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CHAPTER 2
INTERNAL AUDITING AS A CONSULTING ACTIVITY THAT EVALUATES AND IMPROVES THE CONTROL PROCESS

2.1 INTRODUCTION

Although the internal auditing profession is not new to the business environment, large changes have occurred in this profession during the last few years. Internal auditors are not only seen as the right hand of management in assuring that policies, plans and procedures are adhered to, they now also fulfil a consulting role, investigating and reporting on crucial issues such as business risks threatening the organisation (Krogstad, Ridley & Rittenberg 1999:27). Internal auditors are still seen as control experts and must continuously monitor and report on areas in the control environment that are, or could become, a potential weakness (Root 1998:120). Therefore internal auditors have the responsibility of being aware of business risks, as well as the effect these risks may have on the various aspects of a business, such as the control environment.

One of the main risks threatening not only the world in general, but the business environment in particular, and therefore, the control environment of organisations, is the disease known as HIV/AIDS (UNAIDS 2000:1). The question arises as to what extent this disease will affect the business environment and individual organisations. Responding to HIV/AIDS in the workplace is essentially about managing the disease and the issue surrounding it as a business risk. This implies having accurate and relevant information about the epidemic, monitoring its progress, knowing or predicting the risk to the organisation, and addressing the risk by managing it (Evian 1998:4).

Various studies have indicated that managements are aware of the risk posed by HIV/AIDS to their organisations (UNAIDS 2000; Deloitte &

Touche 2002). It is still uncertain whether internal auditors, in a consulting capacity, are supporting management in monitoring and managing HIV/AIDS by studying the effect of HIV/AIDS for organisations. It is the internal auditors' duty, and the primary focus of this study, to understand the effects of HIV/AIDS on the control system of an organisation. As the control environment forms the basis of the control system (COSO 1992:23), an internal auditor, as a control expert, first has to identify the risk posed by HIV/AIDS to this area to be able to assist management in controlling the effects of the disease on the control system.

The consulting role of internal auditors, particularly with regard to an evaluation and the improvement of the control process, can only be fully appreciated if the internal auditing function within the profession is properly understood. With this objective in mind, an overview of the history of internal auditing, the definition of internal auditing, the Professional Practices Framework (PPF), the Competency Framework for Internal Auditors (CFIA), and the changing role of internal auditing with regard to control, risk and corporate governance processes, are highlighted in this chapter.

2.2 THE HISTORY OF INTERNAL AUDITING

As early as the beginning of the twentieth century, economic growth made it difficult for organisations to maintain control of their business activities and operational efficiency. Management lost direct contact with most of its subordinates. To overcome the problem of controlling the activities of the organisation, people known as internal auditors were appointed to review and report on what was happening. The tasks performed by the internal auditors varied from the checking of routine financial and operational activities, to analysing and appraising these activities (Institute of Internal Auditors Inc 2003).

As the profession evolved, internal auditors wanted greater recognition of their function and on 17 November 1941 The Institute of Internal Auditors

Incorporated (IIA Inc) was established in the United States of America (Institute of Internal Auditors Inc 2003). The initial purpose of the IIA Inc was to provide internal auditors with an opportunity to share their common interests and concerns (Sawyer, Dittenhofer & Scheiner 1996:9). Today, the IIA Inc is a dynamic international organisation that meets the needs of a worldwide body of internal auditors, dedicated to the continuing professional development of individual internal auditors and the internal auditing profession as a whole (Institute of Internal Auditors Inc 2003).

In 1944, Arthur E Hald, one of the founders of the IIA Inc, made the following statement:

> Necessity created internal auditing and is making it an integral part of modern business. No large business can escape it. If they haven't got it now, they will have to have it sooner or later, and, if events keep developing as they do at present, they will have to have it sooner. (Flesher 1996:3)

These words became true as internal auditing became one of the fastest growing professions of the second half of the twentieth century (Flesher 1996:3).

The activities of internal auditing expanded from being a watchdog (performing assurance activities for management) to being a guide dog for management. Modern internal auditing's responsibility is as broad as the current business environment. According to Arnold Baker, chief economist of a large organisation in the United States of America, there is going to be a fundamental change in the global economy, unlike anything we have seen before. An example of these dramatic changes is the fact that only one of the twelve largest industrial organisations in the United States of America in 1990, General Electric Company, still exists today (Marks 2001:44).

Internal auditors need to add value to an organisation by making sure that the activities of an organisation are performed economically, efficiently and

effectively; by foreseeing potential risks as well as by identifying existing risks, such as HIV/AIDS, that can threaten the organisation as a whole; by addressing corporate governance in their audit activities; by making sure that the organisation keeps up with the latest technology and processes; and much more (Marks 2001; Krogstad *et al* 1999).

To make sure that internal auditors keep up with changes in their environments, the IIA Inc developed a Common Body of Knowledge (CBOK) during 1972 (Sawyers *et al* 1996:29). This has been regularly updated, and during 1999 the IIA Inc's Research Foundation developed the Competency Framework for Internal Auditors (CFIA), to provide internal auditors with guidelines regarding their knowledge and the competencies needed to stay in touch with the changing business environment (McIntosh 1999:5). The changing role of the profession includes consulting. Internal auditors may also benefit from these guidelines because they can equip modern internal auditors better to evaluate new threats to the business environment, such as HIV/AIDS. The CFIA focuses on the skills needed by an individual person to be an efficient internal auditor.

For a long time, the environment that internal auditors operate in, namely internal audit departments or activities, lacked guidance on its role and responsibility towards the organisation it served. According to Mautz and Sharaf (1982:11), internal auditing was a well-established and well-respected activity, but there was little indication that it was well defined or clearly directed. The Statement of Responsibilities of Internal Auditing was prepared by the research committee of the IIA Inc and approved by the Board of Directors at its meeting on 15 July 1947. The purpose of the Statement was to establish a set of guidelines that defined the proper role and responsibilities of the internal auditing function within an organisation (Flesher 1996:34). The Statement has also been regularly updated and in June 1999, the IIA's Board of Directors voted and approved a new set of guidelines, headed by a new definition in the form of the Professional Practices Framework (Institute of Internal Auditors Inc 2003).

The definition is not only the starting point for these new guidelines, but forms the basis for the Professional Practices Framework (PPF - see section 2.4 for a detailed discussion) and the Competency Framework for Internal Auditors (CFIA - see section 2.5 for a detailed discussion).

2.3 DEFINING INTERNAL AUDITING

To appreciate fully the role an internal auditor can play in managing HIV/AIDS as a business risk, it is important to consider the nature of internal auditing. The definition of internal auditing forms the basis of the rest of the PPF. It is therefore important to investigate the changes that the definition has undergone to incorporate the new role of the internal auditing function as a consulting activity, with specific reference to the role of internal auditors with regard to the impact of HIV/AIDS as a business risk.

One of the elements of the first Statement of Responsibilities of Internal Auditing accepted by the IIA Inc in 1946, was a formal definition of internal auditing (Sawyers & Sumners 1973:5), namely:

> Internal auditing is an independent appraisal function established within an organization to examine and evaluate its activities as a service to the organization.

This definition led to the following statement of objective and scope issued in the same year (Sawyers & Sumners 1973:6):

> The objective of internal auditing is to assist members of the organization, including those in management and on the board, in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed. The audit objective includes promoting effective control at reasonable cost.

The above definition focuses mainly on the examination and evaluation of activities performed by the organisation; that is, compliance testing regarding the systems and informing management of weaknesses in the system or non-adherence to policies and procedures implemented by management.

As business processes became more complicated, information more widely obtainable, and the corporate world in general more sophisticated, the need for the internal audit profession to adapt to this new environment became evident. In 1997 the IIA Inc assembled a multi-national group, consisting of practitioners, academics and consultants, known as the Guidance Task Force (GTF) to study the needs of the profession (Institute of Internal Auditors Inc 2003). This group studied the internal auditing profession from several perspectives, for example, the global profession, internal auditing knowledge, and the future of the profession. The study concluded amongst other things, that the then prevailing definition of internal auditing was insufficient to articulate what the modern internal auditing profession does (McIntosh 1999). This definition was also insufficient to support the profession in providing consulting services with regard to various issues, for example, threats to the business environment such as HIV/AIDS.

On 26 June 1999, the IIA Inc Board of Directors approved the following new definition of internal auditing (Krogstad *et al* 1999:27):

> 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.

In table 1 the key elements of the new definition are compared to those of the previous definition to emphasise the changes made.

Table 1: Comparison of the previous and new definitions of internal auditing

Previous definition	New definition
Independent appraisal function	Objective assurance and consulting activity
Established within an organisation	Independently managed within an organisation
Examines and evaluates its activities as a service to the organisation	Adds value to improve the operations of the organisation
Assists members of the organisation in the effective discharge of their responsibilities	Assists an organisation in accomplishing its objectives
Does analyses, appraisals; makes recommendations; provides counsel and information concerning the activities reviewed	Uses a systematic and disciplined approach
Promotes effective control at reasonable cost	Evaluates and improves the effectiveness of the organisation's risk management, control and governance processes

Source: Institute of Internal Auditors (1999:6)

In the above table, the consulting role of an internal auditor, as well as the fact that this role is based on assistance to management to help accomplish the organisation's objectives by identifying and managing threats, such as HIV/AIDS, is highlighted.

The original purpose of internal auditing was to provide assurance concerning historical activities in the organisation. Management's concept of internal auditing broadened over the years, which led internal auditors also to fulfil a consulting role. The new definition incorporates this added responsibility in the concept of consulting activities. Furthermore, there has

been a shift from the original watchdog role to a more futuristic approach that is based on adding value (Coetzee & Du Bruyn 2001:63).

The new definition of internal auditing encompasses all the dimensions of the internal auditing function, suggesting a profession that is characterised by broad business parameters and technical skills. Internal auditors should understand business strategy. The definition envisions internal auditors who focus on adding value by facilitating change through advice and counsel, in some cases even providing assurance to parties outside the organisation, for example, trading partners. The new definition expands the scope of internal auditing to recognise its key role in corporate governance and risk management, in addition to control activities (Coetzee & Du Bruyn 2001:63).

The new definition of internal auditing was the first of a number of changes that have resulted in a review of the status of guidance provided to internal auditors. The new definition has highlighted the wider responsibilities of internal auditing, for example, the consulting role, and therefore necessitated a revision of the current guidelines as embodied in the PPF. As HIV/AIDS is a potential threat to the business environment, including the control system, it is clear that the new definition, as part of the PPF, and the other elements of the framework incorporate the role to be played by internal auditors regarding this risk.

2.4 THE PROFESSIONAL PRACTICES FRAMEWORK (PPF)

Structural guidance is needed to keep up with the dramatic changes to the business environment and hence to the internal auditing profession. The scope of internal auditing activities has expanded, as highlighted in the new definition of internal auditing, and the need for guidance that can be followed, regardless of the industry, audit speciality or sector, has increased. The new definition of internal auditing also paves the way for the PPF, which provides a structural format for the different elements of

professional guidance. It consists of the following elements (Institute of Internal Auditors Inc 1999):

2.4.1 Definition of internal auditing

The definition of internal auditing is the umbrella under which the rest of the elements fall and has changed to incorporate the changes in the business environment (see the above discussion) and even new challenges to the internal auditing profession in its consulting role where threats to business objectives have to be managed, for example, HIV/AIDS.

2.4.2 Code of ethics

A code of ethics has been established to promote an ethical culture throughout the internal auditing profession. The code applies to all internal auditors performing internal audit services, regardless of the industry and the changing business environment.

2.4.3 Standards for the professional practice of internal auditing *(standards)*

The *standards* are the minimum requirements to be maintained by internal auditors for acceptable practice within the profession. They consist of various criteria by which the activities of internal auditing are evaluated and measured. The *standards* have been restructured to align them with the new definition of internal auditing and they now have a much broader perspective, prescribing a proactive role for internal auditors not only in control activities, but also in risk management and corporate governance processes, thus including the assistance of internal auditors to management regarding threats (such as HIV/AIDS) and the management and control of such risks.

2.4.4 Guidance – practice advisories

These guidelines include specific topics that currently require attention and may have a limited life or may be included in the formal *standards*, depending on importance, usage and acceptance.

2.4.5 Guidance - development

These guidelines consist of educational products, research studies. and other relevant material. They are not mandatory, but should help internal auditors to assist management with control, risk management and corporate governance processes relevant to the organisation. They are a valuable tool to be used in guiding internal auditors in the assistance to management regarding HIV/AIDS and its threat to the control environment.

The framework (PPF) is intended to encourage quality internal auditing services on a consistent basis worldwide and to guide internal auditors, management and audit committees. It is the internal auditor's task to operate within a professional framework to assist the organisation in achieving the highest quality results and its long-term objectives. New threats and risks such as HIV/AIDS, changes, innovations and other matters affecting the organisation should thus be investigated and if need be, incorporated into the framework to provide the internal auditor with guidelines regarding these issues.

As already discussed, the PPF consists of guidelines that define the role and responsibilities of the internal auditing activity. The skills needed by internal auditors to fulfil this role and responsibilities are detailed in the CFIA.

2.5 THE COMPETENCY FRAMEWORK FOR INTERNAL AUDITORS (CFIA)

The framework provides important insights into the future practice of internal auditing, as well as guidelines, competencies, the knowledge and skills needed for internal auditors to know how to perform their tasks. Therefore the manner in which internal auditors should address risks that threaten the organisation, such as HIV/AIDS, is explained in the discussion of the future role of internal auditing, the primary customers of internal auditing, the value proposition of internal auditing, and the competencies required of internal auditors to be able to perform their responsibilities properly. The CFIA consists of six modules. Each is discussed briefly below in connection with risk management, corporate governance and control (McIntosh 1999).

2.5.1 Overview

The overview consists of, *inter alia*, a short discussion on the main findings and challenges to the internal auditing profession, and an overview of the objectives and structure of the CFIA.

2.5.2 Internal auditing: the global landscape

This document consists of internal audit practitioners' experiences that will help determine the direction global internal auditing is taking, and includes the scope of internal auditing work; the numbers and location of internal auditors; the required competencies and qualifications; the professional development and training of internal auditors.

The scope of internal auditing activities varies as a result of cultural factors, organisational factors (such as the internal auditor being either a watchdog or a guide dog), and external events in a specific country that affect organisations (Birkett, Barbera, Leithhead, Lower & Roebuck 1999a). Risks and therefore controls thus vary according to the cultural mix of the workforce and the client base, as well as circumstances

affecting the country and organisation. This also influences internal auditors' role regarding the risk of HIV/AIDS.

2.5.3 Competency: best practices and competent practitioners

This document is divided in two parts, namely a description of a competent internal auditing function, and competency standards for internal auditors.

Internal auditing work takes place within diverse organisational settings, and constant change is taking place. Therefore internal auditors should have the competencies, skills and knowledge needed for the particular organisation that is being investigated. This includes international, institutional, organisational, sector/industry, internal auditing function and work knowledge. The field of practice includes knowledge regarding strategic functioning (understanding the organisation's environment), risk exposure (for example HIV/AIDS), the effect on the control system and control needed to minimise the risk, constant improvement in handling the risks identified in the control system, and assurance that the systems are functioning as implemented and planned by management (Birkett *et al* 1999b). This again underlines the fact that internal auditors need to understand the effect of risks such as HIV/AIDS on the business, including the control environment, to be able to perform their tasks with due professional care.

2.5.4 Internal auditing knowledge: a global perspective

In this document, existing information on research on internal auditing is examined. It illuminates the relationship between internal auditing practice and its contexts of practice. It implies that understanding the uniqueness of the organisation that must be audited is vital.

The document states that it is important for internal auditors to understand how factors such as relevant laws and regulations, the organisational functioning, the manner in which the organisation is managed, changes or

potential changes that are either internal or external, risks or potential risks threatening the organisation (such as HIV/AIDS) and the control system used by management to help achieve its objectives influence the organisation. Only by mentioning these issues can effective internal auditing activity occur that adds value to the organisation (Birkett *et al* 1999c).

2.5.5 The future of internal auditing: a Delphi study

This document sets out the opinions of 136 internal auditors regarding the issues identified by the *Internal Auditing Knowledge: Global Perspectives* module (refer to 2.5.4). The result of the research performed in global perspectives, was a comprehensive investigation into the opinion of internal auditors regarding critical issues and concepts in internal auditing.

Of the respondents in the survey, 75%indicated that they thought internal auditing would fulfil a consultative/facilitating/educational role in future. A large group, namely 77% of the respondents, indicated that assurance about the efficiency and effectiveness of risk management was the key task of internal auditing. In addition, 83% agreed that the internal auditors' contribution should enhance the understanding of controls that can be used in an organisation to address risks. The need to understand and manage risk has become a key concern for management and the study indicated the necessity of continuously improving risk management in the face of ongoing change and of minimising risk by means of proper governance and control (Birkett *et al* 1999d:81-85). This survey again highlights the important role of internal auditors in assisting management with the identification of risks such as HIV/AIDS, and the implementation of proper plans, for example, controls, to minimise such risks within an organisation.

2.5.6 Assessing competency in internal auditing: structures and methodologies

This document addresses the issue of how an internal auditing function's competencies can best be assessed, and the assessment of key role capabilities.

The CFIA has created a dramatically new image of the internal auditing profession. Internal auditors must constantly evaluate what they contribute to their organisations' reaching of objectives, and the skills and knowledge needed for them to be successful in meeting these demands. It is important that they understand the environment within which their organisation is functioning, including the extent of the threat of HIV/AIDS, and the effect of this disease on their organisation. Thereafter, they need to make sure that the internal auditing function has the necessary skills and knowledge to assist management with a particular threat.

2.6 THE ROLE OF INTERNAL AUDITING

Internal auditors need to make a meaningful contribution to meeting their organisation's main need, namely to reach its objectives. The Institute of Internal Auditors Inc has assisted individual internal auditors and internal auditing activities in this task by publishing the CFIA and PPF as sets of guidelines to fulfil this task.

As can be seen from the new definition of internal auditing, internal auditors are expected to add value and earn their living by advising management regarding control, risk and corporate governance processes and factors threatening these (Marks 2001:45), for example, HIV/AIDS. Thus, if this disease thus threatens the accomplishment of the organisation's objectives, internal auditors must investigate the effect of this risk on the control system and play a consulting role in adding value to the organisation and assisting management with its role.

In South Africa, the King Committee on Corporate Governance investigated corporate governance to promote the highest standards in managing a business. According to Sir Adrian Cadbury,

> Corporate governance is concerned with the balance between economic and social goals and between individual and communal goals… the aim is to align as nearly as possible the interests of individuals, corporations and society (King Committee on Corporate Governance 2002:8).

The King Report concluded that the objective of internal auditing is to assist management in the effective discharge of its duties and responsibilities; and therefore the scope of internal auditing includes control (including the control environment), risk management (investigating the potential threat of HIV/AIDS) and governance (how management is addressing this potential threat). It is important to note that, according to the King Report (2002:45), control and risk management, is still the responsibility of management and the board of directors, although internal auditors provide guidance and are actively involved.

The King Report acknowledges the contribution that internal auditing can make to the well-being of an organisation. The internal auditing profession has reacted by investigating and changing the definition of internal auditing. The new internal auditing definition now includes, apart from evaluating and testing the control system, the task of addressing risks threatening the organisation, and investigating the organisation's corporate governance by evaluating and improving the effectiveness of governance processes (Krogstad *et al* 1999). The role of internal auditing regarding these three key elements is discussed in more detail below.

2.6.1 Control

The control environment is a sub-section of an organisation's control system (COSO 1992:17). According to Standard 2120 of the IIA Inc, the internal audit activity should assist an organisation in maintaining effective

controls by evaluating their effectiveness and efficiency and by continuously promoting improvement (Institute of Internal Auditors Inc 2003).

A report similar to the King Report for South Africa, the Treadway Commission's report for the United States of America issued in 1987 (COSO 1992), identified control as the most important mechanism that management can use to ensure that its plans and procedures are adhered to, thus minimising the risks threatening the organisation (Root 1998). The Committee of Sponsoring Organisations (COSO) was asked to conduct a review of internal control as a result of the findings of the Treadway Commission's report (COSO 1992).

The committee called for organisations to work together to integrate the various internal control concepts developed and used by different organisations and to develop a common point of reference for internal control. Currently the committee is revising the 1992 COSO report and has published an exposure draft report for public comment (COSO 2003). The changes are briefly indicated in this study (see 2.6.2) after the current COSO report has been discussed. As the revised COSO report is still in a draft format and the main issue included in this study, namely the control environment, is basically the same, the 1992 COSO report is discussed in more detail.

The purpose of the COSO study was to provide a common understanding of internal control among all parties and to assist management in exercising better control over an entity. The result was a report, Internal Control – Integrated Framework, issued in 1992. The study developed a comprehensive definition of control, namely (COSO 1992:3):

> Internal control is a process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- effectiveness and efficiency of operations;
- reliability of financial reporting; and
- compliance with applicable laws and regulations.

The first category focuses on the reaching of an organisation's business objectives, including the identification and management of risks. The second category looks at the data gathered and used in the decision-making process and financial statements. The third category examines compliance of laws and regulations to which the organisation is subject. Internal control, including the control environment, must thus support management's task to accomplish the organisation's objectives by identifying and managing risks or potential risks, such as HIV/AIDS.

A framework for the concept of internal control was developed by the committee to incorporate all of the above. This framework consists of six components (COSO 1992:17), which are briefly discussed below.

2.6.1.1 The control environment

The control environment provides an atmosphere in which people conduct their activities and carry out their control responsibilities. It serves as the foundation for the other five components. The control environment has a direct influence on the way activities are structured, objectives are established and risk is addressed; and therefore it affects the control consciousness of people performing their day-to-day activities. For control and risk management to be successfully implemented in an organisation, internal auditors need to understand the environment internal auditing is built on. The control environment also forms part of the primary research problem, namely the effect that HIV/AIDS has on the control environment.

The control environment is thus the foundation for the rest of the control system. If the control environment is functioning effectively, chances are better that the rest of the control system can also work as planned. A

proper control environment forms a sound basis for the control system of an organisation by setting the tone in an organisation and influencing the control consciousness of its people (Du Plessis & Grobler 1998:126).

The control environment consists of various elements. The COSO framework divides this environment into seven elements. Each of these elements is briefly defined below (COSO 1992; Root 1998).

a Integrity and ethical values

Integrity and ethical values refer to management's attitude, actions and behaviour regarding ethical issues. Moral guidance and procedures, an ethical code, a code of conduct and disciplinary procedures are some of the important issues discussed. So, for example, there are various legislative stipulations regarding HIV/AIDS, which is a global issue. This legislation plays an important role and could influence an organisation's integrity and ethical values (see Chapter 3 regarding issues such as the fact that HIV/AIDS is being a non-notifiable disease in South Africa, prevalence testing, where management can set the example, and other issues).

Although a properly documented ethical code and disciplinary system is important, the behaviour of management regarding ethical values tends to carry even more weight in influencing the workforce, for example, speaking the truth at all times, keeping to promises, complying with rules and regulations, respecting private and confidential information (Ramsey 1996:14).

b Commitment to competence

Commitment to competence refers to the need for employees to have the necessary knowledge and competence to perform their duties properly. If an employer does not have and display the necessary qualities, the control environment is weakened (Boynton & Kell 1995:17). Factors such as employee performance, a loss of personnel, the need to recruit new personnel, and abnormal absenteeism, are some of the risk factors that

threaten the competency levels of the workforce. Internal auditors have to investigate the level of influence that HIV/AIDS has on these factors within an organisation.

c The board of directors and the audit committee

The board and the audit committee should be effective and efficient in performing their duties regarding the control system, including the rest of the elements of the control environment.

d Management's style and philosophy

These elements refer to the attitude with and the manner in which management runs the day-to-day activities of the organisation. If management ignores major risks or potentially catastrophic circumstances such as HIV/AIDS, the control system is not only weakened, but it becomes more difficult to reach the organisation's objectives (Holman 1996:63).

e Organisational structure

The organisational structure is the framework used for the execution, controlling and monitoring of the activities of the organisation to ensure that the organisation's objectives are reached. Resources are organised in a formal, structured manner, and if this is disrupted, for example, due to a loss of personnel as a result of AIDS, or absenteeism as a result of HIV, the structure could either collapse or not fulfil its function (Ratliff *et al* 1996:526).

f Delegation of authority and responsibility

Delegation refers to the methods used and the degree to which authority and responsibility are allocated to individuals. If certain individuals are removed from the organisation by being abnormally absent or dying as a result of HIV/AIDS, a weakness is created, as another individual may end up having too much authority and responsibility (Dunn 1996:162).

g Human resources policy and practice

Human resources management should ensure the employment of sufficient and capable people, as well as the development and well-being of these employees. An employment policy that is not in line with government regulations, medical aid and pension plans, training, remuneration structures, and much more, can create risks that could threaten the organisation. As discussed in more detail in Chapter 3, legislation, government's code of good practice on HIV/AIDS issues, management's responsibility regarding HIV/AIDS in the managing of a business and other factors all play a key role in the development of policies and practices for the workforce.

2.6.1.2 Risk management

The second component of the COSO framework is risk management, as every entity faces a variety of risks that threaten the reaching of the organisation's objectives (for example, HIV/AIDS). These risks must be identified, measured, analysed and controlled.

2.6.1.3 Control activities

Control activities are the policies and procedures that help to ensure that management’s directives are carried out and that the necessary actions are taken to address any risks identified. These activities include, for example, management's strategic plan on how to deal with risks such as HIV/AIDS.

2.6.1.4/5 Information and communication

The fourth and fifth elements, information and communication, identify the need for pertinent information to be identified, captured and communicated in a form and time frame that enables people to carry out their responsibilities. Effective communication must also occur in a broader sense, as all staff must receive a clear message from top management

that control responsibilities must be taken seriously, that people must understand their role in the internal control system, as well as how individual activities relate to the work of others.

2.6.1.6 Monitoring

The last component, monitoring, addresses the fact that we live in a changing environment. Internal control systems need to be monitored; a process that assesses the quality of the system's performance over time to make sure that current risks are identified and the necessary controls are in place to address these risks (Root 1998). Even if a risk such as HIV/AIDS is not a threat to a specific organisation at a given time, the situation may change after a certain period. Therefore risk and potential risk must be constantly monitored.

As can be seen from the above discussion of the COSO model (1992), the control environment sets the tone for establishing objectives for the organisation. Setting objectives is a precondition to risk assessment. There must first be objectives before management can identify risks that threaten their chances of achieving these objectives and can take the action necessary to manage these risks (COSO 1992). Therefore management needs to be aware of the business risk that HIV/AIDS poses to an organisation. Then it needs to address this risk by implementing a proper strategic plan.

2.6.2 Risk management

According to various dictionaries, risk is the possibility that an accident or a loss can occur, or a potential threat as a result of an uncertainty (for example, HIV/AIDS is an uncertain and sometimes unrecognised threat to society and the business environment). For the purposes of this study, risk is classified as business risk. According to Arthur Andersen (1998) risk is:

> the threat that an event or action will have a negative effect on the ability of the organisation to achieve its business objectives and to execute its strategies effectively.

Risk management is the responsibility of management, and it is management that must decide on the organisation's appetite for risk. To manage risk, management should have an understanding of the concept of risk in general, the specific risks that threaten the organisation and the risk management process (King Report on Corporate Governance 2002). It is therefore important to identify whether HIV/AIDS is a risk in general (see Chapter 3), and if so, if this risk threatens a specific organisation.

The process of identifying and analysing risk is an ongoing process. As circumstances (internal and external) changes for the organisation, risks threatening objectives must be addressed (COSO 1992). To manage all the diverse risks facing the organisation, including HIV/AIDS, a structured approach is required. Furthermore, according to the IIA Inc's Standard 2110, the internal audit activity should assist the organisation by identifying and evaluating significant exposures to risk (Institute of Internal Auditors Inc 2003).

The Committee of Sponsoring Organizations (COSO 1992) saw the importance of organisations' managing risk. A revised COSO exposure draft report for public comment, the Enterprise Risk Management Framework, has recently been made available on the Internet (COSO 2003). Whereas the first COSO report focuses on control and risk as part of the implementation of proper control procedures, the second report focuses on enterprise risk management and controls as a tool to help manage risks threatening an organisation. According to the draft report, all entities face uncertainty, but management must decide how much uncertainty the organisation is prepared to accept and must manage the process, not overstepping that line. The steps identified in the enterprise risk management process are the internal environment (the foundation for the other components), setting objectives (management determines the

strategic, operational, reporting and compliance objectives of the organisation), event identification (management determines factors influencing events, for example, internal or external), risk assessment (how events will affect the achievement of objectives), risk response (for example, avoiding, reducing, sharing or accepting risk), control activities (policies and procedures to help ensure that risk responses are properly executed), information and communication, and monitoring the process.

The internal environment is the basis for the rest of the process and refers to basically the same issues as the term control environment in the current COSO report. Concepts such as risk management philosophy, risk appetite and risk culture has been added to the current elements of a control environment.

To conclude, management must understand risks in general (such as HIV/AIDS), be able to identify risks threatening the organisation and to implement a suitable risk management programme (for example, a proper control system) to address and minimise these risks. Internal auditors should assist management with this process and therefore need to understand risks in general and the effect of such risks for their organisations.

Risk management is one of the key issues of corporate governance processes, which are the responsibility of management. Therefore internal auditors need to understand the governance processes implemented by management to be able to play a consulting role in the management of the organisation.

2.6.3 Corporate governance

More than ever before, management and audit committees are seeking assistance from internal auditors on corporate governance issues (Steinberg & Pojunis 2000:34), including vital issues such as HIV/AIDS. This need was also recognised when the concept of corporate governance

was incorporated in the new definition and standards of internal auditing (Institute of Internal Auditors Inc 1999). The role of internal auditing in assisting management with corporate governance was also included in the King Report (King Report on Corporate Governance 2002).

Corporate governance is defined by mainstream accounting and finance literature as the range of control mechanisms that protect and enhance the interest of shareholders of business enterprises (Fama & Jensen 1983:311). As the role of internal auditing evolved to include increased guidance, it became necessary to identify specific areas where the internal audit activity could assist management (Steinberg & Pojunis 2000:36).

The IIA Inc Standard 2130 states that the internal auditing activity should contribute to the organisation's governance process by evaluating and improving the process (Institute of Internal Auditors Inc 2003). The IIA Inc Research Foundation and PricewaterhouseCoopers have conducted a study on the Board of Directors' responsibilities and leadership, and have identified tools that internal auditors need to assist management with this task (PricewaterhouseCoopers 2000:2). This study identified eight key responsibilities for the Board, namely strategy and planning; risk management; tone at the top; measuring and monitoring performance; transformation; management evaluation, compensation and succession planning; internal and external communication; and effective board dynamics. It was also agreed that the first five areas should be the focus areas for internal auditing in assisting management.

With the exception of strategy, the topic discussed most at Board level is risk (Steinberg & Pojunis 2000:36). Directors do not like surprises, such as people who become ill or die as a result of HIV/AIDS, incidents such as product failure, physical or technology disaster, or problems due to failing to comply with new legal or regulatory stipulations with regard to HIV/AIDS, to interfere with their management plans. Because managing risk is a core competency for most internal audit departments, the department can provide great value helping the Board to identify significant

risks. Management tends to be neglectful about ensuring that the organisation has an effective, ongoing process to identify risks, measures the potential impact against a varied set of assumptions, and does what is necessary to manage risks proactively (Steinberg & Pojunis 2000:37).

The PricewaterhouseCoopers (2000) study's results show that effective Boards recognise that corporate culture starts with the tone set by management. Increasingly, directors recognise that softer issues, such as ethical values, the competency of employees, and human resources policies and practices must also be evaluated and addressed. Internal auditors have long familiarised themselves with these issues while studying and assessing the control environment. Familiarity with these concepts enables internal auditors to assist management in providing the Board with relevant information, and to supplement it with direct input (Steinberg & Pojunis 2000:38). Therefore internal auditors as control experts, understand the control environment and can assist management in managing the organisation (corporate governance) by identifying the effects that HIV/AIDS, as a risk to the organisation, poses to the control environment.

2.7 CONCLUSION

As can be seen from the discussion above regarding the new definition of internal auditing, as well as the PPF and CFIA, it is clear that internal auditors in a consulting capacity are well equipped to assist management in identifying the effects of HIV/AIDS on the control environment. It is also clear that internal auditors can be expected to assist management in the areas of control and risk, and therefore of delivering value at the highest levels of their organisation, by enhancing corporate governance. As can be seen from the above discussion, the concepts of control, including the control environment, risk management and corporate governance are inseparably linked. Internal auditors must help their organisations to accomplish their objectives by evaluating and improving the effectiveness of risk management, control and governance processes.

The question now to be answered by management and internal auditors is whether HIV/AIDS is a risk, not only globally, to individual countries or areas, but also to specific communities and organisations functioning within specific boundaries. If HIV/AIDS is a risk, the next question that needs to be asked is how internal auditors, as control experts, can support management in a consulting role to address this risk and the effect thereof on the control environment.