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**THE FACULTY OF COMMERCE
DEPARTMENT OF ACCOUNTING**

**RESEARCH TOPIC
AN INVESTIGATION ON THE EFFICIENCY OF INTERNAL AUDITING IN RISK
MANAGEMENT
A CASE OF CITY OF MUTARE**

BY DWRIGHT MATENHESE

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**THIS DISSERTATION IS SUBMITTED IN PARTIAL FULFILLMENT OF THE
REQUIREMENTS OF THE BACHELOR OF COMMERCE ACCOUNTING
HONOURS DEGREE AT THE MIDLANDS STATE UNIVERSITY**

GWERU ZIMBABWE: SEPTEMBER 2014



DECLARATION FORM

I, Dwright Matenhese, Registration number R112874Q, hereby declare that this dissertation is my own original work and has not been previously submitted for any degree or examination at any other university

Signature:

Date:

APPROVAL FORM

The undersigned give their certification on reading and recommending to the Midlands State University for acceptance: a research project entitled, ‘**An investigation of the efficiency of internal auditing in risk management: A case of City of Mutare**’ submitted by **Dwright Matenhese (R112874Q)** in partial fulfilment of the requirements of Bachelor of Commerce Accounting Honours Degree (HACC) with Midlands State University.

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DEDICATION

This dissertation is dedicated to my brothers, I admire them for their everlasting support, love and their desire for the best out of my life. May the Lord Almighty bless them abundantly they are my source of inspiration.

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My heartfelt appreciation goes to my supervisor, Ms. Takachicha for enriching the intellectual quality of my research. Your guidance was my pillar of strength during the course of the whole project. I thank you, may the Lord richly bless you.

My profound appreciation goes to my brothers who are always there for me through thick and thin, I salute you for your unwavering support and effort in all matters of life. Your support shall always be cherished. I love you all, may the Lord bless you always.

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ABSTRACT

The central point of this research is to investigate the efficiency of internal audit in risk management. Mutare City Council was used as the case in this research. This was necessitated by the fact that the council has been a victim of corrupt tendencies and theft, operational costs have increased and service delivery has declined leading to ratepayer dissatisfaction. The researcher in trying to come up with relevant information made a critical review on the relevant literature related to the aforementioned problem. The literature was mainly centered on the role of internal audit in risk management. The research methodology used by the researcher was quantitative and qualitative in nature. The data collection process included the administering of questionnaires and an interview to extract the relevant data for analysis. The data collected was analysed qualitatively in such a way that the relevant results were obtained. The findings made by the researcher were presented, analysed and appropriate recommendations were suggested. The research found out that the efficiency of the internal audit in risk management is hindered because of various factors that affect the function. Furthermore, resources are a major impediment in the internal audit department of City of Mutare in trying to achieve its goals.

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

This chapter highlights, the background of the study, statement of the problem, research objectives, research questions, the importance of the study, assumptions which will be made in this research and definitions of key terms used in the research.

1.1 Background To Study

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”. (IIA 2014)

Mutare City Council (MCC) has been experiencing operational ineffectiveness as residents have been complaining of poor service delivery especially in refuse collection and water supply services. According to a survey report conducted in 2012 it indicated that about 32% of the city's water meter readers were not functional and it was one of the major reasons ratepayers were defaulting payments (City Engineers' Report 19 September 2012) . While operational challenges were said to be the cause it was revealed in a report by the town clerk department that the funds for the repairs and maintenance of the water meter readers had already been allocated but were misused. (Town Clerk's Report 25 September 2012).

In 2013 MCC topped newspaper headlines when it clocked eight months without paying low level workers and contract workers whilst the town clerk took home a whopping \$15 000 monthly salary plus allowances up to the tune of \$6 000. The human resource manager (HRM) report revealed that MCC owed workers up to \$3 million and were also planning to retrench two hundred employees to ease the burden. (HRM Report 20 June 2013).

MCC has been delaying or defaulting statutory payments for Zimbabwe Revenue Authority (ZIMRA) and National Social Security Association (NSSA). In July 2013, NSSA garnished the local authority bank to recover \$97 500 which it was owed. (Board minutes 24 July

2013). According to the audit conducted by the Urban Development Corporation (UDCorp) it was reported that eleven managers pocketed over \$200 000 in monthly salaries and allowances and the audit examination revealed that their benefits were not disclosed on payroll for tax purposes. By so doing, UDCorp indicted that MCC was violating chapter (23:04) section 8 of the Income Tax Act. (External Auditors Report 2013).

Fraudulent and corruption activities have been taking place within the local authority. MCC internal auditors exposed massive fraud indicating that the local authority lost more than \$30 000 in a well-orchestrated residential stands scam between February 2009 and May 2012. (Internal Auditors Report 20 June 2012). The internal auditors Report also revealed that there were fictitious deliveries of water chemicals which were later detected after eighteen months and MCC was prejudiced \$40 258. (Internal Audit Report 20 June 2012). The 2013 external audit report unearthed \$11 000 which went missing through the reprinting of duplicate receipts as well as unrestricted access to manual receipt books. (External Auditors Report 2013).

The council lacks a proper non-current asset register thereby exposing the local authority's assets to misappropriation and theft. (Audit Committee Minutes 15 November 2010). The local authority's tender process was also put to question as it paid a down payment of \$330 000 to Shitazburg Investments (Private) Limited to supply pipes. It was later discovered that it was a briefcase company and MCC failed to recover the money. (Notes to the Annual Financial Statements 2011).

1.2 Statement Of The Problem

The internal audit profession is not a static but a transitional profession. Internal audit function has shifted from an internal control and compliance based to a risk based approach. The alarming cases of inefficiency, corruption, fraud, scandals and exposure to risk for local authorities call for a study of the role played by the Internal Audit Function in mitigating those risks.

1.3 Main Research Question

To what extent is the internal audit efficient in adding value, risk management and improving the operations of the organization as a whole?

1.3.1 Sub Research Questions

- What is the role played by internal auditing towards risk management?
- What factors prevent internal auditing from adding value to the organization?
- How is risk managed by the internal audit department?
- What are the elements that make up an effective risk management system within the organization?
- How best can internal auditing be made effective?

1.4 The Objectives Of The Study

- To establish the role played by internal auditing in risk management.
- To investigate factors that prevents internal auditing from adding value to the organization.
- To establish how risk is managed by internal auditing
- To determine the elements that make up an effective risk management system within the organization.
- To establish ways that improves internal audit effectiveness.

1.5 Justification Of The Study

1.5.1 To The Researcher

The research is in partial fulfilment of the Bachelor of Commerce Accounting Honours degree at Midlands State University. The study will enhance the knowledge and skills of the researcher as well as enhancing the understanding of the internal audit function in risk management.

1.5.2 To Midlands State University

The research will provide literature review for other students and members of staff who in the future may carryout research on the subject under study.

1.5.3 To Mutare City Council

Management and staff of MCC will find great benefit in reading this research as it will provide the organization with information as well as recommendations that can assist the local authority to achieve its objectives.

1.6 Delimitations Of The Study

The research will be conducted and limited to MCC and will focus on the operational risk facing the organization as opposed to market or credit risk. The period covered by the study is from the year 2009 to 2014.

1.7 Limitations Of The Study

1.7.1 Financial Constraints

There were inadequate funds as costs such as printing and travelling expenses had to be met. Instead of travelling regularly, some information was obtained over the phone and through e-mails.

1.7.2 Time Constraints

There was limited time to research as deadlines had to be met. Time was limited as the researcher had to travel to and from the source of information. Therefore, the researcher worked around the clock.

1.7.3 Access To Information

Some information that was needed for this research was said to be confidential. However an assurance was given to the organization that the information will not be misused and will be treated in strict confidentiality.

1.8 Definition Of Terms

Local Authority – “an administrative body responsible for the government of a town or a city and is officially responsible for all the public services and facilities in that area”. (Urban Councils Act 2006).

Internal Auditing – “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”. (Institute of Internal Auditing 2014)

Value Addition – “the process of improving opportunities to achieve organization objectives, identifying operational improvement and or reducing risk exposure through both assurance and consulting activities”. (Institute of Internal Auditing 2014)

Management – “These are officers or people responsible for the coordination of people to accomplish goals and objectives using available resources efficiently and effectively”. (Griffiths 2006)

Consulting Services – “Advisory and related client service activities, the nature and scope of which are agreed with the client, are intended to add value and improve an organization’s governance, risk management, and control processes without the internal auditor assuming management responsibility”. (Institute of Internal Auditors 2014).

Objectivity – “a state of mind or quality of being true even outside of a subject’s individual biases, interpretations, feelings and imaginings”. (Griffiths 2006)

Risk –“uncertainty of outcome, whether positive opportunity or negative threat, of actions and events. It is the combination of likelihood and impact, including perceived importance”. (HM Treasury 2004).

Risk Management – “It is the systematic process of understanding, evaluating and addressing these risks to maximise the chances of objectives being achieved and ensuring organizations and communities are sustainable”.(Institute of Risk Management 2014)

1.9 Acronyms And Abbreviations

CAE	Chief Audit Executive
CBOK	Common Body Of Knowledge
ERM	Enterprise Risk Management
HRM	Human Resources Management
IA	Internal Auditor
IAF	Internal Audit Function
IIA	Institute of Internal Audit
IPPF	International Professional Practice Framework
ITA	Income Tax Act
IRM	Institute of Risk Management
MCC	Mutare City Council
NSSA	National Social Security Association
UDCorp	Urban Development Corporation

1.10 Summary

This chapter looked at the background to the study, statement of the problem as well as the justification of the research. It also looked at the limitations and delimitations before defining key terms which were used. Chapter two will focus on the theoretical and empirical literature review on internal auditing and risk management.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter covers the literature review on internal audit and risk management and provides an overview of the scholarly information published to date. The review covers the major aspects relevant to the study at hand. It seeks to bring to light the underlying link between internal audit and risk management and show how effective and efficient risk management can be achieved.

2.1 Origins Of Internal Auditing

Historically, internal auditing served as a simple administrative procedure comprising mainly of checking documents, asset counts, evaluation of internal control systems, and compliance testing (Pickett 2005). Internal auditing was considered as a monitoring function which represented the organization's "policeman and watchdog" (IIA 2014). "The role of internal auditors is shifting from a traditional audit approach to a more proactive value-added approach where internal auditors are taking up partnerships with management". (Raad 2006). Internal auditing rose as the growth and increasing complexity of firms in the early 20th century stretched the capabilities of managers and thereby created efficiency and effectiveness in solving problems. By adding managerial aspects to financial and compliance activities, internal audits were recognized as a means of assisting overburdened managers. (IIA 2014).

Higher standards of business responsibility were set for company management by the public and shareholders as organizations grew and expanded. The internal auditor had to ensure that every transaction was properly authorized and correctly documented and accounted for. This resulted in the closer involvement of the internal auditor with the financial reporting of an entity. (UNISA 2001). As the profession evolved, internal auditors wanted greater recognition of their function and on 17 November 1941, The Institute of Internal Auditors was established in the United States of America (IIA 2013). Internal audit role is extending beyond financial reporting controls to include audits of non-financial information. It is

playing a more prominent and proactive role in risk management and key emerging risks. (Ernst & Young LLP 2011).

2.1.1 Internal Auditing

“The internal audit function is set up by management of an enterprise to examine, evaluate and report on accounting and other controls on operations”. (Millichamp, 2002, p.46). It can be seen as an appraisal activity within an entity that reviews, monitors and makes recommendations for the improvement of systems. (Denmark CIS Auditing (2006)). The Institute of Internal Auditors (2014) states that 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”. (IIA 2014).

The Internal audit is provided within the organization and is different from the external audit role. (King III 2009). The concept of independence is important, the function carrying out the internal auditing activity should be outside the normal management hierarchy. The audit function has a requisite to have adequate status and be able to stand back from the operation under review for it to be of use. (Pickett 2005). The internal audit should report to the board or Audit committee in order to enhance its independence and effectiveness. (King III 2009).

2.1.2 Overview Of Risk

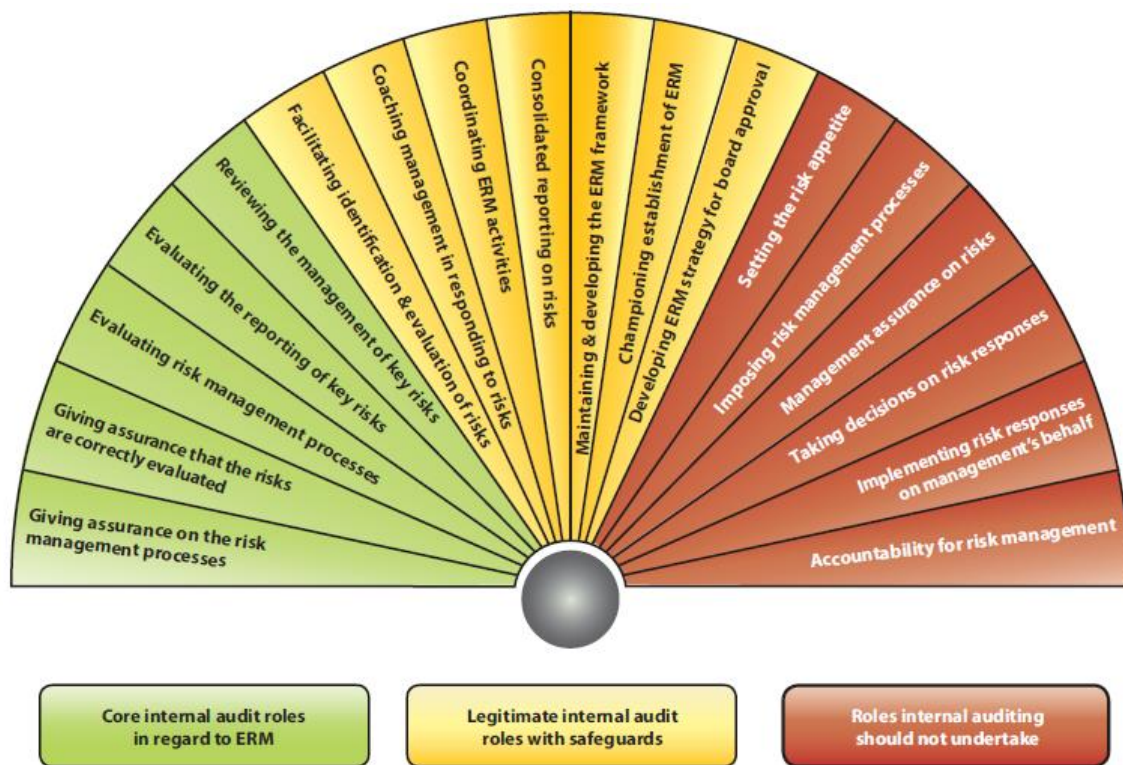
Van Peurse (2005) states that internal auditors often find themselves explaining their role to their managers and workmates because their role is misunderstood. Internal auditors face the challenge of having to educate their colleagues as to what the auditor can and cannot do. The core internal audit roles in risk management as stated by IIA (2009) includes giving assurance on risk management processes, appraising the reporting of key risks and reviewing the management of key risks.

According to IIA (2009) Internal Audit also has significant legitimate roles in risk management, which incorporates the following, enabling identification and evaluation of risk, training management in responding to risk, directing Enterprise Risk Management (ERM)

activities and developing risk management strategy for board approval. According to David Griffiths, (2006) providing assurance on the risk management framework is arguably a more important role than documenting and advising on internal financial controls. He criticises the Sarbanes Oxley Act of 2002 for providing additional work to internal audit departments by focusing them on internal controls rather than risk management. However, there are other roles that internal audit should shun from with regard to risk management and these includes setting the risk appetite, accountability for risk management and taking decisions on risk response. (www.theiia.org).

Figure 2.1 below shows a summary of the core internal audit roles in risk management, legitimate internal audit roles in risk management and roles internal auditors should not undertake pertaining to risk management.

Figure 2.1 Internal Audit Roles In Enterprise Risk Management (ERM)



Source: The Institute of Internal Auditors Research Foundation White Paper (2011)

2.1.3 Challenges Faced By The Internal Audit Function In Risk Management

According to IIA (2011) the internal audit function faces key challenges in adopting to meet new expectations or new requirements, addressing internal audit's role in evaluating risk management, working with limited resources, developing a continuous focus on risks and

interference by management in their work thereby impairing their independence. Stewart J & Subramanian N (2005) documents that line managers stereotypes that internal auditors lacks skills and knowledge to provide useful help thereby ignoring their advice, hence reducing internal audit's effectiveness.

2.2 Internal Audit's Value Addition To The Organization

The concept of value added has been embedded in definition of internal auditing, as noted in the glossary to the Standards. The IIA's *International Standards for the Professional Practice of Internal Auditing*, defines add value as "Value which is provided by improving opportunities to achieve organizational objectives, identifying operational improvement, and or reducing risk exposure through both assurance and consulting services". (IIA Standards, 2010, p.18).

The Internal Audit Function (IAF) should add value by contributing to risk management. In order to minimise the risks identified, the IAF needs to determine what obstacles may stand in the way of achieving the objectives of the organisation (e.g. for Local Authorities some of the objectives are provision of quality service, provision of housing stands) and also assess the controls that are in place to determine whether those controls are appropriate and adequate in the light of the risks identified (Sawyer, Dittenhofer and Scheiner, 2003).

The value added concept is discussed using the International Professional Practices Framework (IIA, 2010, p.18) which states that the "IAF will add value when it provides important opportunities to achieve organizational objectives, when it identifies operational improvement and when it contributes to reducing risk exposure through both assurance and consulting services". Gramling and Hermanson (2006 p.37) believed that "internal auditors add value when they take proactive steps to educate their board and audit committees on possible governance roles".

According to the Common Body of Knowledge (CBOK, 2006, p.197) survey, there are value indicators or methods used by the organizations to measure the value of internal auditing. These include the following "the acceptance and implementation of recommendations, the number of management requests for internal assurance or accessing projects, and the reliance by the external auditors on the internal audit's work".

2.2.1 Measurement Of Internal Audit’s Value Addition

According to Roth (2003) the concept of value added internal audit held by IAFs has direct relevance to internal audit effectiveness, because the latter serves as a measure of the former. Savcuk (2007) believes that an internal audit function, being a constituent part of corporate governance, can add value to an organization only if it is effective. The attributes for IAF effectiveness include subordination to the audit committee, professional certification, experience, internal audit strategy and operating responsibilities. Ray (2009) acknowledges that there are many ways to measure whether or not IAFs add value to their organisations. Reference was made to the value indicators cited by the CBOK (2006) as well as the number of management requests for assurance and consulting service.

TARLOK TEJI, a partner of DELOITTE & TOUCHE Company proposed the Synoptic score table method to measure the performance of the organizations internal auditing. (Institute of Internal Auditors UK & Ireland, 2011). The Synoptic score table shows the major areas where the Internal Audit can add value or be of benefit to the organization using the objectives set or pursued by management. (Institute of Internal Auditors UK & Ireland, 2011).

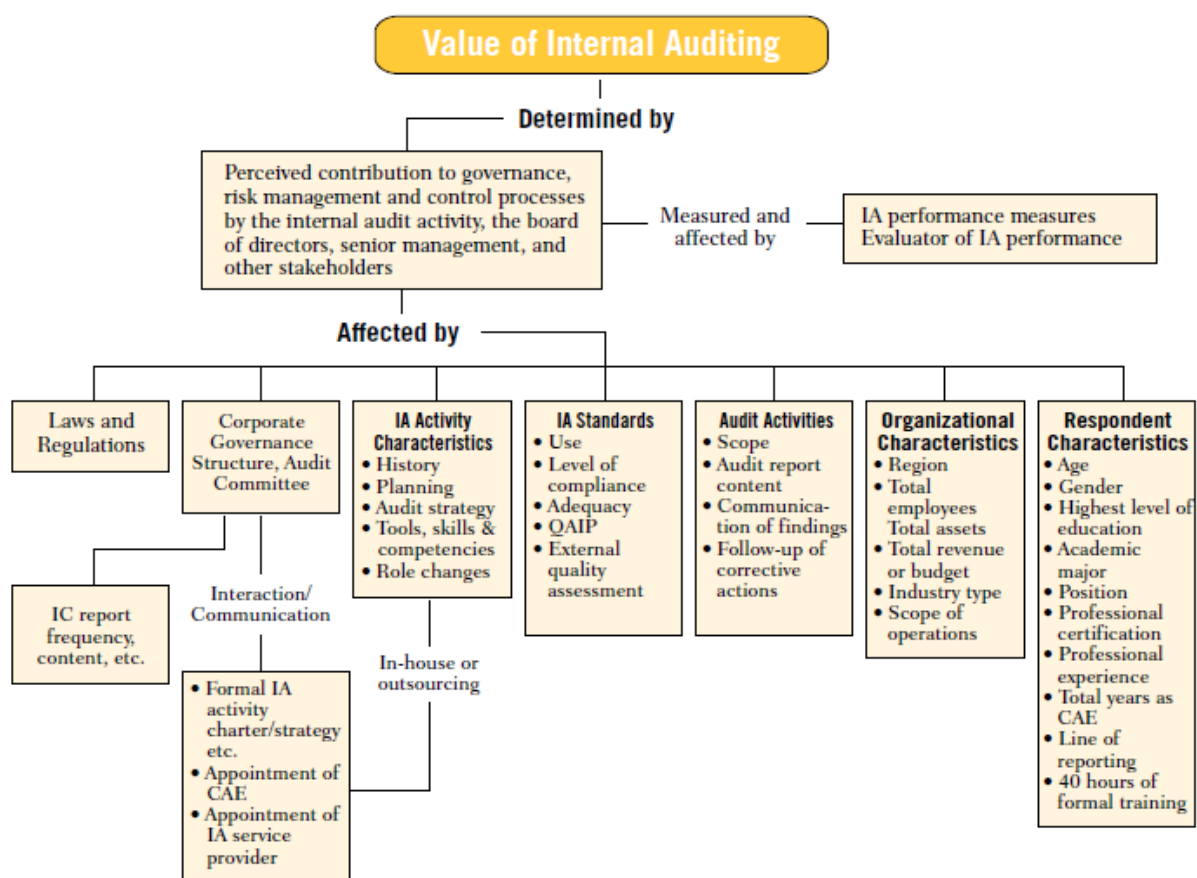
Perspectives	Purposes	Objectives	Measure
Customer	Continual increase of the customer’s satisfaction	<ul style="list-style-type: none"> - reducing the time of cashing - increasing the importance of deliveries in due time - reducing the number of the complaints from customers 	<ul style="list-style-type: none"> - the overage time of cashing - the percentage of deliveries in due time - the number of complaints from customers
Financial	Continual increase of financial performance	<ul style="list-style-type: none"> - lowering costs - increasing sales - increasing market quota 	<ul style="list-style-type: none"> - overage unitary cost - increasing profit ratefor sales - market quota - investment rate of rentability
Internal business	Continual improving of internal processes of the business	<ul style="list-style-type: none"> - reducing the cycle of time - increasing quality - increasing productivity 	<ul style="list-style-type: none"> - the overage time of the cycle - the number of flaws and repaired items - production/worker

Table 2.1 Synoptic Score Table of Tarlok Teji

Source: Internal Auditing & Business Risk Magazine – The Institute of Internal Auditors U.K and Ireland in association with Deloitte & Touché (2011).

However, according to The IIA’s Global Internal Audit Survey (2011) the value of internal audit work is shown by its usefulness to the organization. Usefulness of internal audit services is reflected by the activity’s alleged contribution, which is affected by organizational characteristics, the internal audit activity’s characteristics, performance measurement of the internal audit activity, and the internal audit services performed. The interrelationships between the perceived contribution (value) of internal auditing and these factors are illustrated in figure 2.2 below.

Figure 2.2 Conceptual Framework For Measuring Internal Audit’s Value



Source: IIA Global Internal Audit Study (2011)

2.3 Risk Management

Douglas, (2009) states risk management as the “identification, assessment, and prioritization of the effects of uncertainty on objectives, whether positive or negative followed by coordinated and economical application of resources to minimize, monitor, and control the probability and impact of unfortunate events or to maximize the realization of

opportunities”.King II report (2002) documents risk management as “the identification and evaluation of actual and potential risk areas as they pertain to the organisation followed by a process of either termination, transfer, acceptance or mitigation of each risk”. It is as much about identifying opportunities as avoiding or mitigating losses. The Zimbabwe standard for Risk Management (SAZS 897, 2003).

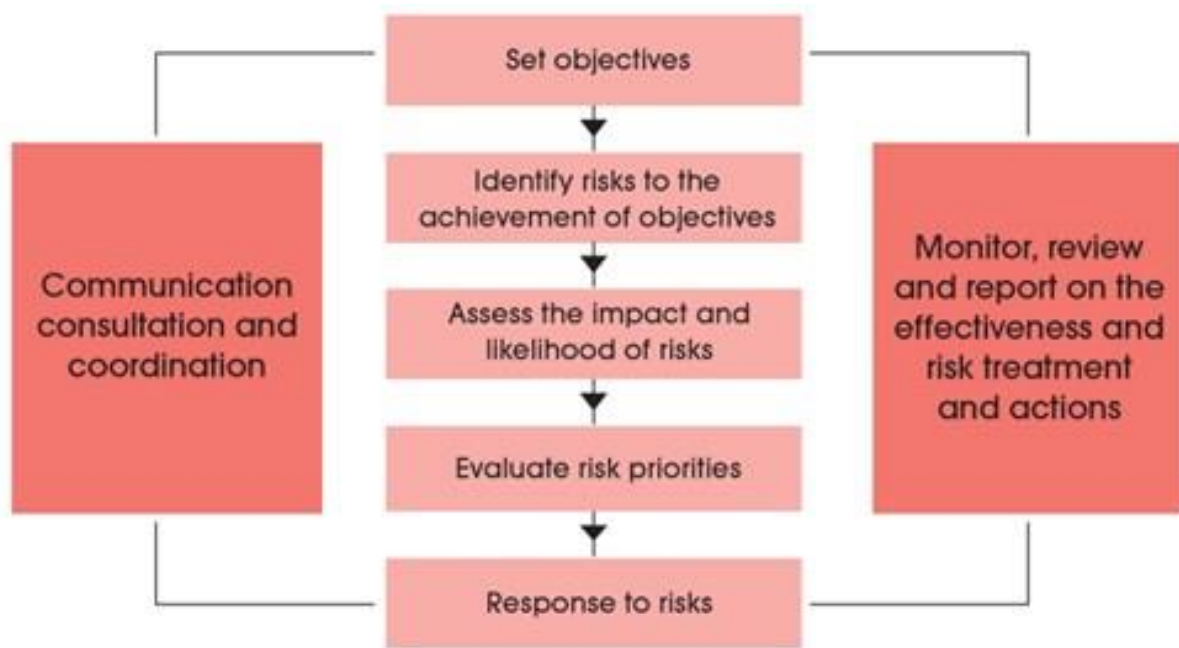
According to the Institute of Risk Management (2014) “Risk Management is the systematic process of understanding, evaluating and addressing risks so as to maximise the chances of objectives being achieved and ensuring organizations and communities are sustainable”. Therefore it encompasses both negative and positive aspects of risk hence it can result in an adverse effect or contribute to benefits or value within an organisation. (www.theiia.org).

2.3.1 Risk Appetite

“The amount of risk that an organisation is prepared to accept, tolerate, or be exposed to at any point in time”. (HM Treasury 2004, p.49).The Institute of Risk Management describes how organizations can design, develop and implement a risk appetite. (IRM 2011).Risk appetite is key to achieving effective risk management and it is important to consider it prior to addressing risks. (HM Treasury 2004).

According to Griffiths (2006) risks above the risks appetite are regarded as a threat to the reasonable assurance that an organisation will achieve its objectives. Ernst & Young stated that designing risk management without defining your risk appetite is like designing a bridge without knowing which river it needs to span. (www.theiia.org). However, it should be known that some risks are unavoidable and the organisation cannot manage it to an acceptable level. (www.hmtreasury.org.uk).

Figure 2.3 Risk Management Diagram



Source <http://www.theiia.org.uk>

2.3.2 The Objectives Of Risk Management

The International Organization for Standardization (ISO) identifies the following objectives of risk management in its committee draft of ISO 3100 (2009). Risk management should create value, be an integral part of organizational processes and be part of decision making process which explicitly address uncertainty and assumptions. It should be systematic and structured and be based on the best available information. Griffiths (2006) advocates that risk management should be dynamic, iterative and responsive to change and be capable of continual improvement and enhancement. According to Marks (2014) the objectives of risk management should give assurance to various stakeholders that critical risks are being managed to acceptable levels.

2.3.3 Risk Based Internal Audit

Risk based internal audit (RBIA) is the “methodology which the Internal Audit department uses to provide assurance that risks are being managed to within the organization’s risk appetite”. In addition “these are processes that manage risks to a level considered acceptable by the board and are working effectively and sufficiently”. (Griffiths, 2006, p.26). “Basically, risk based auditing ensures that the organization is within its acceptable level of risk after

controls are put into place”. (Lovaas, 2009 p.81).When the risk management framework is not very strong or does not exist, the organization is not ready for RBIA. It shows that the organization’s system of internal control is poor. Internal auditors in such an organization should promote good risk management practice to improve the system of internal control. (Institute Of Internal Auditors 2014).

Lovaas (2009) notes that what actually differentiates risk-based auditing is the fact that it extends and improves the risk assessment process, looking at areas based on risk instead of focusing on controls. The table below depicts the difference between a risk based approach and a traditional approach.

Traditional	Risk-Based
➤ Audit focus	➤ Business focus
➤ Transaction-based	➤ Process-based
➤ Financial account focus	➤ Customer focus
➤ Compliance objective	➤ Risk identification, process improvement objective
➤ Policies and procedures focus	➤ Risk management focus
➤ Multiyear audit coverage	➤ Continual-risk-reassessment coverage
➤ Policy adherence	➤ Change facilitator
➤ Budgeted cost centre	➤ Accountability for performance improvement results
➤ Career auditors	➤ Opportunities for other management positions
➤ Methodology: Focus on policies, transactions and compliance	➤ Methodology: Focus on goals, strategies and risk management processes

Table 2.2: The difference between risk based approach and traditional approach

Source: Petter Lovaas. (2009). A comprehensive risk based auditing framework for small and medium sized financial institutions. Dakota state university. p81

2.3.4 Internal Audit Change To Risk Paradigm

The definition of internal auditing according to IIA asks internal auditors to shift their perspective to the underlying business risks. The IIA Performance Standard 2110 requires the Internal Audit function to assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems. (IIA 2014). Internal audit's change from control paradigm to risk paradigm can be summarized as shown below.

Characteristic	Control Paradigm	New Risk Paradigm
➤ Internal audit focus	➤ Internal control	➤ Business risk
➤ Internal audit response	➤ Reactive after the fact, discontinuous observers of strategic planning initiatives	➤ Coactive, real time, continuous monitoring, participants in strategic plans
➤ Risk assessment	➤ Risk factors	➤ Scenario planning
➤ Internal audit tests	➤ Important controls	➤ Important risks
➤ Internal audit methods	➤ Emphasis on the completeness of detail/control testing	➤ Emphasis on the significance of broad business risk covered
➤ Internal audit recommendations	➤ Internal control strengthened cost benefit efficient	➤ Risk management avoid/Diversify risk share/transfer risk control/accept risk
➤ Internal audit reports	➤ Addressing the functional controls	➤ Addressing the process risk
➤ Internal audit role in the organisation	➤ Independent appraisal function	➤ Integrated risk management

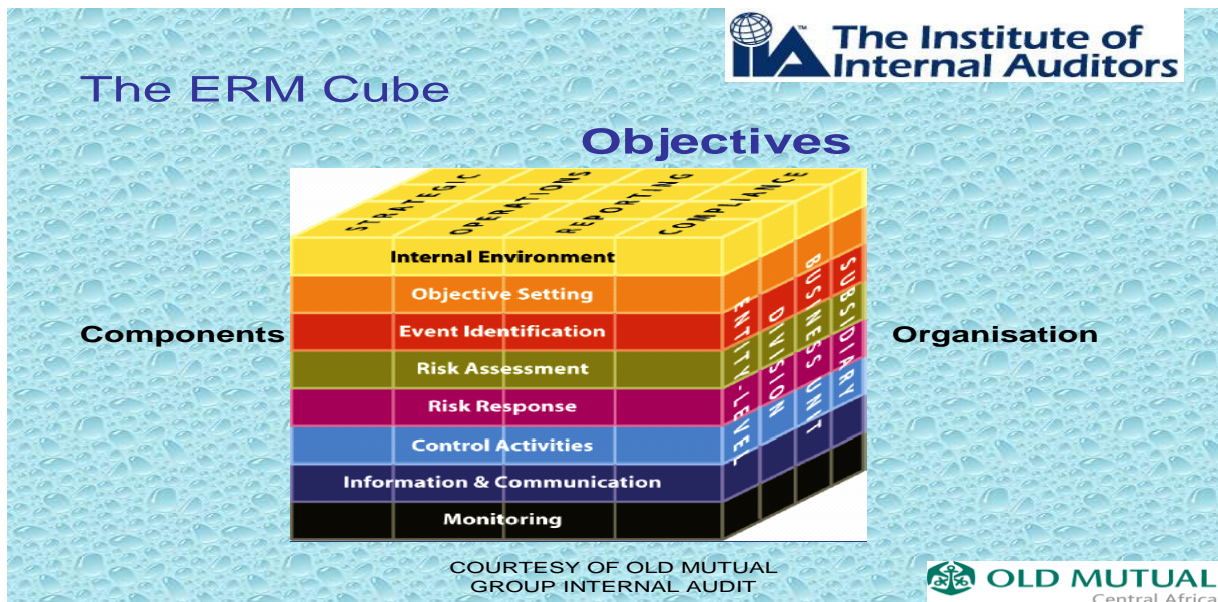
Table 2.3: Internal audit's change from control paradigm to risk paradigm

Source <http://www.mc2consulting.com/riskart8.htm>

2.3.5 The COSO Framework

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2004) released ERM - Integrated Framework to provide organizations with a roadmap for identifying risks, avoiding pitfalls as well as taking advantage of opportunities to grow shareholder value. According to information available online on www.coso.org the framework provides concepts and principles, a common language and elements of a risk management framework, and it provides criteria for entities to use in determining whether their risk management is effective, and if not, what is needed to make it so. The framework has eight components shown in the figure below.

Figure 2.4: The Enterprise Risk Management (ERM) Cube



Source: Institute of Internal Auditors (IIA), (2013)

2.3.6 Risk Based Internal Audit And Risk Management

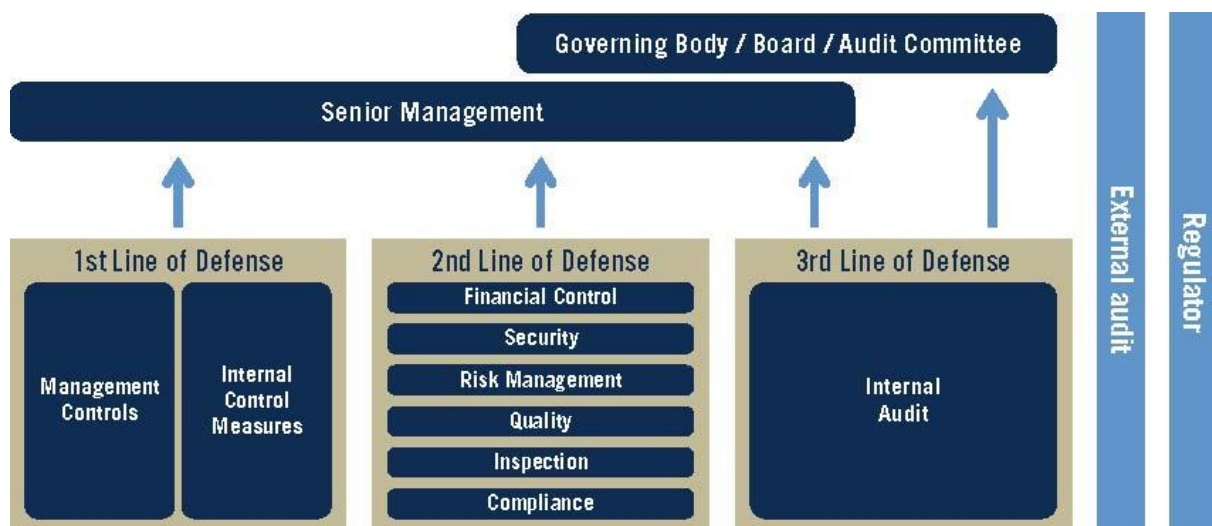
According to the IIA (2014), managers own risks and it is their responsibility to control them. Internal auditing provides an opinion, to management, as to whether risks are properly controlled. Theoretically, since managers own risks, they must ‘manage’ them and that accountability cannot be passed to a third party. Norman Marks (2014) states that management needs to own risk, with risk management serving as facilitator. IIA - UK and Ireland Publication (2004) depicts that internal auditors should give as much assistance provided that managers do not come to regard them as the risk owner.

King III report (2009) has shown that, if risk managers exist, the responsibilities of internal audit and risk management must be clearly defined and communicated within the organisation and both functions should report to different senior managers or directors to reinforce the distinction. Griffiths (2006) states that management will set up a framework to identify, assess and manage risks by appointing risk managers. The role of internal audit activity in risk management is helping to identify and evaluate risks. (IIA 2004). According to Ernst & Young king III final synopsis (2009) the board is ultimately responsible for the governance of risk and is required to approve the risk management policy and plan. Risk tolerance and risk appetite limits should be set and monitored by the board.

2.3.7 The Importance Of Internal Auditing As The Third Line Of Defense In Risk Management

The Three Lines of Defense model, management controls and internal control measures is the first line of defense in risk management, followed by compliance established by management as the second line of defense, and Internal audit is the third line of defense. Each of these three “lines” plays a different role within the organization’s wider governance framework (IIA 2013)

Figure 2.5 The Three Lines Of Defense Model



Source: Adapted from ECIIA/FERMA Guidance on the 8th EU Company Law Directive, article 41) cited in IIA Position Paper (2013)

2.3.8 Coordinating The Three Lines Of Defense

IIA position paper, (2013) documents that because every organization is unique and specific situations vary, there is no one “right” way to coordinate the Three Lines of Defense. When assigning specific duties and coordinating among risk management functions, it can be helpful to keep in mind the underlying role of each group in the risk management process.

FIRST LINE OF DEFENSE	SECOND LINE OF DEFENSE	THIRD LINE OF DEFENSE
Risk Owners/Managers	Risk Control and Compliance	Risk Assurance
Operating management	-limited independence -reports primarily to management	- internal audit - greater independence - reports to governing body

Table 2.4. Summary of the Three Lines of Defense

Source: IIA Position Paper (2013)

Marks (2014) agrees with the concept of distinguishing the roles of management, risk management, and internal audit as having benefits to the organization by enhancing coordination with the different departments of the organization. However, he argues that risk management is not about defense but it’s about management taking the right risks and making informed decisions. He states that defense implies that risk is bad when actually it is not since it can be positive or negative.

2.4 Enhancing The Internal Audit Function

Enhancing and improving the efficiency of the Internal Audit entails addressing the challenges that face the profession. The major challenges facing internal audit units are, lack of resources, lack of sufficient knowledge of their organization’s business strategy and lack of sufficiently skilled staff (Deloitte, IIA U.K & Ireland 2008). The size of the IA team clearly determines the amount of time that internal auditors can dedicate to auditing activities and could this result in rotation of work which will provide more objectiveness. (Zain, Subramaniam and Stewart 2006).

The relationship between the internal audit staff and the organisation’s management is important in determining the independence and objectivity of the internal auditor. Based on

interviews with Australian internal auditors, Van Peurse (2005), concluded that independence from management and objectivity are dominant features of successful auditing programs. Top management support is key to the effectiveness of internal audit as it has been found to be a crucial element in the success of other organizational processes such as organisational change (www.poli.haifa.ac.il/~acohen/docs)

Sarens (2009) suggested that internal audit can be considered effective when the quality of the internal audit function has a positive impact on the quality of corporate governance. He also links internal audit quality to the capacity to monitor internal control processes and improvement in risk management. To improve risk management and internal control processes, the internal auditors have to convince the external auditors about the quality of their work, persuading managers to implement their recommendations. The internal auditors should be given a platform to air their recommendations. (IIA 2014).

Managers and officers have to decide on whether and how to enact internal auditors' recommendations. As highlighted by El-Sayed Ebaid (2011), audit findings and recommendations would not serve much purpose unless management is committed to implement them. Van Gansberghe, (2005) states that implementation of audit recommendations is therefore highly relevant to audit effectiveness.

Internal audit being an activity means that it can be outsourced or co-sourced. Outsourcing and co-sourcing of internal audit services have become wide spread in recent years (Ernst & Young 2006). It has been argued that an outsourced provider may be more objective than an in-house internal audit function as it is difficult for an employee to be truly independent of management (James, 2003).

Internal audit departments can on their own improve the efficiency of their work by taking certain actions. These include rebalancing internal audit objectives and focusing on risk and stakeholder expectations, sharpening dialogue with senior management and the audit committee to support them in risk management, acting as change agents and facilitating positive change. Internal auditors need to be alert to change and the rate at which risks can evolve. (www.protiviti.com)

IIA (2013) position paper report states five strategies that internal audit leaders should adopt for effective risk management and they encompass improving and aligning with stakeholder expectations, assuming a leadership role in coordinating the second and third lines of defense, enhancing internal auditing's capability to address critical strategic business risks, developing and implementing knowledge on talent acquisition strategies and lastly, becoming a trusted advisor to the audit committee and executive management.

2.5 Summary

This chapter was a review of related literature and it assisted the researcher to familiarise himself with both the theoretical and empirical information regarding internal auditing and risk management. The review of the relevant literature guides in the development of a suitable methodology in chapter three.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter presents an overview of the methods or techniques that were utilised in the collection and analysis of data employed by the researcher in conducting the research. It elucidates the methodology used as well as presenting an analysis of the instruments that were used in the data collection and analysis stages. It clarifies the rationale behind the use of the identified methods in order to show that the credibility of research findings is anchored on the appropriateness and reliability of methods used in the data collection and analysis process. It explains the research design as well as the case study method which was used. It presents the sampling procedure as well as the data collection instruments.

3.1 Research Design

Blumberg, Cooper and Schindler (2011), states that research design is the plan and structure of investigation so conceived so as to obtain answers of the research questions. The research design therefore is a plan for the entire research study that gives the framework of the research's plan of action. Research design aids the researcher to gain more knowledge on the study. De Vaus (2001) documents that the purpose of a research design is to make certain that the evidence gained enables the user to answer the initial question as unambiguously as possible. There are three research strategies that can be used in carrying out a research namely; the experiment, case study and survey. This research is based on the case study method.

3.1.1 Descriptive Research

According to Yin (2008) "descriptive research is a type of research method used to describe what was in existence in respect to conditions or variables that were found in a given situation". Wyk (2013) advocates that the main aim of descriptive research is to provide an accurate and valid representation of the factors that pertain to the research questions. The researcher used descriptive research because it portrays accurately the characteristics of a particular individual situation or a group and it includes fact finding enquiries of different kinds. It also gave a detailed, highly accurate picture of the problem on hand as well as the background or context of the problem Descriptive research method was chosen so as to

enhance the whole research process and it was used in conjunction with explanatory/analytical research.

3.1.2 Case Study

According to Robson (2002, p.178) cited in Saunders, Lewis and Thornhill (2009) “a case study is a strategy for doing research which involves an empirical investigation of particular contemporary phenomena within its real life context using multiple sources of evidence”. Creswell (2009) documents that “a case study is a qualitative strategy used by the researcher to explore the depth of a program”. According to information available online on www.docstoc.com/125354600/Research it states that a case study is often used where it represents a critical case or, alternatively, an extreme or unique case. Conversely, a case study may be selected because it is typical or it provides an opportunity to observe and analyse a phenomenon that few have considered before. In this research the case is City of Mutare.

3.2 Qualitative And Quantitative Data

According to Glaser et al (2008) “a case study approach can have a combination of both qualitative and quantitative data from a subsequent survey”.

3.2.1 Quantitative Data

According to Blumberg, Cooper and Schindler (2011), quantitative data refers to all numerical data and other data that could usefully be quantified to help the researcher answer the research questions and to meet the objectives. It is applicable to phenomena that can be expressed in terms of quantities. It is structured in such a way so as to guarantee (as far as possible), objectivity, generalizability and reliability (Bryman and Bell (2003). Here the research is objective and the research results are both numerical and non-numerical. There was questionnaire validation and checking of all returned questionnaires for completeness. Analytical tools that include tables and graphs were used in presenting and summarizing the quantitative aspect of data.

3.2.2 Qualitative Data

Saunders, Lewis and Thornhill (2009) documents that qualitative data refers to all non-numeric data or data that have not been quantified and can be a product of all research strategies. It is any information that can be captured which is not numeric. According to

Kalaian 2008 “Qualitative data gives descriptive specific research in a sensitive, detailed and contextual manner”. The descriptive research had the advantage of using a sample and research instruments like interviews. This research involved a descriptive write-up and presentation of the findings.

3.3 Population

“Population is the full set of cases from which a sample is taken from”. (Saunders, Lewis and Thornhill 2009), thus it is the number of subjects, elements or group of people that one can investigate. Blumberg, Cooper and Schindler (2011) states that it is a group of individuals that have one or more characteristics in common that are of interest to the researcher. The target population is generally the group from which individuals are selected to participate in a study. The target population was made up of all office employees and management of six of the departments at Mutare City Council, namely, Housing, Health, Finance, Town Clerk, City Engineer and Chamber Secretary Department.

Department	Target Population
Finance	13
Chamber Secretary	9
Town Clerk	7
Health	4
City Engineer	4
Housing	3
TOTAL	40

Table 3.1 Research Population

3.3.1 Research Sample

Blumberg, Cooper and Schindler (2011) defines a sample as being a smaller group of the population selected for observation and analysis. Yin (2008) documents it as number of people to be surveyed. Sampling involves the application of tests to less than 100 percent of the total population from which conclusions can be derived. The sample should be representative of the group.

3.3.2 Sampling Techniques: Cluster Sampling

Blumberg, Cooper and Schindler (2011) states that cluster sampling is when you divide the population into discrete groups prior to sampling. The groups can be based on any naturally occurring grouping. For this research, City of Mutare's target population was naturally divided into six clusters, namely, Finance, Chamber Secretary, Town clerk, Health, City Engineer and Housing departments.

After grouping the target population into clusters, purposive sampling was then applied to the clusters. According to Bryman and Bell (2003), Purposive sampling begins with a purpose in mind and the sample is thus selected to include people of interest and disregard those who do not suit the purpose, Purposive sampling came about on the selection of personnel that was based on the researcher's judgment that the relevant information could only be sought from the chosen personnel.

3.3.2.1 Justification For Using Purposive Sampling

The researcher was able to judge the subjects that were representative of the problem being studied as he is familiar with the Local authority and in addition the researcher was able to choose respondents that were knowledgeable about the research. The researcher also faced a strict deadline so by using purposive sampling it enabled saving of time. However, using purposive sampling has its demerits since the sample selected may not be representative of the population and there is potential for sampling bias.

3.3.2.2 The Criteria Used For Inclusion Of A Respondent In The Sample

The participants ought to have been employed by Mutare City Council for more than three years, should have a diploma or a recognised certificate from a recognised educational body, should have come across the activities of the internal audit at some point and lastly they should be willing to take part in the research.

3.3.2.3 Sample Size

According to Yin (2008), sample size is the number of people that should be surveyed. Sample sizes reduce the expenses and time by allowing information about the whole population to be estimated without having to survey each member of the population. Thirty people were selected from six departments with the majority of them coming from the Finance and Chamber Secretary which constitute a greater portion of all office workers at Mutare City Council.

POPULATION STRATUM	SAMPLE	PRIMARY SOURCE
Finance Department	10	Interviews and Questionnaires
Chamber Secretary Department	7	Questionnaires
Town Clerk Department	5	Interviews and Questionnaires
Health Department	3	Questionnaires
City Engineer Department	3	Questionnaires
Housing Department	2	Questionnaires
TOTAL	30	

Table 3.2 Sample Size

3.4 Primary And Secondary Data Sources

3.4.1 Primary Data

According to Wyk (2013), primary data is that data the author assembles in the field specifically for the project. It is data originally collected for the first time for the purpose of the research. The data specifically is for solving the problem at hand and the data collected is ideal for the study. This research analysed Mutare City Council, and therefore management and staff were the sources of primary data. The primary sources of data used for this research were questionnaires and interviews.

3.4.1.1 Benefits Of Using Primary Data

The data that the researcher collected was specific to the current research and therefore it was more accurate in answering the research questions and meeting the objectives of the research. The researcher conducted the research himself and was able to gather first-hand information, which is more clear and straight forward than secondary information.

3.4.1.2 Demerits Of Using Primary Data

It was cumbersome to sort out and arrange the data in order so as to come up with reasonable ideas and conclusions. It was relatively expensive since the researcher had to travel to Mutare City Council to carry out interviews and submit the questionnaires.

3.4.2 Secondary Data

Kumah, (2009) states that secondary data is information that already exists which has been collected for another purpose. In this research part of the data was obtained from readily existing written documents such as management reports, journals and books. These were used to support the findings of the primary data.

3.4.2.1 Benefits Of Using Secondary Data

The data was readily available to the researcher so it was relatively inexpensive. The collection of the data required a lot of reading thereby assisting the researcher in gaining more knowledge pertaining to the research.

3.4.2.2 Demerits Of Using Secondary Data

The information from secondary data was in most cases outdated so the researcher had to put aside part of the information and remain with current relevant information. Some of the information was available but unsuitable for the study.

3.5 Research Instruments

Research instruments are the various methods that have been used during data collection. Kothari (2009) defined research instruments “as devices used to collect data in the form of questionnaires, interview schedules and checklists”. “The instruments items should be very clear, logical and ought to address the research understudy”. The researcher used questionnaires and interviews

3.5.1 Questionnaires

Wyk (2013) defines a questionnaire as a distributed set of questions that can either be mailed or administered. Yin (2008) described a “questionnaire as a set of standardized questions used to collect individual data about a specific topic”. “A questionnaire should include all techniques of data collection in which each person is asked to respond to the same set of questions in a predetermined order” (Saunders, Lewis and Thornhill 2009). The aim of the questionnaire is to gather information from all interested parties and to obtain varied responses that would assist in solving the research problem. In this research, one questionnaire with both open ended and close ended questions was compiled for management, internal audit staff and other employees.

3.5.1.1 Benefits Of Using Questionnaires

It was a relatively cost effective method of collecting information from many people in a short period of time. They allowed respondents time to respond to the research questions since the researcher dropped them at the organisation and picked them after two days. They provided anonymity to respondents thereby enhancing privacy and confidentiality. Accurate and reliable answers were obtained as the absence of the researcher enabled the respondents to give independent answers especially in the case of sensitive answers. Quantifying the questionnaire results was relatively easy to the researcher.

3.5.1.2 Demerits Of Using Questionnaires

The researcher was unable to observe body language such as gestures and facial expressions since the questionnaires were answered in his absence. The researcher received few unambiguous responses that were left unexplained as well as few questionnaires that were half way answered.

3.5.2 Interviews

Saunders, Lewis and Thornhill (2009), define an interview as a purposeful discussion between two or more people. The emphasis is to solicit direct responses from a set of prepared questions. The interview questions were open ended thereby giving room to the interviewee to express his or her opinion on that particular question. This provided the researcher with an opportunity to get more information otherwise not covered by the structured questionnaire. Interview questions were compiled for the internal audit department.

3.5.2.1 Benefits Of Using Interviews

They provided instant feedback to questions asked and the researcher was able to probe for explanations from the respondents thereby enabling clarity and deep understanding. Better data accuracy was generally ensured as the respondents were given an opportunity of giving a direct respond and this allowed the researcher to assess roughly when there was bias or a tendency to deviate from the asked information. Verbal responses or cues were also noted, evaluated and comprehended.

3.5.2.2 Demerits Of Using Interviews

Conducting interviews proved to be time consuming as only one interview was carried at time. It was also relatively expensive as the researcher had to travel to Mutare City Council to conduct the interviews.

3.5.3 Likert Scale

According to LaMarca (2011) he stated that a Likert scale is “an ordinal technique for the measurement of attitudes, beliefs and opinions whereby individuals made decisions on their rank of agreement”. According to Bryman and Bell (2003) the Likert Scale measures the degree of intensity with which respondents feel about an issue. Saunders, Lewis and Thornhill (2009) documents that Likert scales are a non-comparative scaling technique which measures a single trait in nature whereby respondents are asked to indicate their level of agreement with a given statement by way of an ordinal scale. The research was based on a five point scale agreement ranging from strongly agree to strongly disagree.

	Strongly agree	Agree	Unsure	Disagree	Strongly disagree

Table 3.3 Likert scale

Source: LaMarca 2011

3.5.3.1 Advantages Of Likert Scales

Likert scales were simple to construct. They were easily understood by the respondents and completion or filling in the Likert scales was done with ease. There were more effective in measuring feelings and attitudes.

3.5.3.2 Disadvantages Of Likert Scales

Participants avoided extreme response categories like strongly agree and strongly disagree in case of sensitive matters.

3.6 Validity And Reliability

Validity refers to the degree to which an instrument measures what it is supposed to measure, Bryman and Bell (2010) identified that validity was linked with the accuracy and

straightforwardness of findings whereas reliability was connected with consistency of the tool of measuring. In order to make sure that the questions were given to the right respondents the researcher hand delivered the questionnaires. To ensure the validity of the data gathered, the researcher had to analyse data obtained and then measure it against stated research objectives.

3.7 Data Presentation And Analysis

Data collected was analysed so as to check for completeness and accuracy of data responses obtained. The research organized and presented the data using tables, pie charts, bar graphs and percentages were calculated to show the various responses of the respondents for each question. Interview responses were compared, analysed and summarised taking into account points raised by the respondents and conclusions were made from the information gathered.

3.8 Summary

This chapter highlighted on the methodology used by the researcher to collect data. In particular, it looked at the research design, research instruments and data collection procedures. Research instruments strengths and weaknesses were mentioned thereby deducing how valid and reliable the methods were. The following chapter represents an analysis of the data which was collected.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

This chapter presents analysis and interpretations of research findings. Questionnaires and interviews were used as data collection procedures. The views from the targeted respondents were considered and presented in the form of tables and graphs as well as in a qualitative nature. The findings and analysis were directed towards addressing research objectives and answering the research questions.

4.1.1 Questionnaire Response Rate

Questionnaires were sent to a target population of 30 people from different departments of Mutare City Council. A total of 25 questionnaires were obtained from the target population as indicated in the table below.

Respondent Group	Questionnaires Sent	Questionnaires Received	Response Rate (%)
Finance Department	10	9	90
Chamber Secretary Department	7	5	71
Town Clerk Department	5	5	100
Health Department	3	3	100
City Engineer Department	3	3	100
Housing Department	2	0	0
Total	30	25	83

Table 4.1: Questionnaire Response Rate

Questionnaire response rate was 83.33%. The unreturned questionnaires were 5 making up 16.66% of the total questionnaires that were sent out. The unreturned questionnaires were made up of two questionnaires that were misplaced, a single questionnaire that was not filled due to work commitment and two questionnaires from the Housing department. The latter were due to the fact that the department is located relatively far away from the rest of the

departments and the researcher could not manage to collect the questionnaires in time. Nevertheless, the information that the researcher wanted was enough for the research as supported by Nadimias and Frankfort (2008) who clarified that a response rate of more than 70% is acceptable as a representation of the sample.

4.2 Data Presentation And Analysis

The data that was collected was presented and analysed using tables and graphs.

4.2.1 Questionnaires Responses

This was the most used data collection method and it involved the majority of the target population or sample. Each question was analysed separately from the other questions thereby enhancing clarity and understanding of the research findings.

4.2.1.1 Profiling, Monitoring And Risk Addressing

This question was meant to assess whether respondents perceived the internal audit as one that was risk focused by being proactive and also timely in its conduct.

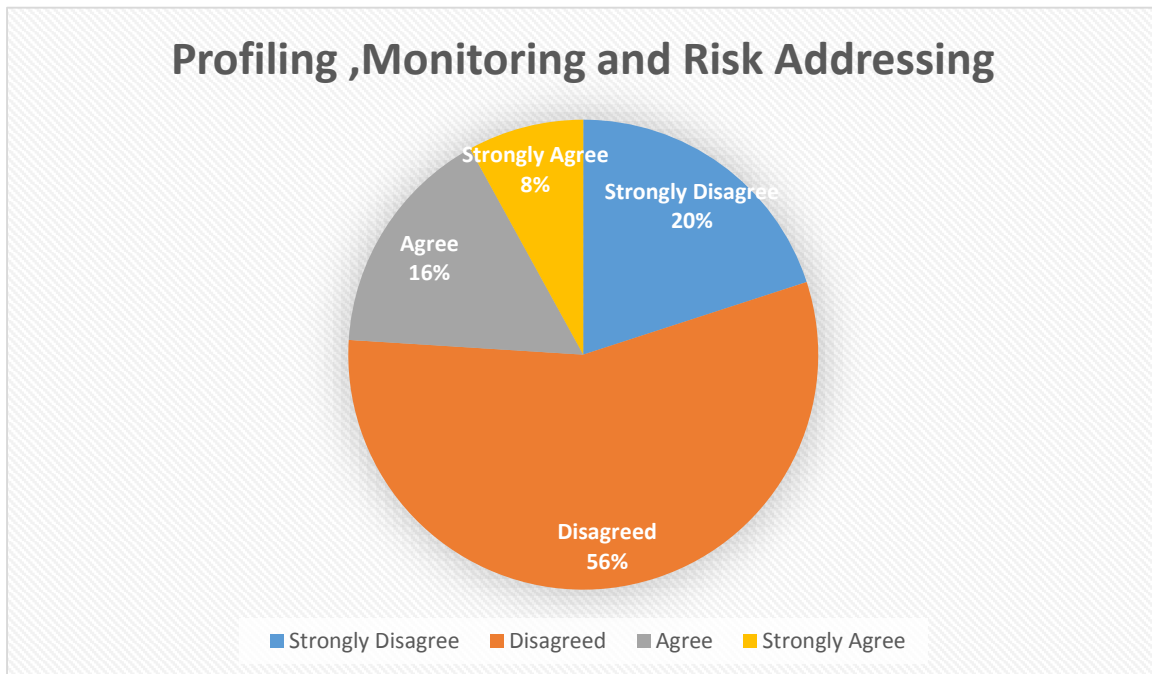


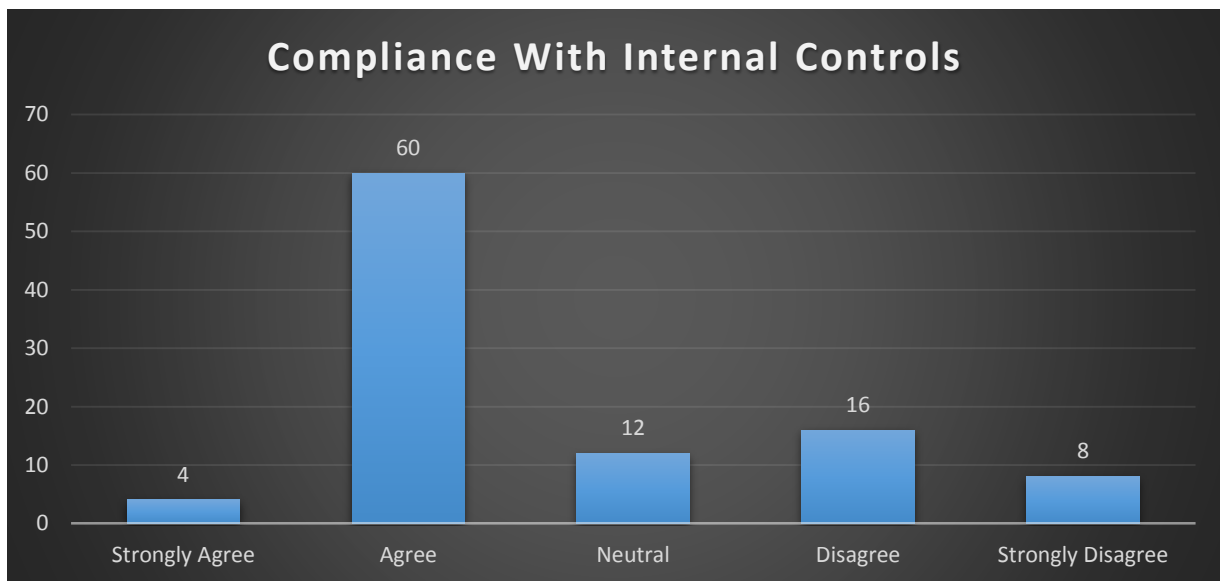
Figure 4.1: Profiling, Monitoring and Risk Addressing

The figure above indicates that 56% disagreed and 20% strongly disagreed giving a total of 76% of the respondents that disagreed that risks were not being profiled, monitored and addressed in time within the organization. The respondents who agreed were 16% and 8% strongly agreed giving a total of 24% of the respondents that agreed. Risk was not being profiled, monitored or addressed in time. HM Treasury (2004) states that by identifying and proactively addressing risk and opportunities business organizations protect and create value for their stakeholders.

4.2.1.2 Compliance Of Internal Controls To Reduce Risks

The objective of this question was to address the degree of compliance of internal controls put in place by management. It focused on whether or not internal controls were being adhered to by all the employees and management.

Figure 4.2 Compliance with internal controls

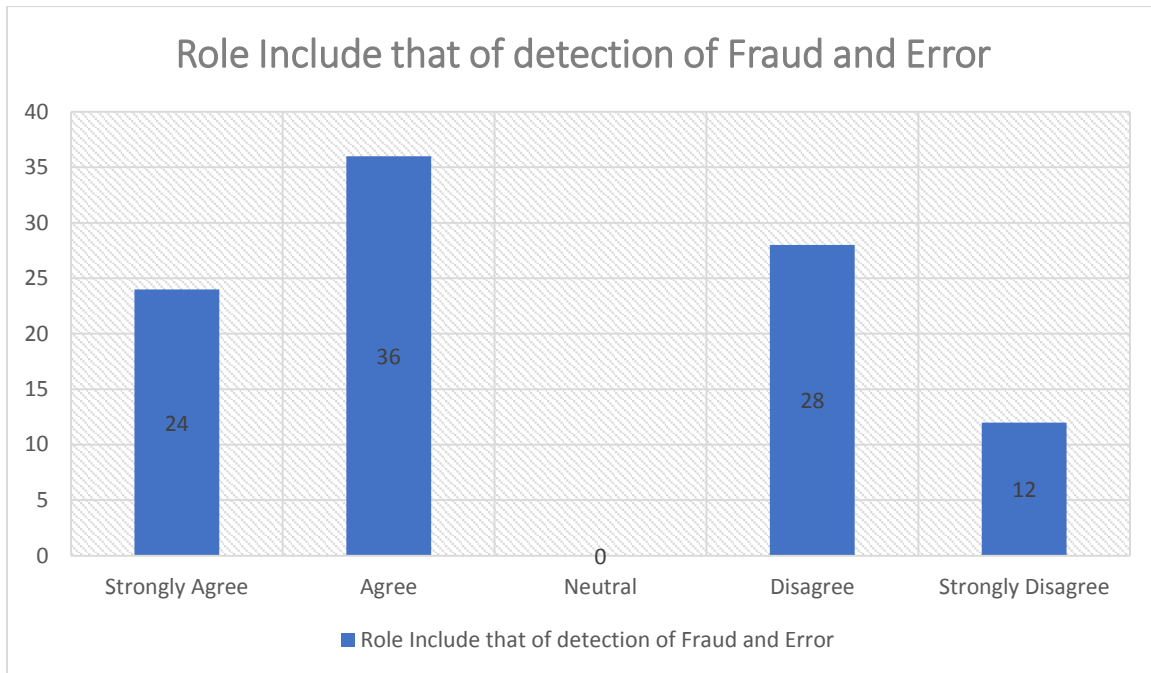


From the data gathered 60% agreed and 4% strongly agreed giving a 64% response that internal controls were being complied with. The respondents that were neutral were 12% whilst 16% disagreed and a further 8% strongly disagreed. There was an indication that internal controls were being complied with. According to Griffiths (2006) compliance is an aspect of traditional audit role that is still very essential today.

4.2.1.3 The Role Of Internal Auditing In Detection Of Fraud And Error

The drive behind this question was to evaluate whether employees and management understood the role of the internal audit function with regard to fraud and error.

Figure 4.3: The Role of the Internal Auditor with Regard to Detection of Fraud and Error

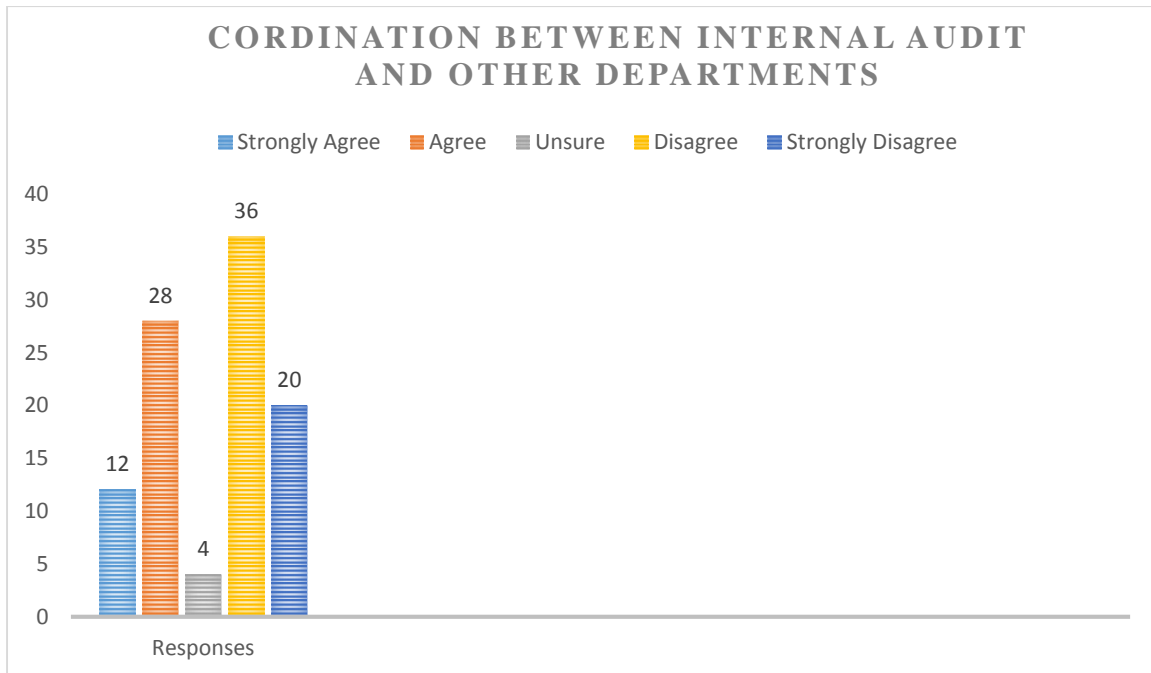


The results showed that 36% agreed whilst 24% strongly agreed with the role of detection of fraud and error. However, there were 12% respondents who strongly disagreed and a further 28% just disagreed. From the results it showed that there were mixed perceptions about the role of internal auditing. A total of 60% agreed thereby showing that the majority of the respondents regard fraud prevention and detection as the role of the internal audit hence showing a gap that exists between the expectations of personnel and what the internal auditors are expected to do. This misconception was highlighted by Barksjo & Mohlin (2005) who state that the critical component of the expectations gap have been found to include auditors fraud detection role and their ability to cope with risk management.

4.2.1.4 Coordination Between The Internal Audit Department And Other Departments

This question aimed at identifying whether there was any coordination or link between the internal audit department and other departments within the council. The aim was to elaborate on the assistance that the internal audit get from other departments when carrying out its routine duties.

Figure 4.4: The coordination between Internal Audit and other departments

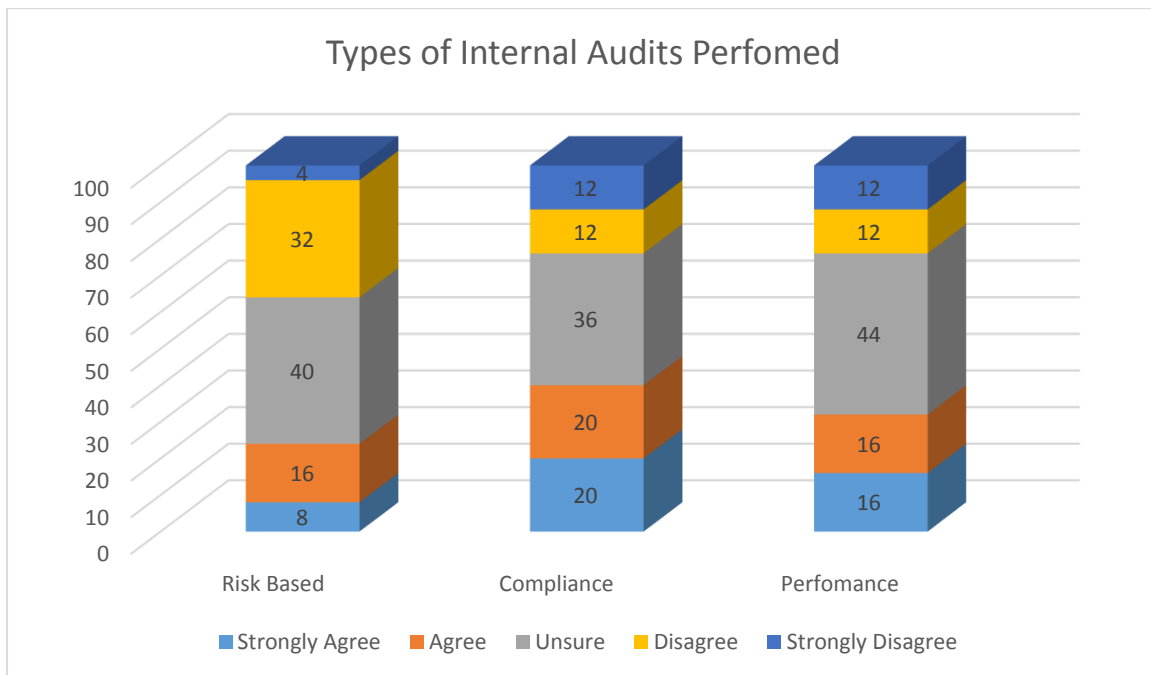


The results show that 12% of the respondents strongly agree and 28% of the respondents just agree giving a total of 40% of the respondents that agree that there was coordination between the internal audit department and the other departments. The respondents that were unsure were 4% whilst 36% disagreed and 20% strongly disagreed with the notion that there was coordination. The results above showed an indication that there was lack of coordination between the departments. Marks (2014) states that coordination brings together all the activities of an organisation leading to the successful achievement of organizational objectives.

4.2.1.5 Types Of Internal Audits Performed In The Organization

The objective of the question was to understand the types of internal audits that were practically performed by the internal audit department. There are many approaches which could be adopted by internal audit depending on the extent to which internal auditors are able to execute their duties on the risk management processes across the organization. (IIA 2014).

Figure 4.5: Types of Internal Audits Performed

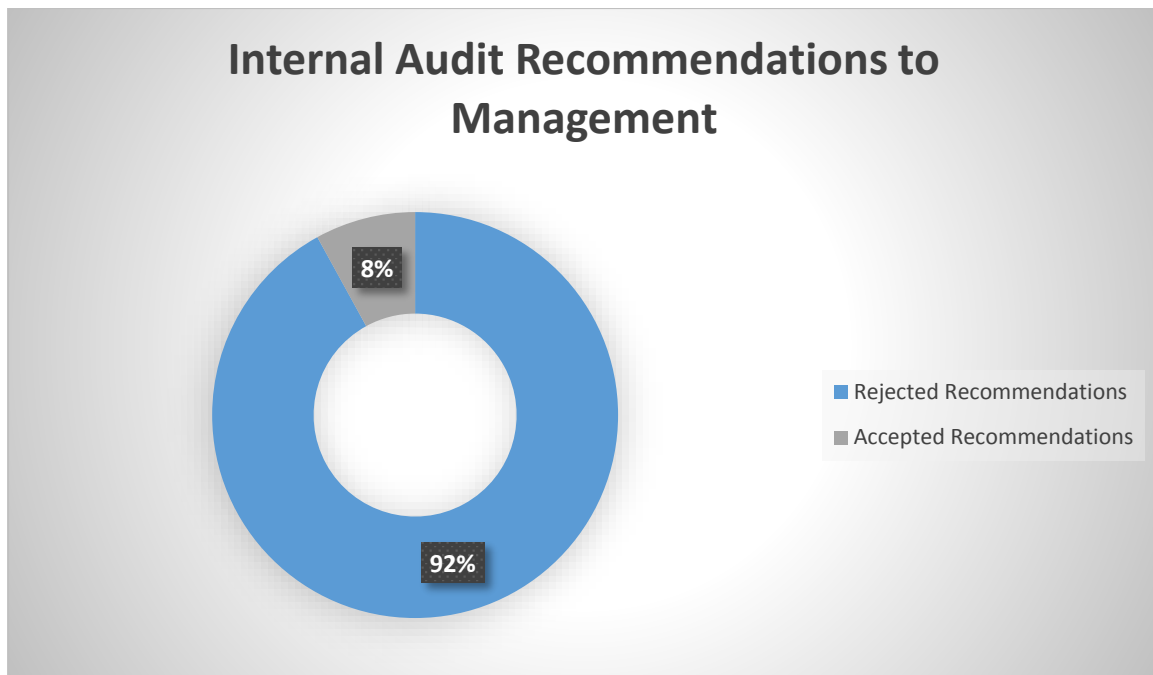


The results indicated above showed that the respondents were unsure about the type of internal audit that was performed. A total of 24% respondent's agreed which was made up of 8% strongly agreeing and 16% just agreeing that it was risk based, whilst a total of 40% indicated that it was compliance based and was made up of 20% whole strongly agreed and a further 20% just agreeing. Performance based was made up of 16% who strongly agree and 16% just agreeing giving a total of 32%. This indicated that compliance was the most performed type followed by performance based and lastly risk based. Griffiths (2006) advocates that there was need to increase risk based internal audits so as to mitigate risk and develop risk management.

4.2.1.6 The Implementation Of Internal Audit Recommendations By Management

The objective of this question was to address the ratio in which management implement recommendations from the internal audit department.

Figure 4.6: Internal Audit Recommendations

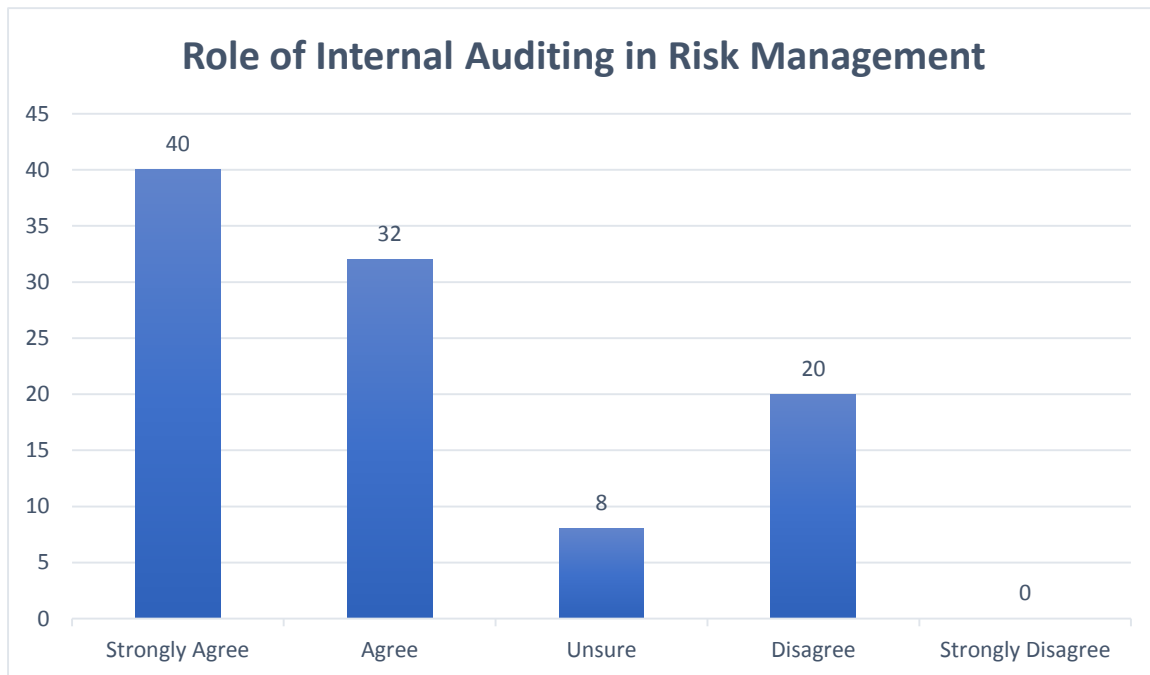


From the results obtained 92% of the recommendations from the internal audit function were not being implemented and only 8% of the recommendations were implemented which is way too insignificant. According to a report by North Tyneside Council (2004, p.2) it documents that “it is best practice for internal auditors to assess the extent to which management have implemented agreed audit recommendations whilst it is managements responsibility to ensure proper consideration is given to internal audit reports”.

4.2.1.7 Internal Auditors Role In Risk Management

This question addressed the role of internal auditors in risk management. It focused on elaborating what the internal audit function is expected to do and what it should not undertake.

Figure 4.7: The Role of Internal Audit in Risk Management

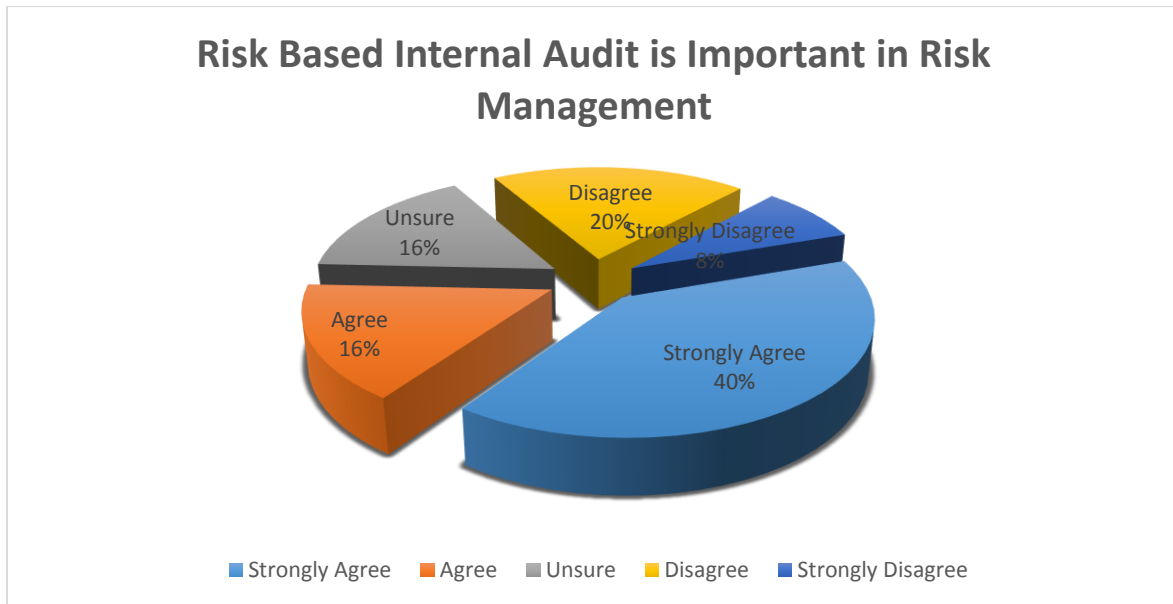


The results indicate that 40% of the respondents strongly agreed and 32% agreed giving 72% of the respondents that agreed that internal audit should provide advice, challenge and support to management’s decision making, as opposed to taking risk management decisions themselves. However 8% were unsure and 20% disagreed with the notion. This means that the respondents knew the role of internal auditing in risk management. IIA (2009) states that internal auditors should not take risk management decisions.

4.2.1.8 The Importance Of Risk Based Internal Audit In Risk Management

The aim of the question was to assess the degree of agreement among the employees and management to the fact that RBIA is pivotal in risk management.

Figure 4.8: The Importance of Risk Based Internal Audit in Risk Management

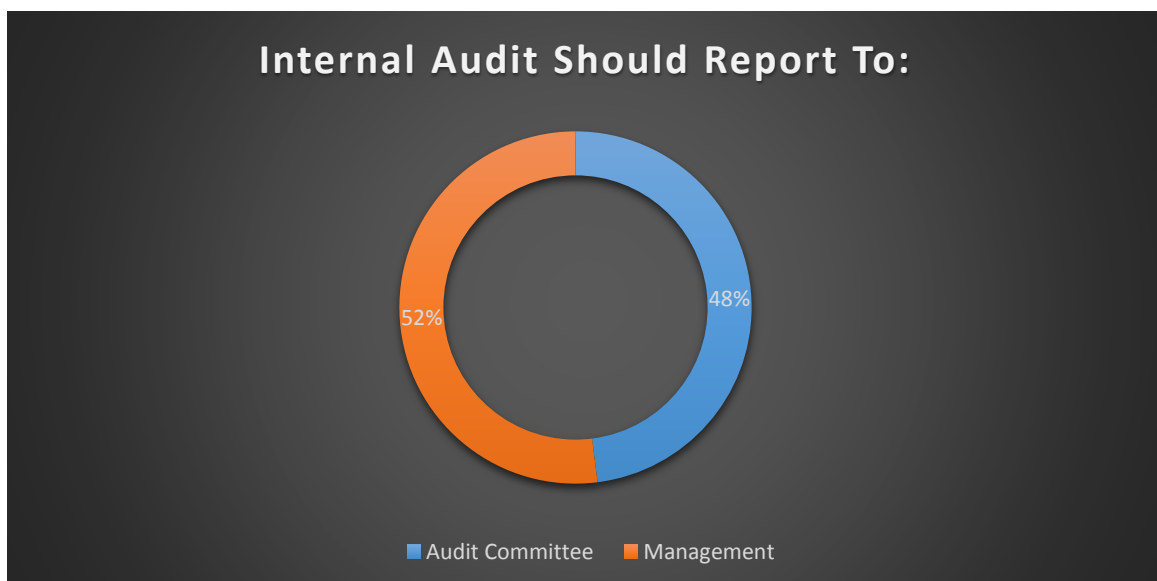


The respondents who agreed were 16% whilst 40% strongly agree and 16% were unsure. There were 20% who disagreed and 8% who strongly disagreed. The results obtained indicated that RBIA is very important in risk management. IIA (2014) recognises RBIA as the methodology that links internal audit to an organization’s overall risk management framework.

4.2.1.9. The Reporting Structure For The Internal Audit

This question assessed the best reporting structure which the internal audit should adopt.

Figure 4.9: The Reporting Structure For The Internal Audit



The results obtained indicated that 52% advocated for the internal audit department to report to management. On the other hand 48% advocated for the internal audit function to report to the audit committee. King III (2009) states that the chief audit executive should report functionally to the audit committee chair and administratively to senior management like the CEO.

4.2.1.10 Factors That Prevent The Internal Audit From Adding Value To The Organization

This question addressed factors that hindered the internal audit function from achieving its objectives and that of the local authority. It aimed at ranking the challenges to see the worst challenge the organization was facing. It sought to investigate the possible principal limiting factors on the scope of the audit department.

4.1.2.10.1 Lack Of Resources

	Strongly Agree	Agree	Unsure	Disagree	Strongly Disagree	Total
Respondents	13	9	1	2	0	25
Percentage	52	36	4	8	0	100

Table 4.2 The Impact Of Lack Of Resources On Adding Value To The Organization

According to the information obtained 52% strongly agreed and 36% agreed giving a total of 88% of personnel that agreed that lack of resources were preventing the internal audit department from carrying out its duties effectively. There were 4% respondents that were unsure whilst 8% disagreed .This means that lack of resources was a factor that was affecting the internal audit department from adding value to the organisation.

4.2.1.10.2 Lack Of Management Support

	Strongly Agree	Agree	Unsure	Disagree	Strongly Disagree	Total
Respondents	7	8	2	5	3	25
Percentage	28	32	8	20	12	100

Table 4.3 The Impact Of Lack Of Management Support On Adding Value To The Organization

The results obtained reviewed that 32% agreed with 28% strongly agreeing to the fact that lack of management support was preventing the internal audit department from achieving its objectives. There were 20% respondents who disagreed and a further 12% strongly disagreed whilst 8% were unsure about the fact that lack of management support was a factor affecting the internal audit. Lack of management support is a factor that hinders the internal audit department from adding value to the organisation.

4.2.1.10.3 Lack Of Qualified Skilled Personnel

	Strongly Agree	Agree	Unsure	Disagree	Strongly Disagree	Total
Respondents	0	2	5	12	6	25
Percentage	0	8	20	48	24	100

Table 4.4 The Impact Of Lack Of Qualified Skilled Personnel On Adding Value To The Organization

The results showed that the majority of the respondents disagreed with the notion that lack of skilled personnel was a factor that was hindering the internal audit. A total of 72% disagreed which was made up of 24% who were strongly disagreeing and 48% just disagreeing. Unsure respondents were 20% and there were only 8% who agreed that lack of qualified skilled personnel was a factor affecting the internal audit from adding value to the local authority. This indicates that lack of qualified skilled personnel was not a factor that was affecting the internal audit department.

4.2.1.10.4 Lack Of Independence

	Strongly Agree	Agree	Unsure	Disagree	Strongly Disagree	Total
Respondents	10	6	3	4	2	25
Percentage	40	24	12	16	8	100

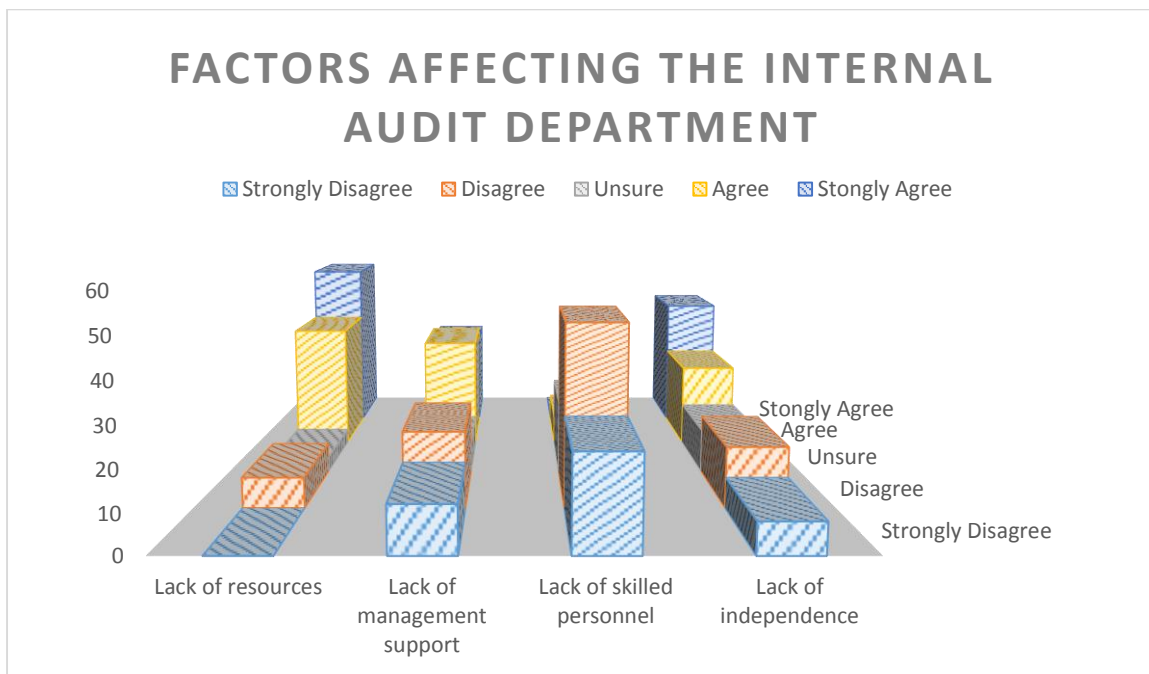
Table 4.5 The Impact Of Lack Of Independence On Adding Value To The Organization

According to the results 40% strongly disagreed and 24% agreed giving a total of 64% agreeing with the notion that lack of independence was a factor that was affecting the internal audit department. 12% were unsure with 20% disagreeing and 12% strongly disagreeing with

the notion. Therefore, lack of independence was a factor that was affecting the internal audit department from adding value to the local authority. Fraser and Henry (2008) documents that lack of independence of the internal audit is a major challenge to their operations.

The results indicated that lack of resources was considered as the worst challenge affecting the internal audit department followed by lack of management support and then lack of independence. Lack of qualified skilled personnel is not a factor that is affecting the internal audit department from adding value to the local authority. The following summarises the factors affecting the internal audit department.

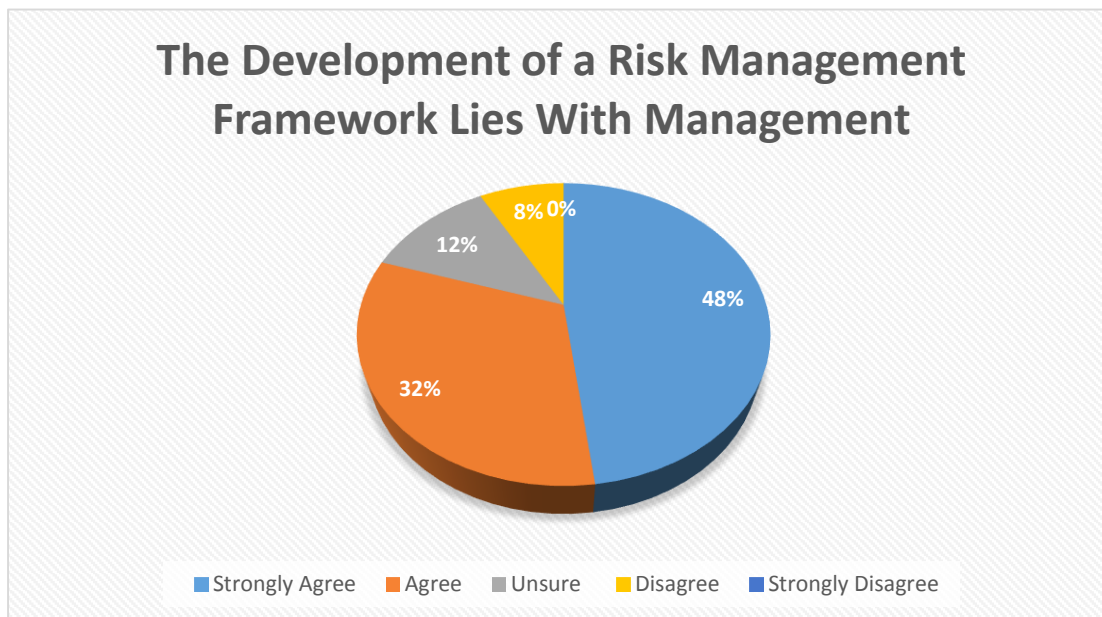
Figure 4.10: Factors Affecting the Internal Audit Department



4.2.1.11 The Role Of Management Developing A Risk Management Framework

This question aimed at finding out who is vested with the responsibility of developing the risk management framework. It also aimed at establishing whether management understood that risk management is their primary responsibility and is not of the internal audit function.

Figure 4.11: Managements Responsibility With Regard To The Development Of A Risk Management Framework.

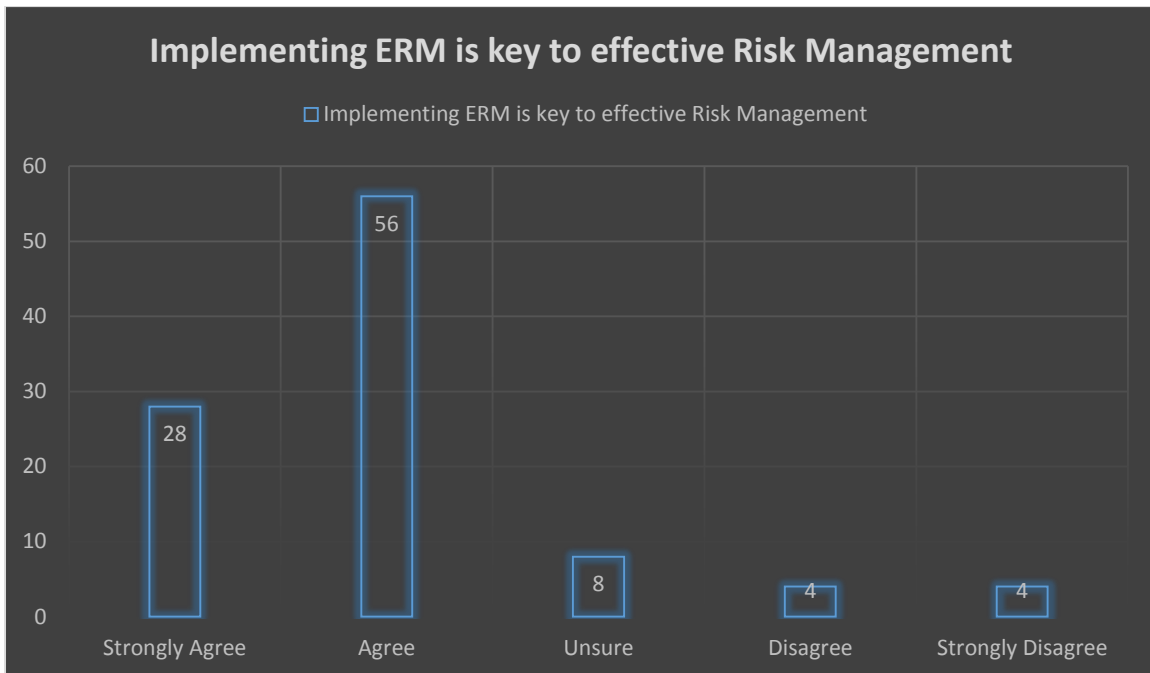


The results indicated that 48% of the respondents strongly agreed and 32% agreed whilst 8% disagreed and 12% were unsure. A total of 80% agreed that the responsibility lies with management and they are the ones responsible to properly identify and manage risk as well as setting the risk appetite of the organisation. According to Aksay and Bozkus (2012), risk management is the primary responsibility of management and the board whilst internal audit is responsible for monitoring, assessing and reporting the effectiveness of conducting risk management in an organisation.

4.2.1.12. Implementing Enterprise Risk Management Is Key To Effective Risk Management

This question aimed at finding out what the employees and management regard as best practice in risk management.

Figure 4.12: Implementing ERM is key to effective Risk Management

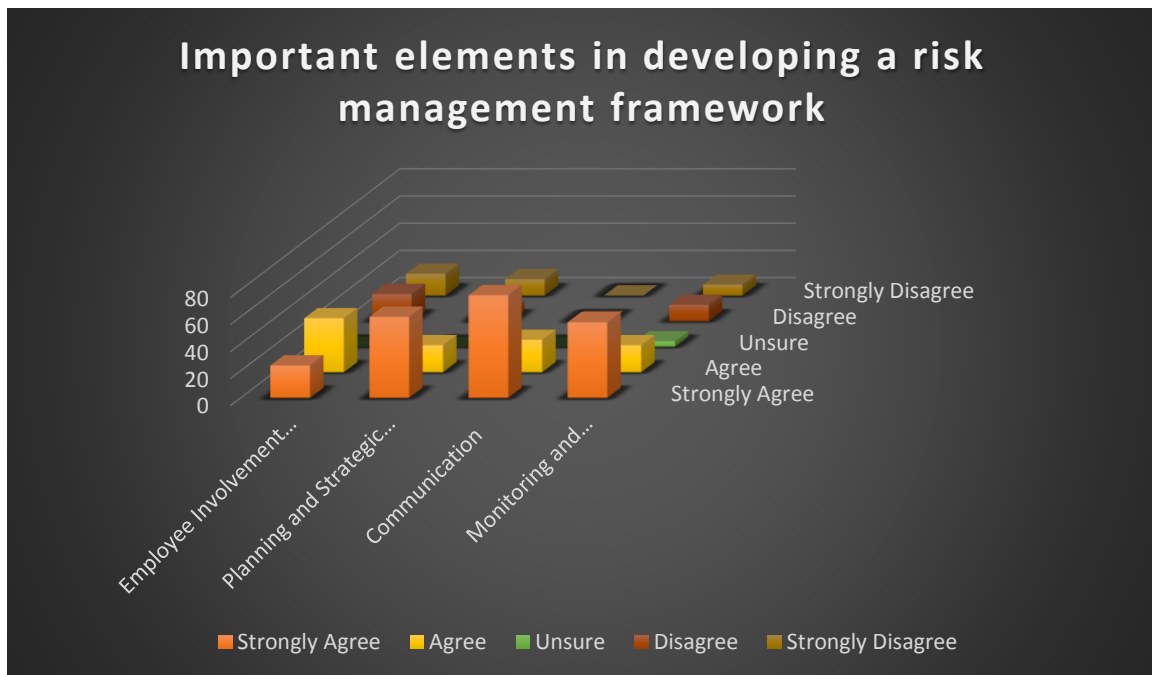


The results showed that 56% agreed and 28% strongly agreed thereby giving a total of 84% of the respondents that agreed that implementing ERM is key to effective risk management. A total of 8% respondents disagreed and was made up of 4% strongly disagreeing and another 4% just disagreeing. The respondents who were unsure were 8%. From the findings gathered ERM is essential and effective in risk management. IIA (2009) documents that ERM is the way to go as it ensures that risks are evaluated, avoided or mitigated and since risk can be positive it also ensures that opportunities are seized.

4.2.1.13. The Important Elements Of A Risk Management Framework.

The question aimed at ranking and addressing some of the elements that are involved in the development of a risk management framework.

Figure 4.13: Essential elements in developing a risk management framework.

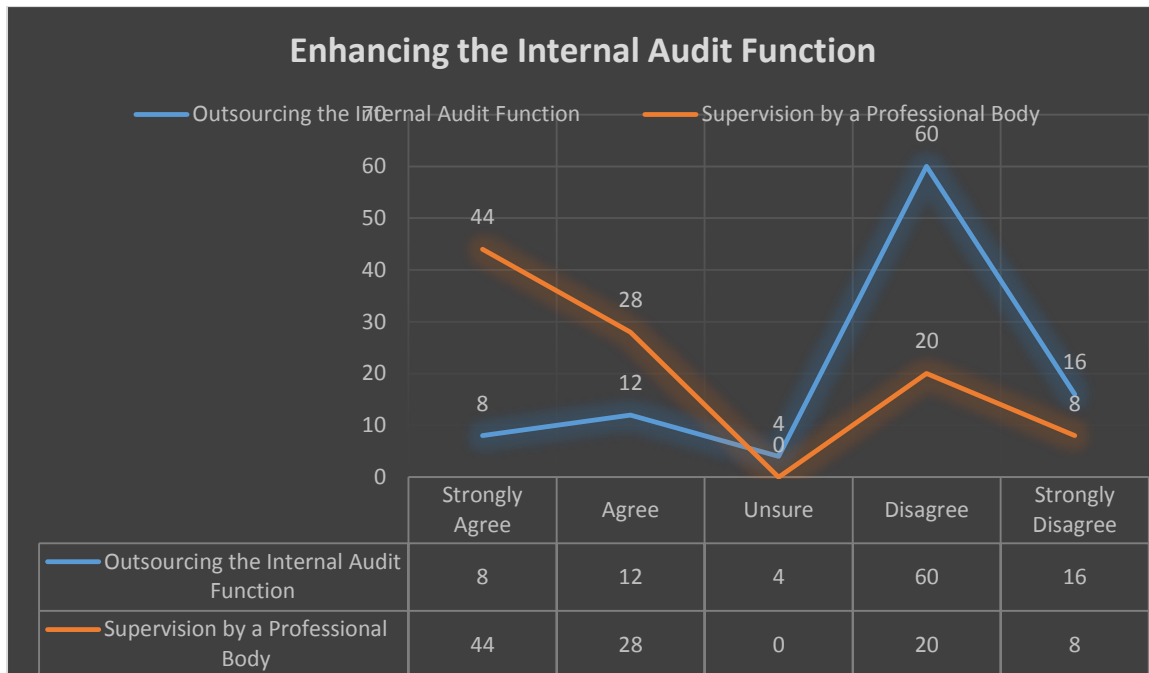


The results obtained indicated that all the elements are important in formulation of an effective risk management framework. These elements can be ranked as follows, first is Communication with 76% who strongly agreed whilst 24% agreed, followed by planning with 52% who strongly agreed and 28% agreed whilst 12% strongly disagreed and 8% disagreed. Monitoring was ranked third with 56% who strongly agreed and 20% agreed whilst 12% disagreed and 8% strongly disagreed. Employee involvement was ranked fourth with 24% who strongly agreed and 40% agreed whilst 16% strongly disagreed and 20% disagreed. The COSO framework (2004) has eight components which are important and they include internal environment, objective setting, event identification, risk assessment, risk response, information and communication and monitoring.

4.2.1.14. Enhancing The Effectiveness Of The Internal Audit Function In Risk Management

This question addressed ways that can improve the effectiveness of the internal audit function. Only two ways were addressed which are outsourcing and supervision by a professional body.

Figure 4.14: Enhancing the Internal Audit Function



4.2.1.14.1. Outsourcing The Internal Audit Function

This question assessed whether outsourcing the internal audit function is better than having one within the organization. The respondents who strongly disagreed were 16% those who disagreed were 60% with the notion that outsourcing enhances the effectiveness of the internal audit function. There were 12% respondents who agreed and 8% who strongly agreed whilst 4% were unsure. According to the information gathered from the respondents outsourcing will not enhance the efficiency of the internal audit department. Ernst & Young LLP (2010) states that outsourcing has been regarded as a panacea to the challenges faced by internal auditing.

4.2.1.14.2. Supervision From A Professional Body

The objective of the question aimed at ascertaining whether supervision by a professional body was key to the effectiveness of the internal audit function. There were 44% who strongly agreed and 28% who agreed with the notion. However, 20% disagreed and 8% strongly disagreed with the notion. The evidence gathered indicated that the employees and management are in consensus with the notion that supervision by a professional body would enhance the effectiveness of the internal audit function. IIA (2013) advocates that being a member or an affiliate of a professional body ensures that the internal audit function keep abreast with the dynamic environment of the profession.

4.3 Interview Response Rate

The researcher managed to conduct three interviews out of the four scheduled interviews thereby, representing a response success rate of 75%. The targeted interviewees were the Town Clerk, the Finance Director, the Chief Internal Auditor and one internal audit staff member. The Researcher was not able to carry out the interview with the Town Clerk as he was very busy. Howards (2008) states that a response rate of 75% or more is regarded as a representation of the sample.

Targeted interviews	Conducted Interviews	Success Rate
4	3	75%

Table 4.6 Interview response rate

4.3.1. Existence Of A Risk Management Framework

The question aimed at finding out the existence of a risk management framework. The respondents all agreed that they have a risk management framework which was designed by management to mitigate all risks that face the local authority. They elaborated that the risk management framework include the management policy, plans and the objectives of the local authority. This view is shared by respondents on questionnaire 4.11 with 48% strongly agreeing and 32% agreeing that management had greater primary responsibility for developing the risk management framework The Societies of Actuaries in Ireland (2011) states that an effective risk management framework needs to capture the interaction between many risk-related activities within the organisation.

4.3.2 The Responsibility For Setting The Risk Appetite

This question objective was to address the responsibility vested in the organisation in terms of setting the risk appetite. All the respondents made it clear that the management were responsible for setting the risk appetite before presenting it to the board for approval .They also elaborated that it was not the role of the internal audit to set the risk appetite. This view is shared by respondents on questionnaire 4.7 with 40% strongly agreeing and 32% agreeing that setting the risk appetite is the role of management. HM Treasury (2004) advocates that risk appetite is key to achieving effective risk management and it is important to consider it prior to addressing risks.

4.3.3 Significant Roles Played By Internal Audit In Risk Management

There were two respondents that agreed that the internal audit plays a significant role in risk management and is responsible for providing assurance that risk management and controls are functioning properly. They pointed out that the internal audit have a stronger understanding of risk management and can informally provide consulting services to management regarding risk management processes and practices. This is in line with the result from questionnaire 4.2 which had 60% of the respondents agreeing that there was compliance with internal controls. IIA Global Internal Audit Survey (2010) cited in IIARF (2011) documents that 57% of internal audit around the world perform audits in ERM processes.

However, one respondent disagreed with the notion citing that internal auditors do provide a role in risk management but the role they play is not very significant since most of them are not confident enough to provide specific assurance and recommendations to management. This view is shared by questionnaire 4.1 in which 56% of the respondents indicated that risks are not being monitored, profiled or timely addressed.

4.3.4 The Effectiveness Of The Internal Audit As The 3rd Line Of Defense In Risk Management

Two respondents concurred that the internal audit is effective as the third line of defense since it enjoys the highest level of independence and objective by reporting functionally to the audit committee and administratively to senior management. IIA (2013) advocates that for the internal audit to be effective it needs to have a high element of independence. However, the questionnaires response on 4.10 indicated that there was lack of independence of the internal audit function with 40% of the respondents strongly agreeing and 24% just agreeing that it is a factor.

The other respondent disagreed that the internal audit is effective as the third line of defense as he advocated that it depends significantly on the other two lines of defense and each line of defense should be supported by appropriate policies and defined roles for it to be effective and efficient. Marks (2014) argues that risk management is not about defense but it's about management taking the right risks and making informed decisions. He states that defense implies that risk is bad when actually it is not since it can be positive or negative.

4.3.5 The Major Factors That Hinder Internal Audit From Adding Value To The Organization

The respondents sighted lack of resources as the major challenge that the internal auditing is facing. They sighted lack of internal audit software as well as the lack of adequate staff members. Lack of management support was also included as a factor that is hindering the internal audit function from adding value to the organization. This view is shared by questionnaire 4.10 with 52% strongly agreeing and 36% agreeing and thereby determining lack of resources as the major factor affecting the internal audit followed by lack of management support with 28% strongly agreeing and 32% agreeing. Savcuk (2007) advocated that internal audit can only add value to an organization if it is effective.

4.3.6. The Best Way To Improve Internal Audit Effectiveness

The respondents advocated for the full implementation of Enterprise Risk Management. This is in line with questionnaire 4.12 which resulted in 84% of the respondents agreeing that implementing ERM is key to effective risk management. They also pointed out that increasing risk based auditing will also enhance the internal audit effectiveness. Griffiths (2006) believes risk based internal auditing is ideal for improving the effectiveness of internal audit.

4.4 Secondary Data Review And Analysis

Secondary data was also reviewed and analysed as a source of data collection. The council is facing operational risk as shown by the human resource report dated 18 June 2013 which indicated that the employees were owed amounts up to \$3 million in unpaid wages and salaries. By September 2014 the unpaid wages and salaries had increased to over \$3 050 000. (HRM Report 5 September 2014).

4.5 Summary

This chapter looked at the research findings, data analysis and presentation. Findings revealed in this research have been clearly presented in the form of graphs and tables, interpreted and analysed. The next chapter addresses summaries of the research project as well as conclusions and recommendations.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.0 Introduction

The previous chapter focused on the presentation and analysis of data from the research carried out. This chapter seeks to attach meaning to the data presented in chapter four. Thus having discussed the findings *vis-à-vis* the research questions, it will draw conclusions from the study and will make recommendations based on the findings.

5.1 Summaries Of Chapters

The objective of the research was to investigate the efficiency of the internal audit in risk management. Chapter one introduced the brief overview of aspects to be covered and the research framework. It further outlined the statement of the problem and gave an account of the background of the study using City of Mutare as the case study. It revealed the research objectives and the importance of the study. Research questions were raised from the research objectives and answered by the results of the study.

Chapter two covered the review of literature regarding the research objectives as well as the research topic. The review provided an insight to the roles of internal auditing in risk management as well as the development of the internal audit profession. It covered a detailed investigation of the factors that affect the internal auditing from adding value to the organization. It looked at internal auditing in risk management as well as the risk management framework, risk based internal auditing and the three lines of defense. The chapter mainly focused on the stated main research question and the sub-research questions.

Chapter three highlighted on the methods or techniques that were used in conducting the research. It focused on the research design, data sources and justified the use of the identified methods. Purposive sampling was considered and justified. Consideration was done of the strengths and weaknesses of research instruments that were employed during the primary data collection process. Questionnaires were the main data collection method used and was complimented by interviews. The Likert Scale was used in the questionnaires thereby measuring the respondents' attitude regarding the questionnaires.

Chapter four centred on the analysis of the data gathered during the research. Every questionnaire response was analysed separately and presented graphically using tables, graphs and pie charts for easier interpretation. Summaries and analysis were provided on the results obtained from the three interviews conducted. Secondary data was used to compliment or support the research findings.

5.2 Overview Of Major Findings

5.2.1 The Role Played By Internal Auditing In Risk Management.

Internal auditing has many roles that it undertakes that are significant in risk management. There are roles that the internal auditors should fulfil for instance giving assurance that the risks are correctly evaluated, evaluating the reporting of risks and coordinating ERM activities. There are also roles that the internal auditors should not fulfil for instance taking decisions on risk responses, setting the risk appetite and accountability of risk management. Internal auditors' role regarding detection of fraud and error is misunderstood by the other employees and management thereby creating the expectation gap than what the internal auditors are required to do.

5.2.2 Factors That Prevents Internal Auditing From Adding Value To The Organization.

They are many factors that hinder the internal audit department from adding value to the local authority. The major factor that the internal audit is facing is lack of resources especially internal audit software's and labour. The lack of the internal audit software and labour leads failure to meet deadlines as well as provision of substandard work. Other factors that are also evident include the lack of management support and lack of independence of the internal audit function.

5.2.3 Risk Management By The Internal Audit

The organization has a risk management framework but it is not yet fully implemented or operational. Risk based internal auditing is being practiced on a low scale. Internal controls are in place and are being followed by employees and management. Risks are not being profiled, monitored or addressed in time.

5.3.4 The Elements That Make Up An Effective Risk Management System

The elements that make up an effective risk management include communication of risk, planning and strategic alignment of risks, monitoring and continuous improvement of processes and employee involvement and empowerment.

5.3.5 Ways That Improve Internal Audit Effectiveness

The internal audit department can enhance its value through many ways that include fully practising risk based internal auditing, supervision by a professional body and fully implementing enterprise risk management. It was also noted that reporting to the audit committee is bringing is ineffective as the audit committee is made up of councillors who are politicians and have little expertise regarding auditing in general.

5.3.6 Conclusion

The major objective was to investigate the efficiency of the internal audit in risk management. It also included identifying ways to improve the internal audit in risk management so as to enhance its value in the organization. The research was successful as it managed to address these issues.

5.4 Recommendations

5.4.1 Profiling, Monitoring And Addressing Risk

Risks should be profiled, monitored and addressed in time as this reduces the overall risk of the local authority. The internal audit should also have a risk register whereby all risks pertaining to the local authority are documented. The local authority should develop a risk assessment process that will help identify and mitigate risks easily. Risk tolerance and risk appetite should be set by management. The Institute of Risk Management (2014) advocates that understanding, evaluating and addressing risks maximises the chances of objectives being achieved.

5.4.2 Clear Communication Of Role

The role of the internal audit department should be clearly communicated within the organization. Training of employees or seminars should be carried to educate the employees

of the roles of the internal audit in risk management. The Chief Internal Auditor may be required to 'sell' the concept and the need for internal audit. The internal auditors should know what they are expected to perform or do within an organization and the employees and management should be well aware of the roles and expectations of the internal audit department. IIA (2009) documents the roles of internal audit in risk management.

5.4.3 Enhancing The Competency Of The Audit Committee

The composition of the audit committee should be made up of at least one member having knowledge in accounting or auditing. They should desist from selecting audit committee members using only political basis but they should select using the basis of performance and competency. King III (2009) advocates that the audit committee members should keep themselves current with key developments in financial reporting.

5.4.4 Reporting Structure That Enhances Independence

The Chief Internal auditor should report administratively to senior management and functionally to the audit committee. (King III 2009). This will ensure that the internal audit function is free from influence and can exercise objectivity in carrying out its duties. Independence of the audit function is an important aspect in risk management. Peurseem (2005) states that independence from management and objectivity are dominant features of successful auditing programs.

5.4.5 Co - Sourcing

The management should consider co-sourcing the internal audit function as a means of countering the adverse effects of the inadequacy of resources. Lack of resources is the major obstacle preventing the Internal Audit Function from being efficient. The local authority will enjoy the benefits of audit software, greater independence and qualified and skilled personnel. Ernst & Young (2010) states that co- sourcing improves efficiency and reduces audit related costs.

5.4.6 Membership To A Professional Body

The internal audit should be an affiliate or a member of a professional body like the IIA or the Institute Of Risk Management thereby enhancing their effectiveness. The internal audit division should try to implement the requirements of the IIA so that they can upgrade the

internal audit function. It should adopt internal auditing standards and work within guidelines provided for the profession. According to information available on www.provit.org membership to a professional body is vital as it helps the internal audit function to keep abreast with the dynamic profession.

5.4.7 Gaining Management Support

Internal Audit need to be able to demonstrate its willingness to add value and work with management. An excellent way to do so is to offer advice on key systems under development. Internal audit can gain management support by being proactive in carrying out its duties. The internal audit can be seen as proactive when it plans ahead of time whereby it saves the organization from impending risks and by so doing the reputation of the function will be enhanced. Indeed the key issue in terms of risk-based audit role in risk management is to look forward not back. No credit will be gained for critiquing the past when management are facing challenges of the future. Sarens (2009) suggested that internal audit can be considered effective when the quality of the internal audit function has a positive impact on corporate governance.

5.4.8 Implementing ERM

The local authority needs to implement enterprise risk management as it assesses, controls, exploits and monitors risks from all sources for the sake of achieving the organizational objectives. ERM is not industry specific therefore it can suit the local authority. ERM is a continuous process designed to mitigate risk and add value to the local authority. Risk based internal auditing (RBIA) is an integral part of ERM. RBIA will ensure that risks are being managed and assures that the residual risk falls within appropriate levels which is the risk appetite of the local authority. According to Dickinson (2010) the highest level of risk that an organization faces is failure to achieve its objectives.

5.4.9 Implementation Of Internal Audit Recommendations

For all material findings and recommendations, there should be in place an agreed and authorized course of action that shows accountability, responsibility and the time frame for implementation to ensure that internal audit work is relevant and effective. Ebaid (2011) advocates that audit findings and recommendations would not serve much purpose unless management is committed to implement them. Follow ups should be done by the internal

audit department and reports on these follow ups made and submitted to senior management and the audit committee. Gansberghe (2005) states that implementation of audit recommendations is highly relevant to audit effectiveness.

5.5 Suggested Areas For Further Study

There are vast developments in the way organizations operate as most organizations are shifting from manual basis to automated processes that involve complex computer systems. There is need to further research in improving internal audit processes using information technology. Further research can be conducted in Computer Aided Auditing Techniques (CAATS).

APPENDIX A



Midlands State University
Faculty of Commerce
Department of Accounting
P Bag 9055
Gweru

15 September 2014

The Finance Director
City of Mutare
P O Box 910
Mutare

REF: APPLICATION FOR PERMISSION TO CARRY OUT RESEARCH AT YOUR ORGANISATION

My name is Dwright Matenhese a student at Midlands State University. I do hereby seek approval for permission to carry out a research, entitled “**An investigation on the efficiency of internal auditing in risk management: A case of City of Mutare**”. The research is a requirement in fulfilling the Bachelor of Commerce Accounting Honours Degree at Midlands State University. The information obtained in the research will be used for academic purposes only and will be treated with strict confidentiality.

I am looking forward to a favourable reply.

Yours faithfully

Dwright Matenhese

APPENDIX B

My name is Dwright Matenhese and I am a student at Midlands State University pursuing a degree in Accounting. I am undertaking this research in partial fulfilment of my degree. Kindly assist by answering the questions below. Your cooperation and contribution in answering this questionnaire is highly appreciated. Information regarding this research will be treated with strict confidentiality and will be used for academic purposes only.

Instructions

Answer all questions

Indicate your response by ticking in the appropriate box

1. Are risks in your organisation being adequately profiled, monitored and timely addressed?

Strongly Agree Agree Unsure Disagree Strongly Disagree

2. Are Internal controls being complied with in order to reduce risks within the organization?

Strongly Agree Agree Unsure Disagree Strongly Disagree

3. In your opinion does the role of internal auditing include that of detection of fraud and error?

Strongly Agree Agree Unsure Disagree Strongly Disagree

4. Is there enough coordination between the internal audit department and other departments within the organization when it is carrying out its duties?

Strongly Agree Agree Unsure Disagree Strongly Disagree

5. What types of internal audits do you perform in your organization?

Type	Strongly Agree	Agree	Unsure	Disagree	Strongly Disagree
Risk Based					
Performance Based					
Compliance Based					

6. The majority of the issues identified and highlighted by the Internal Audit Function are considered and implemented by management?

Strongly Agree Agree Unsure Disagree Strongly Disagree

7. Internal audit should provide advice, challenge and support to management's decision making, as opposed to taking risk management decisions themselves?

Strongly Agree Agree Unsure Disagree Strongly Disagree

8. Risk based internal audit is an important element of risk management?

Strongly Agree Agree Unsure Disagree Strongly Disagree

9. Internal Audit should report to

	Strongly Disagree	Agree	Unsure	Disagree	Strongly Disagree
Management					
Audit Committee					

10. Internal Audit is prevented from adding value by:

Factors	Strongly Agree	Agree	Unsure	Disagree	Strongly Disagree
Lack of resources					
Lack of management Support					
Lack of skilled personnel					
Lack of independence					

11. Management has greater and primary responsibility over the development of Risk management framework?

Strongly Agree Agree Unsure Disagree Strongly Disagree

12. Implementing Enterprise Risk Management is key to effective risk management?

Strongly Agree Agree Unsure Disagree Strongly Disagree

13. The important elements of a risk management framework are

Element	Strongly Agree	Agree	Unsure	Disagree	Strongly Disagree
Employee involvement and empowerment					
Planning and strategic alignment					
Performance and appraisal					
Communication					
Monitoring and continuous improvement					

14. Do the following enhance the effectiveness of the internal audit function in risk management?

	Strongly Agree	Agree	Unsure	Disagree	Strongly Disagree
Outsourcing					
Supervision by a Professional body					

End of Questionnaire

Thank You Very Much

APPENDIX C

Interview Questions for Management and Internal Audit Staff

1. Does your organisation have a risk management framework?
2. Who is responsible for setting the risk appetite in your organisation?
3. In your opinion does the internal audit play a significant role in risk management?
4. Is the internal audit effective as the 3rd line of defense in risk management?
5. What are the major factors that hinder internal audit from adding value to the organization?
6. In your opinion how best can we improve internal audit effectiveness?

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