

Internal auditing system effectiveness for detecting fraud



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INTRODUCTION

The chapter shall look at the background of the study, statement of the problem, research questions, objectives of the study, purpose of the study, hypothesis, assumptions of the study, delimitation of the study, limitations of the study, and the organisation of the study.

BACKGROUND OF THE STUDY

Auditing was firstly introduced in the year 1879, in the banking sector when banking institutions were required by the statute to have an audit system, which was not generally extended until 1900 (Millichamp and Taylor: 2012). It was defined by Mainoma, (2007) as an independent examination of the financial statements, and expression of an opinion on the financial statements of an organisation by the selected auditor, in line with their professional requirements and the required statutory regulations. This means that the appointed auditor is responsible to expressing an opinion on the financial statements of an organisation, the auditor here mean an individual or a firm doing audit of an organisation. The auditor should be approved and must have personal and operational independence in order to perform his duty effectively.

Since it was introduced, auditing is mainly divided into two broad categories as internal and external auditing. Internal auditing as its name implies, operates within the organization and external auditing also operates externally. The Chartered Institute of Public Finance and Accountancy (CIPFA), as cited by Johnson (2006: 47) defines internal audit as “ an independent appraisal function within an organisation for the review of <https://assignbuster.com/internal-auditing-system-effectives-for-detecting-fraud/>

activities as a service to all levels of management. It is a control which measures, evaluates and reports upon the effectiveness of internal control, financial and otherwise, as a contribution to the efficient use of resources within an organisation." From this definition then it means Internal audit's objective is to assist organisational members in the effective discharge of their duties and also most organisations in the world either large or small undertake internal auditing as a vital measure of internal control systems in their operations.

Internal auditing is a legal requirement in all tiers of the government including local authorities. The reason behind this is that local authorities and all public sector organisations are funded by the public funds and therefore must be accountable for its use, hence auditing process of the public sector bodies' place greater reliance on the effectiveness of internal auditing than what the private sectors does. Local government as a segment of the public sector is one of the three tiers of government in Zimbabwe. At local government level, all local authorities are entrusted with public resources and they are charged to have a duty of ensuring proper utilisation of those resources. In a bid to optimise proper utilisation of those resources, laws and regulations are enacted in order to control expenditure and the sources to financing these expenditures. To ensure adherence to laid down laws and regulations internal auditing system was established in the local authorities (Badara 2012).

According to the Institute of Internal Auditors (2001) Internal auditing system within an organisation is expected to safeguarding the assets of the organisation and where appropriate, they verify the existence of such <https://assignbuster.com/internal-auditing-system-effectives-for-detecting-fraud/>

recorded assets. That it means internal auditors have powers to undertake observations, enquiries and also independent checks on the firm's operations, documents and assets in line with the organisational rules and regulations to come up with an effective audit output. Despite the fact that internal auditing system exists in various local authorities worldwide with internal control systems in place, the act of financial crime such as fraud and other irregularities still continue and mostly detected by the external auditors.

Regardless of the internal auditing system in Zimbabwean organizations (both public and private), the value of fraud and other financial irregularities is extremely high; in six months to December 2012 it was reported at US\$1.2 billion which is about 32 percent of the overall value of fraud and other financial irregularities cases in Africa (KPMG 2012). Internal auditing was introduced in Zimbabwean local authorities by the Ministry of Local Government [M1] in a bid to reduce the risk of fraud and other financial irregularities; to assist the external auditors; to identify opportunities for improving economy, efficiency and effectiveness and to assess the organization's internal controls (Zimbabwe Councils Act 29: 13).

ZRDC is one of the seven administrative district councils in Masvingo province. It is a structured organization with the internal auditing system in place. Its internal auditors report functionally to the councilors through the audit committee and administratively to the chief executive officer, they also communicate and interact directly with the council through the audit committee, including in executive sessions and committee meetings as appropriate (ZRDC Internal Audit Charter 2012). Despite the existence of <https://assignbuster.com/internal-auditing-system-effectives-for-detecting-fraud/>

internal auditing system at ZRDC, numerous cases of fraud and other financial irregularities were continuously reported by the external auditors (ZRDC External Auditors Report 2012).

This prevailing situation at ZRDC gave rise to doubts on the unit's competence and effectiveness mostly in fraud and other financial irregularities detection and prevention by local government authorities and all other interested stakeholders as since their expectations were not fulfilled. This was mainly characterized by misunderstanding on what users of the council's financial information expect management to do, and what management expects internal auditors to do as far as fraud and other irregularities detection and prevention is concerned. Users of the council's financial information expressed their concern on the system's weakness as since they expect the system to be the council's " watchdog" on any fraudulent activity existing (Zimbabwe Councils Act 29: 13).

The research project will therefore sought to evaluate the effectiveness of internal auditing system in Zimbabwean local authorities mostly in detecting, preventing and reducing fraud and any other financial irregularities in the day to day operations of Zaka Rural District Council.

STATEMENT OF THE PROBLEM

Numerous cases of fraud and other financial irregularities have been continuously reported at ZRDC despite the existence of internal auditing system. The council is losing more revenue from its income generating projects, rates collection, donations and government grants due to

fraudulent activities, errors and distortion of figures in the preparation of <https://assignbuster.com/internal-auditing-system-effectives-for-detecting-fraud/>

financial statements by the council employees and management. Internal auditing system is failing to detect most of these cases such that they take too long uncovered or sometimes never been detected. As a result the council is failing to meet its statutory obligations and delivering quality services to its clients. To this end the effectiveness of the council's internal auditing system in fraud and any other financial irregularities detection needs to be evaluated

RESEARCH QUESTIONS

- How effective is the Internal Auditing system at ZRDC in detecting fraud and other financial irregularities
- Why are most material fraud and other financial irregularities go for so long undetected and some never detected by the Internal Auditing system?
- To what extent is ZRDC Internal Auditor's independence considered by both users and management?
- Are all the recommendations passed by the Internal Auditors acted upon by management?

OBJECTIVES OF THE STUDY

The objectives of the study are to:

- evaluate the effectiveness of the internal auditing system in detecting fraud and other financial irregularities at ZRDC.

- discover why most material fraud and other financial irregularities take too long to be detected and some never detected by the internal auditing system at ZRDC.
- establish the independence of ZRDC internal audit unit.
- establish whether the internal audit unit's recommendations are acted upon by management.

PURPOSE OF THE STUDY

- The research is to be carried out in partial fulfilment of the Bachelor of Commerce (Hon) Degree in Accounting at Great Zimbabwe University. The research will widen the researcher's academic knowledge through detailed analysis of the project
- The researcher wants to draw an evaluation of the effectiveness of the council's internal audit unit in detecting fraud and errors that will save to reduce discrepancies between what the users, management and the audit unit believes to be the purpose of the internal audits and the actual nature of the internal auditor's duties.
- To find the reason why the internal auditing system is failing to detect most material fraud and other financial irregularities that the external auditors detects.
- The final researched work may be used as reference by other students who may want to do the same or related topic.

6. HYPOTHESIS

Null hypothesis

- ZRDC's internal auditing system is not effective in detecting fraud and other financial irregularities.

Alternative hypothesis

- ZRDC's internal auditing system is effective in detecting fraud and other financial irregularities.

ASSUMPTIONS

- The researcher assumed that the study would be successful and methodology used was appropriate to produce true results.
- The researcher will gather information which is free from bias and relevant to the area under study.
- There will be good cooperation between the researcher and the respondents.
- The sample to be selected representing the whole organisation of ZRDC and its environment.
- ZRDC is the good representative of all local authorities in Zimbabwe.

DELIMITATION OF THE STUDY

- The study will focus on effectiveness of internal auditing in Zimbabwean local Authorities using a Case of Zaka Rural District Council in Masvingo province for the period of 2012 to 2013. It will be confined to the CEO, council employees, internal auditors, audit committee, finance committee, councilors and district administrator of Zaka Rural District Council from which information and data will be gathered.

LIMITATIONS OF THE STUDY

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- The researcher may have limited access to information due to the need to respect ethical code of the council in the process of gathering information. Access to information will be facilitated by the Treasurer due to the good relationships which were established while on attachment.
- Limited resources will be a problem; however most of the typing will be done by the researcher in order to reduce costs. The researcher started to conduct the research during the vacation which started in December 2013 to February 2014 in order to reduce pressure during the learning period

10. Organisation of the Study

Chapter one is an introductory chapter that paves out the research study. It gave a brief outline of the introduction and background of the study, statement of the problem, research questions, objectives of the study, justification of the study, statement of hypothesis, assumptions of the study. The chapter also highlighted the limitations and delimitations of the study.

Chapter two gives a detailed review on the conceptual, theoretical and empirical review of related literature pertaining to the effectiveness of internal auditing in local authorities. Chapter three also explain the research methods that were used in the research study including, research design, research instrument, data connection procedures and data presentation and analysis plans.

Chapter four focuses on data presentation, interpretation and analysis of the data collected from respondents during the research. Lastly, chapter five

focuses on the conclusions which can be drawn from the research and making recommendations where necessary to various stakeholders.

Summary

This chapter concentrates on brief description of the background to the study, justification of the study and what the research sought to achieve. The next chapter focuses on review of related literature.

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