----------------|------------|--------------------------|----------|-------|-----------|
| | | M | F | BA/ BSC | MA/ MSC | 1-5 | 5-10 | 10-15 | >15 |
| Director | 6 | 6 | - | 1 | 5 | | 1 | | 5 |
| Advisor to the Governor | 1 | 1 | - | 1 | | | | | 1 |
| Department Manager | 5 | 5 | | 2 | 3 | | | | 5 |
| Total | 12 | 12 | | 4 | 8 | | 1 | | 11 |

Table 2:- personal data of the CRS members

| Job Position | No. | Sex | | Education Level | | Service Year in the Bank | | | |
|-----------------------------|----------|----------|----------|-----------------|------------|--------------------------|----------|-------|----------|
| | | M | F | BA/ BSC | MA/ MSC | 1-5 | 5-10 | 10-15 | >15 |
| Systems Audit Division Head | 1 | - | 1 | | 1 | | | | 1 |
| Senior Management Auditor | 1 | 1 | - | 1 | | | 1 | | |
| System Auditor | 2 | 2 | - | 2 | | 2 | | | |
| Junior Management Auditor | 3 | 3 | - | 3 | | 3 | | | |
| Junior System Auditor | 2 | 2 | - | 2 | | 2 | | | |
| Total | 9 | 8 | 1 | 8 | 1 | 7 | 1 | | 1 |

Table 3:- personal data of the auditors

Two separate questionnaires were prepared for the two target groups, namely, one for CRS members and one for auditors depicted in table 1 & 2. Accordingly, a total of 28 questionnaires covering all members of the population were distributed; and the response rate was found to be 75% and 85.7% for the CRS members and the auditors, respectively.

Details of findings of the survey and corresponding analysis are dealt in the subsequent topics.

3.2 Internal Audit Charter

Internal audit charter is important document through which the board/management gives the internal audit department the authorities it to have direct access to information and communicate with any member of staff. It provides authority to examine any activity or entity of the organization, as well as to access any records, files or data, including information and minutes, whenever relevant to the performance of its assignments. In view of this underlying understanding, the IIA stipulated the importance of internal audit charter in the International Standards for Professional Practice of Internal Auditing as: *'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'* (IIA 1000).

Current practice in the bank shows that the internal audit of the bank does not have approved internal audit charter and guidelines which as a result forcing the IAD to perform its duties in a disorganized way. The survey tried to examine the auditors how they are conducting management audit without approved internal audit charter. The feed-

back collected from the questionnaire revealed that (table 4) the internal audit standards and best practices are commonly used (57.1%) to provide the management auditors with direction and guidance in the performance of their auditing. The result also reflects that the auditors use TORs, draft audit charter and discussion with auditees as a basis to handle their tasks.

| Question | Response | % |
|--|---|-------|
| How are you managing the regular auditing tasks in the absence of internal audit charter and guidelines? | By referring to IIA standards and best practices | 57.1% |
| | Based on annual plan and TOR prepared by the supervisor | 21.4% |
| | Using draft charter and guidelines | 14.3% |
| | Based on agreement with auditees on audit scope and methodology | 7.1% |

Table 4:- response of auditors for question on internal audit charter

The theories and best practices presupposes that internal auditing practicing organization should have approved internal auditing charter which defines the objective, scope, internal audit position, authority, responsibility and internal relationships of internal audit function within the organization, and the accountability of the head of the internal audit. In this regard, the result obtained in the survey exposed that the auditors did not follow unified direction and standardized procedures in executing their duties. The situation seems critical inviting for immediate consideration and action by the management of the bank.

3.3 Organization Structure

Review of best practices entails internal audit function to have direct reporting relationship with the Board of Directors or Audit Committee of the Board.

Organization structure and reporting relationship is considered by the IIA and best internal audit practicing institutions as basic factor to evaluate the independence and objective assurance service provided by internal audit functions.

The IIA states that *the chief audit executive should report periodically to the board and senior management on the internal audit activity's purpose, authority, responsibility, and performance relative to its plan. Reporting should also include significant risk exposures and control issues, corporate governance issues, and other matters needed or requested by the board and senior management (IIA 2060).*

The experiences of local public institutions included in the survey also showed that the management audit function to have direct reporting relationship with the highest level in the organization decision-making echelon. The director responsible for performance audit function in the EAL directly reports to the board of directors and CEO of the EAL on internal audit matters.

The CRS of the bank recommended the internal audit department to report to the Board of Directors (KPMG 2004). However, the internal audit department consisting of the management and system audits functions currently reports to the Governor of the bank.

In the survey, a question was asked for both target groups whether the current organization structure and reporting relationship of the IAD is appropriate. The result obtained reveals that the two groups have conflicting view (position) with respect to the current reporting relationship of IAD. The response from the CRS committees' members (table 5) indicated that 58.3% supported the current organizational structure and reporting relationship, whereas 25% and 16.7% of the respondent considered the current structure and reporting relationship as 'moderately appropriate' and 'not appropriate' respectively.

| Question | Response | | |
|--|-------------|------------------------|-----------------|
| | Appropriate | Moderately Appropriate | Not Appropriate |
| Do you think the current organizational structure and reporting relationship of the Internal audit Department is appropriate to provide independent and objective assurance? | 58.3% | 25% | 16.7% |

Table 5:- response of CRS committees for question on structure

On the other hand, the findings of the data obtained from the auditors (table 6) indicated that 55.6% of the respondents consider the current organizational structure and reporting relationship as 'not appropriate'; and 33.3% and 11.1% considered the structure as 'moderately appropriate' and 'not appropriate' respectively.

| Question | Response | | |
|--|-------------|------------------------|-----------------|
| | Appropriate | Moderately Appropriate | Not Appropriate |
| Do you think the current organizational structure and reporting relationship of the Internal audit Department is appropriate to provide independent and objective assurance? | 11.1% | 33.3% | 55.6% |

Table 6:- response of auditors for question on structure

Absence of good governance along with lack of transparency and accountability are the major predicaments in failure to achieve the desired goals. The need for more rational and informed decision making in the use of resources necessitated for the establishment of management audit in the bank. Such kind of audit assists the board of directors by reporting on management's performance in an organization as it deals with the results of operating decisions by management.

Basel Committee for Bank Supervision stated *'The head of the internal audit department should have the authority to communicate directly, and on his/her own initiative, to the board, the chairman of the board of directors, the member of the audit committee (if one exist) or the external auditor where appropriate, according to rules defined by each bank in the audit charter. This reporting may cover, for example, bank management's making decisions which are contrary to legal or regulatory provisions (Basel 200).*

In reference to its role to provide an independent and objective assurance on the economy, efficiency and effectiveness of operations and objectives achieved by the bank, giving an authority to the

management audit or the internal audit function to directly report to both board and governor will make a sense.

Suggestion reporting relationship- A survey was made on those respondents assuming the current reporting relationship is moderately or not appropriate to suggest reporting relationship that they might think appropriate. The result of the survey indicated that (table 7) 100% of both respondents of the CRS members and auditors suggested the internal audit department to report to the board of directors or the audit committee to be assigned by the board.

| Question | BoD/ Audit Committee |
|--|----------------------|
| If your answer on the organizational structure and reporting relationship of the internal audit department is 'moderately appropriate' or 'not appropriate', Please suggest the type of structure/reporting relationship that you might think appropriate? | 100% |

Table 7:- response of CRS members and auditors for question to suggest on structure

From the response it is boldly acknowledged that the reporting relationship of the internal audit function affect the degree of independent and objective assurance to be provided. In this respect, making the internal audit to directly report to the board of directors will enhance accountability and good governance.

3.4 Staffing

i. Number

Ensuring high quality audit results require recruitment of qualified management auditors in adequate number. With small number, it will be difficult for the management audit to cover all auditable functions and meet its objectives. Of course, both in theories and practice, there is no hard rule as to the number of management auditors an office should have. The underlying understanding, however, is the larger the size of the organization-the wider the scope of management audit and the larger the number of management auditors. Hence, the number should be subject to review and adjustment depending on the change in the size of organization and scope of audit; and the audit office should ensure that proper fit exist. The need for ensuring availability of adequate resource including audit staff is stipulated in the standards of the IIA: *The chief audit executive should ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan (IIA 2030).*

As per its manpower establishment, the management audit division of the Bank is staffed with seven auditors including the head of the division. The management audit is expected to cover all units of the Bank based on risk-based priority. Within its service of two years it conducted performance audit on three departments.

The survey result on to on the adequacy of the number of management auditors to meet what is expected of it. The result obtained from the auditors indicated that (table 8) 66.7% agreed that the management audit has enough number of auditors whereas 22.2% of the respondents voted as the number is not inadequate.

| Question | Response | | No Response |
|---|----------|-------|-------------|
| | Yes | No | |
| Is the number of management audit staff adequate to meet the objective of management audit service? | 66.7% | 22.2% | 11.1% |

Table 8:- response of auditors for questionnaire on number of auditors

From the survey, it can be observed that the management audit has enough number of auditors to meet its current work demand. Hence, the feed-back confirmed with the customary practice of staffing- to start at small scale. Starting with smaller number and revise as and the volume of audit work requires seems acceptable.

ii. Disciplinary Mix (Composition)

The traditional practice of audit offices was to recruit auditors from accounting field. The trend however has changed in line with the changes that have been occurring in the internal audit field and with emerging role of the management audit plays. Best practices tell to recruit management audit staffs from a mix of discipline taking in to account the nature of examination they might engage. Staffing the management audit of the bank with mix professionals enables to build versatile management audit team. Domestic experience in the OFAG and the EAL affirmed that management audit unit needs to contain staff from different professions. The professional composition of the performance audit department of the OFAG includes management, accounting, economics, engineering, biology, political science & international relation and environmental science. Similarly,

the management audit staff of the EAL entertains business and economics fields.

The management audit staff of the bank was recruited from single discipline. As a result all the auditors have university undergraduate degree in management. In the survey, a question was asked to investigate the auditors' opinion towards the current professional composition of the auditors. The response to the questionnaire depicted that (table 9) 11.1% responded the current mix as adequate and 77.7% as not adequate to perform their task as required whereas 11.1% of the respondents were silent on the issue.

| Question | Response | | |
|---|----------|-------|-------------|
| | Yes | No | No Response |
| Do you think the existing professional mix (disciplinary composition) of management audit staff adequate? | 11.1% | 77.8% | 11.1% |

Table 9:- response of auditors for questionnaire on professional composition

Suggestion on additional professions- Those respondents who considered the current composition as 'not adequate' were investigated to suggest additional field of studies the management audit should contain. Accordingly (table 10), 50% of the respondent suggested economics, 25% accounting, 16% IT, and 8.3 % statistics to be added in the staffing profile of the management audit of the Bank.

| Question | Response | % | No Response |
|---|------------|-------|-------------|
| If your answer is the professional mix is not adequate, what other professions need to be included? | Economics | 50% | |
| | Accounting | 25% | |
| | IT | 16.7% | |
| | Statistics | 8.3% | |

Table 10:- response of auditors for question on professional composition

The result clearly depicted the recent development in the field of management audit role. The management auditors often deal with a variety of issues requiring sound knowledge and technical skill in different fields. In this regard, the feed-back from the survey agrees with the theoretical framework and current trend in the field. Hence, including additional professions in the existing mono-disciplined management audit unit of the Bank seems sound. By crating multi-discipline staff, the management audit unit can change itself into a pool of knowledge capable of assurance and consulting service on risk assessment and operational efficiency the varied functions that the bank has.

3.5 Strategic Plan

Management audit offices prepare audit strategic plan and the associated budget, commonly covers for three years. The plan indicates the timing and frequency of areas to be examined during the strategic plan. Over the period, the plan should be reviewed and updated regularly to adapt it to the changes and developments in the organizations and environment at large. In principle, management audit offices have the authority to prepare their audit plan and determine scope of activities based on the nature and significance of

activities to the attainment of overall organizational objectives. For management audit offices the important strategic plan item is audit selection –the method and rational for selecting subjects for audit. In preparing the plan, management audit should conduct detail risk assessment over the organization’s activities and associated risks inherent to the activities. Based on the result of the assessment, priority will be established. In this connection, the IIA has established a standard: *The internal audit activity's plan of engagements should be based on a risk assessment, undertaken at least annually. The input of senior management and the board should be considered in this process (2010.A).*

The management audit of the NBE has prepared and implemented a five year strategic plan in 2004. However, the plan was prepared in the absence of bank-wide risk assessment. As a result, management audit programs were prioritized based on general survey using general risk measuring factors made on only seven departments out of a total of fifteen departments.

In the survey, a question was designed to get the opinion of the auditors on the effectiveness of the current strategic plan. The result indicated that (table 11) 66.7% considered the plan as effective and 33.3% replied as the plan is not effective.

| Question | Response | |
|--|----------|-------|
| | Yes | No |
| Do you think the internal audit strategic plan is effective to bring the desired change? | 66.7% | 33.3% |

Table 11:- response of auditors for question on strategic plan

The result obtained from the survey lacks conformity with best practices. Accordingly, irrespective of the underlying fact that the plan was prepared without conducting risk assessment on all the functions of the bank, the respondents consider the plan as effective to meet expectations. Such variation invites for further investigation and verification using other data collection techniques.

The survey also asked those respondents considered the plan as 'not effective' auditors to state the deficiencies they observe on the plan. Accordingly, lack of risk-based priority of audit tasks, participation of the internal audit staff and proper implementation were viewed as major deficiencies of the strategic plan (table 12).

| Question | Response | % |
|--|--|-------|
| What are the deficiencies of the plan? | Lack risk-based priority setting of tasks | 33.3% |
| | Prepared without the participation of internal audit staff | 33.3% |
| | Lack of proper implementation | 33.3% |

Table 12:- response of auditors for question on strategic plan

Strategic plan beyond stating well recognized items such as vision and mission of the audit helps to explain how the mission is to be accomplished and establish targets against which performance will be measured. The performance audit is said to be effective if its programs achieve profound results, measured by success in having recommendations effectively implemented and the impact achieved. In this regard, conducting bank-wide risk assessment and setting effective management audit plan and establishing priority-based audit programs is reasonable and worth consideration.

3.6 Plan and Budget Approval

The approval authority on plan and budget varies from institution to institution. Hence, in practice, depending on specific structural settings, the executive management (senior management) or board of directors (audit committee) approves management audit plan and budget. The IIA established the following standards in relation with internal audit plan.

The internal audit activity should be free from interference in determining the scope of internal auditing, performing work, and communicating results (1110.A1).

On similar way the Basel Committee on Banking Supervision established the authority for plan approval under the optional discretion of the chief executive officer of the bank or board of directors. Accordingly it states: *The audit plan should be established by the internal audit department and approved by the bank's chief executive officer or by the board of directors or its audit committee, if one exists,*) (Basel 2001).

On the contrary there are arguments favoring the need to provide the management (performance) audit unit with full authority to determine on the plan and scope of the audit.

'To have a full degree of independence, performance audit offices need authority to select subjects for audit without approval of the legislature, governor or some other oversight body. Most, if not all, federal and local government auditors have such authority' (AGA 2006).

The plan and budget of the management audit of the bank is to be approved by the board of directors along with the overall budget of the bank. Such practice is being exercised in other audit offices too. The board of directors of the Ethiopian Airlines approves the plan and budget of the management audit unit.

The survey result indicated that (table 13) 67.7% of the respondents recommend the board of directors or audit committee to approve the internal audit budget whereas 33.3% opted for the executive management of the bank as appropriate budget approving authority.

| Question | Response | % |
|--|------------------------------------|-------|
| Who should review and approve the internal audit budget in your opinion? | Board of Directors/Audit Committee | 67.7% |
| | Executive Management | 33.3% |

Table 13:- Response of auditors for question on budget

The survey result in this regard fits into the conceptual framework stated in international standards and practice of experiencing institutions. Hence, the response of the respondents seems acceptable.

3.7 Salary Scale

Fixed pay in the form of salary supported by good benefit packages is the major important financial factor enabling organization to attract or retain qualified staff. Management auditors are in short of supply making the profession expensive. Development of recruits from universities into management auditors requires longer time (more

than two or three years) and is also a costly exercise. Hence, maintaining adequate salary structure, from entry to senior auditors level, is important to recruit and retain highly competent, energetic, and experienced management auditors.

In the bank, job grades and salary scales are generally determined centrally at a bank level. Salary is often determined based on degreed professions (accounting, management, economics, etc.) without taking in to account to scarcity of professions. Job grades are also established bank-wide with the view of maintaining internal consistency and equity. Accordingly, management auditors' positions are classified into three levels-junior auditor, auditor and senior management auditor- similar with other common jobs like accounting and personnel officers.

The survey result on the question designed to check the adequacy of the auditors' salary structure to acquire qualified auditors indicated that (table 14) 77.7% of the respondents viewed the salary structure as 'not adequate' to attract/retain competent auditors.

| Question | Response | | |
|--|----------|-------|-------------|
| | Yes | No | No Response |
| Is the existing salary scale for the internal audit staff adequate to attract and/or retain skilled and experienced management auditors? | 11.1% | 77.8% | 11.1% |

Table 14:- Response of auditors for question on salary structure

The same question was asked to the management of CRS members. In similarly way, the result showed that (table 15) 50% viewed the

existing salary scale as 'not adequate' to attract and retain qualified auditors.

| Question | Response | | No Response |
|--|----------|-----|-------------|
| | Yes | No | |
| Is the existing salary scale for the internal audit staff adequate to attract and/or retain skilled and experienced management auditors? | 25% | 50% | 25% |

Table 15:- Response of CRS members for question on salary structure

Literature and data obtained from the OFAG (interview) told that management audit is among the highly marketable profession. The number of years required to develop entry level professionals into management auditors coupled with absence of universities providing management audit at degree levels force organizations to make internal adjustment to keep their auditors motivated. In view of this prevalent fact, the response obtained through the survey seems reasonable alarming the bank to treat the issues at this initial stage of management audit exercise.

3.8 Professional Competence

Professional competence of management auditors is critical to successfully implement management audit in organizations. One of the common impediments in the smooth implementation and operation of management auditing is the insufficient knowledge and expertise to conduct the audit and produce quality audit reports. Management auditors thus should be conversant with management audit concepts and technical audit skills through structured classroom-based and on-the-job trainings supported by technical

internal audit experts. Above the basic university first degree required for entry-level, management auditors should develop their skill by continuing graduate studies. In view the fact, the IIA discussed the need for internal auditors' competence in its standards: *Internal auditors should possess the knowledge, skills, and other competencies needed to perform their individual responsibilities (IIS 1210). It also stated that internal auditors should enhance their knowledge, skills, and other competencies through continuing professional development (IIA 1230).*

Recognizing the need for professional competence in the form of education and continues training, the consultant undertook the comprehensive restructuring study of the Bank put building the capacity of management audit staff as a precondition to implement management audit in the bank; and ultimately the consultant was in confirmed that the bank lacked the capacity to implement management audit (KPMG 2004).

i. Education Level

Professional competence, and particularly knowledge and experience, within the internal audit department itself deserve special attention (Basel 2001). To meet the growing demand for and diversity of management audit services, the management audit division of the bank as a whole as well as individual management auditors must be competent. Domestically, there are no universities specially provide graduate study to educate internal auditors as management or performance auditor. As a result, the bank either sponsor their auditors to continue graduate studies in MBA, ACCA, Accounting &

Finance, Certified Internal Auditor (CIA), etc or hire trained auditors qualified in the mentioned fields.

Based on the information obtained from the personal profile section of the questionnaire designed, the educational level of management auditors is first degree.

The survey result obtained from the auditors indicated that (table 16) 55.6% and 33.% consider the current educational level of auditors of the Bank as 'Appropriate' and 'Not Appropriate' respectively; and 11.1% did not replied.

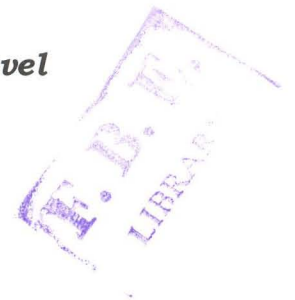
| Question | Response | | |
|--|----------|-------|-------------|
| | Yes | No | No Response |
| Do you think the educational level of management audit staff adequate? | 55.6% | 33.3% | 11.1% |

Table 16:- response of auditors for question on education level

In the survey respondents who consider the current education level as 'not adequate' were asked to recommend educational level they might think appropriate. The response showed that (table 17) all suggested a post graduate degree in relevant fields and CIA.

| Question | Response | % |
|--|----------|-------|
| If your answer to the educational level of management audit staff is not adequate, please state your recommended level of education? | MA/MSC | 50% |
| | CIA | 33.3% |
| | ACCA | 16.7% |

Table 17:- response of auditors for question on education level



Related question was asked for members of the CRS committees to get their view on the overall competence (education wise) of the internal audit department of the bank. The result indicated that (table 18) 83.3% felt the IAD lacked the required capacity adequate capacity to meet its objectives.

| Question | Response | |
|---|----------|-------|
| | Yes | No |
| Do you think that the internal audit has the required capacity to effectively discharge its responsibilities? | 16.7% | 83.3% |

Table 18:- response of CRS members for question on capacity of internal audit

Additional question was asked for those responded that the IAD does not have the required capacity to obtain their view on actions to be taken to improve the IAD's capacity. The survey identified that (table 19) 19% of the respondents suggested upgrading the educational level of the auditors, 42.9% recommended providing internal auditing training, and 38.1% favored for technical assistance, and 19% suggested for skill upgrading.

| Question | Response | % | No Response |
|---|---|-------|-------------|
| If your answer to question asked on the capacity of IAD is 'No' what actions do you suggest to improve (or make it capable) the capacity? | Upgrade the educational level of auditors | 19% | |
| | Provide internal audit technical training | 42.9% | |
| | Technical assistance | 38.1% | |

Table 19:- response of CRS members for question on education level

The adequacy of educational level of the management auditor must be assessed and evaluated in light of the nature and complexity of its responsibilities and the output the auditors are expected to deliver. The role of management audit is thus providing independent and objective assurance and advice on the effectiveness of risk management, governance, internal control, and appraise the efficiency and economy of operations. The scope of service to be provided by the management audit includes all functional and operational areas of the bank. Hence, the growing in the complexity and type of operations conducted in the bank make the need for knowledge upgrading critical.

The experiences of public institutions surveyed indicated that management auditors should acquire qualifications above first degree. More than 80% of management (performance) auditors OFAG are ACCA qualified and the remaining are continuing for ACCA. Similarly, 40% of the management (performance) auditors of the EAL are ACCA qualified and the remaining auditors are continuing on same field. Thus, the result of the survey proved the immediate need for capacity upgrading of the management audit.

ii. Training

The practice of modern day auditing in the areas of management auditing requires auditors to become capable of doing their job as per acceptable international auditing standards. Management auditors should attend continuous classroom training on areas of management assurance methodology, risk assessment techniques, performance auditing, etc. supplemented by on-the-job practical training which include on how to actually conducting management.

Thus, the development of professionals into performance auditors could be achieved through a combination of formal and on-the-job training. Government performance auditors are required by auditing standards to obtain continuing professional education. The government auditing standards of the USA required each auditor to obtain 80 hours of continuing professional education every two years with at least 20 hours obtained in one of the years (AGA 2006). Local experience of the OFAG through that the office has passed with through rigorous classroom and on the job programs while the office were implementing performance audit supported by foreign consultant (for six months). Further, to ensure continuity of skill upgrading, the OFAG has a policy making every auditor to in-house training for a minimum of 40 hours per year.

The survey addressed the issue of training by asking the auditors whether they take management audit training. The response showed that (table 20 & 21) 88.9% answered that they took performance audit training for 7 days, and 11.1% did not. The survey attempted to investigate whether the training was adequate (Table 22). Further, and a question was asked to suggest the type of trainings they might think are appropriate (table 23).

| Question | Response | |
|--|----------|-------|
| | Yes | No |
| Do you take training in management audit training? | 88.9% | 11.1% |

Table 20:- response of auditors for question on training

| Question | Response | % |
|--|-------------------------------------|------|
| If your answer to the training is yes, please state the type and name of training you took | Performance Auditing for seven days | 100% |

Table 21:- response of auditors for question on training

| Question | Response | | |
|--|----------|----|-------------|
| | Yes | No | No Response |
| Do you think the trainings are adequate to effectively perform your auditing task? | 88.9% | | 11.1% |

Table 22:- response of auditors for question on training

| Question | Response | % |
|--|----------------------------------|-------|
| If your answer to the adequacy of training is no, what kind of training you suggest? | Management/ performance auditing | 66.7% |
| | Risk based auditing | 11.1% |
| | Systems auditing | 11.1% |
| | Fraud investigation | 11.1% |

Table 23:- response of auditors for question training

From the survey result, it is obtained that auditors working on the engage in the management audit function were provided with one week an introductory training on performance auditing concepts. From the theories and domestic experience of OFAG, however, it has been observed that this short training is not enough for a clear understanding and application of this modern auditing methodology in the Bank's endeavor. In this regard, the survey explicitly exposed the presence of management audit skill gap which would constrain the division to meet its objectives.

3.9 Prospects of Management Audit in the NBE

The National Bank of Ethiopia has been in the process of transforming its internal audit function **in** line with the recent developments in the internal audit field. The introduction of modern-day auditing in general and implementation of management audit in particular will benefit the bank in the following ways.

- ☑ Management audit will serve as an important instrument, applying accepted internal auditing standards, to ensure whether the resources of the bank's are used optimally and operations are performed in efficient, effective and economical manner. In this respect, it helps to provide independent assurance and ensuring accountability and transparency in the use of public resources.

- ☑ Regular management audits determine if the bank is carrying out its responsibilities effectively and efficiently and determines if reported in performance measures is accurate.

- ☑ The audit assists to identify unnecessary activities, areas of duplications and costly services; come up with suggestions to solve the problems.

- ☑ The management audit focuses on results, evaluating the effectiveness and suitability of controls by challenging underline rules are compliance audit plus cause and effect analysis. In this regard, the audit serves, when performed correctly, as the most useful tool of evaluation methods as results in change.

- ☑ Assists management to identify risk areas and assess the level of residual risk and controls related to them.

- ☑ Moreover, the audit helps to improve overall institutional performance of the bank by measuring actual performances of plans and projects against strategic goals and objectives.

CHAPTER FOUR

CONCLUSIONS AND RECOMMENDATIONS

4.1 Conclusions

Management audit has been introduced in countries around the world since last 30 years. In recent days many public institution in Ethiopia has also started management (performance) audit practices as important tool to promote accountability in public spending. The National Bank of Ethiopia has introduced management audit in 2004 as part of the implementation process of its comprehensive restructuring study conducted by a foreign firm, KPMG. Though the experience and initiatives are at still at the embryonic stage, assessment of the current system enables to ensure whether the strategy, structure and system in placed support to bring the desired change. This paper therefore dealt with assessment of the practice of the management audit of the NBE so as to identify the challenges and prospects. The practice was thus appraised benchmarking internal auditing standards and experiences of best practicing local public institutions.

The assessment and subsequent appraisal was made with factors accepted as critical for successful execution of management audit. The variables used include existence of internal audit charter, structure and work relationship, staffing (number & disciplinary composition), professional competence (education & training) of management auditors, effectiveness of internal audit strategic plan, plan and budget approving authority, and salary structure.

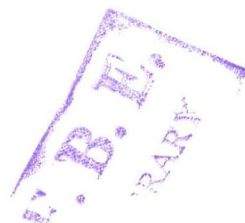
Based on the findings of the research the following conclusions are made.

- ☑ Organizational structure and reporting relationship are found one of the most important factors determining the independence and the degree of objective assurance role of the management audit of the bank. In view of this internal auditing standards and best practices revealed that the need for making the audit accountable to the board. Thus, the management audit structure and its reporting relationship is found as major constraint that will preclude the management audit function from playing its expected role.

- ☑ It was found that the internal audit in general does not have approved charter and guidelines. As a result, the management audit lacked legitimized rights and authority over information and its relationship with auditees.

- ☑ It was observed that the institutional capacity level of the management audit in general and the auditors in particular was found low to execute the audit per the standards and requirements of modern day auditing. The problem is accounted for lack of prior readiness and effective implantation plan. Hence, it was concluded that lack of the required knowledge and skill will deter management audit from playing its role.

- ☑ The number of management audit staff is found to be adequate. With regard to the disciplinary composition of staff, it is found



that the current practice of recruiting the auditors from the field of management only limit the opportunity developing audit teams with expertise management audit demands.

- ☑ The current plan and budget approval system and authority was found appropriate and in agreement with common practice exercised by institutions surveyed in the research.

- ☑ Absence of bank-wide risk assessment exercise and risk management organization impeded the effectiveness of management audit plan.

- ☑ The current job grading and salary structure were found not motivating to attract or retain qualified management auditors.

4.2 Recommendations

Based on the above conclusions, the following recommendations are drawn:

- ☑ There is a strong need both in theories and practice to make the internal audit function to board of directors. Establishing a direct reporting relationship of the internal audit with the board will guarantee its independent in one hand and provide the board with the opportunity to regular objective assurance on risk management process, effectiveness and efficiency of operations, and adequacy of internal control system.

- ☑ The authority, responsibility and work relationship of the internal audit should be legitimately delimited. To this effect, the executive management of the bank should give prior attention and approve the internal audit charter and guidelines of the management audit.

- ☑ There is strong stand from the management auditors on the need to make the management audit function a pool of expertise of relevant disciplines. The idea is commendable in view of its potential benefits of enhancing competent team development capable of handling management audit projects in all specialized functions of the bank. Thus, it is suggested to make the management audit division to include auditors with economics and accounting background.

- ☑ The current job grading and classification levels and salary structure should be revised with due consideration on the nature and complexity of the job, and the responsibilities entrusted with the auditors on one hand and current demand of the skill in the labor market on the other.

- ☑ To mitigate the knowledge gap of management auditors, the bank should encourage and sponsor management auditors to follow ACCA, and CIA in addition to the of MBA and Accounting & Finance that the bank has sponsoring.

- ☑ Management auditors should attend continuous classroom training on areas of management assurance methodology, risk assessment techniques, performance auditing, etc. The

classroom training should also be supplemented by on the job practical management audit training managed by a technical expert. To training policy should be designed to ensure sustainability of trainings in the area.

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Appendix

- **Questionnaire I (Auditors)**
- **Questionnaire II (CRS Members)**

Questionnaire I

(Target Group: Internal Auditors of the NBE)

Name (Optional): _____

Sex: Male Female

Position: _____

Educational Level: BA/BSC MA/MSc

Service Year in the Bank: 1-5 5-10 10-15 Above 15

1. The Internal Audit Department of the National Bank of Ethiopia is reporting to:

The Board of Directors of the Bank

The Governor of the Bank

The Vice-Governor of the Bank

Other _____

2. Do you think the current organizational structure and reporting relationship is appropriate to provide independent and objective assurance?

Appropriate

Moderately Appropriate

Not Appropriate

3. If your answer to question no. 2 is 'Moderately Appropriate' or 'Not Appropriate', please suggest the organizational structure/reporting relationship that you might think appropriate.



4. How are you managing the regular auditing tasks in the absence of approved Internal Audit Charter and guidelines?

5. Do you think that your internal audit strategic plan effective to bring the desired change?

Yes No

6. If your answer to question no. 5 is 'No', what are the deficiencies of the plan?

7. Who do you think should review and approve the internal audit budget?

Board of Directors Executive Management Other _____

8. Is the number of management audit staff adequate to meet the objectives of the management audit services?

Yes No

9. Do you think that the existing professional mix (disciplinary composition) of management audit staff adequate?

Yes No

10. If your answer to question no. 9 is 'No' which other professions need to be included.

Economics Accounting Other _____

11. Is the existing salary scale for the internal audit staff adequate to attract and/or retain skilled and experienced management auditors?

Yes No

12. Do You think that the educational level of the management audit staff is adequate?

Yes No

13. If your answer to question no. 12 is 'No' please state your recommended level of education.

14. Do you take training in management auditing technique?

Yes No

15. If your answer to question no. 14 is 'Yes', please state the type of training you took and the name of the training institution?

1. _____
3. _____
2. _____
4. _____

16. Do you think the trainings are adequate to effectively perform your auditing task?

Yes No

17. If your answer to question no. 16 is 'No', what kind of training do you suggest?

1. _____
3. _____
2. _____
4. _____

18. Additional comments/suggestions

Thankyou for giving me your precious time!

Questionnaire II

(Target Group: Members of the Comprehensive Restructuring Study)

1. General Profile

Name (Optional): _____

Sex: Male Female

Job Position: _____

Educational Level: BA/BSC MA/MSc

Service Year in the Bank: 1-5 5-10 10-15 Above 15

2. What was your role on the restructuring study of the National Bank of Ethiopia?

- Chairman of the Steering Committee
- Member of the Steering Committee
- Member & Secretary of the Steering Committee
- Chairman/Member of the Accounting & Internal Audit Taskforce

3. Do you think the current organizational structure and reporting relationship of the internal audit department is appropriate to provide independent and objective assurance on risk management, operations and governance?

- Appropriate
- Moderately Appropriate
- Not Appropriate

4. If your answer to question no. 3 is 'Moderately Appropriate' or 'Not Appropriate', please suggest the organizational structure/reporting relationship that you might think appropriate.

5. Is the existing job grade classification and salary scale of the Bank adequate to attract and/or retain skilled and experienced management auditors?

Yes

No

6. If your answer to question no . 5 is 'No', what is your suggestion.

a) suggestion on the job grade classification

b) Sugestion on the salary scale

7. Do You think that the internal audit has the required capacity to effectively discharge its responsibilities?

Yes

No

8. If your answer to question no. 7 is 'No', what actions do you suggest to improve (or make it capable) the capacity.

Upgrade the educational level of auditors

Provide internal auditing technical training training

Technical assistance

Other _____

9. Additional comments/seggestions

Tankyou for giving me your precious time!