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**ASSESSMENT OF INTERNAL AUDITORS' ROLE IN PROCUREMENT  
COMPLIANCE RISK MANAGEMENT:-  
THE CASE OF SELECTED BUDGETARY PUBLIC ORGANIZATIONS**

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**A Research Project submitted for the Partial fulfillment of the  
Requirements of the Degree of Master of Science in Accounting and  
Auditing to the department of Accounting and Finance**

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**ADDIS ABABA, ETHIOPIA**

## DECLARATION

I, the undersigned, declare that this thesis is my original work and has not been presented in any other university, and that all sources of materials used for the thesis have been duly acknowledged.

Declared By: Name: Meskerem Wendwessen Benty

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Date: 26 June 2019

### **Statement of certification**

This is to certify that Meskerem Wendwessen Benti has carried out a thesis on the topic “Assessment of Internal Auditors’ role in procurement Compliance risk Management:- the case of selected budgetary public organizations” under my supervision. In my opinion, this thesis is suitable for submission in partial fulfilment of the requirements for the award of the MA Degree in Accounting and Finance.

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## **Abstract**

The purpose of the study is to assess the role of internal auditors in procurement compliance risk management of selected budgetary public organizations. Accordingly competency, compliance, Independency, and Risk management has been taken as major parameters for comparison. To make the data reliable sufficient questionnaires were distributed for the target population. Questionnaires designed to measure the level of agreement of the respondents on the applicability of each parameter. Specifically, the study assess the independency of the Internal Auditors in performing their duties, examine the level of their involvement in procurement compliance risk management process, and assess the extent to which the management members act upon Internal Auditor's findings and recommendations so as to perform the procurement compliance risk management task of the public organization. Data collected from both primary and secondary sources of information. Questionnaires, unstructured discussions with respondents and observations used as data collection instruments while desk research used to complement the primary data. The result point out internal auditors of public organizations under study have limited role in procurement compliance risk management and also failed to have proper practice in conducting procurement audit; the essential procurement compliance risk management tool.

# **Chapter One**

## **Introduction**

### **1.1. Background of the study**

Government of FDRE has taken the initiative to further enhancement of good governance, transparency, accountability and efficiency and effectiveness of government operations, including compliance risk management and the internal control framework of Ministries and all government entities that directly receive and manage budget allocations.

To this effect, Government provide for the necessary legislative framework by promulgating multiple Financial Administration Proclamation and Council of Ministers Regulation as well as directives issued by Ministry of Finance. And also it took measures to reorganize and strengthen internal auditing in these organizations.

After the promulgation of the 1995 constitution, in accordance with Article 55 (I) of the constitution the federal government proclaimed the first financial administration proclamation number 57/1996. Pursuant to this proclamation and Article 68 of the same, Regulation number 17/1997 was issued by the Council of Ministers. According to Regulation number 17/1997 article 2/14 "Internal Audit" means a systematic, independent and appraisal of all operations, including administrative activities, for purposes of advising management practices and controls. From this definition one can infer that the scope of internal Auditing function is advising the management of a public organization. Though it has also some control role, as a function, controlling activities are performed by internal control department.

The internal control function has also some aspects of legal compliance management activities. According to Art 2/15 of the same regulation "Internal Control" means the plan of organization and all the coordinated methods and measures adopted by management to safeguard asset, ensure the timeliness, accuracy and reliability of accounting data, promote operational efficiency and maintain adherence to regulations and directives. This regulation levied power to the Ministry of Finance to develop and maintain appropriate standards of work and conduct for application throughout all public bodies internal audit functions.

Proclamation number 648/2009 is the last financial administration proclamation. This new law makes a serious advancement in defining the role and tasks of internal Audit function of a public organization. According to Art 2/25 of the proclamation "Internal Audit" is an independent and

objective assurance and consulting activity designed to add value and improve an organizations operations which helps an organization accomplish its objectives by bringing in a systematic and disciplined approach to evaluate the effectiveness of risk management, control and governance process.

This definition clearly incorporates the risk management function as an integral part of internal audit. The Regulation proclaimed following the proclamation mentioned above, Regulation Number 190/2010, gives more emphasis on the duties and responsibilities of Internal Audit. According to Art 60 of the regulation Internal audit of public body shall have unlimited power of audit over the whole range of finance, property and activity of their public body.

The Internal Audit of public bodies shall be responsible for conducting internal audit at specific intervals to evaluate the performance of the public body and to ascertain that public money and public property are used for intended purposes, and submitting audit reports to the head of the public body and to the Minister and follow-up measures taken based on their audit findings indicated in their report. As per the establishing proclamations, Proclamation Number 916/2015 Art 18, the Ministry of Finance (MOF) has the responsibility to establish systems of internal audit, and follow-up the implementation of same; ensure the harmonization of systems of internal audit established at the levels of both federal and regional governments.

Based on this power, the Ministry has issued a manual that contains a code of ethics for internal auditors and procedural guidance on the conduct of audits (MOFED, 2004). Internal audit standards of the Ethiopian Government, specified in the manual, closely match those published by the IIA.

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

The consulting services are advisory in nature and performed at the specific request of an engagement client. When performing consulting services the internal auditor should maintain objectivity and not assume management responsibility.

The task of Internal Audit in helping an organization by improving its effectiveness of risk management involves activities directed in controlling the compliance of the organization to relevant policies, regulations and directives.

Therefore it is at such point that the impact of the internal auditors functions needs to be checked as to whether they have really contribution in controlling managers decisions in line with their compliance to variables in the regulatory environment.

Thus the main purpose of this study is to conduct a survey study through analyzing the roles of internal Auditors in procurement compliance risk management of public organizations.

## **1.2. Statement of the Problem**

Compliance risk is exposure to legal penalties, financial forfeiture and material loss an organization faces when it fails to act in accordance with industry laws and regulations, internal policies and other regulatory variables.

Internal Auditors are duly obligated to render assurance and consultancy services to their organization. While rendering their assurance services which involve the internal auditor's objective assessment of evidence to provide an independent opinion or conclusions regarding an entity, operation, function, process, system or other subject matter and consulting service which are targeted in satisfying the specific request of an engagement client, the Auditors might be challenged and viewed by the managers as an obstacles and hindering variables for the smooth operation and performance of the organization. On the other hand they are required to safeguard the interest of the public/government by controlling every activity of the managers and are also entrusted to check the compliance of the managers to the regulatory variables.

According to the Federal government of Ethiopia Financial Administration Proclamation number 648/2009 Art 7, the Internal Audit of public bodies are responsible for conducting internal audit at specific intervals to evaluate the performance of the public body and to ascertain that public money and public property are used for intended purposes, and submitting audit reports to the head of the public body and to the Minister, follow-up measures taken based on audit findings.

The law assumes that if the internal auditors perform their duty properly and effectively, the public money can be safeguarded proactively so that it will not be subjected to maladministration. In effect it enables the proactive safeguarding the public money from any public servant who, with intent to obtain for him or to procure for another an undue advantage

and by any means, injures the public interests entrusted to his charge and which it is his duty to protect.

But for the last consecutive 5 years, the Federal Auditor General report indicates multiple violations of the financial administration laws and procurement manual which resulted, as reported, in serious or grave maladministration of public money. These situations pose serious concerns on the perceived roles of the internal auditors.

Thus the issue here is on how to manage the balance between the Auditors activities and performances in properly playing their assurance and consultancy role on the one hand and creating smooth and reliable working environment within the organization without compromising their responsibilities to keep the interests of the public/government good and safe. This raises the challenge to check the level of their role in procurement compliance risk management and how they can contribute positively in the protection of the public interest in proactive manner.

### **1.3. Research Questions**

The study will try to answer mainly

What are the procurement compliance risk management strategies of public organization and the role of internal auditors in the process?

Specifically the study will try to answer

- How the procurement strategies designed for public organization to manage compliance risk management are applied and controlled in the functions of Internal Auditors?
- How far internal auditors involve in the compliance risk management process of their organizations?
- How proper the relationship among Internal Auditors and top management is in creating enabling environment to internal auditors with the capacity of protecting the public money from embezzlement?
- How the top management of public organizations use the assurance and consultancy services of Internal Auditors in compliance risk management task of the organization?

## **1.4. Objectives of the study**

The main objective of the study is to assess the current practice and organizational settings of the Internal Auditors and their role in procurement compliance risk management of public organizations under study.

Based on the main objective, the study encompasses the following specific objectives

- To assess the organizational setting of internal auditors in public organizations;
- To assess the role of internal auditors in procurement processes of public organizations;
- To check the use of procurement audit as compliance risk management tool by public organizations and
- To assess the practice of top managements of public organizations in correcting the findings and implementing the recommendations of internal auditors and the follow up of internal auditors themselves.

## **1.5. Significance of the Study**

The researcher believes that the result of this research would have the following significances.

- This study could be used as an initiation for those who are interested to conduct a detailed and comprehensive study regarding the contributions and roles of Internal Auditors in compliance risk management.
- Since compliance problems are the main and trending Audit findings and are become almost usual and standard content of Federal Auditor General's audit findings report, the study will try to investigate the possible proactive measures to be taken to minimize the compliance problem by exploiting the assurance and consultancy services of Internal Auditors.

## **1.6. Scope and limitation of the study**

The focal point of the study is some selected government budgetary organizations. The compliance variables are diverse and complicated. Therefore this study will be limited to procurement compliance risk management.

## **Chapter Two**

### **Literature Review**

#### **2.1. The Functional development of Internal Audit**

The definition of internal auditing published by the IIA in 1947 defined Internal auditing as it deals primarily with accounting and financial matters but may also properly deal with matters of an operating nature.

However, the shift to a war economy in the early 1940s triggered the expansion of the internal audit scope beyond the traditional financial audit (IIA, 2015). Whittington and Pany said the expansion was driven by the increasing of size, scope and complexity of business activities which then resulted in the emergence of the need for management to overcome operational problems. (quoted in Helianti 2016, p.13)

In addition, as Ramamoorti said, verification of accounting information started to be used for evaluation of business performance and employees as well as decision making (quoted in Helianti 2016, p.13). The companies responded to the condition by officially establishing internal audit unit to enable top management to track significant business development through collecting an informative reporting of selected business facts (quoted in Helianti 2016, p.13). As the definition given by IIA 1947, mentioned above, stipulates internal auditors are duly expected to deal with matters of operating nature. And as Ramamoorti discussed, the functions of internal auditing has gradually expanded from an appraisal of whether authorized accounting and financial policies have been followed to an assessment of the compliance of all operating policies and procedures of the company as well as the soundness and effectiveness of control over all operations (P.13)

As Mousa discussed, in 1957, the IIA changed the emphasis of the responsibility of internal auditing to any phase of business activity. This was demonstrated in the new definition of internal auditing issued by the IIA in 1957 as follows:

“Internal Audit is an independent appraisal activity within an organization for the review of accounting, financial and other operations as a basic service to management.”

It is a managerial control, which functions by measuring and evaluating the effectiveness of other controls (quoted in Helianti 2016, p.14).

From the broader view of the definition given by Institute of Internal Auditors (IIA 1957) and co reading with the assurance service expected from internal auditors, one can infer that internal auditing includes the tasks of appraising the actions of the management whether it is in compliance with relevant laws and regulations and safeguarding assets of the organization.

As Ferramosca discussed, the definition given to Internal Auditing by the Institute of Internal Auditors characterized internal auditing as "an autonomous examination work, set up inside an organization to analyze and assess its exercises as a support of the organization". By estimating and assessing the effectiveness of hierarchical controls, inside examining, itself, turns into a critical administrative control gadget, which is specifically connected to the authoritative structure and the general standards of the business (quoted in Barzan 2018, p.220).

The above discussions demonstrate that the internal audit function is considered as partner in advancing corporate governance of public organizations. The current development in Ethiopian financial administration and procurement laws gave serious emphasis to internal auditors established under each public organization in line with conceptual development in the area.

As Lenz and Hahn (2015) discussed Internal auditing is "a vital part of an organization's administration that gives sensible confirmation that the accompanying targets are being accomplished: effectiveness and proficiency of activities, dependability of money related detailing, and consistence with appropriate laws and controls" (quoted in Barzan 2018, p.220).

“Internal auditors are employed by all types of organizations to audit for management. Internal auditors’ responsibilities vary considerably, depending on the employer. Some internal audit staffs consist of only one or two employees doing routine compliance auditing. Other internal audit staffs may have more than 100 employees who have diverse responsibilities, including many outside the accounting area. Many internal auditors are involved in operational auditing or have expertise in evaluating computer systems” (Arens, Elder and Beasley 2012, p.16).

## **2.2. Internal Auditing in Ethiopian Context**

### **2.2.1. Establishment of Auditor General Office**

The first organization to audit government finance was introduced in the regime of Emperor Haileselassie. After the promulgation of the 1931 constitution, the Emperor issued a new proclamation to effect the establishment of Audit commission. With the formation of the Audit Commission by Proclamation No. 69/1944, the commission was empowered to undertake external audit of accounts of the Ministry of Finance; Government of Ethiopia in 1944, which was subsequently mandated to conduct external audit of other budgetary institutions as well.

Kinfu emphasized in his historical perspective article on accounting and Auditing in Ethiopia “The issuance of Ministry of Finance directives in 1942, which focused on public sector fund utilization, marked the development of modern auditing in Ethiopia” (quoted in Desalegn & Aderajew 2007, p.472).

This is the beginning for the formation of today’s Office of the Federal Auditor General of Ethiopia (OFAG), which, amongst other duties, monitors and regulates the accounting and auditing profession in the country. The second development was also effected at the regime of the Emperor by bringing to reality the formation of the Office of the Auditor General (OAG) in 1961 by Proclamation 199/1961. This proclamation empowered the OAG greater authority than was provided in the 1944 proclamation that established the Audit Commission.

### **2.2.2. The birth of Internal Auditing**

Internal audit as a separate function appeared during the Derg regime. Initially the political orientation of Derg was communism. But as its history manifests it gradually tilted to include the concept private property ownership in its political orientation.

Because of this, in the year of 1987, the mixed economy political program declared in the country by the Derg Government. This paradigm tilt causes many legal changes. One of these changes was the empowerment of the public enterprises in their business doing. This empowerment entails the need to control the managerial activities through internal auditing unit.

As Lemma Argaw discussed, internal Auditing function has existed for quite a long time in Ethiopia; however, it got legal recognition in late 1980s. The internal auditing function started in the budgetary public sector as part of internal control. However, the latter part of the 1940s witnessed the establishment of Internal Audit functions in the Ministry of National Defense, Ministry of Education, and Ministry of Finance.

It was also at this time that the Internal Auditing units began to sprout in non-budgetary public sector (public enterprises) like Ethiopian Highway Authority, Ethiopian Airlines, Ethiopian Telecommunications, and financial sector that formed the modern layer of the National Economy" (quoted in Hamdu, Arega & Addisu, 2014, P. 82)

By the promulgation of Proclamation No. 13/1987 the Auditor General was mandated a new task in addition to its standard service, to monitor and regulate internal auditing in government offices and state-owned enterprises, to issue minimum requirements for recruitment of internal auditors, provide training to internal auditors, and require reports on internal audit of government organizations.

Perhaps the most direct impact on the current status of internal auditing in Ethiopia came from Proclamation No. 13/1987. From Proclamation No. 68/1997 preamble and the discussion made by Zeleke one can understand that, the Federal Democratic Republic of Ethiopia's (FDRE) new economic policy need to be supported by a modern and reliable audit system in order to ascertain proper implementation through effective monitoring of administrative, developmental and service rendering institutions in the Federal Public Sector (quoted in Hamdu, Arega & Addisu, 2014, P. 82)

Proclamation No. 13/1987 not only reemphasized the importance of the internal audit function in government departments and public enterprises; it also empowered the Office of Auditor General in three aspects that are whether accounting records are properly maintained and reliable, whether the assets of the ministries and enterprises are adequately safeguarded and properly maintained and whether policies and procedures laid down by top officials/management are complied. And this implies that less attention was given to operational audit as a service to management. (quoted in Hamdu, Arega & Addisu, 2014, P. 82)

After the fall of Derg regime, the political economy orientation of the ruling government is totally changed and many state owned enterprises become main actors in the economy and the public service institutions also become big. This development dramatically expanded the public budget to be allocated. Because of this Government has taken the initiative to improve and strengthen the internal auditing practice both in public bodies and fully and/or partially Government owned enterprises.

Thus Government has taken the initiative to further enhance good governance, transparency, accountability and efficiency and effectiveness of its operations, including compliance risk management and the internal control framework of Ministries and all government entities that directly receive and manage budget allocations.

### **2.2.3. Government Finance Administration and Internal auditing**

After the promulgation of the 1995 constitution, in accordance with Article 55 (1) of the constitution, the federal government proclaimed the first financial administration proclamation number 57/1996.

This proclamation, as it is clearly stated in its preamble, shows the emphasis given by the Federal Government for the need to induce a modern and efficient financial administration system which is essential to a well-functioning government and to set out the basic concepts, principles and elements which govern the management of financial resources.

Pursuant to this proclamation and Article 68 of the same, Regulation number 17/1997 was issued by the Council of Ministers. On July 1, 1997 the Financial Administration Regulations No. 17/1997 was issued in which the responsibility of internal audit function was transferred from the Office of the Auditor General to the Minister of Finance to develop and maintain appropriate standards of work. According to Regulation number 17/1997 article 2/14 "Internal Audit" means

“a systematic, independent and appraisal of all operations, including administrative activities, for purposes of advising management practices and controls.”

From this definition we can surmise that the task of internal Auditing is systematic, independent and appraisal function. The term ‘systematic’ shows that the law considers internal auditing as a

professional service with defined systems and standards. More over the inclusion of term ‘independent’ in the definition indicates the dream of the law maker in establishing strong audit organ within the public organizations itself by keeping the natural distance between the management and the auditors.

The need of the Auditors independence by the lawmakers demonstrates, at least on legal papers, their understanding on the power of the managers to influence auditors so that they can hide their intentional wrong doings and negligent acts which contradict or fail to comply with the existing procedures and regulations.

And the term ‘appraisal’ shows the task of internal auditors is not giving advice for the management in proactive manner. Rather the focus is directed in examining the actions of the management and giving feedback and comment after effect.

The law views the advising and controlling aspects of the appraisal functions separately. Thus internal auditors are given the assignment on advising the management and on the other hand the control task is assigned to ‘Internal Control division’ of the same organization.

According to Art 2/15 of the same regulation “Internal Control” means

“The plan of organization and all the coordinated methods and measures adopted by management to safeguard asset, ensure the timeliness, accuracy and reliability of accounting data, promote operational efficiency and maintain adherence to regulations and directives.”

From this definition we can infer that the internal control function has some aspects of legal compliance management activities by maintaining the adherence of the management to regulations and directives.

#### **2.2.4. Mandates and Responsibilities of Internal Auditors**

The Institute of Internal Audit defined Internal Audit as an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. Therefore the responsibilities of internal auditors are expected at least to comply with this standard definition. The main features in this definition are the tasks of rendering objective assurance and consulting the management.

Theoretically internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations.

It helps an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Therefore functions of internal auditing needs to be independent of the audited function. This independence also shall be demonstrated in action and appearance. When we say 'in appearance' we are referring to the perceived independence. Internal audit departments need to ensure their organizational posture as it allows them to operate successfully on strategic issues. If inappropriately positioned within the public organization, internal audit deals with tactical issues and is viewed only at that level. Inappropriate positioning can also raise serious concerns about the overall independence of the function.

An assurance service is an independent professional service to improve the quality of information for decision makers. The possible forms of assurance services include services related to business performance measurement and information system reliability.

Internal and external Auditors provide Management consulting services that enable their clients to operate their businesses more effectively. These services range from simple suggestions for improving the client's accounting system to advice in risk management, information technology and e-commerce system design, mergers and acquisitions due diligence, business valuations, and actuarial benefit consulting. (Arens, Elder and Beasley, 2012, p.27)

The responsibilities of internal auditors in Ethiopian context are defined by law. The Council of Ministers regulation on the financial administration of the federal government, Regulation No. 17/1997, lists the responsibilities of internal Auditors.

According to Article 6 of the regulation the Internal Audit of Public bodies are responsible for

- A. conducting Internal Audit at specific intervals to ascertain that public money and property are used for intended purposes, and submitting audit reports to the head of the public body;

- B. developing audit programmes and audit procedures which are specifically designed to meet the requirements of the public body;
- C. developing a monitoring system which will, at regular intervals, test and report to management on the public body's compliance' with the applicable internal and external directives and procedures; and
- D. advising management, at regular intervals, on its internal practices and controls and on whether they are efficient, effective and economical.

By comparing and contrasting the list of responsibilities with the standard definition given to internal auditors by IIA as “ ... an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations” we can observe that the definition adopted by the law makers, except the inclusion of some indexed description, is similar with the standard definition.

After conducting the national civil service reform program, the federal government issued a new proclamation to provide for the financial administration, Proclamation number 648/2009.

Also under this proclamation Article 2/25, “Internal Auditing” is defined as

“an independent and objective assurance and consulting activity designed to add value and improve an organizations operations which helps an organization accomplish its objectives by bringing in a systematic and disciplined approach to evaluate the effectiveness of risk management, control and governance process”

The new Institute of Internal Auditors (IIA) definition of internal audit is as follows: Internal auditing is

“an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

These two definitions show us that the definition to Internal Audit in the financial administration proclamation is direct copy of the definition given by IIA.

This definition states that scope of internal auditors is assurance and consulting activity. In the scope parameter, the definition is more similar with the previous law.

As discussed above, assurance services involve the internal auditor's objective assessment of evidence to provide an independent opinion or conclusions regarding the public body, operation, function, process, system or other subject matter.

According to Article 7 of the proclamation the Internal Audit of public bodies shall be responsible for:

- A. conducting internal audit at specific intervals to evaluate the performance of the public body and to ascertain that public money and public property are used for intended purposes, and submitting audit reports to the head of the public body and to the Minister, follow-up measures taken based on audit findings ;

The main elements in this responsibility description are time, evaluation of performance, purpose of usage of the public money and property and reporting.

The auditing activity is expected to be performed at specific interval. This shows auditing is not a day to day activity. Rather it is time bounded evaluation process.

Auditing is not a managerial activity which is expected to run the day to day business of the public organization. It is judgmental activity based on the results identified in the evaluation process. In practice it is common to observe managers inviting internal auditors to join management meeting and decision making process. But the practice is wrong as it causes bias and hinders the independence of the auditor.

- B. developing audit programs and audit procedures which are specifically designed to meet the requirements of the public body;

Internal auditors are expected to develop their own procedures. The efficiency measurement of procedures and programs is measured by their ability to meet the requirement of the public body. Here one can raise the question that while they are evaluating the management of the public body, how can they strive to meet the

requirement of the organization? But it is essential to view that the requirement of the public body, which can be deduced from the mandate documents, laws and strategic plans of the public body, and the requirement of the management are different.

- C. developing a monitoring system which will, at regular intervals, test and report to management and the Minister on the public body's compliance with the applicable internal and external directives and procedures; and this shows compliance with directives and procedures is monitoring variable and not auditing variable.
- D. advising management, at regular intervals, on its internal practices and controls and on whether they are efficient and economical.

From this list of responsibilities we can infer that the nature and scope of the assurance engagement of the internal auditors are determined by themselves and can vary from one public body to the other based on the appetite of the internal auditors and the nature of the public body.

Because consulting services are advisory in nature, and are generally performed at the specific request of an engagement client, the nature and scope of the consulting engagement are subject to agreement with the engagement client.

When performing consulting services the internal auditor should maintain objectivity and not assume management responsibility. However, the work of the auditor is so much bounded up with advising management, at regular intervals, on its internal practices and controls and on whether they are efficient and economical based on the findings of the audit which are usually detection of fraud in the eyes of the general public. While conducting the investigation task it is necessary that the auditor's interest in fraud should be placed in its proper perspective.

Although it is obvious that the detection of fraud with the minimum of delay is a matter of great importance, the efficiency of an internal audit department, however, is sometimes judged by the number of defalcation it uncovers.

Internal audit is a long-standing function and an effective tool of management in public bodies. It has been a recognized component of organizations in public sectors. Internal auditing is often seen as an overall monitoring activity with responsibility to management for assessing the effectiveness of control procedures which are the responsibility of other functional managers.

According to Article 60 of financial administration Council of Ministers Regulation No. 190/2010, the internal audit function is not limited to the operation of any particular function within an organization. Rather, it is all-embracing and accordingly is structured in the organization as an independent department responsible only to a high level management of the public body and the Minister of Finance.

Internal auditing which is often seen as constituting a large and significant aspect of an organization's financial control system is a vehicle to success and survival. Internal auditing is taking on increased importance in many of today's global organizations by assisting management in evaluating controls and operations and thereby providing an important element of global control.

#### **2.2.5. Internal Auditing and the power of Ministry of Finance**

According to Article 3/2 of the Council of Ministers Financial Regulations No.17/1997, Ministry of finance has the responsibility to develop and maintain appropriate standards of work and conduct for application throughout all public bodies of internal audit functions. This clearly indicates that, though internal auditors are accountable to the head of the organization, the prime responsibility of monitoring functions of internal auditors lies under the hands of the Ministry.

The Ministry of Finance and Economic Development has the authority to issue internal audit manuals for use by all organizations that are wholly or partially financed by the government budget. The Ministry has issued a manual that contains a code of ethics for internal auditors and procedural guidance on the conduct of audits. Internal audit standards of the Ethiopian Government, specified in the manual, closely match those published by the IIA.

Desalegn & Getachew argue that as a result of changes in organizational needs, technology and complexity of organizations' activities and systems, the nature of the services sought from the internal auditors has been transforming over the years from an emphasis on traditional/compliance audit where independence has been the core paradigm, to a value-adding role where partnering with management is accorded greater significance (quoted in Hamdu, Arega & Addisu, 2014 P. 81).

To promote the independence of the internal Audit, a new proclamation to amend the Federal Government of Ethiopian Financial Administration, proclamation No. 970/2016 proclaimed. According to Article 5/13 of the proclamation Ministry of Finance shall setup an independent audit committee either for each public body separately or for a group of public bodies, as the context requires, which supports the function of internal audits. And according to Article 7/1 of same, the head and professional staff of internal Audits of public bodies shall be accountable to the Minister of Finance.

Internal audits of public bodies shall carry out financial audit including accounts of grants, loans and internal revenue, and performance audit of their respective public bodies. The Internal Audit of public bodies shall be responsible for conducting internal audit at specific intervals to evaluate the performance of the public body and to ascertain that public money and public property are used for intended purposes, and submitting audit reports to the head of the public body and to the Minister and follow-up measures taken based on their audit findings indicated in their report.

As per the establishing proclamations, Proclamation Number 916/2015 Art 18, the Ministry of Finance (MOF) has the responsibility to establish systems of budgeting, accounting, disbursement and internal audit for the federal government, and follow-up the implementation of same; ensure the harmonization of systems of budgeting, accounting, disbursement and internal audit established at the levels of both federal and regional governments.

Based on the power given to the Ministry of Finance by Proclamation number 648/2009 and as amended by proclamation number 916/2015, the Ministry has issued a manual that contains a code of ethics for internal auditors and procedural guidance on the conduct of audits, Manual Number 7/2010.

Public bodies should maintain an effective internal audit function staffed with an adequate number of qualified personnel appropriate to the size and the nature of the organization. The internal auditor's qualifications, staff, status within the public body, reporting lines, and relationship with the top management and the Minister must be adequate to ensure the internal audit function's effectiveness and objectivity.

Accordingly the Minister issued Internal Auditors Administrative Manual which transfer the mandate on the Internal Auditors accountability and reporting line, hire, fire, promotion

procedures and defining minimum qualification requirements to the Ministry of Finance; Manual Number 47/2016.

### **2.3. Legal Compliance**

It is customary practice to Governments to establish audit requirements for public bodies to undergo at least an annual audit of their compliance with applicable compliance requirements. The practice dictates compliance audits usually are performed in conjunction with the annual financial statement audit. Compliance audit is conducted to determine whether the auditee is following specific procedures, rules, or regulations set by some higher authority (Arens, Elder and Beasley 2012, p.14).

A compliance audit is based on the premise that management is responsible for the public body's compliance with compliance requirements. Results of compliance audits are typically reported to management, rather than outside users, because management is the primary group concerned with the extent of compliance with prescribed procedures and regulations. Therefore, a significant portion of work of this type is often done by auditors employed by the organizational units. (Arens, Elder and Beasley 2012 p.14)

Thus Compliance risk can be understood as the risk of legal or regulatory sanctions that arises when an organization fails to comply with laws, regulations, or the standards or codes of conduct applicable to the organization's business activities and functions.

The definition given to the term Internal Audit by proclamation number 648/2009 includes the phrase “.....an organization accomplish its objectives by bringing in a systematic and disciplined approach to evaluate the effectiveness of risk management, control and governance process.”

This shows that internal auditors' assurance and consulting services have strong legal commitment in helping the management to achieve or accomplish its objectives. But the help is limited to effectiveness evaluation of the management's actions in risk management, control and governance.

One of the risks management of public bodies face is Compliance risk. Activities of public bodies in performing their mandated duties are mostly subjected to comply with regulatory

requirements. The task of risk management involves managerial activities in identification, measuring, controlling and monitoring of the risk.

From this we can infer that management's responsibility for the public body's compliance with compliance requirements may include:

- a) Identifying the public body's programs and understanding the compliance requirements associated with the program
- b) Establishing and maintaining effective controls that provide reasonable assurance that the public body administers government programs in compliance with the compliance requirements
- c) Evaluating and monitoring the public body's compliance with the compliance requirements
- d) Taking corrective action when instances of noncompliance are identified, including corrective action on audit finding.

The definition given to the term Internal Auditors, as mentioned above, failed to clearly state or incorporate the concept of compliance.

But because compliance risk is one of the risks that managements of public body faces and Internal Auditors are supposed to help the management in its actions to manage risks efficiently, it is logical to argue that internal auditors have a duty to evaluate the compliance risk management activities of the public body.

Unlike the definition given to the term "internal auditor" discussed above, Article 7/1/C of the financial administration Proclamation number 648/2009 clearly states that it is the responsibility of internal Auditors to develop a monitoring system which will, at regular intervals, test and report to management and the Minister on the public body's compliance with the applicable internal and external directives and procedures.

Because, as indicated in the definition, Internal Auditing service is independent and objective assurance service and consulting activity designed to add value and improve an organization's operations, the auditor's objectives in a compliance audit shall be to obtain sufficient appropriate audit evidence to form an opinion to provide reasonable assurance of detecting material

misstatements resulting from noncompliance with provisions of compliance elements and report to the management on whether the management complied in all material respects with the applicable compliance requirements.

According to Article 7/1/a of proclamation number 648/2009, Internal Auditors are supposed to conduct internal audit at specific intervals to evaluate the performance of the public body and to ascertain that public money and public property are used for intended purposes, and submit audit reports to the head of the public body and to the Minister.

Internal auditors are integral parts of the public body and are expected to help the management in achieving its objectives by efficiently managing its compliance risk. This could be achieved only if their opinion reaches the management before ruinous damage occurred on public money and property due to non compliance to compliance elements. Thus one can say the term “specific interval” shall have a meaning of interval less than one year; could be quarterly or semi annually.

At the same time after delivering their report, Internal Auditors are expected to follow-up measures taken based on audit findings mentioned in their report.

## **2.4. Public Procurement Audit**

The auditing function has the primary objective of providing reasonable assurance that a set of specified and established criteria have been complied with; and it involves the collection and evaluation of sufficient evidence to determine whether an assertion corresponds with established criteria.

The two main forms of audits involved in public procurement are internal and external audits. The main difference in the audit process between these two borders on the extent of details.

Public procurement audit can be explained as the process of gathering and evaluating sufficient evidence on government procurement activities to ascertain whether specified laid down procedures have been complied with or not. Mapesa and Kibua said Public procurement audits are seen as very important to the realization of value addition to government procurement in terms of ensuring accountability, transparency, prevention of improper procurement practices, and improving upon past procurement performance (quoted in Etse & Assenso 2006, p. 2).

### **2.4.1. Reasons for Public Procurement Audit**

To accomplish the organization's objectives, the most important tool is effective procurement plan. Procurement plan that aligns to the objective of the organization programs and budgetary process can expedite the accomplishment of the goals.

It is one of the pre-requisites for the effectiveness and efficiency of the procurement function, thus leading to the ultimate success of the organization. Procurement planning will make sure that the employees can effectively and efficiently mitigate the challenges affecting procurement process, and it significantly reduces the delay in the process.

The current practice in Public procurement audit by PPA auditors be evidence for the attention drawn to procurement planning which enables the public organizations to act in response whether there was an actual need for a given procurement; whether the procurement procedure achieved value for money, and whether public procurement regulations were adhered to.

### **2.4.2. Public Procurement Audit in Ethiopia**

In Public Procurement process, sound procurement policies have critical role in poverty reduction, attainment of health and educational objectives, and prudent management and utilization of national resources.

Over the years Ethiopia has made attempts at improving her public procurement process by doing a number of things including: the enactment of a public procurement law establishing PPA, Proclamation No. 649/2009, the creation of which contributes a lot to provide effective and efficient administrative function for public procurement; to provide a sound legal and institutional framework for a standardized procurement system; actively participating in international and regional procurement networks; infusing professionalization and capacity development by providing educational and training opportunities in the area of public procurement.

The reports produced by OFAG emphasized and admonition the advantages of an effective and efficient procurement system. However the practice continue to elude the federal government due to problems such as weak monitoring and evaluation of the public procurement process;

weak compliance with financial regulations; deficiencies in procurement auditing especially by internal auditors.

It has been identified that though a number of developing countries have reformed their public procurement system, many of the systems remain weak and serve to squander scarce domestic and foreign resources (OECD, 2005).

As per the introductory remarks made in most of the procurement audit report, which is part of Federal Auditor General Office's annual Audit reports, the main objective for auditing public procurement is to ensure that procurement activities are done in an effective, efficient, and economical manner within the provisions of relevant laws, regulations and guidelines (Report of Office of the Auditor General). The reports indicate that the procurement audit process is limited to a comprehensive review and evaluation of relevant public procurement procedures, and operations, contract documents and reports as well as all relevant documents.

The Public Procurement and Property Administration Agency of FDRE had issued Public Property Manual (PPA) as mandated in the Proclamation No. 649/2009 and the Federal Government Public Procurement Directive. The Manual is a public document issued with the intention to be used by all public bodies undertaking public procurement using public funds, in accordance with the Proclamation and Directive.

The Public Procurement and Property Administration Agency (PPA) manual proposes that effective planning allows requirements to be aggregated into larger purchases at lower unit costs, rather than frequent sourcing of quotations for identical items and issuing many individual local purchase orders. It allows the private sector to respond more effectively to the requirements and specifications of the Government (PPA, 2011).

The mandate of the Agency's for procurement audit is derived from the Ethiopian Federal Government Procurement and Property Administration Proclamation No. 649/2009 and established under the article 15.9 (Functions of the Agency) and article 5.19 of the Directive. In accordance with the Proclamation article 15.9, PPA may conduct audit to ensure that procurement and property administration activities of public bodies are in accordance with the Proclamation, directive, and other documents governing public procurement and property administration.

The public procurement manual has no clear provisions on the role and involvements of internal Auditors to ensure regular internal monitoring of procurement activities which is aimed at assessing the professional efficiency and effectiveness of procurement as well as to ensure the overall effectiveness of the procurement.

Section 7 of the manual gives the mandate to Audit to PPA. This provision states that the PPA shall conduct audits of procurement activities of procurement entities. The primary objectives of procurement audits are to: determine whether proper procedures have been followed by a procurement entity in its procurement administration; ascertain whether activities of the entity are in accordance with relevant laws and regulations; determine whether proper records have been maintained with respect to the entity's operations; assess the adequacy of rules and procedures applied in procurement operations with regard to the protection of public assets and property.

To proactively ensure efficiency, accountability, and transparency in the management of public sector resources, the Ministry of finance and Economic Development based on the mandate given by Financial Administration Regulation Number 190/2010, gives more emphasis on the duties and responsibilities of Internal Audit. According to Art 60 of the regulation Internal audit of public body shall have unlimited power of audit over the whole range of finance, property and activity of their public body.

Internal audits of public bodies shall carry out financial audit including accounts of grants, loans and internal revenue, and performance audit of their respective public bodies. The Internal Audit of public bodies shall be responsible for conducting internal audit at specific intervals to evaluate the performance of the public body and to ascertain that public money and public property are used for intended purposes, and submitting audit reports to the head of the public body and to the Minister and follow-up measures taken based on their audit findings indicated in their report.

As per the establishing proclamations, Proclamation Number 916/2015 Art 18, the Ministry of Finance (MOF) has the responsibility to establish systems of budgeting, accounting, disbursement and internal audit for the federal government, and follow-up the implementation of same; ensure the harmonization of systems of budgeting, accounting, disbursement and internal audit established at the levels of both federal and regional governments.

Based on this power, the Ministry has issued a manual that contains a code of ethics for internal auditors and procedural guidance on the conduct of audits (MOFED, 2004). Internal audit standards of the Ethiopian Government, specified in the manual, closely match those published by the IIA.

According to this Regulation Internal Audit Units which are expected to report to the Ministry of Finance on the efficient and judicious utilization of public resources are compulsory parts of each public institution.

Public Procurement is one of the major objectives of any government striving to deliver goods and services to its people. Indeed, procurement permeates the entire spectrum of the development process since the government is a major purchaser of goods and services that entails the application of colossal amounts of money running into millions of birr.

In an attempt to address these weaknesses, the federal and regional governments have tailor made legal framework to provide an efficient system of procurement.

The Office of General Auditor delivers their report annually to House of people's representatives. And it has become a common phenomenon to hear non compliance report with value of multi hundred millions birr. One of the major non compliance problem areas is public procurement.

From the reports of the Federal Auditors general Office for 4 consecutive years, specifically on non compliance issues on procurement compliance elements, we can observe the following. The OFAG reports procurements concluded in failing to comply with the mandatory compliance elements

**For the year 2012/13**

የፋይናንስና ኮሙኒኬሽን መ/ቤቶች	ብር 3,695,461.41
የአቅም ግንባታ መ/ቤቶች	ብር 133,397,807.60
የልማትና ማህበራዊ መ/ቤቶች	ብር 23,025,417.90
የንግድና አስተዳደር መ/ቤቶች	ብር 5,773,950.65
<b>ድምር</b>	<b>ብር 165,892,637.56</b>

**For the year 2013/14**

የፋይናንስና ኮሙኒኬሽን መ/ቤቶች	ብር 10,938,646.93
የአቅም ግንባታ መ/ቤቶች	ብር 184,600,282.00
የልማትና ማህበራዊ መ/ቤቶች	ብር 755,655,097.77
የንግድና አስተዳደር መ/ቤቶች	ብር 5,508,966.22
<b>ጠ/ድምር</b>	<b>ብር 956,702,992.92</b>

**For the year 2014/15**

የፋይናንስና ኮሙኒኬሽን መ/ቤቶች	ብር 53,079,171.88
የአቅም ግንባታ መ/ቤቶች	" ብር 338,034,098.03
የልማትና ማህበራዊ መ/ቤቶች	ብር 103,657,148.90
የንግድና አስተዳደር መ/ቤቶች	ብር 49,982,635.37
<b>ጠ/ድምር</b>	<b>ብር 546,059,783.00</b>

**For the year 2015/16**

የፋይናንስና ኮሙኒኬሽን መ/ቤቶች	ብር 15,802,727.15
ገቢዎችና ጉምሩክ ባለስልጣን	ብር 774,051.89

የልማትና ማህበራዊ መ/ቤቶች	ብር 13,282,333.69
የአቅም ግንባታ መ/ቤቶች	ብር 98,796,196.46
ከፍተኛ ትምህርት ተቋማት	ብር 163,811,204.22
የንግድና አስተዳደር መ/ቤቶች	ብር 32,483,588.79
<b>ጠ/ድምር</b>	<b>ብር 324,950,102.20</b>

As discussed above every public organization has its own internal audit department. But the report of OFAG highlights their role is not to the expectation of the law makers. The data analysis part of this paper will try to reveal the reasons.

## **CHAPTER THREE**

### **Research Design and Methodology**

This chapter outlines the approaches used in gathering information to obtain the relevant data for processing in order to achieve the objective of the study, how it was designed and presented. In addition, it illustrates the area of examination with regards to those discussed.

Furthermore the researcher will also explain how the selected public enterprises internal audit practice was chosen, the sample size, data collection and data analysis used in the study.

The research methodology describes the means used to collect data to address central research questions enumerated. The following part outlines the research design, the research method, the population under study, the sampling procedure, and the method that was used to collect data. The reliability and validity of the research instrument are addressed. Ethical considerations pertaining to the research are also discussed.

#### **3.1. Research Design**

Research Design is a blueprint for fulfilling research objectives and answering research questions. In other words, it is a master plan specifying the method and procedure for collecting and analyzing the needed information (Adams, 2007, p 81). Descriptive research is aimed simply at describing phenomena and is not particularly concerned with understanding why behavior is the way it is (Adams, 2007, p 21). Besides, descriptive research assumes that the researcher has prior knowledge about the problem situations (Malhotra & Peterson, 2006, p 76).

The design for this study is descriptive research that was used to assess the role of internal auditors in procurement compliance risk management.

#### **3.2. The Subject of research**

The study was conducted on selected federal government budgeted organization internal auditors role in public procurement process. As it has become common, in the past ten years, to hear repeated embezzlement report in the Federal Auditor General's report to the House of Representatives that involves significant portion of the organizations budget, the assessment of the role of the internal auditors in procurement compliance risk management is critically essential.

The internal auditors in different public organizations and the auditors with the power to regulate and monitor public procurement process and auditors in the Office of Federal Auditor are considered to make the research.

#### **3.3. Population**

Generally, the population is the whole internal Auditors at the selected Public organizations and Auditors in regulatory organizations and Federal Auditor General Office.

### **3.4. Sampling procedure**

Purposive samples normally involve a more deliberate effort to secure a sample that conforms to some predetermined criteria. (Fetter & McMillan, 1980, p. 177) The researcher uses a non-probability sampling design in the form of a purposive sampling method was adopted and considered to be appropriate to gather the data

### **3.5. Sample Size**

The ultimate objectives of sampling are to select sample from the total population. Sample size of 50 respondents representing the selected public enterprises in the federal budgetary public organizations were selected based on the appropriateness for the research topic purposively.

### **3.6. Data Collection Procedures**

Because of the use of questionnaire in the study for data collecting purpose, it was especially important that all respondents have interest in participating in the study. Thus to induce interest in the study, all respondents were initially informed in person about the purpose and objectives of the study. This was in assurance that anonymity would be protected, even though some of them are willing to declare themselves.

Accordingly, fifty (50) questionnaires were administered from those who actively participate in the auditing process in different perspectives and mandates of which all questionnaires were returned, yielding a 100 % response rate, which is good enough.

To gather data for this research, both primary and secondary sources of information were used. The primary sources include data gathered by distributing questionnaires and personal discussions conducted with internal auditors and Director in Ministry of Finance Inspection Department.

The method of data collection includes interviews and administration of questionnaires. Both quantitative and qualitative data were collected using open-ended and close-ended questions.

#### **3.6.1. Primary Data**

Personal Discussions were conducted with respondents to collect data for the study as well as questionnaires. Unstructured discussions were employed as a tool for collecting data.

#### **3.6.2. Secondary Data**

In this study the researcher adopted qualitative research approach. Qualitative questions are answered using established qualitative procedures. Qualitative data observed from instances during interactions with auditors and by using questionnaires and observational notes.

Written questionnaires about internal auditing practices were utilized by asking a number of open-ended questions and the responses obtained through the structured interview that allow for variations. Qualitative analysis on the other hand was based on data collected in words than in

figures unlike the quantitative analyses. This type of analyses gives a wider and strong explanation about a problem, a process, an event etc. in a specific situation or area.

### **3.7. Questionnaires Design and Administration**

#### **3.7.1. Questionnaires**

Questionnaires were distributed to 20 internal auditors from 5 public organizations and to 30 auditors in the regulatory and monitoring mandated public organizations and auditors in OFAG.

Questionnaires are organized in the form of affirmative statements, relating to the concepts an assessment of internal audit practice in the organizations.

The choices in each questions organized as it enables respondents to make assumptions about the order but not the spacing of the response options. To elicit additional information, the respondents were requested to provide open- ended responses if they have opinions which they feel the researcher would find useful.

#### **3.7.2. Data Analysis**

Data analysis consists of examining, categorizing, tabulating, or otherwise recombining the evidence, to address the initial proposition of a study (Yin, 1989, p. 105). The researcher analyzed the data collected via questionnaires with qualitative research which is fundamentally interpretative i.e. the researcher interpreted the qualitative data. Thus, the analysis of interpretation of qualitative data combines to seek convergence among the results.

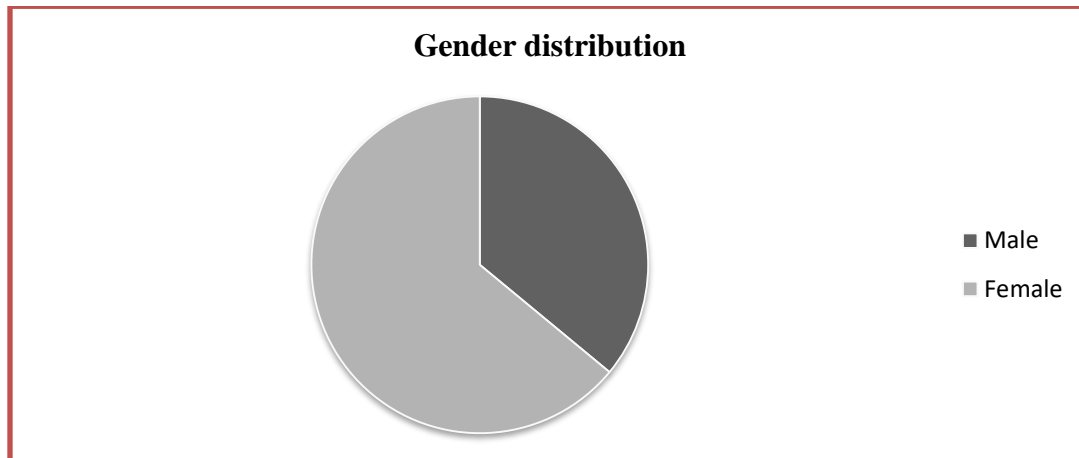
## **Chapter Four**

### **Data Analysis**

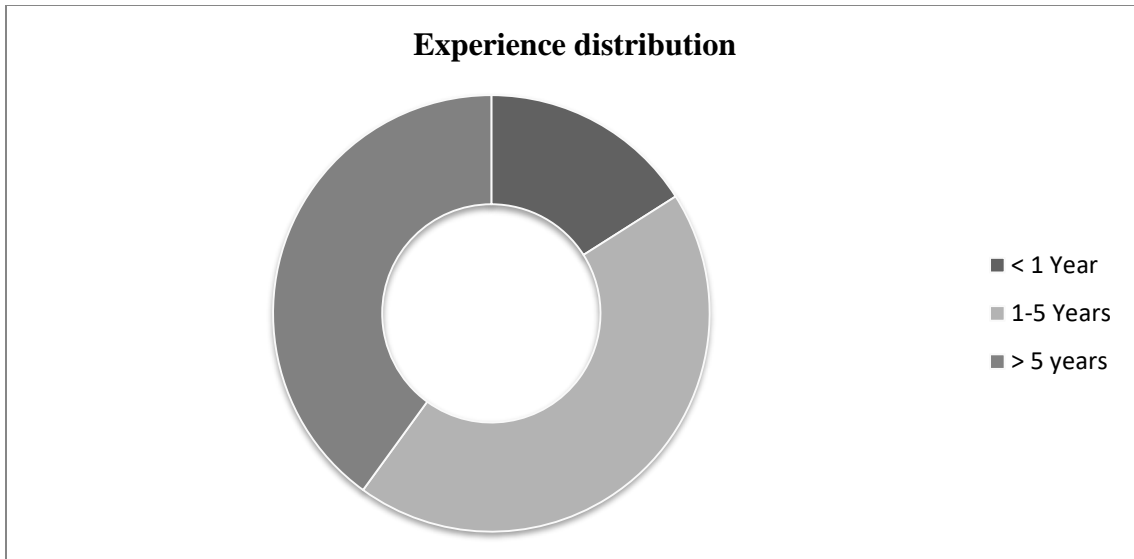
This Chapter will present the results on the data collected through the use of questionnaire and unstructured discussions with respondents and analyzed.

#### **4.1. Respondents description**

All 50 respondents are auditors in different organizations and with different job description. Gender wise, of the total 50 respondents 18 are male and 32 are female. This shows the auditor positions in most of the organizations are occupied with female.



Of the 50 respondents 8 respondents have less than 1 year experience, 22 respondents have 1-5 years experience and the rest 20 respondents have above 5 years experience. While administering the questionnaire distribution, the researcher had discussions with the respondents. With that discussion the researcher make clear that the work experience to be declared is their direct experience in auditing. Therefore the above mentioned experience of the respondents is all in auditing.



The educational status of the respondents is also diversified. Of the 50 respondents 1 respondent's educational status is diploma level. 37 of the respondents have Bachelor Degree and the remaining 12 have MSC. The researcher believes this educational level diversification would enable us to get the proper reflection on the questionnaire.

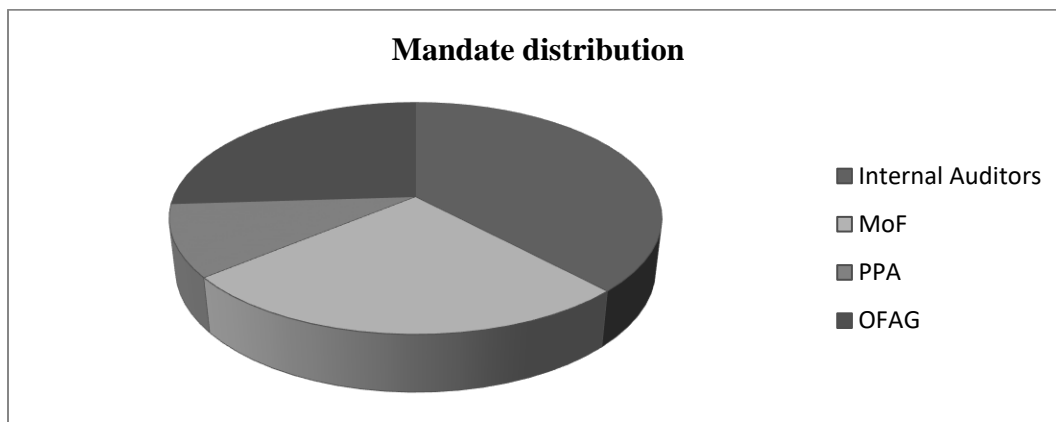


The respondents are from different public organizations. 19 of the respondents are internal auditors and 31 are Auditors with regulatory and examination mandate. Of the internal auditors 4 are from Saint Petros Hospitals, 3 are from Science and Technology University, 5 are from Ministry of transport, 3 are from Ethiopian Mapping Agency and 4 are from Ministry of Public enterprises. These public organizations are selected purposely based on the OFAG report which indicates the occurrences of multiple procurement incompliance.

Ministry of finance's inspection department has the mandate to regulate the performances of internal auditors in public organizations. For this purpose internal auditors in public organizations are required by law to submit their audit report to the ministry. Taking this as a back ground the researcher develop different questionnaire to the auditors in ministry of finance's inspection department. Accordingly of the 31 auditors with regulatory and examination mandate 13 are auditors from Ministry of Finance inspection department.

The federal government procurement and property administration agency (PPA) has the mandate to audit the procurement process conducted in every public organization. The audit is compliance audit. For this reason the researcher distribute questionnaire for 5 auditors in PPA.

The initial idea for this research was instigated by the repetitive embezzlement report mentioned in the OFAG reports submitted to House of people's representatives. Because of this, the researcher believes the reflection from the auditors in OFAG would be essential for this research. Therefore 13 auditors from OFAG are contacted with the questionnaire specifically prepared for the Office.



## **4.2. Internal Auditors relationship with the Management**

### **4.2.1. Independence Test**

Internal audit is an independent appraisal function established by the management of an organization for the review of internal control system as a service to the organization (Millichamp 2002). This definition shows that the role of internal audit in an organization is the review of internal controls which brings about safeguarding of assets and improved performance.

The IIA (2010) explicate internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations.

According to MOF's Internal Audit Manual No.7/2010 Article 5/2 the objective of internal audit is stated as follows.

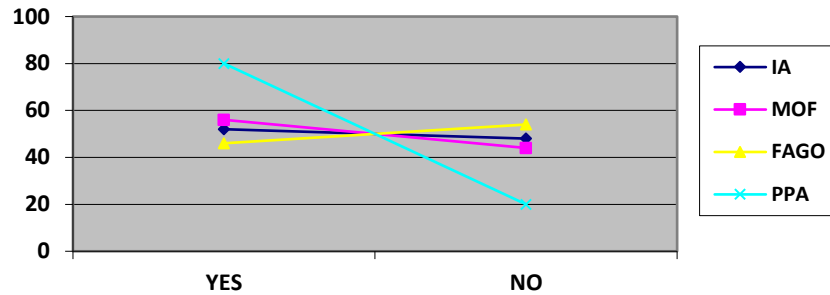
γWS\_ åÄ!T ytêqrW zmÂÊE yâÄ!T xtgÆBR £dTN bmktL ymS¶Ã b@t\$N x\%oRÂ γWS\_ q\$\_\_R  
|R>T bmgMgMÂ |UTN¼ tU\$+nTN bmft> lms¶Ã b@t\$ t=¥¶ Xs@T¼ ÍYÄ y\_f\_R W-@-¥ γçn  
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Therefore, as the above definitions and legal documents show, internal auditors need to have absolute independence from the management so that they can perform their objective assurance and consulting activity to the management.

To the independence test, respondents were asked what they think about internal auditors. Of the 19 internal auditors 10 said internal auditors are independent from the CEO, 12 from the Management team, 13 from the department heads and 14 from the procurement department. 9 of them said internal auditors not independent from the CEO, 7 not from the management team, 6 not from the Department heads and 5 not from the procurement department. This shows that 52 % of internal auditors believe that they are independent from the CEO and 48% believes otherwise. On the other cross check question the respondents were asked whether internal auditors have fear of the CEO. 63% of the respondents say NO.

On the same independence test 54% of the Auditors in MOF and 46% of auditors in OFAG said internal auditors are independent from the CEO. This reflection shows that the independence of internal auditors from the CEO and the management has negative perception by external auditors.

**Chart 1:- independence test**



Though the percentage differences shows positive result towards independence, the 48% of respondents' from internal auditors and the 54% of respondents' from OFAG's negative reflection towards independence is not minimal to ignore. Thus one can infer the perception towards independence of internal auditors from the CEO and the management team is not to the required level.

Lack of independence of the internal auditors on the CEO and the management team could have inverse effect on the performance of internal auditors. The real reasons for the lack of independence of internal auditors need further study and justification.

#### **4.2.2. Access to Documents and Records**

Access to documents is a critical variable to Audit. To satisfy the purpose of the audit, auditors must obtain a sufficient quality and volume of evidence. Auditors must determine the types and amount of evidence necessary and evaluate whether the information corresponds to the established criteria. This is a critical part of every audit.

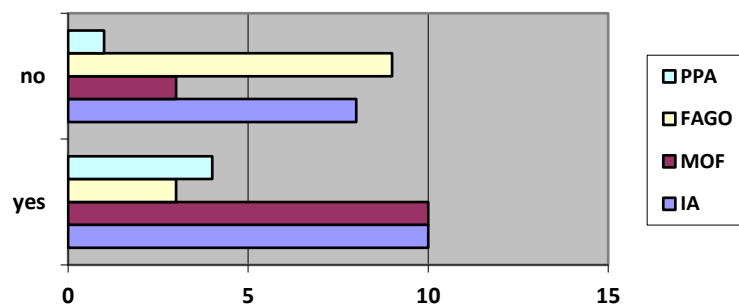
On the issues of access to documents and records the MOF Internal audit manual No. 7/2010 art 10/2 clearly states as follows;

yWS\_ äÄ!T `šđÂ äÄ!téC bms¶Ä b@t\$ WS\_ äÄ!T k,ÄdRg#T g#ÄY UR GNß#nT xšcW BIW  
 y,ÄMn#ÆcWN ¥ÄcWNM ¥Sr©ãCÄ mr©ãC y¥yT½ äÄ!T y¥DrGÄ bÄÄ!T bdrs#ÆcW W-  
 @èC šY Ñl# ¶±RT lms¶Ä b@t\$ ybšY `šđÂ l,n!St&, y¥QrB½

This shows the law gives the right to the internal auditors to access all the documents they need which has direct relationship with the subject of the audit.

For the access to documents and records test, of the 19 internal auditors 10 respondents (52%) said yes while 9 respondents (48%) said no. This almost equivalent reflection shows the access to documents is perceived negative by the internal auditors themselves. On the contrary, of the 13 respondents 10 respondents (77%); the auditors in the MOF’s inspection department, believes internal auditors have good access to records and documents. This reflection is almost totally negated by reflection made by OFAG auditors. Of the 13 respondents 9 respondents (70%) said internal auditors cannot access documents and records as they think right.

**Chart 2:- Access to documents test**



### **4.3. Valuation and placement of Internal auditors**

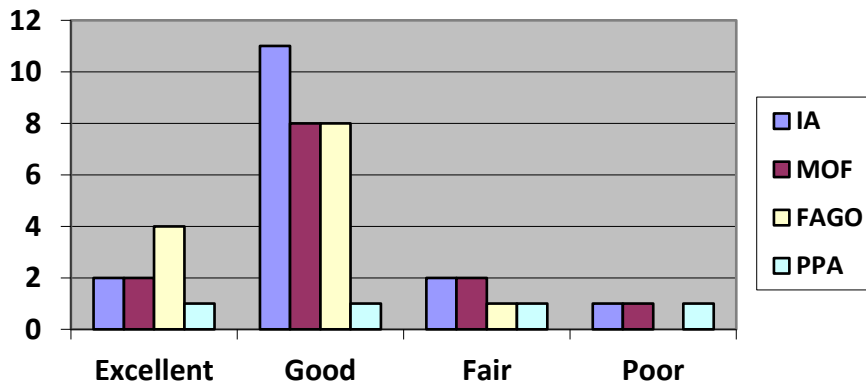
#### **4.3.1. Internal Auditors valued as member of the management**

The perceptions of the top management of public organizations towards their internal auditors have immense effect on the performance and organizational placement of internal auditors.

Based on this assumption respondents were asked on the perception of internal auditors as valued members of the public organizations. Of the 19 internal auditor respondents 13 (68%) respondents; of the 13 MOF respondents 10 (77 %) and of the 13 OFAG respondents 12 (92%) rate good and excellent. This rating is above the average.

The question here is that if the top management has negative perception to internal auditors, the tendency towards them could be isolation. But the respondents rate the valuation of internal auditors as members of the management team above the average; i.e good. This shows us the need to attitudinal change is imperative.

**Chart 3:- internal Auditor as valued member of the management team**



### **4.3.2. Organizational placement of internal auditors**

According to the MOF internal audit manual No. 7/2010 article 8, each public organization is required to establish free and independent internal audit department and also to assign qualified auditors and department head with attested leadership quality.

Respondents were asked about the organizational placement of auditors. Of the 19 internal auditors respondents 13 (69%) rate above average; good and excellent. Of the 13 MOF respondents 8 (62%) rate same. This shows the organizational placement of internal auditors perceived positive by respondents.

## **4.4. Professionalism of internal Auditors**

### **4.4.1. Objectivity of Internal Auditors**

All internal auditors are required to maintain independence in fact and in appearance, perform all professional responsibilities with integrity, and maintain objectivity in performing their professional responsibilities.

The MOF internal audit manual No 7/2010 art 17 clearly states the objectivity rule as follows.

yWS\_ äÄ!téC äÄ!T y,ÄdRg#TN |%o mr©äC sBSbW bmgMgM XÂ W-@t\$N b¥úwQ rgD  
kFt¾WN yÑÄ ,²ÄêEnT bGL{ ¥úyT Y-bQÆcêLÝÝ

This shows the objectivity issue is mandatory in the internal auditors' day to day activity.

Of the 19 internal auditors respondents 12 (63%) say internal auditors produce their report independently on what they observed. 37% of them respond to the contrary. 85% of respondents from MOF and 77% of respondents from OFAG confirm positive to same. They also rate the objectivity of internal auditors good and excellent.

At the same time about the professionalism of the auditors, of the 19 internal auditor respondents 13 (68%) rate above good, of the 13 OFAG respondents 9 (69%) rate same.

#### **4.4.2. Knowledge of auditors about their own organization**

Organizations internal auditors assume the part of undertaking an autonomous examinations and giving affirmation on different activities of their organization. This empowers an organization to meet its operational destinations through well thoroughly considered and devoted ways to deal with and assess and enhance how best to improve administration. This requires internal auditors to have proper knowledge of their organization.

Respondents were asked how they perceive the knowledge of internal auditors about their organizations. Of the 19 internal auditors respondents 14 (74%) rate above average. And of the 13 MOF respondents 7 (54%) rate good and excellent. Of the 13 OFAG respondents, 8 (62%) rate same.

This shows us that respondents from internal auditors and OFAG have positive perception about the knowledge of internal auditors. But the respondents from MOF; an institution with regulatory power, perceived the knowledge of internal auditors to their own organization is not to the expected level. These respondents have chances to read and review the internal audit reports produced from public organizations. Therefore their rating has power to win high attention. If internal auditors knowledge about their own organization is challenged with the regulatory body it indicates the existence of serious problem with the issue.

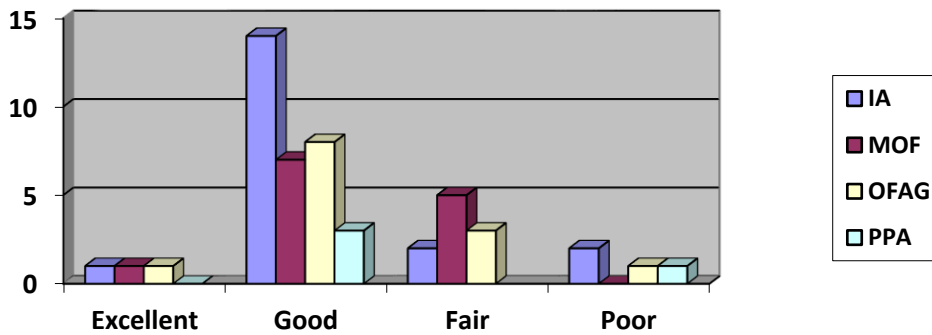
#### **4.4.3. Knowledge of internal auditors about procurement process and procedures**

Internal auditing is a profession and activity involved in counselling organizations regarding how to better achieve their objectives through managing risks and improving internal control (Asare, 2009). The key role of internal audit is to assist the management of the organizations in

discharging their governance responsibilities. To do so they need to have proper and sufficient knowledge on the audit topic. Procurement audit is specialized area of audit practice. It requires fair understanding of procurement processes and procedures.

Respondents were asked on the internal auditors' knowledge about procurement processes and knowledge. Of the 19 internal auditor respondents 14 (74%) rate good; of the 13 MOF respondents 8 (62%) rate good and excellent; of the 13 OFAG respondents 8 (62%) rate good and of the 5 PPA respondents 3 (60%) rate good.

**Chart 4:- internal auditors knowledge of procurement procecess and procedures test**



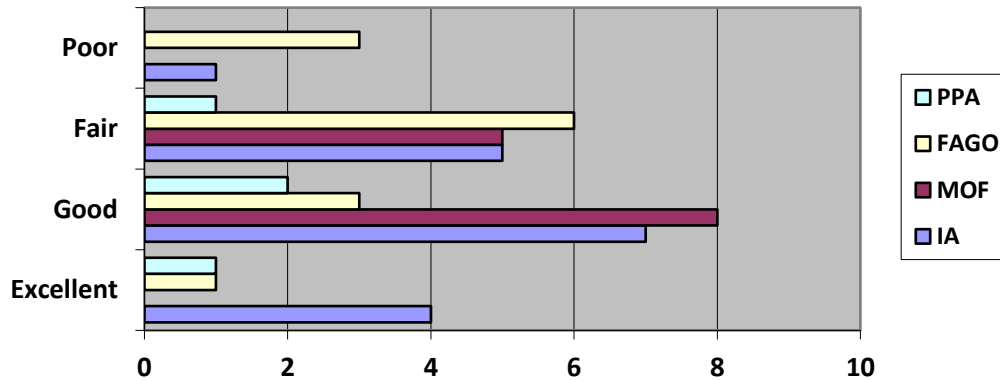
#### **4.4.4. Procurement audit practice of public organizations**

Procurement audit is specialized type of audit. For most of public organizations operational audit conducted once in a year is a common practice. The procurement issues are usually encompassed in such audits. As this research is focused on procurement compliance audit issues, respondents were asked to rate public organization's procurement audit practice.

Of the 19 internal auditors respondents 11 rate above average; of the 13 MOF respondents 8 rate good and 5 rate fair; of the 13 OFAG respondents 9 rate below average and of 5 PPA respondents 2 rate good.

The instigating point for this research is the repeated embezzlement revelation report of OFAG. Respondents from OFAG reflected the practice is below average; fair and bad. But the respondents from internal auditors rate themselves above average. This indicates the existence of acknowledging the poor practice from internal auditors' side.

Chart 5:- Procurement audi practice of public organizations test



## 4.5. Procurement Auditing and reporting

The objectives of internal auditors are guided by their organizations' needs. Internal auditors may focus exclusively on documenting and testing controls or may serve primarily as consultants focusing on recommendations that improve organizational performance.

Not only may internal auditors focus on different areas, but the extent of internal auditing may vary from one organization to another. Internal audit reports are not standardized because the reporting needs vary for each organization. Procurement audit is one of the areas where the assistance of auditors is required.

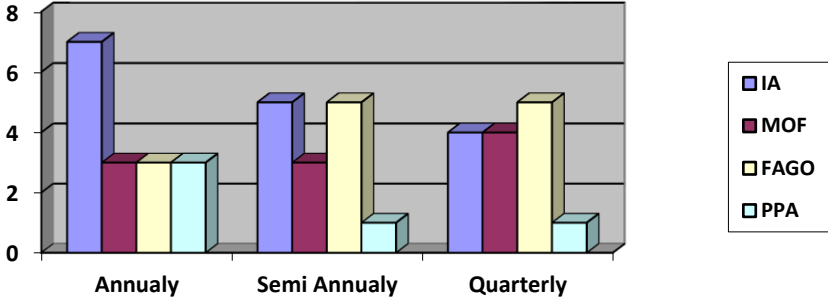
### 4.5.1. Audit timing

Audit timing is one of the essential variables in testing the effectiveness of audit. Respondents were asked on the timing of procurement audit in public organizations. According to the Public procurement manual (PPA, May 2011) Article 1.3.4.1.1. the audit directorate is required to produce procurement audit reports on a quarterly basis. Apart from these statutory reports, auditors should produce reports at the end of each audit exercise. Accordingly internal auditors of public organizations are required to produce procurement audit report in quarterly basis.

Of the 19 internal auditors respondents 7 said annually, 5 said semi annually and 4 said quarterly; Of the 13 MOF respondents 3 said annually, 3 said semi annually and 4 said quarterly; of the 13 OFAG respondents 3 said annually, 5 said semi annually and 5 said quarterly; and of 5 PPA respondents 3 said annually, 1 said semi annually and 1 said quarterly.

These statistics clearly shows the existence of different understandings on the timing of the procurement audit in public organization. Timing of audit is one of the major variables in measuring its the effectiveness. If we see the difference in internal auditors’ respondents only, we can simply observe there is huge difference in understanding of the timing of the audit itself. This difference demonstrates the existence of serious problem in the audit process.

**Chart 6:- Public procurement audit timing test**



**4.5.2. Feed back of the report**

The purpose of submitting audit report to the management is to give feedback on the actual performance of the organization in line with the tested operations.

The difference we observe among the respondents in the timing of the audit itself indicates the existence of critical differences in the ratings of the values of the feedback.

Of the 19 internal auditors respondents 5 rate good 6 rate below average; of the 13 MOF respondents 5 rate good and 8 rate below average; of the 13 OFAG respondents 5 rate good and 8 rate below average and of the 5 PPA respondents 4 rate fair which is below average.

This shows us that the feedback from procurement audit is not as such considered as valuable comment by the top management of the public organizations under considerations.

**4.5.3. Follow up of corrective actions**

According to the FDRE public procurement manual, the objectives of reporting are to notify the management of the results of the audit and to make recommendations, where appropriate. These reports will identify the audits carried out, recommendations resulting from the audits

undertaken, follow up actions on previous audit reports and the audits planned for the next period (PPA, may 2011)

According to Article 1.3.4.3. of public procurement manual the Quarterly Reports is meant to report on the procurement audit work carried out in the preceding quarter. A well prepared report will frankly and concisely comment on the adequacy of the control and procurement system of the auditee and will provide observations and recommendations on the efficiency, effectiveness and economy of the procurement systems examined during the quarter.

The quarterly report will brief the Head of Public Body on the adequacy of the procurement system of the auditee and enable action to be taken on such matters together with corrective measures as may appear necessary (PPA, may 2011).

It is important for both the auditor and the auditee to know the extent to which corrective action has taken place to resolve previously reported issues. The auditors conduct a follow-up after the completion of an audit. Some audits may need to be followed up sooner than others, due to the significance and nature of the issues raised in the original report.

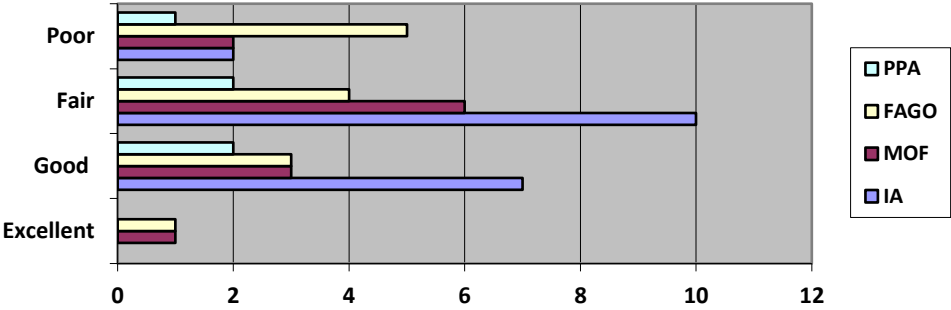
Following up on auditors' recommendations may serve three main purposes:

- (i) increasing the effectiveness of audit reports—the prime reason for following up audit reports is to increase the probability that recommendations will be implemented;
- (ii) evaluation of auditors' performance – following up activity provides a basis for assessing and evaluating auditors' performance; and
- (iii) creating incentives for learning and development – following up activities may contribute to better knowledge and improved practice.

Having this as a background respondents were asked to rate the follow up actions of internal auditors. Of the 19 internal auditor respondents 7 (37%) rate good and 12 (63%) rate below average; of the 13 MOF respondents 3 (23%) rate good and 8 (62%) rate below average; of 13 OFAG respondents 3 (23%) rate good and 9 (70%) rate below average and of 5 PPA respondents 1 (20%) rate good and 3 (60%) rate below average.

This statistics shows, though follow up of corrective actions as per the prior audit report is the main responsibility of internal auditors, the practice is very gaunt.

**Chart 7:- Corrective actions followup test**



From the report timing and corrective actions follow up statistics we can infer the help of internal auditors in procurement risk assessment and the imperative partnership among the management and internal auditors in procurement control issues are almost underprovided. The repetitive procurement procedures noncompliance reports proved this assertion.

On the issues of procurement procedures compliance, the federal Auditor General office produces annual audit report on almost all public organizations. One of the main complains aired in the House of Representatives is the lack of corrective actions by the management of the audited public organizations.

The MOF audit manual No 7/2010 article 7/10-11 clearly states the following as responsibilities of internal auditors;

- 10. qDä bqrb#T yÄÄ!T ¶±RèC m\rT yXRMT XRM© ÄltwsdÆcWN G"èC bmk-tL yXRMT XRM© XNÄ!wsÇÆcW lms¶Ä b@t\$ yb\$Y `šđ y¥œsB½
- 11. yWÀ äÄ!téC b,ÄqRÆ\*cW G"èC \$Y yXRMT XRM©äC XNÄ!wsÇ KTTL y¥DrG½

From this we can simply understand that internal auditors are required to check the reports produced by external auditors like OFAG and perpetrate themselves to the follow up of the corrective actions to be taken. This is one of the critical management tools of compliance risk management.

Respondents were asked if they check the findings of the OFAG audit report in line with the internal auditors report. Of the 19 internal auditors respondents 7 (36%) says yes and 8 (42%) says no; of the 13 MOF respondents 4(31%) says Yes and 8 (62%) says no; of 13 OFAG respondents 4 (31%) says yes and 7 (54%) says no and of 5 PPA respondents all of them (100%) says no.

From this statistics we can simply infer that no comparison of findings between internal auditors and OFAG reports on the same auditee was made. This shows how the public organizations leaders and internal auditors designate lower importance to the findings of OFAG.

This is also reflected on the results of the assessment of management's reaction on the findings of internal auditors. Respondents were asked how they see the reactions of the managements of the public organizations on the reports of internal auditors. Of the 19 internal auditors 10 says positive and 3 says negative; of the 13 MOF respondents 4 says positive and 9 says negative and of 5 PPA respondents 5 says negative.

## **Chapter Five**

### **Summary of Findings, Conclusion and Recommendations**

#### **5.1. Introduction**

The modern internal auditing practice is characterized by broader scope and diversified activities than the traditional in many aspects. As shown in the literature review part, internal auditing function has changed from the simplest fraud investigation to the modern value addition service through time. As indicated in the FDRE procurement audit manual and MOF internal audit manual, internal audit is one of the main compliance risk management tools. Almost all duties and responsibilities levied on internal auditors through the above mentioned audit manuals proved the importance of internal auditors in procurement compliance management process.

This section of the thesis summarizes the findings of the research, the gaps identified, the researcher's conclusion and recommendations.

#### **5.2. Summary of Findings and conclusions**

Internal audit is an independent appraisal function established by the management of an organization for the review of internal control system as a service to the organization. The MOF internal audit manual also clearly obligates the managers of public organizations to form independent internal audit department. Compliance risk management requires the integration of the management with internal control system. The independence test reveals that there is negative perception to internal auditors. Therefore the researcher believes that the procurement compliance risk management lacks one of its arms.

Auditing is the process of examining documents and records against preset standards. When it comes to procurement compliance risk management, the measuring standards are the procedures drawn by the public procurement laws and manuals. The access to documents and records test reveals that there is serious problem in this regard. Such problems have serious potential in encumbrance of the assistance the management could exploit from internal auditors in its compliance risk management.

The internal audit procurement compliance risk management function is inseparably linked with its role within the organization and should therefore be capable of responding to all

regulatory requirements. The procurement audit manual and the MOF internal audit manual dictate the positioning of internal audit in public organizations as one of critical departments with immense independence and professional capability. However, as the study reveals internal audit function is not developed to the required extent in public organizations and therefore internal auditors are not playing their role in procurement compliance risk management process to the expected level.

The MOF internal audit manual and public finance administration laws give the mandate on monitoring the performance of internal auditors in public organizations to MOF. The responsible department for this specific task in MOF is the inspection department. Using their prior information and experience observed from the reports produced by internal auditors of public organizations, auditors in the MOF inspection department challenged the knowledge of internal auditors in public organizations.

This indicates internal auditors in public organizations lack the trust, one of the main inherent qualities expected from internal auditors, of the management and third parties. This could cause the breakage of the necessary bond between internal auditors and the management team of public organizations in their mutual task of procurement compliance risk management.

When internal auditors fail to do what the management and the regulatory organizations expects them to do, this will cause a loss of confidence in the internal audit. Internal auditors could get demoralized when their reports are not appreciated by management. If audit recommendations are not adopted and implemented by management, then internal audit has no value addition to the organization.

Internal auditing is a profession and activity involved in counselling organizations regarding how to better achieve their objectives through managing risks and improving internal control. Procurement is a specialized subject which requires a high degree of knowledge and skill of those who are engaged in procurement of goods, works and services. Therefore internal auditors need to have proper skill and knowledge in procurement if they are to help the management in procurement compliance risk

management. The study reveals that there is positive perception on this issue. But the procurement compliance problem encountered by the public organizations is also visible.

As per the public procurement audit manual, Procurement audit was supposed to be conducted in quarterly basis. Had this been the reality in public organizations, the flourishing of the practice could have been apparent. But the study reveals the opposite. This indicates the need to take serious action in implementing the provisions of the public procurement manual so that public organizations could enjoy the assistance of internal auditors in procurement compliance risk management task of the management.

The public procurement manual requires the production of procurement audit report in quarterly basis. But the result of the respondents' reflection analysis shows us that there is no clear understanding of procurement audit timing in the sector. From this it is possible to observe that the practice of public procurement audit is almost inexistent. This in effect cuts the public organizations essential arm in procurement compliance risk management. The result by itself suggests the instigation of procurement audit training and mandatory implementation of the manual.

As discussed before following up on auditors' recommendations may increase the effectiveness of audit reports, provide basis for assessing and evaluating auditors' performance and creating incentives for learning and development which in effect contribute to better knowledge and improved practice. But the practice in public organizations is to the contrary. Though internal auditors are legally required to follow up the implementations of corrective actions indicated in their audit report and external auditors report, they failed to give proper attention for such responsibility. The effect of this failure is blatantly exhibited in the reports of OFAG annual reports.

### **5.3. Recommendations**

Based on the findings and the conclusions drawn, the study recommends the following

Negative perceptions in most cases come from those who stand to benefit if an audit is not done, and when an audit is done they are found wanting. It is caused by the desperation to discredit audit for personal gain. Loss of confidence in the internal audit function is the impact of internal audit expectation gap not met. When internal auditors fail to do what the management and the regulatory organizations expects them to do, this will cause a negative perception. Therefore internal auditors should be trained and alerted to perform to the higher expectations of the top management of the public organizations and to the satisfaction of the regulatory bodies; i.e MOF and PPA.

The absence of independence and objectivity in the internal audit function is another cause of negative perception to internal auditors. The independence and objectivity of the internal audit function may be affected by the relationship between internal auditors and the top management of public organizations. Therefore both the top management of public organizations and internal auditors should work hard and establish stringent system that enables both parties to achieve the attainment of actual and perceived independence of internal auditors.

Public procurement involves huge amount of public capital. This exposes the process for unbearable embezzlement. Such problem can be mitigated by implementing strict compliance risk management system.

To exploit the advantages of public procurement audit in procurement compliance risk management process of the public organizations, the public procurement audit structure has to be introduced and incorporated in the existing internal auditing and reporting system as a separate internal audit different from the customarily operational audit report. To this effect the financial administration laws and public procurement laws and manuals needs to be revised.

Internal auditors should get support from the top management. Top management should accept audit findings and correct errors as per the recommendations rather than viewing auditors as fault finders. To make this happen MOF and PPA should give proper attention and due consideration to continual training of internal auditors and top managements of public organizations.

Top Managements of public organizations should demonstrate high level commitment to the implementations and due considerations of internal audit findings. Management should respond to all findings and recommendations in time. Management should also cooperate with auditors.

Auditors should embark on continuous training. Auditors should always be objective and factual. Auditors should be friendly and approachable and constantly strive to improve their performance. Auditors need to have knowledge of the area being audited.

#### **5.4. Area for future research**

This study was conducted on selected budgetary public organizations and it only looked at internal audit departments in the public organizations. Therefore, factors causing negative perceptions about internal auditors and their impact on the performance of the role of internal auditors in procurement compliance risk management function need to be researched in depth including public enterprises.

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**Addis Ababa University**  
**College of Business and Economics**  
**Department of Accounting and Finance**

**Questionnaire**

Dear interviewee,

I am a student pursuing Msc. Accounting and Auditing at Addis Ababa University faculty of Business and Economics. During my studies am supposed to conduct a study research concerning assessment of the role of Internal Audit in procurement Compliance risk Management topic so as to enable me to complete my studies.

Therefore, I cordially request you to fill the following set of questions by giving relevant and reliable information.

**Section A: General Information**

1. Sex             Male             Female

2. For how long have you working in your organisation?

2.1. Below 1 year           

2.2. 1 to 5 years           

2.3. Above 5 years           

3. Academic qualification level

3.1. Below diploma           

3.2. Diploma           

3.3. Bachelor           

3.4. MA; MSC; MBA           

**Section B:- Main Part**

4. Do you think internal auditors in public organization are independent in all their works from

4.1. The chief executive?

Yes             No

4.2. The management Team?

Yes             No

4.3. Department Heads?

Yes  No

4.4. From the department head responsible for procurement?

Yes  No

5. Do you think internal auditors fear of

5.1. The chief executive?

Yes  No

5.2. The management Team?

Yes  No

5.3. Department Heads?

Yes  No

5.4. From the department head responsible for procurement?

Yes  No

6. Do you think auditors access all the documents as they think right?

Yes  No

7. Do you think internal auditors produce their report independently on what they observed?

Yes  No

8. How do you think internal audit valued as a member of the management team?

Excellent  Good  Fair  poor

9. Do you think the Organizational placement of the internal audit activity to ensure its independence and ability to fulfil its responsibilities?

Excellent  Good  Fair  poor

10. How do you rate the internal auditors' free and unrestricted access to records, information, locations, and employees during the performance of their engagements?

Excellent  Good  Fair  poor

11. How do you rate the objectivity of the internal Auditors?

Excellent     Good     Fair     poor

12. How do you think the Professionalism of internal Auditors?

Excellent     Good     Fair     poor

13. How do you rate the Knowledge of auditors about their own organization?

Excellent     Good     Fair     poor

14. How do you rate the Knowledge of internal auditors about procurement process and procedures?

Excellent     Good     Fair     poor

Please explain why

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15. How do you rate the procurement audit practice of public organization?

Excellent     Good     Fair     poor

Please explain why

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16. Procurement audit conducted in public organizations

Annually     semi-annually     quarterly

Please explain why

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17. How do you rate the duration of the internal auditors' procurement audit?

Excellent     Good     Fair     poor

Please explain why

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18. How do you rate the feedback internal auditors to the chief executive and the management team on emerging issues during procurement audit?

Excellent     Good     Fair     poor

Please explain why

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19. How do you rate the feedback the internal auditors to your organization's audit on their own organization?

Excellent     Good     Fair     poor

Please explain why

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20. How do you rate the timeliness of the procurement audit report of internal auditors?

Excellent     Good     Fair     poor

Please explain why

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21. What do you think about the accuracy of the procurement audit findings of internal auditors?

Excellent     Good     Fair     poor

Please explain why

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22. How do you rate the clarity of the procurement audit report?

Excellent     Good     Fair     poor

Please explain why

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23. How do rate the internal audit follow-up on corrective actions based on the results of the procurement audit?

Excellent     Good     Fair     poor

Please explain why

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24. How do you rate the coordination of your organization with internal auditors in follow up and corrective actions of public organizations based on the results of the procurement audit?

Excellent     Good     Fair     poor

Please explain why

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25. How do you rate the assistance of internal auditors to management in procurement risk assessment?

Excellent     Good     Fair     poor

Please explain why

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26. How do you rate the assistance of internal auditors to their organizations in procurement compliance risk assessment?

Excellent     Good     Fair     poor

Please explain why

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27. How do you think the partnership of internal auditors with your organization on procurement compliance risk issues?

Excellent     Good     Fair     poor

28. Did you ever observe differences in procurement audit findings between reports of the internal auditors and your organization's auditors?

Yes     No     I did not made any comparison among the reports

29. If yes, on what aspects

Payment     budget     procurement  
 inventory

Please explain why

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30. Do you professionally accept the findings and the content of internal auditors procurement audit report?

Yes     No     Partially accept and partially reject

Please explain why

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31. How do you see the reaction of the management on the internal auditors' procurement audit report?

Positive       Negative       mild resistance

32. How do you see the support of the management in investigation works?

Positive       Negative       mild resistance