

CHAPTER 1

BACKGROUND TO THE STUDY

1.1 INTRODUCTION

This chapter provides an introduction to and outline of the rest of the study. The topic of the study, namely the effect of HIV/AIDS on the control environment: an internal audit perspective, can be divided into two broad areas. The first is the role and function of an internal auditor, as the study focuses on an internal audit perspective on the problem. The second is HIV/AIDS. This is investigated to determine whether the disease is a threat to the world as a whole, individual countries, the business environment, organisations and individuals. The literature available on this topic is also critically reviewed, the problem formulation and hypotheses are discussed, as well as the rationale for the research study, the research design and the way the rest of the chapters are divided.

1.2 BACKGROUND

As mentioned above, the background to the study can be divided into two main areas. These are discussed briefly below.

1.2.1 The role and function of internal auditors

An internal auditor is a professional person who functions within an organisation to assist management with certain tasks. Although internal auditing is not a new concept, considerable changes have occurred in the last few years regarding the functioning of the profession.

One of the characteristics of a profession is the need to maintain a high degree of competency. The Institute of Internal Auditors has developed a Professional Practices Framework (hereafter referred to as PPF) in order

to meet this goal (Institute of Internal Auditors 1999). Three key elements in the framework are the definition of internal auditing, the Standards for the Professional Practice of Internal Auditing, and the Guidance - Development and Practice Aids. These are briefly explained in the context of this study.

The definition of internal auditing is the following:

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes (Institute of Internal Auditors 1999:3)

The above definition implies that it is important for an internal auditor to address control, including the control environment; risk management, including the identification and management of risks threatening the organisation's reaching of its objectives; and corporate governance, including assisting management by identifying crucial issues that could affect the organisation.

The new Standards for the Professional Practice of Internal Auditing (hereafter referred to as *standards*) are the criteria by which the success of the operations of an internal audit activity are evaluated and measured. The previous set of standards focused on the role of internal auditors in a compliance function, especially control. The *standards* were updated to include the issue of risk and corporate governance.

The Guidance - Development and Practice Aids include educational products, research studies and other relevant projects. The use of these aids is not mandatory, but internal audit staff could use them to assist organisations and those individuals to whom specific aspects of these guidance aids are relevant. The results of research studies that are relevant to the functioning of an internal auditor have been incorporated

into the guidance aids, and can be used by internal auditors to help them to assist management with its duties.

The new definition, as starting point of the rest of the PPF, encompasses all the dimensions of the internal auditing activity, suggesting a profession that is characterised by broad business parameters and technical skills. Internal auditors should understand business strategy and should focus on adding value by facilitating change through advice and counsel (Coetzee & Du Bruyn 2001:63). The concepts of control, risk management and corporate governance must be understood and incorporated in the internal auditing activity.

The control process is one of the elements addressed by the definition. Control is broadly defined as a process designed to provide reasonable assurance that the organisation's objectives will be achieved (COSO 1992:13).

The Treadway Commission has performed a comprehensive study on control in organisations and the study resulted in the COSO Report (1992). The report identified six elements of a sound control system, namely the control environment, risk assessment, control activities, information capture, the communication of information and continuous monitoring. The COSO report is currently being updated and will be re-issued early in 2004 (COSO 2003). For the purposes of this study, however, the specific elements in the control environment that form the basis of this research document have remained the same. Therefore the current COSO document methodology is used.

COSO divides the control environment into several categories. It is important for management, and for an internal auditor who is in a guiding role to management, to understand the effect of risks on the control environment. The categories identified by COSO are the following:

- a Integrity and ethical values – Management’s attitude, actions and behaviour regarding ethical issues, moral guidelines and procedures, an ethical code and disciplinary actions are some of the important elements. The risk in terms of the focus of this study is that no formal policy on how to treat people with HIV/AIDS may have been issued by management
- b Commitment to competence – Employees should have the necessary knowledge and competence to perform their duties. The risks include that competent people infected with HIV/AIDS may not be doing their job properly; new appointments need to be made from a smaller pool of candidates; and many more relevant issues.
- c Board of directors and the audit committee – An effective and efficient Board and audit committee see to it that the control system functions as planned, including the control environment.
- d Management’s philosophy and style – This refers to the attitude of management and the manner in which management manages the day-to-day activities of the organisation, for example, formal, informal, aggressive, or conservative.
- e Organisational structure – This refers to the framework used for the execution, controlling and monitoring of the activities of the organisation. The risk is that, because people are on sick leave or dying, the organisational structure can collapse.
- f Delegation of rights and responsibilities – This refers to the method used and the degree to which rights and responsibilities as well as initiatives are allocated to individuals. The risk is a lack of a comprehensive contingency plan to address a situation where people are infected with HIV/AIDS, for example, where people are on sick leave, or dying.

g Human resources policies and procedures – The employment of sufficient and capable people, and the development of these employees are affected most by the disease. Employing people with HIV/AIDS, the treatment of employees that are infected, medical aid issues, and pension plans, are some of the issues that must be investigated.

As the control environment is a broad concept, this study concentrates on the elements of the control environment where HIV/AIDS can play a major role, namely in commitment to competence, in the organisation's structure, and human resources policies and procedures.

A proper control environment forms a sound basis for the control system of the organisation. The control environment's success is based on the people driving the system (Arens & Loebbecke 1997:289). An inadequate control system operated by honest, competent people is of more value to an organisation than a proper system controlled by corrupt management and/or employees.

HIV/AIDS, like cholera, influenza, and other diseases caused by viruses, is a disease that affects humans. The huge number of people who have HIV/AIDS, especially in Sub-Saharan Africa, make this a disease that also threatens the business world and the workforce. The control environment in an organisation is based on the actions and attitudes of the management and the employees of that organisation. Therefore HIV/AIDS could and most probable does have an influence on the control environment.

1.2.2 HIV/AIDS

The world is becoming increasingly complex and the most serious challenges are by nature global. One of these global challenges, identified by the Millennium Project (one of several environmental organisations focusing on HIV/AIDS), is the control and reduction of new and re-

emerging diseases and immune micro-organisms (Glenn & Gordon 2002:15). Since the first cases of HIV/AIDS were reported 20 years ago, nearly 58 million people have been infected and 22 million have died - and these are only the known figures (Brookings Institution 2001:1). In 1997 the Doyle model predicted that by the year 2000 between 8% and 10% of adults in South Africa would be infected with HIV, increasing to about 22% in the year 2010 (Williams, Gouws & Abdool Karim 2000:297). The national prevalence rate amongst pregnant women already reached 24,8% in 2001, with KwaZulu-Natal being the highest at 33,5% and the Western Cape the lowest at 8,7% (Department of Health 2001:5).

What is of the greatest concern to the business environment is that infection rates are very high amongst young, economically active persons (UNAIDS/WHO 2002:4). This not only influences consuming power, but has an overwhelming effect on the workforce. It is thus a major threat to the achievement of strategic business objectives and related business risks. Hence, the incidence of HIV/AIDS is a matter of great concern for internal auditors.

A further concern for organisations is the various legislative stipulations and regulations related to HIV/AIDS. Some of the rules and regulations applicable include:

- the Employment Equity Act No 55 of 1998;
- the Labour Relations Act No 66 of 1995;
- the Occupational Health and Safety Act No 85 of 1993;
- the Basic Conditions of Employment Act No 75 of 1997;
- the Constitution of South Africa Act No 108 of 1996;
- the Code of Good Practice on Key Aspects of HIV/AIDS and Employment; and
- the King Report on Corporate Governance for South Africa, 2002.

Responding to HIV/AIDS in the workplace is essentially about managing the issue as a business risk; that is, having accurate and relevant

information about the epidemic, monitoring the progress, knowing or predicting the risk and addressing the risk by managing it (Evian 1998:4). To be able to address the problem of HIV/AIDS, management needs to know the risks involved, and minimise the risk by implementing a proper strategic action plan. The implementation and maintenance of a sound control system is the responsibility of management (King Committee on Corporate Governance 2002:45), but internal auditors are responsible, according to the new internal audit definition, for assisting management with this task. HIV/AIDS is a threat to people, therefore to the workforce and thus to the control environment. Management must understand the effect of HIV/AIDS on the business environment as well as its effect on the control environment.

1.3 LITERATURE REVIEW

An extensive review of the relevant literature has revealed that while much research has been done on HIV/AIDS, no research on the role of internal auditors regarding the effect of HIV/AIDS on an organisation has yet been done. The effect of HIV/AIDS on the control environment itself has also not yet been studied.

One of the largest research projects on HIV/AIDS in South Africa is the study conducted by the Centre for International Health (2002) at the Boston University School of Public Health. *The Program on the Social and Economic Impacts of the HIV/AIDS Epidemic* is a multidisciplinary, applied research programme conducted by the Centre. It brings together expertise in infectious diseases, public health, demography, epidemiology and economics in an effort to understand the effects of HIV/AIDS on households, businesses, government and other institutions in the developing world. It also addresses the need to identify and evaluate policies and programmes to mitigate the impact of HIV/AIDS (Centre for International Health 2002).

The HIV/AIDS Boston programme has various projects in progress, but the largest research programme is the *Study of the Impact of HIV/AIDS on Businesses in South Africa*, where, with the support of UNAIDS and the private sector, valuable information regarding the threat of HIV/AIDS is obtained and monitored. Six companies in heavy industry, agriculture, mining (processing), mining (extraction), retail and service have been examined (Rosen, Simon, Vincent, Macleod, Fox & Thea 2003a:10). A model for analysing the cost of HIV/AIDS to organisations has been developed as a result of the study (ARCH Project Annual Report 2000:2) (see table 4).

However, Dr Clive Evian, a well-known researcher on the topic of HIV/AIDS, has been actively involved in the study of HIV/AIDS in South Africa since the early 1980's, not only in the medical field, but also studying the effect of HIV/AIDS on organisations and the implementation of proper strategic plans. Various organisations were monitored by his organisation, Aids Management and Support, since the mid-1980's. He is now in a phase where follow-up investigations on some of these organisations are being performed. The effect of a proper corporate strategy can thus be measured by comparing the results of the first survey with those of the follow-up (Evian 2002).

The South African Business Coalition on HIV/AIDS (SABCOHA) was established in December 1997, committing itself to establishing a knowledge centre for best practices, policies, news, statistics and other guidance to mitigate the economic and social impact of HIV/AIDS. Information regarding global trends, the South African situation, the micro - and macro-economic impact, individual company level impact, business responses to the epidemic, and other relevant information, is available to members (SABCOHA 2002). Deloitte & Touche (2002) has issued a report on SABCOHA's assessment of HIV/AIDS initiatives in the private sector.

The information gathered by these research projects as well as other research studies forms the basis of the data used by this study.

1.4 PROBLEM FORMULATION AND HYPOTHESES

1.4.1 Primary problem formulation

HIV/AIDS is a known threat to the world, especially in Sub-Saharan Africa and South Africa (UNAIDS/WHO 2002:4). It is vital that the effects of the disease on the economy and organisations are studied. Management is responsible for a sound control system, and internal auditors are seen as control experts and must assist management with this task.

Various studies have indicated that management/s are aware of the risk that HIV/AIDS poses to their organisations (see Barac & Otter 2001:26, Deloitte & Touche 2002:1). Internal auditors should support management in their task by studying the consequences and effects of HIV/AIDS on the organisations concerned. It is internal auditors' duty, and hence the primary focus of this study, to understand the consequences of HIV/AIDS for the control system of an organisation. As the control environment forms the basis for the control system, the internal auditor first has to identify the risk that HIV/AIDS poses for this area to be able to assist management in controlling the effect of HIV/AIDS on the control system.

1.4.2 Sub-problems

The primary problem of identifying the effects of HIV/AIDS on certain elements of the control environment is divided into the following secondary problems:

- 1 Is the internal auditor aware of the business risk that HIV/AIDS poses for the organisation?
- 2 Is the internal auditor part of management's plan to address the risk posed by HIV/AIDS to the organisation?
- 3 What is the knowledge and input of internal auditing in management's strategic plan regarding HIV/AIDS?
- 4 What is the risk of the affect of the disease for the competency of the workforce and how will this effect the control environment?

- 5 What risk do the consequences of the disease pose for the structure of the organisation regarding the day-to-day management of activities?
- 6 What issues are a risk to the organisation and need to be addressed by management regarding the human resources policies and procedures?
- 7 Is the internal auditor aware of the possible effect that HIV/AIDS could have on the control environment?

1.4.3 Hypotheses

To guide this study and to provide a framework for the organisation for the structuring of conclusions and recommendations, the following research hypotheses were formulated:

- 1 Internal auditors are aware of the HIV/AIDS epidemic and the consequences that this risk holds for the organisation.
- 2 Internal auditors are assisting management with strategic objectives, strategies (plans) and related objectives regarding the risk of HIV/AIDS to the organisation.
- 3 HIV/AIDS, as a business risk, has an effect on certain elements of the control environment in organisations.
- 4 The effect of HIV/AIDS on the control environment can weaken the control system as a result of the loss of key elements in the system.
- 5 The cost involved in managing the risk of the consequences of HIV/AIDS must be paid to strengthen and/or maintain the control environment.

1.5 ROTIONALE FOR THE RESEARCH STUDY

As seen from the above problem formulation and the hypotheses, this study aims to prove that HIV/AIDS has an effect on certain elements of the control environment, and that internal auditors, as management consultants, should advise management on how to monitor and manage this risk. If this study can show that HIV/AIDS does affect the control

environment, the results can be used to ask what internal auditors are doing about this risk. In particular, one can then ask whether the internal auditor is bringing the fact that HIV/AIDS is affecting the control environment to management's attention. If this study concludes that very little is being done by internal auditors to address this risk, a set of guidelines should be developed by the internal audit profession globally, and it should be distributed to members of the Institute of Internal Auditors Inc to guide internal audit practitioners. The guidelines should be developed to assist internal auditors in their role, helping management to understand and control the effects of HIV/AIDS in their organisations. The guidelines should be published in the form of more Guidance - Development and Practice Aids as part of the Professional Practice Framework.

1.6 RESEARCH DESIGN

The research study is divided into two main areas, namely, an investigation as to, firstly, whether HIV/AIDS has an effect on certain elements of the control environment and, secondly, whether internal auditors are aware of such effects and the role they have to play with regard to this risk.

1.6.1 Data used

Data gathered by the Centre for International Health, Boston University School of Public Health forms the basis of the information used to determine whether HIV/AIDS has an effect on certain elements of the control environment. To determine the role of internal auditors in managing this risk, a questionnaire was designed and used as an aid in interviews with chief audit executives or other senior internal auditors responsible for risk management in their organisations.

1.6.2 Research method

The research focused on the three main areas of the control environment that would probably be most affected by HIV/AIDS, namely the commitment of the workforce to competency, the organisational structure, and human resources policies and procedures.

To establish the competency of the workforce, information regarding the cost of HIV/AIDS to an organisation, and other aspects was obtained and measured against the overall performance of the organisation for issues such as employee performance, a loss of personnel, the recruitment and training of new personnel, production, and absenteeism and the effect thereof on the morale of the workforce.

The organisational structure is influenced by the diminishing of a competent workforce, increased use of technology to reduce labour dependency, and absenteeism and the effect thereof on the delegation of rights and responsibilities.

Human resources policy and procedures could be affected by legislation on recruitment processes, the need to train new employees, training regarding HIV/AIDS prevention, the testing of employees and the treatment of HIV/AIDS positive employees, higher remuneration as a result of the smaller source of competent people, sick and compassionate leave, and medical aid and pension fund contributions.

The research first attempted to identify whether HIV/AIDS does have an effect on the abovementioned factors. Thereafter, a survey was used to address the knowledge of and the role played by internal auditors regarding the business risk posed by HIV/AIDS to their organisations.

The results were interpreted and meaningful conclusions about the effect of HIV/AIDS on business risk and the control environment were drawn from an internal auditing perspective.

1.7 OVERVIEW OF THE STUDY

The rest of the study can be briefly explained by providing an overview of each chapter.

In Chapter 2 internal auditing as a consulting activity that evaluates and improves the control process is explained. An overview of the history of internal auditing is given. This includes a definition of internal auditing, the Professional Practice Framework, and the Competency Framework. These are all explained in the context of the role of internal auditors in an organisation. The concepts of control, risk management and corporate governance are highlighted.

In Chapter 3 the possible risk of HIV/AIDS to the world, the global economy, individual governments, the business environment and organisations, and the role of management are investigated. Background on the nature, origin, prevention and cure of the disease, as well as the extent of the epidemic, are discussed.

Chapter 4 focuses on the literature available on the effect of HIV/AIDS on the control environment and the role of internal auditors in limiting this risk. The study first investigates the role of internal auditors in determining the effects of HIV/AIDS on an organisation. It then looks at the effect of the disease on the control system, in particular on the competency of the workforce, organisational structure, and human resources policies and procedures.

Chapter 5 describes the research methodology used in the empirical study and Chapter 6 presents an analysis of the research findings of the investigation. The chapter first focuses on the effect of HIV/AIDS on certain elements of the control environment and then looks at the role of internal auditors in controlling this risk. Next, internal auditors' awareness of HIV/AIDS as a risk to the organisation, their assistance to management

in controlling the risk, and their awareness that the disease weakens the control system are discussed.

In Chapter 7, the conclusions of the study are set out, recommendations are made, and other potentially relevant research areas that need to be investigated are identified.

1.8 SUMMARY

In this introduction, a brief overview is given of the profession of internal auditing, the risk of HIV/AIDS, and the role of internal auditors regarding this potential risk. The chapter has also identified the research problem and methodology to be used in the rest of the study. The next chapter gives a more detailed explanation of the profession of internal auditing.