



Faculty of Economics and Business

**INTERNAL AUDITING - PUBLIC
SECTOR OF THE SARAWAK STATE
GOVERNMENT**

Jeman Bin Udin

Kota Samarahan
2002

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INTERNAL AUDITING – PUBLIC SECTOR OF THE SARAWAK STATE GOVERNMENT

P.KHIDMAT MAKLUMAT AKADEMIK
UNIMAS



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JEMAN BIN UDIN

A Research Paper Submitted in Partial Fulfillment of the
Requirement
For the Degree of Corporate Master in Business Administration
Faculty of Economics and Business
Universiti Malaysia Sarawak
2002

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APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Corporate Master in Business and Administration.



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This research paper was submitted to the Faculty of Economics and Business, UNIMAS and is accepted as partial fulfillment of the requirements for the degree of Corporate Master of Business and Administration.

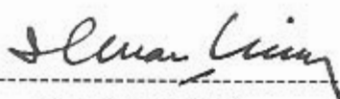


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I hereby declare that this research is the result of my own investigations, except where otherwise stated. Other sources are acknowledged by footnotes giving explicit references and a bibliography is appended.

Signature :  _____
15 th April 2002
Date : _____

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DEDICATION

This project paper is for
my wife, Siti Zaiton Hj. Jahidin with love and affection
and also to my handsome and beautiful children, Shazrul Jizan
Jeman,

Effa Nurfasya Jeman, Fatin Nadzirah Jeman and Faiz Nurhan Jeman
To whom I promised five years ago that I could obtain this
prestigious Corporate Master Of Business Administration (CMBA)
on a part time basis and on a constraint budget.

To all of you knowledge is power and never stops learning!

Menuntut ilmu adalah taqwa Menyampaikan ilmu adalah ibadah Mengulang-ulang ilmu adalah zikir Mencari ilmu adalah jihad ‘Al-Ghazaly’

ACKNOWLEDGEMENTS

This project paper is truly the synergistic product of a team of people. Without their tireless, wholehearted, unique contributions it never would have come about. I express my deep appreciation to them:

-my supervisor of this project paper, Associate Professor Dr. Sazali Abu Mansor, the Dean Faculty of Economic and Business for his remarkable judgment and counseling on many key issues, invaluable advice, guidance and support that enable me to complete this project paper on time.

-The Honorable State Secretary, Yang Berhormat Datuk Amar Abdul Aziz Hussein for his support of government servant to pursue further education as well as the Sarawak State Government for the scholarship that enable me to finance this CMBA program.

-my immediate head Encik Len Talif Salleh who is our Acting General Manager, STIDC for his patience in handling and understandings the problems faced by part time student like us .

-my Brother-in-law, Yang Berhormat Encik Abdul Wahab Aziz, for his lifelong loyalty and friendship, his inspiration to me in the development of the ideas in this project paper.

-to the happy memory of my late father who brought up all the nine children.

-my mother, Hajjah Mordiah Ekram, who taught me to keep learning all these years in time of sorrow and happiness.

-my internal audit friend Tuan Hj. Yusuf Bin Hj. Bujang, the internal auditor attached to the State Internal Audit Unit to whom I seek for comment and advice.

-all the lecturers that had taught me through this master degree course in CMBA.

To all of you, may Allah bless you always.

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ABSTRACT

The main area of concerns or problems to investigate are whether the public sector of the Sarawak state government are moving toward a more professional approach in the current practices of internal auditing and simultaneously to find out the reason why the Institute of Internal Auditor, Malaysia (IIAM) are not eager to organize courses or seminars in Sarawak.

The method of collecting primary and secondary data respectively was by distributing questionnaires and by telephone interview as well as through books, magazines and through the Internets. All the fourteen government departments and statutory bodies are chosen as 100% sampling area. The statistical method used is based on frequency and percentages with the assistance of the SPSS software.

The main results are that the internal audit units in the public sector of the sarawak state government are moving toward a more professional approach in the current practices of internal auditing based on the reasons that they are practicing risk management, corporate governance, internal controls and fraud investigations which are good practices of internal auditors. The use of audit software proved that the internal auditors have upgrade their talents and skills in the use of latest technology as well as attending the latest seminars and courses to keep abreast of the current situations. The cooperation of the Sarawak District Society of the Institute of Internal Auditors, Malaysia, The Centre for Modern Management and the various Associations-Association of Business Scholars (Unimas) and UiTM Alumni Associations of Sarawak (MITSA) are needed to promote the internal auditing profession in Sarawak.

ABSTRAK

Masalah utama yang dihadapi ialah samada unit-unit audit dalaman di sektor perkhidmatan awam kerajaan Negeri Sarawak telah menuju kearah pendekatan yang profesional didalam mempraktik ilmu-ilmu pengauditan yang terkini dan juga untuk mengetahui mengapa Institut Juruaudit Dalaman Malaysia tidak berapa minat untuk mengadakan kursus atau seminar di Sarawak.

Cara untuk mendapatkan data asli dan data yang sedia ada ialah dengan mengagihkan borang soalselidik dan juga menerusi buku-buku, majalah-majalah dan juga menerusi internet. Kesemua empatbelas buah badan kerajaan dan badan berkanun diambil sebagai contoh kajian. Kaedah statistik yang digunapakai ialah perulangan dan peratus dengan penggunaan perisian SPSS.

Kajian menunjukkan unit-unit audit dalaman didalam sektor perkhidmatan awam negeri Sarawak telah menuju kearah pendekatan yang profesional dengan mempraktikkan cara pengauditan yang terkini seperti risiko pengurusan, penyiasatan penyelewengan, tadbir urus korporat (corporate governance) dan kawalan dalaman yang baik dan juga menghadiri kursus dan seminar bagi memperbaiki kemahiran. Juga terdapat penggunaan perisian audit yang menunjukkan unit audit dalaman menggunakan teknologi terkini didalam kerja seharian mereka . Akhir sekali, Pertubuhan Kawasan Sarawak bagi Institut Juruaudit Dalaman Malaysia dengan kerjasama Centre for Modern Management (CMM) dan juga persatuan-persatuan-Association of Business Scholars (Unimas) dan Persatuan Alumni UiTM Sarawak (MITSA) perlu memainkan peranan yang penting bagi mengembangkan profesion ini di Sarawak.

CHAPTER 1

1.0 INTRODUCTION

1.1 Background study.

Internal auditing is not new especially for the public sector of the Sarawak state government. Way back to the 1970s, Internal Audit Units have been set up in the state statutory bodies such as the Sarawak Economic Development corporation (SEDC), Sarawak Land Development Board (SLDB) and other state government agencies. However, not much studies have been carried out to determine how effective the units are in carrying out the internal audit practices in confronting the complex changing of the present day business activities. Internal audit unit was set up in 1992 under the state financial secretary office.

In the year 2000, the unit was placed under the state secretary office in order to promote greater transparency and accountability of financial and operational matters (Rakan Sarawak, December 2000). This move hopes to see more focus and attention to improvements of system efficiency and financial disciplines by controlling officers and heads of departments.

Currently, all government Ministries and agencies have put in place many elements of good corporate governance, including corporate objectives and strategies; corporate planning; internal audit and audit committee; performance standards and measurement; evaluation, review and reporting mechanisms; values and code of ethics, benchmarking, risk management, etc.

The government has introduced various reform programmes in the public sector in its effort to introduce good principles of governance to promote a greater sense of responsibility and transparency in the government's operations and decision-making process. So far, the government has introduced and implemented programmes such as systems and procedures improvement, establishment of Internal Audit Unit; the Inspectorate Unit, the formation of specific committee to tackle various issues on management integrity, financial management and accounts. These initiatives here taken to uphold

structures and this will serve as the main defense against fraud, corruption, and mismanagement within the public sector.

These reforms were brought about after conducting studies and review on the overall government's operations, including systems, procedures as well as rules and regulations. National Audit Department has been the prime mover towards these reforms as can be seen from the issue; observations and recommendations raised in the audit reports. Apart from that, Audit Department has also been playing an active role in several high level committees, particularly the Special Cabinet Committee on Financial Management, which is headed by the Deputy Prime Minister. This committee deliberates on all issues, including issues, which are of public concerned brought about outside the formal mechanism available within the government.

The problems faced by the internal auditing profession in Sarawak were as follows:

The Institute of Internal Auditors, Malaysia was not eager to organize courses or seminars in Sarawak due to poor response from the participants. It should be noted that in running such courses or seminars the participants were the most important factor.

The Sarawak District Society of the Institute of Internal Auditors, Malaysia was not active in promoting the internal audit in Sarawak. Ever since the set-up of the District Society few years ago, the activities of this Society were not seen in the local newspaper.

Internal audit carry out their auditing work more on compliances rather than on risk management, control self assessment and other best internal audit practices.

1.2 Objectives of the study.

The main objective was to investigate the level of internal auditing in the Sarawak State Government, Statutory Bodies and Local Authorities.

Other specific objectives include:

- To find out the various components in internal auditing as regard to risk management, fraud, control self-assessment and internal controls.
- To determine the professional competency of the internal auditors in executing the internal auditing activities.
- To know whether the head of internal audit units as well as their supporting staff receives the required level of training.

1.3 Significance of the study and limitation.

This paper could reveal the current practices of internal auditing in the public sectors of the sarawak state government. The paper could determine the strength and weaknesses of the present internal audit teams in the public sectors of the sarawak statement government.

In respect of the limitations, major obstacles would be the secondary data on internal auditing for the Sarawak State Government as the matter was highly confidential and would not be disclosed to the publics.

1.4 The scope of this study

The scope of the study will cover only the Sarawak State Government Department, Statutory Bodies and Local Authorities.

1.5 Organization of the chapters

Chapter One touched on major issues in respect of the importance of internal auditing, about the internal auditing itself as well as the technology in internal auditing. Chapter Two would cover on the literature review on risk management, the assessment of risk, the type of risks as well as its implication. The element of corporate governance in the public sector as well as touching a little bit on the

private sector. Chapter Two also stressed on fraud . The major reasons why fraud occurred as well as the internal controls needed . Other than that the aspect of an Audit and outsourcing were also being looked into. Chapter Three would cover on the topic of research methodology on how the data were collected and the procedure for the analysis of data. Chapter Four was on the findings that was in respect of the analysis of problems statements, objectives and hypothesis. Finally, Chapter Five focused on the conclusions and recommendations.

CHAPTER 2

2.0 LITERATURE REVIEW

2.1 The Importance of Internal Auditing

Lawrence B. Sawyer (1993) in his Article of "*Why Internal Auditing*" appeared in the December Issue of the Internal Auditor Magazine posed a number of reasons why Internal Auditing was a very important function. Auditing—both internal and external—has its roots in antiquity. In about 3600 B.C., according to records of an early Mesopotamian civilization, scribes used to prepare summaries of financial transactions. Tick marks, dots, and circles indicated a painstaking comparison of one record with another. The Greeks, and the Romans after them, had an abiding regard for control over finances. The suspicious Greeks preferred slaves to keep records because they reasoned that a slave under torture could be considered more reliable than a freeman under oath.

The function of checking figures has survived to this date. The Internal Auditors provide service to their organization to ensure proper internal controls, risk management and good governance processes. The General Manager would like to see whether their operating personnel done their jobs according to established standards, procedures and instructions and also to make sure costs were reduced at level of operation. This is where the service of the Internal Auditors is highly demanded. The other reason is the counsel the auditors can provide objective views on highly technical matters.

In the acquisition of a company internal auditors were called to determine the reliability of the financial data whether true information were given and the internal auditors job were to check and make final decision whether to proceed with such acquisition or otherwise.

On the other hand, the shareholders of the company need internal auditors to act as a watchdog over the operation and running of this company. Internal Auditors will review the established policies for example on the management of fixed assets whether proper controls were established in the acquisition and disposal of assets.

In the case of the Cooperative Society, internal auditors were established to monitor the financial records as well as the operation to

ensure procedures and policies were adhered to at all level of operations.

In the government sector, the internal audit units as well as the internal audit committees were set up to ensure resources were fully utilized. Stories were heard about the mismanagement of resources such as the purchase of fertilizers whereby purchases exceeded usage causing the stocks to spillage and rotten at the warehouse.

The Board of Directors also needs internal auditors. Beleaguered board members, subject to legal action for failing to carry out their responsibilities, desperately reach out for reliable information.

Gregg R. Maynard (1999), in his Article *Embracing Risk*, which appeared in the Internal Auditor Magazine stated that Internal Auditing as a function of Risk Management. He stressed that management in many types of organizations is now evaluated not only by its performance record, but also by the adequacy and effectiveness of its risk management activities.

2.1.1 Internal Auditing

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

The standards for the Professional Practice of Internal Auditing (SPPIA) at Appendix II formulated by the Institute of Internal Auditors Inc is a global attempt to look at internal audit objectives from a holistic management approach (Ruin, 2001:51). According to the SPPIA guidelines, the spectrum of internal audit objectives would be:

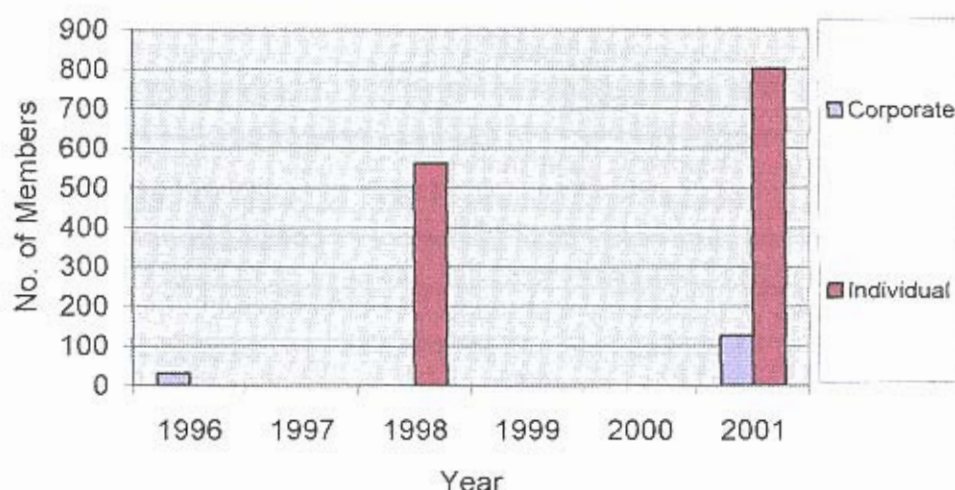
- (i) To determine whether results of operations are consistent with established objectives and goals and whether the operations are being carried out as planned. Mission accomplishment, and making the audittee feels good—the stark contrast between the 'traditional audit attest-function' and 'modern internal auditing'.
- (ii) To ascertain compliance with plans, policies, procedures, regulations or laws. Stretching further from verifying

compliance, auditors should determine whether those regulations and rules are acceptable and relevant for the operations in relation to current changes and competitions in the market place. This encompasses issues like 'not only doing things right but also doing the right things' (effectiveness vs. efficiency).

- (iii) To review the integrity and reliability of both operating and financial information, and how much such data are classified, reported, identified and measured.
- (iv) To assure that organizational assets as well as other resources are used and deployed economically and efficiently. This audit exercise includes verifying that assets are in existence and adequately safeguarded.

The Institute of Internal Auditors (IIA) was formed in Florida, USA in 1941. Consequential to the Malaysian needs, a Chapter was established in 1977 in Kuala Lumpur, Malaysia. Growth in size and stature in internal auditing in Malaysia was eminent resulting in the conferment of a National Institute Status by IIA Inc. in January 1988. The institute stood independently as Institute of Internal Auditors Malaysia. Development was continuous, growth was vigorous and the strategic move for corporatisation of the Institute took form in July 1994, thus giving birth to a new entity, the Institute of Internal Auditors Malaysia, a company limited by guarantee and not having a share capital. The membership of IIAM has grown from strength and strength. Individual membership increased from 562 in 1998 to 800 in 2001 and Corporate membership has grown steadily from 31 members in 1996 to 127 in 2001 as shown in Figure 1.1 below.

Figure 1.1: Corporate & Individual Membership



Source : IIAM Annual Report 2001

2.1.2 Objectives of IIAM

The objectives for which the institute is established are as follows:

- To advance the theory and practice of internal auditing in all its aspects.
- To recruit, educate, train and assess by means of examination or otherwise a body of members skilled in these areas.
- To preserve at all times the professional independence of internal auditors in whatever capacities they may be serving.
- To maintain high standards of practice and professional conduct by all its members.
- To do all such things as may advance the profession of internal auditing in relation to industry, commerce, education and the public service.
- To provide practicing internal auditors with a forum for exchanging ideas and expertise on matters of common interests, to develop their professional skills and to enhance their contribution to the organizations they serve.
- To enhance the professional status of internal auditing in Malaysia.

- To create an awareness in interested parties on the benefits of professional internal auditing.
- To develop courses and conduct examinations for the continued professional development of the members.

2.1.3 The many facets of audit

(i) Value for money auditing (VFM)

Government activities in developing countries have increased manifold over last three decades. They are no longer confined to defense and maintenance of law and order. The size of government departments and agencies has increased enormously. In most of the countries large public sector corporations have been established to pursue the policy objectives of the governments.

These public sector corporations or state-owned enterprises(SOE) draw large chunks out of the national budgets. But are the taxpayers getting value for their money for every rupee spent by these SOEs? Probably no one knows for sure. "Value for money Auditing" or "Performance auditing" is an approach for carrying out audits of SOEs activities and passing judgment on the economy, efficiency and effectiveness of their operations (Javed, 1988).

While financial and operational audits have long been recognized as integral parts of successful management strategies for many companies, the Management Audit has been welcomed enthusiastically by enterprising executives to evaluate their company's efficiency and effectiveness in clear and objective terms (Alexander Hamilton Institute, 1983).

(ii) The management audit

The management audit will:

- Uncover unprofitable operations before they drain company resources.
- Focus energies on productivity improvements that yield immediate results.
- Coordinate production schedules on purchasing policies and inventory practices into smooth running operations.
- Pinpoint personnel problems that lead to low morale, high turnover and general employee malaise.
- Create profitable new marketing and merchandizing strategies.

- Identify and fulfill the management information needs of the corporation hierarchy.

For a public sector organization to achieve the maximum benefit from the activities of internal audit, it is essential that the auditor should not be engaged in any system, which he normally review and appraise (Buttery *et al*, 1989).

Internal audit activity should be unrestricted and auditors should have full rights of access to records, assets, and personnel, and should receive such information and explanations, as they consider necessary for the performance of their duties.

The Institute of Internal Auditors has developed the Internal Auditor's Handbook (Heeschen *et al*, 1984) and a tool kit (Tarr, 1991) for those who are going to establish an internal audit department for the first time and for those who are new to the responsibilities of internal audit.

Management at all levels is absorbed with operations and rarely can spare the time required to make detailed study of any procedure or system (Fonorow, 1989). To obtain an objective, analytical review of specific operations, management turns to the professional trained in the art of analyzing records, controls and procedures—the internal auditor.

2.1.4 Software in internal auditing

Audit technology has involved to the point where virtually every aspect of the internal audit process can now be facilitated by some form of software tool (Salierno, 2001). Data analysis, risk management, fraud investigation, work paper management and internal control evaluation, for example, are all processes that have entered the digital realm. Software applications increasingly are enabling audit shops to boost their efficiency and effectiveness and to broaden the scope of audit process.

In the Internal Auditor's 2001 software survey it was revealed that the vast majority of respondents report that they are using data extraction and analysis software, and most indicate they are pleased with the results. The Survey results suggest that auditors who engage in computer-assisted fraud work are using their software more extensively-and more proactively- than in the past. Despite increasing

threats to information systems security over the last several years, few auditors report that they are using network security assessment software. When asked which type of software would increase most in importance to their audit shops over the next three years, the majority survey respondents cited data extraction and analysis tools.

This was especially true in 1996 when the same survey (Prawitt *et al*, 1996) was carried out and accordingly the category of software that was increasingly importance over the next three years were as follows:

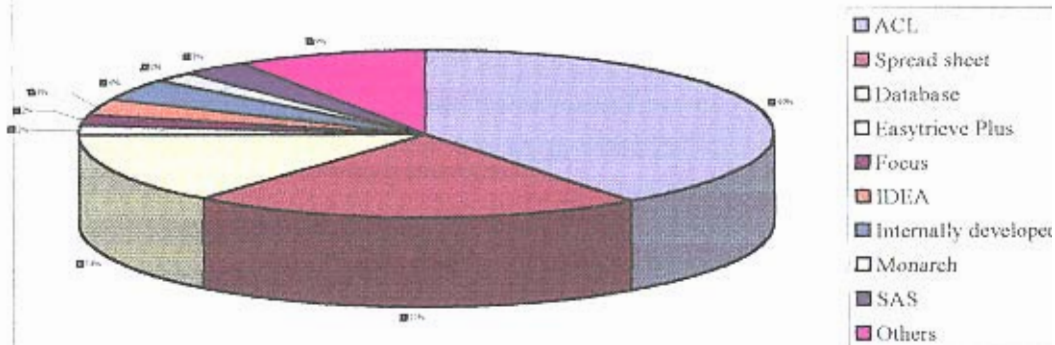
Table 2.1: Software Category

Software category	Rank
Data Analysis/Extraction	1
Audit Management/Risk Analysis	2
Database	3
Spreadsheet	4
Utility/Other	5
Word Processing	6
Data Management/Groupware	7
Network Analysis/Audit	8
Presentation Graphics	9
Systems/Control Audit	10

Source:Douglas F.Prawitt & Marshall B. Romney(1996) Super Software, The Internal Auditor Magazine, August 1996:19.

It was observed that Data Analysis, Risk Analysis and Database were the top three category of software to be used in the near future. Figure 2.1 below shows that in term of the product or the brand of software being used in the data extraction and analysis it was observed that 40% of the users were using ACL software, 21% using Spreadsheet Software, 14% using Database software, 4% using Internally Developed Software, 3% using IDEA and SAS respectively, 2% using Easytrieve Plus Report Writer Software, Focus Software and Monarch Software respectively and the rest totaling 9% were other brands.

Figure: 2.1 Data Extraction and Analysis Software



Source: David Salierno (2001), *Tools of the Trade*, The Internal Auditor Magazine, August 2001: 32.

2.2 Risk Management

Cassell English Dictionary, defined risk as 'a hazard, chance of harm, injury loss. From the management's mindset, risk is actually a concept. It is a measure of probabilities or uncertainties, a probability that an action or event might adversely affect an individual or an organization. The impacts or effects of risk could have political, economic, financial and regulatory implications.

Risk management is all about managing uncertainty; where the outcome is always an unknown, and at times a mystery like in gambling when you would either win an occasions but loss all the times (Ruin, 2001).

Risk management has been a subject of discussion ever since the IIAM organized the first annual conference on internal auditing in 1985. A topic on risk management and management audit technique (Shand, 1985) stated that proper assessment of risk and materiality is

fundamental to any audit. Whatever the type of audit the objective of risk and materiality assessment is the same-to obtain value for money from the audit dollar by directing the auditor's attention to those matters which are crucial to the forming of a conclusion on the matter being reviewed.

Risk is any issue which could impact the ability to meet the objectives (Dato Johan, 2000). Risk management is an on going process as follows: Identifying risk, Measure its potential impact, Do what's necessary to manage it, and Monitors the action.

The element of risk in a financial audit can be generally defined as overall acceptable risk. This is based on the client or management sensitivity to the results of the audit. It is susceptible to political, social and economic pressures and the necessity stay within the legal constraints. Inherent risk-the risk that error will inherently exist in the information being audited. Control risk-the risk that the control systems in operation will fail to prevent or detect errors in the information being audited.

The subject of risk is intensified when the world is entering the new millennium. At this phase in the Y2K battle, some internal auditors are sweating over whether their organizations will enter the new millennium with a celebratory bang or a horrific crash (Figg, 1998). For this matter, to prevent a seemingly strong Y2K project from crumbling at last minute, internal auditors should systematically address several common risks, including the lack of management attention, poor project plan as well as vendor certifications .

Risk is the potential exposure to unexpected financial and non-financial damage arising from deficiencies in the management of the organization in pursue of its business objectives (Chong, 2001).

Currently some of the fundamental risk management challenges facing the organization were poor operational control , poor clarity in corporate governance, inadequate funding or capitol , inadequate MIS, Risk management, lack of understanding of risk exposure and poor management of financial risk.

The management should:

- Identify and evaluate risks faced by the company for consideration by the board

- Design, operate and monitor a suitable system of internal control which implements the policies adopted by the board.

Auditors have traditionally been trained to gain and conform an understanding of the system of internal control on the path of evaluating the efficiency and effectiveness of management's controls. Now, internal auditors are being asked to shift their perspective from controls to the underlying business risks (McNamee, 2000) Acquiring an understanding of business risk is linked to at least three elements: a thorough understanding of the business process, imaginative tactics for generating ideas about possible effects of risks, and a framework or risk model that provides a common language for discussing risk.

A thorough understanding of the business process requires a collaborative approach. Because internal auditors are outside the business units, they can never be so knowledgeable about the processes as the managers who own them. At the same time, those who are immersed in a business process probably lack the perspective of an internal auditor who has examined a number of similar processes. When the two experts are brought together, their combined expertise may result in a greater understanding of business risk.

To tap this reservoir of information about risk, a stimulus and one or more creativity tools are often required. Brainstorming sessions, self-assessment workshops, templates, and a checklist tools are among the common devices that can stimulate thinking and ideating about the risks within an organization.

After business knowledge and strategies for sparking imagination have been established, some means of organizing and communicating that knowledge must be designed. Internal auditors and management must agree on a risk framework or model and a common language of risk.

In order to manage business risk (Lokman, 2001) strategies such as terminating the activity for high potential loss, high likelihood of occurrence and high cost of control, reducing the risk by having the appropriate business controls (Policy, Organization, Procedure, Supervision and Review) and transferring the risk to a third party (outsources) and finally accepting the risk.

The most important aspect in risk management would be the risk assessment. Fatimah Abu Bakar (2002) in her paper Designing and Implementation of effective Internal Controls presented at the Seminar on Corporate Compliance and Internal Controls at Petaling Jaya on 27-28 February 2002 stated that the objective of risk assessment is to prioritize risks and risk is measured based on probability of occurrence and severity of consequence. She further mentioned that the implications of the following risks:

Table 2.2: Four Useful Categories of Risk

	Definition	Significance	Likelihood
Customer Risk	Loss of customer	Number and type of customer affected	Probability of losing customers
Operational Risk	Errors or inefficiencies in internal processing systems	Significance of errors or inefficiencies (i.e. What harm could the error do? How much time could be wasted	Probability of errors or inefficiencies occurring
Financial Risk	Loss of money Unreliable report	Total Ringgit Malaysia Involved	Probability of loss data
Regulatory Risk	Noncompliance with laws and regulations	Penalties (fines, imprisonment, loss of reputation)	Probability of occurrence Probability of detection by regulators.

Source: Fatimah Abu Bakar, Designing and Implementation of Effective Internal Controls, Seminar on Corporate Compliance and Internal Control, Petaling Jaya, 27-28 February 2002

Further to these implication Puan Fatimah applied the Business Risk Matrix as follows:

Table 2.2: Business Risk Matrix

Probability of occurrence					
Almost certain	High	High	Critical	Critical	Critical
Likely	Moderate	High	High	Critical	Critical
Moderate	Low	Moderate	High	High	Critical
Unlikely	Low	Low	Moderate	High	High
Remote	Low	Low	Low	Moderate	High
	Insignificant	Minor	Moderate	Major	Catastrophe

Magnitude of Impact

Source: Fatimah Abu Bakar, Designing and Implementation of Effective Internal Controls, Seminar on Corporate Compliance and Internal Control, Petaling Jaya, 27-28 February 2002

2.3 Corporate Governance.

Corporate governance looks at issues pertaining to transparency, integrity, effectiveness and accountability in the management of the affairs, business conduct and all other activities of an organization (Ruin,2001:3-4). The concern is for the welfare, good performance, corporate ethics and morality, and social and public responsibility for the dignity and good corporate citizenship expected of an entity.

The adjective '*corporate*' comes from the noun '*corporation*'; while the noun '*governance*' is derived from the verb '*govern*'.

Simply put, 'corporate governance' refers to a group of people getting together as one united body with the task and responsibility to direct, control and rule with authority. On a collective effort this body is empowered to regulate, determine, restrain, curb and exercise the authority given it.

2.3.1 The need for corporate governance

In today's world of corporate jungle, there have been many nerve-racking real life stories on the rising cases of corporate receiverships, hostile takeovers and mergers, and alarming entrepreneurial scandals

Further to these implication Puan Fatimah applied the Business Risk Matrix as follows:

Table 2.2: Business Risk Matrix

Probability of occurrence					
Almost certain	High	High	Critical	Critical	Critical
Likely	Moderate	High	High	Critical	Critical
Moderate	Low	Moderate	High	High	Critical
Unlikely	Low	Low	Moderate	High	High
Remote	Low	Low	Low	Moderate	High
	Insignificant	Minor	Moderate	Major	Catastrophe
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leading to unimaginable losses and collapses of even the most archaic and formidable business houses founded on dynastic powerful traditions (Barings plc was one of them).

The lesson to be learnt is that nothing should be taken for granted and, that even the most archaic of management styles need not necessarily guarantee sound corporate governance. A business empire or conglomerate that is big, powerful and dynamic today could wind up in the smoggy ash tomorrow if the issues pertaining to corporate accountability is not understood and reviewed from time to time.

Let us recall some past as well as recent business headlines in many advanced countries involving Barings, BCCI, Maxwell in U.K; National Savings Banks & Trust in USA; Bond Corporation, Tricontinental, Quintex in Australia; and closer home in Malaysia, the then Co-operative Bank. What do these one-time big corporate names have in common? Losses and to the tune of great millions of dollars. Has corporate governance got anything to do with them? It is an entrepreneurial dictum that in business everything revolves around the element of 'risk' so that the more risk there is the more would be the returns. While the risk-free business endeavours might fetch peanuts (or nothing at all if one hides the cash under the pillow!). But then one of the prime purposes of superior and responsible management is to ensure that the inherent risk is adequately 'governed' so that corporate governance's function among the management and board appears to have been discharged and addressed well.

2.3.2 Corporate governance guidelines

Many countries now have established corporate governing standards for the guidelines of company management and its Board. In U.K. the Cadbury Commission is at the forefront in formulating such policies while in the U.S. the standards are set by the Committee of the Sponsoring Organization (COSO) whose membership comprised distinguished accounting professional like the AICPA and IIA Inc.

2.3.3 Development of Corporate Governance in the Public Sector

The evolution of the Malaysian Public Sector since the 1980s from one that was regarded as the prime mover of growth and played the leading role in socio economic development to one that plays a

facilitating and regulating role has greatly influenced the development of corporate governance within the public sector.

This shift of role of the Malaysian Public Sector is influenced by the new policy direction set by the government by appointing the private sector as the engine of growth and thereby enhancing public-private sector collaboration in bringing about national development. With the greater collaboration between the public and private sector, the public sector has adopted and adapted the private sector concepts and approaches, giving emphasis to customer satisfaction by the deliverance of more efficient and effective services.

By adopting and adapting to the private sector concept, appropriate and clear corporate governance arrangements are crucial in the organization success. In line with this, a number of reform programmes involving restructuring and re-engineering of organizations and systems outsourcing, corporatisation, Privatization, introduction of innovative systems and procedures; customer-oriented service, optimizing the usage of IT; better management practices; ethical values, etc. were introduced.

By nature of their operations these reform programme are complementary to each other and they emphasize the importance of risk management, monitoring, control and accountability reporting by the management to the relevant authorities. The overall strategy of these reforms programmes can be seen as twofold, that is:

- Innovation, where new systems, procedures and controls are introduced either by replacing or modifying them in order to rectify any defects detected.
- Surveillance, where management is obliged to conduct periodic review and assessment on the existing systems, procedures and controls, report to central agencies on the compliance to rules and regulations, pinpoint serious defects in internal controls to curb fraudulent activities or potential exposure to fraud.

The establishment of the Internal Audit Unit in major ministries and agencies and the establishment of the Financial Management and Accounts Committee (FMAC) at all ministries and agencies further strengthened the control structure within the public sector. The FMAC serves in a similar manner as Audit Committee.

2.3.4 Challenges and New Role For Public Sector Auditors

This development poses several challenges to the role played by Audit Department. These reforms imply that the audit objectives, approaches, methods and techniques should be continuously be reviewed by the auditors in the public sector. These new trends in governance introduced through the various reform programmes can be categorized into: privatization, financial management, human resource modernization programmes and information technologies.

These challenges brought about by the reforms have made it inevitable for the office not only to broaden their role and scope of function, but more importantly, to enhance their skills and expertise in various fields. In this context, auditors are expected to venture beyond their traditional role of merely evaluating statutory compliance and operational aspects of an entity; they are expected to contribute to the dynamism and growth of the organization by promoting good corporate governance and ensuring that the internal control systems of the organization promote high standards of corporate governance and transparency. This means that Audit Department will assist management to maintain and refine the control structure through continuous evaluation.

The National Audit Department has to adopt and adapt a pro-active and innovative approach in audit approach and methodologies and at the same time maintaining their professionalism, independence and to discharge its duties without fear or favor.

- **Privatization**

Exposure of the Audit staff to the operations of the private sector businesses and acquisition of expertise in carrying out an effective audit. Depending on the nature of business of the entity to be privatized, the nature of the sale and of the transactions, my staff need to acquire the expertise with regards to the various aspects of the operations and management of the private sector.

The government has established regulatory bodies within ministerial control and direction. These regulatory bodies play a vital role in the accountability process for the activities and performance of the privatized entities. Therefore it is vital that the public auditors ensure that the implementation of the privatization programmes and the

These are the real challenge: and the challenge to acquire the right knowledge, skills and intuition in order to make meaningful contribution to organizations. Public auditors must increase their level of competency and maintain their professionalism in order to add value through their function to the organizations and the environment in which the business of the organization is conducted. In such a demanding environment, the success of the audit will be influenced by several factors:

The auditor's ability to position itself and exert a prominent role in the efforts undertaken by the organization to establish credible corporate governance. This will depend on the extent to which the auditor effectively resourced and integrated into the organization's corporate governance framework. This can only be achieved by establishing the trust with the management and at the same time maintaining their functional independence and objectivity. The auditors have to earn the confidence of the management in this new domain through their performance which will largely be influenced by the knowledge, competency, skills and their professionalism in performing the task.

The demand for auditors to redefine their audit focus. By redefining the audit focus, auditors can play a role in establishing better practice performance, financial and risk management framework and thereby promoting a responsive control environment essential for proper accountability. Auditors must adopt a forward-looking approach, in the sense that they now audit in the current context rather stand-alone. These forward-looking approach will definitely add value to their role. By adopting this approach, auditor will be at the frontier on most organizational issues. It is not uncommon in this current demand and needs, auditors are expected to act as adviser to management on internal controls system and other issues, and therefore it is paramount that auditors enhance their array of expertise as I have stressed earlier.

The advancement of Information Technology which fundamentally change how organizations operate, leading to new paradigms of performance improvement both in the public and private sector worldwide. This development has a far reaching implication on risk associated with IT, security and controls employed to safeguards assets, ensure confidentiality, integrity and credibility of financial

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records and information. A recent survey conducted by Fortune 500 companies in the U.S. backed by the FBI found financial losses from computer crime topped USD 360 million from 1997 to 1999. Computer crime is definitely having a growing impact on business performance and even its existence. With the advent of e-commerce and the emergence of Internet as a market place, there will be increasing pressure on management of the organizations information system and systems controls.

Understandably, stakeholders demand reasonable assurance on the integrity and credibility of the IT systems before they could rely upon the financial and others information from the system to make informed decisions. Therefore the establishment of manual, IT security policy and user-friendly information systems and the existence of effective controls based on best practice are essential and an integral part of good corporate governance. Good corporate governance should also ensure that useful and relevant information are made available effectively and timely. This will allow an assessment whether programme / activity outcomes are consistent with agreed corporate requirements and add to overall corporate performance.

Good corporate governance (Chang,2001) ensures the increase transparency of corporate decision-making, increase the transparency of corporate reporting process and improve corporate accountability. The key elements of corporate governance consists of Accountability such as the credibility, financial and social responsibilities.

In conclusion, it is pertinent that the audit function involve within the corporate framework structure and positioned itself so as to be able to contribute effectively towards enhancing the standard of corporate governance in the organization. Therefore, auditors must take every possible effort to make audit function relevant at all times and contributing effectively as part of the organization.

2.4 Frauds

Cassell Student English Dictionary London 1994 defines 'fraud 'as '...an act or course of deception deliberately practiced to gain unlawful or unfair advantage, such deception directed to the detriment of another...'. (Ruin,2001:133)

Having understood the definition of fraud, and the ways fraud could be perpetrated, it is not hard to understand and recognize fraud's existence in the following transactions:

- improper payments such as illegal political contributions, bribes, kickbacks, and payoffs to government officials or persons of authority for favors and expedited approvals; intermediaries of government officials, customers, or grease-monies from suppliers/vendors.
- Sale or assignment of fictitious or misrepresented assets.
- Intentional, improper related-party transactions in which one party receives some benefit not obtainable via an arm's length transactions, assets, liabilities or company income.
- Prohibited business activities such as those which violate government statutes, rules, regulations or contracts.
- Intentional, improper transfer pricing e.g. valuation of goods exchanged between related organizations. By intentionally structuring pricing techniques improperly, management could improve the operating results of a company involved in the transaction to the detriment of the other company. (Another term for this is window-dressing or creative accounting).
- Tax fraud (tax-evasion as opposed to tax-avoidance).

Most frauds schemed on companies are discovered by chance rather than through control mechanism or normal detection. This was affirmed by a worldwide survey done in 1995 by a leading professional firm. Events or agents that alerted management to corporate wrongdoings are tip-offs and accidental discoveries as a result of management changes. This showed that there could be a lot more fraud happening than 95% of the respondents stated that the risk of fraud had increased over the past five years (1990-1995); and among the other significant findings of this survey were the following:

- fraud were more likely to be detected in entities where the responsibility for preventing fraud had been delegated by

executive management to its other independent departments such as internal auditing or security and investigation unit.

- 75% of fraud was committed by employees. Financial institutions reported more fraud being perpetrated by people outside the organizations.
- More that 25% of those organizations that took part in the survey have lost in excess of GBP600K (RM4M) to fraudsters in the past 5 years (1990-1995).
- Corporations were often more concerned about growing the business than protecting it against fraud; and in some instances creating a gap that allowed white-collar crimes to slip and eating away' the organizations.

2.5 Control Self Assessment

The Institute of Internal Auditors defined Control Self Assessment (CSA) as a process through which internal control effectiveness is examined and assessed. The objective is to provide reasonable assurance that all business objectives will be met.

CSA is a methodology used to review key business objectives, risks involved in achieving those objectives and internal controls designed to manage those risks (Work, 2001).

The most important factors why the CSA are successful are because employees feel valued and involved "Management is listening to me", heightened awareness of relationship between objectives / risks / controls and improved working relationships.

The benefits of CSA includes proactive, increases control consciousness, better alignment of operations and risk management, better measurement/assessment of subjective areas, increases stakeholders assurance, utilizes employees expertise and the breakdowns of communication barriers.

Other benefits of CSA includes increases the scope of coverage of internal control reporting during the given year, identifies the high risks and unusual items for more focused audit work, increases the effectiveness of corrective action by transferring the ownership to operating employees.

Harend Prasad, the Vice President, Audit in its paper, Compliance Vs. Consulting in the Asian 2001 Conference on Internal Auditing stated that CSA was good for the audit because of less resources, risk focus, compliance in nature, harness line support, timeliness, scalability and visibility. He also stated that the benefits of CSA includes management provides support for control culture, line managers seen as 'owners' of risks and controls, line supports control improvements, enhances governance of organization and interaction of various departments including audit.

2.6 Internal Controls

Internal controls in public enterprises can be evaluated more effectively if they are prepared and reviewed by a professional internal audit unit which is independent and reports direct to management (Hill, *et al*,1989:146). On the other hand, the system of internal controls (Alexander Hamilton Institute,1982) in an organization consists of all procedures and policies that promote accuracy and reliability in accounting and operating data; safeguard the firm's resources against waste, fraud, and inefficiency; measure the extent of the operating department's compliance with company policy; and evaluate the overall efficiency of the operating functions

Judi Geisler(1983) in his book about the questions and answers in auditing stated the different types of internal controls as Organizational controls, Segregation of duties, Physical controls, Authorization and approval, Arithmetical and accounting controls, Personnels, Supervision and Management controls. These provide comprehensive information on internal controls and further to these the practical application of internal control (Woolf,1979) was noted in respect of General financial arrangements, Cash and cheques (received and paid), Wages and salaries, Purchases and trade creditors, Sales and debtors, Stocks and work in progress, Fixed assets and investments.

2.7 Audit Committee

The set-up of an audit committee was mandatory in a public listed companies but exception was given to government department, statutory bodies and local authorities. However, now in most statutory bodies their exist audit committees.

The board of directors should develop a written charter setting forth the duties and responsibilities of the audit committee. The board of directors should approve the charter, review it periodically and modify it as necessary. The charter should be goal oriented rather than taking a detailed 'cookbook' approach (Vallabhaneni *et al*,1994:64).

Primary responsibilities for the organizational financial reporting lies with the top management, overseen by the board of directors. The audit committee consisting of independent directors, has oversight responsibility in the area. The audit committee is one of many committees of the board of directors. Establishment of a committee, of course, does not relieve the other directors of their responsibility with respect to the financial reporting process.

Audit committees have become an integral element of the internal control system of an enterprise (Allison,1994). The audit manager ought to make it very clear to everybody that it stands behind the internal auditor, that no manager can manipulate or threaten with reprisals for simply doing the job. Management has to become accustomed to the notion that audit committees have responsibilities to ask tough questions; and management must accept the idea that this process is not intended to be critical of its performance.

2.8 Outsourcing

Internal auditing can provide an independent assessment of the assumptions that management has made with regard to proposed benefits of outsourcing (Figg,2000). Specific areas that the internal auditors can address include whether or not:

- The arrangement will be on short term or long term
- The costs have been proven
- The evidence and calculations supporting the decision to outsource have been verified.

The specter of outsourcing -- whereby public accounting firms take over the internal auditing function -- has become one of internal auditing's hottest issues

(Gibbs *et al*,1994). Aggressive marketing efforts by public accounting firms have created a virtual panic in some internal

auditing departments and left many staff members fearful that their jobs may be in jeopardy.

Outsourcing issues should be approached with a comprehensive understanding of all the implications and factors involved, such as the statement of internal controls, economics, resources, methodologies, culture and core competencies.

One area that internal auditors could check for any outsourcing activities would be the agreement between the organization and the third party.

2.9 Conclusion

The above literature review covered internal auditing in general, risk management, corporate governance, fraud investigations, internal controls, audit committee and control self assessments which were the basis for good practices in internal auditing. These materials were obtained from courses, seminars, conferences, magazines, books, and other published materials which were relevance in internal auditing.

CHAPTER 3

3.0 RESEARCH METHODOLOGY

3.1 The data collection

This project paper is based on primary and secondary data. The steps involved in obtaining the data for this project paper are as follows:

- (i) Specifying the data requirement.
- (ii) Determining which data is available from internal sources.
- (iii) Determining which data is available from external sources
- (iv) Identifying the data that must be obtained from primary sources.
- (v) Scrutinize data's strategy.
- (vi) Obtaining and collecting the data

Majority of the data required in the preparation of this paper are available from secondary sources. Primary data are also collected to ascertain and to determine the reliability, accuracy, and validity of these secondary data.

3.1.1 Primary data

The writer used the questionnaires, discussions and telephone interviews with people in the internal auditing profession to get first hand information. Sample of the questionnaire is at appendix I.

3.1.2 Secondary Data

Secondary data are obtained from books, Seminar papers, conference papers, workshop and magazines.

3.2 Selection of sampling size

There are 14 state government agencies in Sarawak that have their own internal audit units. The distribution of these agencies is as follows:

TABLE 3.1 Distribution of State Government Agencies in Sarawak that set up their own Internal Audit Units.

Division	Percentage (%)	Number	Name of Government Department, Statutory Bodies and Local authorities
Kuching	71.4	10	Chief Minister Office (CMO)
			Sarawak Economic Development Corporation (SEDC)
			Sarawak Timber Industry Development Corporation (STIDC)
			Kuching Water Board(KWB)
			Sarawak Electricity Supply Corporation (SESCO)
			Sarawak Housing and Development Corporation (SHDC)
			Dewan Bandaraya Kuching Utara(DBKU)
			Dewan Bandaraya Kuching Selatan(DBKS)
			Jabatan Kerja Raya(JKR)
			Kuching Port Authority(KPA)
Sibu	0.0	0.0	Nil
Sarikei	7.2	1	Rejang Port Authority(RPA)
Bintulu	14.2	2	Bintulu Development Authority(BDA)
			Bintulu Port Authority(BPA)
Miri	7.2	1	Miri Manucipal Council(MMC)
Limbang	0.0	0.0	Nil
Lawas	0.0	0.0	Nil
Total	100.0	14	

Source : Tuan Hj. Yusuf Hj. Bujang, Internal Auditor, Chief Minister Office, Kuching.

To be effective in determining the sampling size, all the 14 respondents are selected.

3.3 Procedure for analysis of data

All the questionnaires were precoded. All the data contained in the questionnaires can be subjected to statistical or manual analysis.

For the purpose of this research a descriptive statistic is applied.

3.4 Conclusion

The respondents have shown interest in the collection of this primary data through filling the questionnaire as well as by telephone. They are very cooperative and willing to give answers.

CHAPTER 4

4.0 FINDINGS (ANALYSIS AND EVALUATIONS)

4.1 Characteristics of the respondents

The respondents are internal audit units in government departments and state statutory bodies in Sarawak.

4.1.1 Category of respondents

Table 4.1: Duration of the Internal Audit Unit

	Frequency	Percent
Less than 5 years	3	21.4
6-10 years	4	28.6
11 years and more	7	50.0
Total	14	100.0

Source: Survey

The majority or 50% of the respondents had been established for more than eleven years indicating that internal audit activities had been going for several years as shown in Table 4.1 above. 28.6% had been in this particular field between six to ten years. Another 21.4% had just been established within five years. An telephone interview with a respondent in one of the state statutory body in Bintulu revealed that the internal audit unit had just been established and being new in this particular field there was a need to know more information in this profession.

4.1.2 Number of audit staff

The size of the internal audit units depend on the coverage of the audit projects as indicated in Table 4.2 below. Majority or 50% of the internal audit unit had engaged more than 11 people in their own unit. Another 28.6% were having a smaller manpower in view of the smaller audit coverage and 21.4% were having between 6 to 10 people. In the case of the state internal audit unit they were having a greater responsibilities and wider scope, as they have to audit state departments and local authorities. In the case of internal audit units in statutory bodies they have to audit their own organization as well its subsidiary companies.

Table 4.2: Number of audit staff

	Frequency	Percent
Less than 5 people	4	28.6
6-10 people	3	21.4
11 people and more	7	50.0
Total	14	100.0

Source: Survey

4.2 Analysis of problem statement, objectives and hypothesis, findings and results.

Hypothesis testing

Analysis of percentages in Table 4.16 and Table 4.17 respectively indicates that majority or 71.4% and above of the internal audit units were practicing the risk management and fraud investigations in their daily activities as compared to the traditional compliance type of audit. This shows that the internal auditors have upgraded their knowledge to such a level that is at par with other international bodies that have practiced this risk management.

On the other hand the set up of audit committee in more than 57.1% in a state and statutory bodies as indicated in Table 4.19 proved that they have accepted the international standard for transparency and accountability. Moreover in the case of technology in internal auditing audit software was used to process data that could accelerate the decision making process as shown in Table 4.21. All these tests proved that the Hypothesis is true.

Table 4.3: Member of IIAM

	Frequency	Percent
yes	7	50.0
no	7	50.0
Total	14	100.0

Source: Survey

Table 4.3 shows that 50% or 7 of the respondents are Professional Members of the Institute of Internal Auditors, Malaysia whilst another 50% were not members yet. Lack of promotion on the part of the Sarawak District Society of the Institute of Internal Auditors, Malaysia (IIAM), caused some of the potential internal auditors did not have first hand information in the profession. On the hand, a face-to-face discussion with the existing audit staff in Kuching revealed a different story-they simply refused to join as members! .

Table 4.4: Membership period

	Frequency	Percent
Less than 5 years	1	14.3
6-10 years	2	28.6
11 years and more	4	57.1
Total	7	100.0

Source: Survey

57.1% or 4 of the respondents have been members for more than 11 years as shown in Table 4.4 above. Another 28.6% are between 6 to 10 years and 14.3% are below 5 Years. An interview with the existing members in Kuching revealed that there were a lot of opportunities when one became a member as explained in detailed in Table 4.5 to 4.7 below.

Table 4.5: Acquiring more internal audit knowledge

	Frequency	Percent
Yes	5	71.4
No	2	28.6
Total	7	100.0

Source: Survey

Table 4.5 indicates that 71.4% or 5 of the respondents joining the IIA for the basic reason that they could acquire more internal audit knowledge whilst 28.6% did not agree. Acquisition of knowledge through courses, seminar or conferences proved that knowledge in internal auditing changing very fast from internal controls to risk management. In the recent Asian 2001 conference on internal auditing on the issue of risk management and governance held in Kuala Lumpur from 10 to 12 October 2001 it was found that there

were 381 local participants as well as 44 foreign delegates from Brunei, China, Hongkong, Indonesia, India, Japan and Singapore. This proved that internal auditors should be informed of the current situation facing the internal audit. In this information technology era, information technology audit is a must for every organization, because in the absence, much of the financial data in the computer had gone unchecked. In this respect IT Auditors were highly sought.

Table 4.6: Develop personality & image

	Frequency	Percent
Yes	11	78.6
No	3	21.4
Total	14	100.0

Source: Survey

78.6% or 11 of the respondents agreed that by joining the IIA they could develop personality and image as a professional internal auditor as indicated in Table 4.6. Joseph Eby in his latest book on essentials of corporate management published in 2001 said that the attributes of effective leaders were: Always with a positive attitude, influential, charismatic character, full of confidence, highly self disciplined, excellent people and communication skills. These were the qualities that should presence in the internal auditors. S. Rao Vallabhaneni & Devi Vallabhaneni (1994) in their book, CIA Examination textbooks, Volume 1 stated that the non- technical skills required of an audit supervisor includes: Hardworking, objective, fair, good communicator, good listener, accessible, good teacher, recognizing other's accomplishments, praising subordinate's work in front of others, motivator, having a sense of humor, showing enthusiasm, sensitive to others' feelings, empathetic toward others, inject humor at work place, supports subordinates, morale booster, able to develop others' skills (mentor), and having a clear understanding of human nature and behavior.

Table 4.7: Build networks with other internal audit

	Frequency	Percent
Yes	10	71.4
No	4	28.6
Total	14	100.0

Source: Survey

Table 4.7 indicates that 71.4% or 10 of the respondents agreed that by becoming the member would build a network of friends in the same line as internal auditors whilst another 28.6% did not agree. It was and stills a belief that 'no man is an island'. Networking is a strategy to build relationship with other people by exchanging ideas and information on the latest development in a particular field.

Table 4.8: Existence of internal audit committee

	Frequency	Percent
Yes	10	71.4
no	4	28.6
Total	14	100.0

Source: Survey

71.4% or 10 of the respondents show that they have established the internal audit committee which was very important in term of transparency and accountability as indicated in Table 4.8. Another 28.6% have not established one. An interview with one of the head of internal audit unit in Kuching revealed that it was not viable to establish such committee at this moment in view of lack of resources- audit manpower and computers. The explanation given was if the audit committee was established than they have to have quarterly meetings and these required enough audit personnels to cover a large audit projects especially the subsidiary companies that had grown in sizes over the past 10 years. Further more additional computers were needed to support the workloads.

Table 4.9: Frequency of meeting

	Frequency	Percent
Quarterly	7	70.0
Due to urgency	3	30.0
Total	10	100.0

Source: Survey

70% or 7 of the respondents said that their audit committee met on a quarterly basis as shown in Table 4.9. This was a good sign of proper internal control where matters pertaining to internal audit could be discussed within the shortest possible time rather than waiting for several months to deliberately solve certain problems. Another 30% of the respondents convene their meeting due to the nature of the problems. In case of urgent matters, one could not wait for several months to find solutions.

Table 4.10: Outsourcing of internal audit activities

	Frequency	Percent
Yes	1	7.1
no	13	92.9
Total	14	100.0

Source: Survey

Only 7.1% of the respondent outsourced their internal audit works in respect of information technology audit where there was a shortage of talents and experience in this particular field as indicated in Table 4.10 above and 4.11 below respectively. This gave a hint that the state government departments were lacking in these IT auditors. Another 92.9% of the respondents did not outsource any internal audit activities. This could be due to the nature of the audit projects that did not require any involvement of outside vendors or any third party.

Table 4.11: Activities-others

	Frequency	Percent
Yes- information technology	1	100.0

Source: Survey

Table 4.12: Specific activities-monitoring financial information, evaluating control, ensuring compliance with law and regulations and assessing operational effectiveness.

	Frequency	Percent
Yes	14	100.0

Source: Survey

Majority or 100% of the respondent's internal audit activities are engaging in monitoring financial information, evaluating internal controls as well as ensuring compliance with law and regulations and operational effectiveness as indicated in Table 4.12 above. A value-added review of controls can improve auditors' contributions to their organization (Hogg,1992).

Table 4.13: Specific activities- risk management

	Frequency	Percent
Yes	10	71.4
No	4	28.6
Total	14	100.0

Source: Survey

71.4% or 10 of the respondents are involved in the risk management activities as indicated by Table 4.13 above. This was a good sign of internal audit development where their activities had moved toward a professional approach in internal auditing. Risk is any issue, which could impact the ability to meet objectives. Another 28.6% of the respondents had not practiced risk management in their daily internal audit activities. A personal interview with the respondent revealed that they were more on compliance audits.

Table 4.14: Specific activities- others

	Frequency	Percent
Yes-fraud	11	78.6
No	3	21.4
Total	14	100.0

Source: Survey

78.6% or majority of the respondents are involved in fraud investigations as their daily audit activities whilst another 21.4% are doing compliances audit as shown in Table 4.14 above. Fraud auditing, while borrowing many techniques from financial auditing, is more of a mind set than a methodology (Bologna, 1992). It relies on creativity (right-brain thinking) as much as it does on reasoning (left-brain thinking).

Table 4.15: Frequency in respect of audit project/area

	Frequency	Percent
once a year	7	50.0
not specific. depend on nature of problem	7	50.0
Total	14	100.0

Source: Survey

50% of the respondents doing their internal audit activities once a year as indicated in Table 4.15 above. This is in term of audit project where they they covered annually. Another 50% shows their audit depend on the nature of the problem where urgent decision was needed and not necessarily on annual basis.

Table 4.16: Line of reporting

	Frequency	Percent
to state secretary	1	7.2
audit committee	8	57.1
general manager	5	35.7
Total	14	100.0

Source: Survey

Table 4.16 shows that 7.2% of the respondents were reporting to the State Secretary. This is in respect of the State Internal Audit Unit where their internal audit activities cover state departments such as the Agriculture Department, Forest Department, and other local authorities as shown in Table 4.19. 57.1% or majority of the respondents is reporting to the Audit Committee and this indicates that audit committee is the best option toward the professional approach to audit practices. Another 35.7% of the respondents are reporting to the General Manager, which is considered a traditional line of reporting.

Table 4.17: Audit charter

	Frequency	Percent
yes	10	71.4
no	4	28.6
Total	14	100.0

Source: Survey

71.4% or 10 of the respondents have the internal audit charter, which basically outline the term of references in doing the internal audit activities. This is a good indicator for the professional approach toward better internal audit practices. The audit charter amongst other things include—line of reporting, procedure of exit entry, report writing, coverage etc.

Table 4.18: Audit software

	Frequency	Percent
yes	1	7.1
no	13	92.9
Total	14	100.0

Source: Survey

Table 4.18 above shows that 7.1% of the respondents have established their internal audit software in keeping with the latest development in technology in internal auditing. They have invested this to ensure proper data are obtained and analyzed for the purpose of internal audit. Reports will be prepared faster with the assistance of this software. Another 92.9% of the respondents have not ventured to use this internal audit software either they did not know the existence of this software or their nature of the job are more toward compliances.

Table 4.19: Nature of software

	Frequency	Percent
Imported	1	100.0

Source: Survey

The type of software used in Table 4.19 was imported and currently in use by one of the respondent. Actually, the software was for the extraction and analysis of data and consequently, the interviews with several respondents revealed majority admitted using Microsoft Word and Excel in their word processing and spreadsheet jobs respectively. It was further revealed that the Microsoft PowerPoint was also utilized for the presentation graphics.

On the other hand, an interview with the a respondent revealed that they were serious to improve the internal auditing service by considering to purchase the internal audit software in the area of risk management but it was not deliberately approved by the management

for the basic reason that it was not importance and in line with the government's austerity drive to keep cost down at all level of operation especially after the 1997 economic crisis.

Table 4.20: Attending conference,seminar, workshop

	Frequency	Percent
yes	14	100.0

Source: Survey

100% or 14 of the respondents agreed that they did send their staff for further training in internal audit to keep abreast with the latest development in internal auditing as per Table 4.20 above. The recent global economic slowdown and the many uncertainties in the region have posed a great challenge to the seminar's organizers as organizations caustiously review their expenditures and tighten their belts to contain cost.

Table 4.21: Local organizers

	Frequency	Percent
yes	14	100.0

Source: Survey

100% of the respondents sent their staff to local organizers to pursue further knowledge through seminar and conferences as indicated in Table 4.21 above. Courses such as financial management were available locally through CMM, NPC and other private organizers but not on internal auditing subjects.

Table 4.22: Semenanjung Malaysia

	Frequency	Percent
yes	14	100.0

Source: Survey

Table 4.22 shows that the major bulk of training in internal auditing subjects were organized in Semenanjung Malaysia. In 2001, 30 workshops/seminars and eight in-house programmes (IIAM Annual Report 2001:10)were sucessfully conducted by IIAM such as the

Audit of Human Resource Management, Reinventing Internal Audit Function and Report Writing for Impact. It was observed that Corporate Governance, Fraud Investigations, Control Self-Assessment and Internal controls were the main focus in these seminars and courses.

Table 4.23: Singapore

	Frequency	Percent
yes	3	21.4
no	11	78.6
Total	14	100.0

Source: Survey

Only 21.4% of the respondents sent their staff for training in Singapore as shown in Table 4.23 above and the rest totaling 78.6% were not eager to do so due to the recent economic slowdown as well as the individual department's policies.

Table 4.24: Other countries

	Frequency	Percent
no	14	100.0

Source: Survey

Majority or 100% of the respondents were not sending their staff to other countries for further training in view of the fact that the country has just emerged from economic downturn and also due to government budget constraint.

Table 4.25: Aspect in Risk Management

	Frequency	Percent
yes	10	71.4
no	4	28.6
Total	14	100.0

Source: Survey

Majority or 71.4% of the respondents indicates that they sent their staff for further training in the aspect of risk management as shown in Table 4.25 above. Another 28.6% regard this particular subject is not important at this time probably due the nature of the job, which is more on compliance auditing. This implies that risk management is a very important aspect in today's internal auditing activities in dealing with the complex and fast changing business world.

Table 4.26: Aspect in fraud Investigation

	Frequency	Percent
yes	11	78.6
no	3	21.4
Total	14	100.0

Source: Survey

Fraud investigation is also a subject which need further training in view of the complexity of transactions as well as now that white collar crimes are becoming rampant. Table 4.26 shows that 78.6% or the majority attending this subject to expose themselves to the latest technique in fraud investigations. Another 21.4% have not expose their staff to this skill in fraud investigations.

Table 4.27: Aspect in Control self assessment

	Frequency	Percent
yes	4	28.6
no	10	71.4
Total	14	100.0

Source: Survey

Only 28.6% were sending their staff for training in control self assessment in view of the subject's low coverage of its usefulness and less popularity. The rest totaling 71.4% were not eager to send their staff on this type of training.

Table 4.28: Aspect in Information technology audit

	Frequency	Percent
yes	6	42.9
no	8	57.1
Total	14	100.0

Source: Survey

42.9% or 6 of the respondents sent their staff on training in information technology audit as indicated in Table 4.28 and another 57.1% were not eager for reason that their organization are not computerized as yet. Information technology audit has gain momentum in view of the increase use information technology. The state government had created the Information and Communication Technology Division (ICT) to oversee the implementation of information technology in the Sarawak Government agency.

Table 4.29: Aspect in Human resource audit

	Frequency	Percent
yes	7	50.0
no	7	50.0
Total	14	100.0

Source: Survey

In respect of human resource audit about 50% agreed that such training was useful in view of risk involved in the human resource department as shown in Table 4.29. Internal auditors can be a potent force to prevent or minimize termination suits (Sawyer,1997).

Suits often hinge on the documentation that employers use in building a case against an employee. In reviewing the personnel files, auditors should see that procedures and policies relating to documents were strictly adhered.

Table 4.30: Other aspect

	Frequency	Percent
Yes-internal controls	11	78.6
no	3	21.4
Total	14	100.0

Source: Survey

Majority or 78.6% of the respondents were attending the internal controls courses or seminar in view of its usefulness in minimizing fraud or loss of assets as indicated in Table 4.30 above. Another 21.4% have not shown any interest on this particular subject.

Table 4.31: Exposure of head of internal audit to conference, seminar, workshop

	Frequency	Percent
yes	14	100.0

Source: Survey

The majority or 100% of the respondents as head of internal audit unit were attending seminar or conference to increase their internal audit knowledge as shown in Table 4.31 above. Majority are also have attended within two years which mean to say they have exposed themselves to the current internal audit practices as indicated in Table 4.32 below.

Table 4.32: The timing of attending conference, seminar and workshop

	Frequency	Percent
Less than 2 years	14	100.0

Source: Survey

Table 4.33: Nature of the first degree

	Frequency	Percent
Accountancy	13	92.8
Marketing	1	7.1
Total	14	100.0

Source: Survey

Majority or 92.8% of the head of internal audit units are accountancy graduates whilst 7.1% are graduates in marketing and management as

indicated in Table 4.33 above. This shows that accountancy are preferred but simultaneously others graduates in marketing and management are also considered provided they have accounting background as well as having experience in similar fields for several years. It should be noted that staff in internal audit should compose a blends of specialists in accounting, marketing, engineering, and information technology in order to render services to a different types of audit projects. In construction for example, engineering personnel are preferred since they know the construction activities very well and they could play a very important role.

Table 4.34: Existence of CIA postgraduate program

	Frequency	Percent
yes	10	71.4
no	4	28.6
Total	14	100.0

Source: Survey

Table 4.34 shows that majority or 71.4% of the respondents knew the existence of the Certified Internal Auditor (CIA) post graduate program and another 28.6% have not heard such program simply because they were not members of IIAM or they were new comers in the internal audit units. In this respect it is observed that not much promotion has been made to market this CIA Program.

Table 4.35: Importance of CIA program

	Frequency	Percent
yes	10	100.0

Source: Survey

Majority of the respondents who have heard the existence of the CIA program agreed that this program definitely adding value to the career as professional in internal auditing as shown in Table 4.35. An interview with a respondent revealed that he did attempt part one of the examination but was unsuccessful. The total number of CIA candidates who sat for the various parts of the examination jumped from 97 in year 2000 to 148 in the year 2001. As at 31 December 2001 there were 83 who hold CIA designations in Malaysia (IIAM Annual Report 2001:40)

Table 4.36: Organizing of Conference, Seminar and Workshop by IIAM

	Frequency	Percent
yes	14	100.0

Source: Survey

Majority or 100% of the respondents as shown in Table 4.36 above agreed that the IIA (M) should conduct courses and seminars in Sarawak. The involvement of the State Internal Audit Unit, Centre for Modern Management (CMM) and the Sarawak District Society of the Institute of Internal Auditors, Malaysia (IIAM) would be better to bring together the internal auditing profession in Sarawak as indicated in Table 4.37 and 4.38 below where the majority or 78.6% and above agreed to such a move.

Table 4.37: Cooperation of State Internal Audit Unit & Centre for Modern Management

	Frequency	Percent
yes	11	78.6
no	3	21.4
Total	14	100.0

Source: Survey

Table 4.38: Sarawak District Society of IIAM

	Frequency	Percent
yes	14	100.0

Source: Survey

The involvement of other associations such as the Association of Business Scholars (unimas), UiTM Alumni association of Sarawak (MITSA) and the local MIA and MACPA would also complement to this profession in Sarawak as majority or 78.6% agreed as indicated in Table 4.39 below.

Table 4.39: Involvement of Other Associations-Association of Business Scholars (Unimas), Alumni Association of Sarawak (MITSA), Malaysian Institute of Accountants (MIA) and Malaysian Association of Certified Public Accountant (MACPA)

	Frequency	Percent
yes	11	78.6
no	3	21.4
Total	14	100.0

Source: Survey

CHAPTER 5

5.0 CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusion

It is concluded that the public sector of the Sarawak State Government are moving toward a more professional approach in the current practices of internal auditing.

It is found that majority of the head of internal audit units are members of the Institute of Internal Auditors, Malaysia (IIAM) and their purpose of joining is to acquire more internal audit knowledge, to develop personality and image as well as to build networking with other internal auditors in the exchange of ideas and sharing knowledge.

Majority of the state departments have an internal audit committee. This shows that there is transparency and accountability in the running of the administration for the purpose of improvements in term of management of assets as well as in executing proper internal controls in order to render quality service to the public as well as other third parties. Due to resource constraints some have not established the Audit Committees yet.

In term of outsourcing of internal audit service, it is found that the area of outsourcing is in respect of the information technology. This suggests that the state is in needs of the information technology auditors (IT Auditors).

In term of technology in executing the internal audit activities, there exists the use of internal audit software for the purpose of assisting the internal auditors in determining the problem areas as well as to improve the situation. It is good to say at this juncture that one of the government agencies is using one of the top categories of software, which is very popular in America today.

In term of implementing the internal audit practices, it is found that majority of the internal audit units are doing

risk management and fraud investigations. This shows that they are moving toward a more professional approach toward the internal audit practices rather than on doing compliance audits, which are somewhat a traditional type of audit.

In the internal audit unit itself, they have established the internal audit charter, which basically outlines the term of references in carrying out the activities.

It is found that the head of the internal audit units as well as their staff have attended the latest courses and seminar as well as conferences in order to keep abreast of the current situation.

5.2 Recommendation

- i. The first priority would be the establishment of a strong foothold in Sarawak itself could bring the internal audit profession on a larger scale. This of course the need to improve the Sarawak District Society of the Institute of Internal Auditors, Malaysia (IIAM) that are presently inactive in organizing seminars or courses.
- ii. The cooperation of the State internal Unit and the involvement of the Centre for Modern Management (CMM) are also needed to spearhead the internal auditing profession in Sarawak as CMM have proper facilities such as lecture room as well as having the experienced manpower to teach.
- iii. The other associations such as the Association of Business Scholars, Unimas and the UiTM Alumni Association of Sarawak (MITSA) as well as the local chapter of the Malaysian Institute of Accountants (MIA) and the Malaysian Certified Public Accountants (MACPA) could also play very important roles in promoting the internal audit profession in Sarawak.

- iv. It is suggested that the Sarawak State Department as well as the state statutory bodies and local agencies should establish the ruling that the head and staff of the internal audit units must be member of the Institute of Internal Auditors, Malaysia (IIAM). This strategy will ensure that these internal audit teams have the capabilities and strong knowledge of internal audits in order to render quality service to their organizations.
- v. Since the set up of an Audit Committee is mandatory for Public Listed Companies the government should also establish the ruling that such Audit Committee should exist in the state department, statutory bodies and local authorities. This will ensure transparency and proper accountability, besides the existing Public Account Committees.

5.3 Concluding remarks

It is without doubt that the public sector of the Sarawak State Government has moved toward a more professional approach in the practices of internal auditing based on the above findings.

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APPENDIX I

A Sample of Questionnaire

QUESTIONNAIRE ON

Internal auditing – Public Sector of The Sarawak State Government

August 2001

Instruction

Please tick (/) in the appropriate Box.

SECTION A (YOUR INTERNAL AUDIT UNIT)

1. How long have your Internal Audit Unit being set up?

a. < 5 years

☐

b. 6 – 10 years

☐

c. > 11 years

☐

For Office
Use

☐ 1

2. How many Audit Staff you have?

a. <5 People

☐

b. 6-10 people

☐

c. >11 People

☐

☐ 2

3. Are you a member of Institute of Internal Auditors, Malaysia (IIAM) ?

a. Yes

☐

b. No

☐

☐ 3

[If yes, please proceed to question No. 4]

[If No, please proceed to question No. 6]

4. How long have you been a member?

a. < 5 years

b. 6 – 10 years

c. > 11 years

<input type="checkbox"/>	
<input type="checkbox"/>	
<input type="checkbox"/>	<input type="checkbox"/> 4

5. Do you think that by becoming a member of IIAM help you a lot in term
(You can answer more than one)

a. Acquiring more Internal audit knowledge.

b. Developing your personality and image as a professional.

c. Building a network of internal audit friends.

<input type="checkbox"/>	<input type="checkbox"/> 5
<input type="checkbox"/>	<input type="checkbox"/> 6
<input type="checkbox"/>	<input type="checkbox"/> 7

6. Do your unit have an Internal Audit Committee?

a. Yes

b. No

<input type="checkbox"/>	
<input type="checkbox"/>	<input type="checkbox"/> 8

[If yes, please proceed to question No. 7]

[If No, please proceed to question No. 8]

7. How many times they convene meeting?

a. Once a year

b. Twice a year

c. Quarterly Meeting

d. Due to urgency

<input type="checkbox"/>	
<input type="checkbox"/>	
<input type="checkbox"/>	
<input type="checkbox"/>	<input type="checkbox"/> 9

10. What are the Specific Internal Audit activities that your unit are doing?
(You can answer more than one)

- a. Monitoring financial information
- b. Evaluating internal controls
- c. Ensuring compliance with laws and regulations
- d. Risk Management
- e. Assessing operational effectiveness and efficiency
- f. Others, please specify

☐
☐
☐
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16

17

18

19

20

21

11. Please state the frequency in respect of each audit project/area

- a. Once a year
- b. Twice a year
- c. Not specific. Depend on nature of problem.
- d. Others, please specify

☐
☐
☐
☐
☐

22

8. Do you outsource any Internal audit activities?

a. Yes

☐

b. No

☐

☐ 10

[If yes, please proceed to question No. 9]

[If No, please proceed to question No. 10]

9. If Yes, in which area?

(You can answer more than one)

a. Monitoring financial information

☐

☐ 11

b. Ensuring compliance with laws and regulations

☐

☐ 12

c. Evaluating internal control

☐

☐ 13

d. Fraud

☐

☐ 14

e. Others, please specify

☐

☐ 15

12. Kindly specify your line of reporting.

- a. To State Secretary
- b. To Board of Directors
- c. To Audit Committee
- d. To General Manager
- e. Others, please specify

☐☐☐☐☐☐

23

13. Do your Internal Audit Unit have an audit's charter that basically outline how to carry out Internal audit activities?

- a. Yes
- b. No

☐☐☐

24

14. Do your Internal Audit Unit have Internal audit software?

- a. Yes
- b. No

☐☐☐

25

[If yes, please proceed to question No. 15]

[If No, please proceed to question No. 16]

15. Please describe the nature of the software.

a. Customized

☐

b. Imported

☐

c. Local Software

☐

d. Others, please specify

☐

☐ 26

16. Do you sent your staff to Conference, Seminar or Workshop?

e. Yes

☐

f. No

☐

☐ 27

[If yes, please proceed to question no.17]

[If no, please proceed to question no.19]

17. Where?

[You can answer more than one]

a. Local

☐

☐ 28

b. Semenanjung Malaysia

☐

☐ 29

c. Singapore

☐

☐ 30

d. Others, please specify

☐

☐ 31

18. Which aspect?

[You can answer more than one]

a. Risk management

☐

☐ 32

b. Fraud

☐

☐ 33

c. Control Self Assessment

☐

☐ 34

d. Information Technology Audit

☐

☐ 35

e. Human Resource Audit

☐

☐ 36

f. Others, please specify

☐

☐ 37

SECTION B (YOUR GOODSELF)

19. Have you attended any Internal Audit Conference, Seminar or Workshop?

a. Yes

☐

b. No

☐

☐ 38

[If yes, please proceed to question no.20]

[If No, please proceed to question no.21]

20. When was your last attending the conference, Seminar or Workshop?

a. < 2 years

☐

b. 3 – 6 years

☐

c. >7 years

☐

☐ 39

21. What is your first degree?

a. Accountancy

☐

b. Marketing

☐

c. Management

☐

d. Others, please specify

☐

☐ 40

22. Do you know the existence of the Certified Internal Auditor (CIA), the post-graduate program Organized by IIA?

a. Yes

☐

b. No

☐☐

41

[If yes, please proceed to question No.23]

[If No, please proceed to question No. 24]

23. Do you think that this CIA will add value to your career as professional in Internal auditing.

a. Yes

☐

b. No

☐

c. Not Sure

☐☐

42

SECTION C (YOUR SUGGESTION)

24. What do you think could possibly bring together the Internal auditing professions In Sarawak?

(You can answer more than one)

- | | | |
|--|--------------------------|-----------------------------|
| a. IIAM to organize conference, seminar or workshop in Sarawak. | <input type="checkbox"/> | <input type="checkbox"/> 43 |
| b. Involvement of state Internal Audit Unit with the cooperation of
the Centre of Modern Management (CMM) | <input type="checkbox"/> | <input type="checkbox"/> 44 |
| c. Active participation of the existing IIAM, Sarawak District Society | <input type="checkbox"/> | <input type="checkbox"/> 45 |
| d. Joint venture in organizing conference, seminar or courses
with other associations such as the Association
of Business Scholars (Unimas), UiTM Alumni Association (UiTM)
Local MIA or MACPA, Malay Graduate Association Of Sarawak
or | <input type="checkbox"/> | <input type="checkbox"/> 46 |
| e. Others, please specify | <input type="checkbox"/> | <input type="checkbox"/> 47 |

THANK YOU FOR KIND COOPERATION

APPENDIX II

Standards for the Professional Practice of Internal Auditing

Standards for the Professional Practice of Internal Auditing

INTRODUCTION

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.

Internal audit activities are performed in diverse legal and cultural environments; within organizations that vary in purpose, size, and structure; and by persons within or outside the organization. These differences may affect the practice of internal auditing in each environment. However, compliance with the Standards is essential if the responsibilities of internal auditors are to be met.

The purpose of the Standards is to:

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

The Standards consist of Attribute Standards (the 1000 Series), Performance Standards (the 2000 Series), and Implementation Standards (nnnn.Xn). The Attribute Standards address the characteristics of organizations and individuals performing internal audit activities. The Performance Standards describe the nature of internal audit activities and provide quality criteria against which the performance of these services can be measured. The Attribute and Performance Standards apply to internal audit services in general. The Implementation Standards apply the Attribute and Performance Standards to specific types of engagements (for example, a compliance audit, a fraud investigation, or a control self-assessment project).

There is one set of Attribute and Performance Standards; however, there may be multiple sets of Implementation Standards: a set for each of the major types of internal audit activity. Initially, the Implementation Standards are being established for assurance activities (noted by an "A" following the

standard number, e.g., 1130.A1) and consulting activities (noted by a “C” following the standard number, e.g., nnnn.C1).

The Standards are part of The IIA’s Professional Practices Framework, which was proposed by The Institute’s Guidance Task Force and approved by The IIA’s Board of Directors in June 1999. This framework includes the definition of internal auditing, the Code of Ethics, the Standards, and other guidance. The Standards incorporate the guidance previously contained in the Red Book, recasting it into the new format proposed by the Guidance Task Force and updating it as recommended in the Task Force’s report, *A Vision for the Future*.

The Standards employ terms that have been given specific meanings that are included in the glossary.

The Internal Auditing Standards Board is committed to extensive consultation in the preparation of the Standards. Prior to issuing any document, the Standards Board issues exposure drafts internationally for public comment. The Standards Board also seeks those with special expertise or interests for consultation when necessary. The development of standards is an ongoing process. The Standards Board welcomes input from IIA members and other interested parties to identify emerging issues requiring new or revision to current standards. Suggestions should be sent to:

The Institute of Internal Auditors
Senior Manager, Technical Services
249 Maitland Ave.
Altamonte Springs, FL 32701
USA
E-mail: standards@theiia.org

ATTRIBUTE STANDARDS

1000 – PURPOSE, AUTHORITY, AND RESPONSIBILITY

The purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the Standards, and approved by the board.

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

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

1100 – INDEPENDENCE AND OBJECTIVITY

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

1110 – ORGANIZATIONAL INDEPENDENCE

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

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

1120 – INDIVIDUAL OBJECTIVITY

Internal auditors should have an impartial, unbiased attitude and avoid conflicts of interest.

1130 – IMPAIRMENTS TO INDEPENDENCE OR OBJECTIVITY

If independence or objectivity is impaired in fact or appearance, the details of the impairment should be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.

1130.A1 – Internal auditors should refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an auditor provides assurance services for an activity for which the auditor had responsibility within the previous year.

1130.A2 – Assurance engagements for functions over which the chief audit executive has responsibility should be overseen by a party outside the internal activity.

1130.C1 – Internal auditors may provide consulting services relating to operations for which they had previous responsibilities.

1130.C2 – If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure should be made to the engagement client prior to accepting the engagement.

1200 – PROFICIENCY AND DUE PROFESSIONAL CARE

Engagements should be performed with proficiency and due professional care.

1210 – PROFICIENCY

Internal auditors should possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should possess or obtain the knowledge, skills, or other competencies needed to perform all or part of the engagement.

1210.A1 – The chief audit executive should obtain competent advice and assistance if the internal audit staff lacks the knowledge, skills, or other competencies needed to perform all or part of the engagement.

1210.A2 – The internal auditor should have sufficient knowledge to identify the indicators of fraud but is not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.

1210.C1 – The chief audit executive should decline the consulting engagement or obtain competent advice and assistance if the internal audit staff lacks the knowledge, skills, or other competencies needed to perform all or part of the engagement.

1220 – DUE PROFESSIONAL CARE

Internal auditors should apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care by considering the:

- Extent of work needed to achieve the engagement's objectives.
- Relative complexity, materiality, or significance of matters to which assurance procedures are applied.
- Adequacy and effectiveness of risk management, control, and governance processes.
- Probability of significant errors, irregularities, or noncompliance.
- Cost of assurance in relation to potential benefits.

1220.A2 – The internal auditor should be alert to the significant risks that might affect objectives, operations, or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified.

1220.C1 – The internal auditor should exercise due professional care during a consulting engagement by considering the:

- Needs and expectations of clients, including the nature, timing, and communication of engagement results.
- Relative complexity and extent of work needed to achieve the engagement's objectives.
- Cost of the consulting engagement in relation to potential benefits.

1230 – CONTINUING PROFESSIONAL DEVELOPMENT

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

1300 – QUALITY ASSURANCE AND IMPROVEMENT PROGRAM

The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. The program should be designed to help the internal audit activity add value and improve the organization's operations and to provide assurance that the internal audit activity is in conformity with the Standards and the Code of Ethics.

1310 – QUALITY PROGRAM ASSESSMENTS

The internal audit activity should adopt a process to monitor and assess the overall effectiveness of the quality program. The process should include both internal and external assessments.

1311 – INTERNAL ASSESSMENTS

The internal assessments should include:

- Ongoing reviews of the performance of the internal audit activity
- Periodic reviews performed through self-assessment or by other persons within the organization, with knowledge of internal auditing practices and the Standards.

1312 – EXTERNAL ASSESSMENTS

External assessments, such as quality assurance reviews, should be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization.

1320 – REPORTING ON THE QUALITY PROGRAM

The chief audit executive should communicate the results of external assessments to the board.

1330 – USE OF “CONDUCTED IN ACCORDANCE WITH THE STANDARDS”

Internal auditors are encouraged to report that their activities are “conducted in accordance with the Standards for the Professional Practice of Internal Auditing.” However, internal auditors may use the statement only if assessments of the quality improvement program demonstrate that the internal audit activity is in compliance with the Standards.

1340 – DISCLOSURE OF NONCOMPLIANCE

Although the internal audit activity should achieve full compliance with the Standards and internal auditors with the Code of Ethics, there may be instances in which full compliance is not achieved. When noncompliance impacts the overall scope or operation of the internal audit activity, disclosure should be made to senior management and the board.

PERFORMANCE STANDARDS

2000 – MANAGING THE INTERNAL AUDIT ACTIVITY

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

2010 – PLANNING

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

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

2010.C1 – The chief audit executive should consider accepting proposed consulting engagements based on the engagement's potential to improve management of risks, add value, and improve the organization's operations. Those engagements that have been accepted should be included in the plan.

2020 – COMMUNICATION AND APPROVAL

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

2030 – RESOURCE MANAGEMENT

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

2040 – POLICIES AND PROCEDURES

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

2050 – COORDINATION

The chief audit executive should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimize duplication of efforts.

2060 – REPORTING TO THE BOARD AND SENIOR MANAGEMENT

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

2100 – NATURE OF WORK

The internal audit activity evaluates and contributes to the improvement of risk management, control and governance systems.

2110 – RISK MANAGEMENT

The internal audit activity should assist the organization by identifying and evaluating significant exposures to risk management and control systems.

2110.A1 – The internal audit activity should monitor and evaluate the effectiveness of the organization's risk management system.

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

- Reliability and integrity of financial and operational information.
- Effectiveness and efficiency of operations.
- Safeguarding of assets.
- Compliance with laws, regulations, and contracts.

2110.C1 – During consulting engagements, internal auditors should address risk consistent with the engagement's objectives and should be alert to the existence of other significant risks.

2110.C2 – Internal auditors should incorporate knowledge of risks gained from consulting engagements into the process of identifying and evaluating significant risk exposures of the organization.

2120 – CONTROL

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

2120.A1 – Based on the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of controls encompassing the organization’s governance, operations, and information systems. This should include:

- Reliability and integrity of financial and operational information.
- Effectiveness and efficiency of operations.
- Safeguarding of assets.
- Compliance with laws, regulations, and contracts.

2120.A2 – Internal auditors should ascertain the extent to which operating and program goals and objectives to determine whether operations and programs are being implemented or performed as intended.

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

2120.A4 – Adequate criteria are needed to evaluate controls. Internal auditors should ascertain the extent to which management has established adequate criteria to determine whether objectives and goals have been accomplished. If adequate, internal auditors should work with management to develop appropriate evaluation criteria.

2120.C1 – During consulting engagements, internal auditors should address controls consistent with the engagement’s objectives and should be alert to the existence of any significant control weaknesses.

2120.C2 – Internal auditors should incorporate knowledge of controls gained from consulting engagements into the process of identifying and evaluating significant risk exposures of the organization.

– GOVERNANCE

The internal audit activity should contribute to the organization’s governance process by evaluating and improving the process through which (1) values and goals are established and communicated, (2) the accomplishment of goals is monitored, (3) accountability is ensured, and (4) values are preserved.

2130.A - Internal auditors should view operations and programs to ensure consistency with organizational values.

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

2200 – ENGAGEMENT PLANNING

Internal auditors should develop and record a plan for each engagement.

2201 PLANNING CONSIDERATIONS

In planning the engagement, internal auditors should consider:

- The objectives of the activity being reviewed and the means by which the activity controls its performance.
- The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of task is kept to an acceptable level.
- The adequacy and effectiveness of the activity's risk management and control systems compared to a relevant control framework or model.
- The opportunities for making significant improvements to the activity's risk management and control systems.

2201.C1 – Internal auditors should establish an understanding with consulting engagement clients about objectives, scope, respective responsibilities, and other client expectations. For significant engagements, this understanding should be documented.

2210 – ENGAGEMENT OBJECTIVES

The engagement's objectives should address the risks, controls, and governance processes associated with the activities under review.

2210.A1 – When planning the engagement, the internal auditor should identify and assess risks relevant to the activity under review. The engagement objectives should reflect the results of the risk assessment.

2210.A2 – The internal auditor should consider the probability of significant errors, irregularities, noncompliance, and other exposures when developing the engagement objectives.

2210.C1 – Consulting engagement objectives should address risks, controls, and governance processes to the extent agreed upon with the client.

2220 – ENGAGEMENT SCOPE

The established scope should be sufficient to satisfy the objectives of the engagement.

2220.A1 – The scope of the engagement should include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties.

2220.C1 – In performing consulting engagements, internal auditors should ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If internal auditors develop

reservations about be discussed with the client to determine whether to continue with the engagement.

2230 – ENGAGEMENT RESOURCE ALLOCATION

Internal auditors should determine appropriate resources to achieve engagement objectives. Staffing should be based on an evaluation of the nature and complexity of each engagement, time constraints, and available resources.

2240 – ENGAGEMENT WORK PROGRAM

Internal auditors should develop work programs that achieve the engagement objectives. These work programs should be recorded.

2240.A1 – Work programs should establish the procedures for identifying, analyzing, evaluating, and recording information during the engagement. The work program should be approved prior to the commencement of work, and any adjustments approved promptly.

2240.C1 – Work programs for consulting engagements may vary in form and content depending upon the nature of the engagement.

2300 – PERFORMANCE THE ENGAGEMENT

Internal auditors should identify, analyze, evaluate, and record sufficient information to achieve the engagement's objectives.

2310 – IDENTIFYING INFORMATION

Internal auditors should identify sufficient, reliable, relevant, and useful information to achieve the engagement's objectives.

2320 – ANALYSIS AND EVALUATION

Internal auditors should base conclusions and engagement results on appropriate analyses and evaluations.

2330 – RECORDING INFORMATION

Internal auditors should record relevant information to support the conclusions and engagement results.

2330.A1 – The chief audit executive should control access to engagement records. The chief audit executive should obtain the approval of senior management and/or legal counsel prior to releasing such records to external parties, as appropriate.

2330.A2 – The chief audit executive should develop retention requirements for engagement records. These retention requirements should be consistent with the organization's guidelines and any pertinent regulatory or other requirements.

2330.C1 – The chief audit executive should develop policies governing the custody and retention of engagement records, as well as their release to internal and external parties. These policies should be consistent with the organization's guidelines and any pertinent regulatory or other requirements.

2340 – ENGAGEMENT SUPERVISION

Engagements should be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed.

2400 – COMMUNICATING RESULTS

Internal auditors should communicate the engagement results promptly.

2410 – CRITERIA FOR COMMUNICATING

Communications should include the engagement's objectives and scope as well as applicable conclusions, recommendations, and action plans.

2410.A1 - The final communication of results should, where appropriate, contain the internal auditor's overall opinion.

2410.A2 – Engagement communications should acknowledge satisfactory performance.

2410.C1 – Communication of the progress and results of consulting engagements will vary in form and content depending upon the nature of the engagement and the needs of the client.

2420 – QUALITY OF COMMUNICATIONS

Communications should be accurate, objective, clear, concise, constructive, complete, and timely.

2421 – ERRORS AND OMISSIONS

If a final communication contains a significant error or omission, the chief audit executive should communicate corrected information to all individuals who received the original communication.

2430 – ENGAGEMENT DISCLOSURE OF NONCOMPLIANCE WITH THE STANDARDS

When noncompliance with the Standards impacts a specific engagement, communication of the results should disclose the:

- Standard(s) with which full compliance was not achieved.
- Reason(s) for noncompliance.
- Impact of noncompliance on the engagement.

2440 – DISSEMINATING RESULTS

The chief audit executive should disseminate results to the appropriate individuals.

24401.A1 – The chief audit executive is responsible for communicating the final results to individuals who can ensure that the results are given due consideration.

2440.C1 – The chief audit executive is responsible for communicating the final results of consulting engagements to clients.

2440.C2 – During consulting engagements, risk management, control, and governance issues may be identified. Whenever these issues are significant to the organization, they should be communicated to senior management and the board.

2500 – MONITORING PROGRESS

The chief audit executive should establish and maintain a system to monitor the disposition of results communicated to management.

2500.A1 – The chief audit executive should establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

2500.C1 – The internal audit activity should monitor the disposition of results of consulting engagements to the extent agreed upon with the client.

2600 – MANAGEMENT'S ACCEPTANCE OF RISKS

When the chief audit executive believes that senior management has accepted a level of residual risk that is unacceptable to the organization, the chief audit executive should discuss the matter with senior management. If the decision regarding residual risk is not resolved, the chief audit executive and senior management should report the matter to the board for resolution.

(Note: Extract from Internal Auditor Magazine, December 2001:73-77)