

**INTERNAL AUDIT FUNCTIONS AND FRAUD DETECTION IN GOVERNMENT
AGENCIES. (CASE STUDY: NATIONAL AGRICULTURAL RESEARCH
ORGANISATION)**

BY

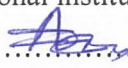
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**ADISERTATION SUBMITTED TO THE SCHOOL OF BUSINESS AND
MANAGEMENT STUDIES IN PARTIAL FULFILMENT OF THE
REQUIREMENTS FOR THE AWARD OF BACHELORS DEGREE IN BUSINESS
ADMINSRATION OF KAMPALA INTERNATIONAL UNIVERSITY**

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DECLARATION

I, **BACHARI BEATRICE**, hereby declare that this information contained in this book is out of my personal effort in research and consultation. No part of this information has been presented in any educational institution for any a word.

Signed.......... Date: 8th / 01 / 2016.....

ACHARI BEATRICE

DEDICATION

Great thanks go to the whole mighty God for the care, love, and protection. Also to my dear parents the late Mr. Owori Zakaria and Owori Matilida for the great work done.

My dear brothers especially Eng. Okello Gaetano who has supported me financially, takes care of me and he is ever there for me. Not forgetting others like Mr. Okumu Donatus and Mr. Odoi Charles who always give assistance whenever they are called upon, my dear sisters for their word of encouragement and advice MS Nyafuono Anne rose, Auma Juliet and all my dear friends and relatives.

APPROVAL

This dissertation has been done under my supervision and submitted for requirement for award of Bachelors' degree in Public Administration of Kampala International University.

Signature



Date



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First and foremost I owe great respect and honor to the almighty God for His protection and love. Despite the fact that entire dissertations was prepared, written and compiled by me, I would like to note the assistance of many persons at different levels without whom this booklet would not have seen the test of time.

Special thanks go to Kampala International University staff members for the logistical support provided during the study.

I wish to extend my sincere gratitude to my supervisor Mrs Ireu Florence For interpretable, constructive guidance and new ideas to have quality work.

I once again appreciate the work done by everyone who struggled to see that this work is a success.

LIST OF ABBREVIATIONS

NARO	National Agricultural Research Organization
BOU	Bank of Uganda
IIA	Institute of Internal Auditors
MMDA	Metropolitan, Municipal and District Assemblies.
MDAS	Ministries, Departments and Agencies
IAD	Internal Audit Departments.
IAA	Internal Audit Agency
ARC	Agricultural Research Council
NRI	National Research Institute.

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ABSTRACT

The study was undertaken with the aim of establishing the relationship between internal audit and fraud detection in government agencies. The objectives of the study were to establish the nature of the internal audit function, to establish the level of fraud detection and to find out the relationship between the nature of the internal audit function and the level of fraud detection in government.

The study was carried out in national agricultural research organization the methodology of the research was qualitative and it was a desk research where views of different authors were collected, synthesized, presented and interpreted. The findings of the study show threat to the audit reports normally have recommendations on the way forward, that the organization has appropriate procedures to fight fraud and the relationship show that the increased focus reflects the internal audit function in government agencies.

The researcher concluded that, internal audit function can be detect fraud in government agencies, the financial statement tends and ratios affect the fraud function, there should be a telephone hotline to detect fraud and the recommendations of the study including NARO should implement all the required measure to detect fraud and should put forward strategies to detect fraud

NARO should implement all the required measure to detect fraud in government agencies. This will increase the performance levels of the agencies. NARO should also put forward strategies to detect fraud and this will help the internal auditors to know who is likely to carry out fraud in any government agency. There should also be strict punishments for whoever is a victim of fraud in any government agency and these rules should be published and strictly followed by all the government agencies.

CHAPTER ONE

1.0 Introduction.

This chapter will present the background of study, statement of the problem, purpose of the study, objectives of the study, Research questions, Scope of the study, and significance of the study, justification of the study and the conceptual framework.

1.1 Historical back ground

Internal controls have existed from ancient times. In Hellenistic Egypt there was a dual administration, with one set of bureaucrats charged with collecting taxes and another with supervising them. In the Republic of China, the Control Yuan, one of the five branches of a government, is an investigatory agency that monitors the other branches of government

The elements and control criteria assume that institutions are applying the concepts, and the reporting standards required by GAAP (Generally Acceptable Accounting Standards) and additional statutory and administrative requirements under government policy, and are actively

Managing the legislative compliance costs associated with both general institutions al operations and financial reporting.

.1.1.1 Theoretical Perspective.

According to Hector Perela (2009), internal auditing function with other intervention mechanisms like financial reporting and external audit to help maintain cost-efficient; contracting between owners and managers. It was designed by government agencies to add value and improve operations. It helped an organization to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes/internal audit helped organization to ensure that financial and other records are reliable and complete. As well as ensuring that management adhere to policies and procedures for orderly and efficient conduct of the business, proper recording and safeguarding of assets and resources. The purpose of internal audit as far as the organization concerned is to get accounting errors corrected and control weaknesses eliminated.

On one hand, fraud detection in government agencies involved an employee or managers of

the victim's organization (Commercial Angles News Letters 2001) the most effective tools for fraud detection are internal audit review, specific investigation by management, employee notification, and accidental discovery. Fraud detection helps Management to address its responsibility through development of an appropriate design of the system of internal control and the effective operation of that system. Numerous fraud prevention and detection techniques are now utilized to reduce the direct and indirect costs associated with all forms of fraud. These various techniques include but are not limited to: fraud policies, telephone hot lines, employee reference checks, fraud vulnerability reviews, vendor contract reviews and sanctions, analytical re news, password protection, firewalls, digital analysis and other forms of software technology, and discovery sampling (Thomas and Gibson, 2003) government departments implement the ideas and decisions of executive government in a particular area of governance. Each department is led by a minister in charge or commissioner, and the main work of the department is determined by legislation. Despite the internal audit function, many government agencies fail to detect fraud for example loss of huge monies in National Agricultural Research Organization NARO). The national agricultural organization is the apex body for guidance and coordination of all agricultural research activities in the national agricultural research system in Uganda. However the auditor's general report to parliament showed that out of shillings 140m recurrent and development expenditure, sh93m went missing in one financial year. Bank statement would be forged which mislead officials. According to Agricultural Research Organization (NARO) chief internal auditor Hussein Dalia (2007) highlighted that the fraud was hard to detect because National Agricultural Research Organization (NARO) operates about 82 bank accounts, making it difficult to monitor all the transactions.

It was worth highlighting that, insufficient internal audit function such as poor financial disclosure evidenced by high level of off balance sheet items, misstatement of records, lack of transparency resulting from gross mismanagement and dubious accounting actions is common in many organizations. Similarly, it was observed in f Trans African ltd (Bank of Uganda, 2002). National bank of commerce in 2001/2002 reported as a loss of seven thousand twenty nine million (729,000,000/=) and the banks liabilities swelled to five billion (5bn/) in year 2002 from two billion three hundred thousand (2.3bn) in 2001. This is probably due to poor internal audit that later affects fraud detection function.

1. 1.2 Conceptual Perspective.

The word “audit” came from the Latin word audire, meaning “to hear”. According to flint (1988), audit is a social phenomenon which serves no purpose or value except if its practical usefulness and its existence is wholly utilitarian.

According to R. K Mautz auditing is concerned with the verification of accounting data with determining the accuracy and reliability of accounting statements and reports.

Internal audit

Is an independent, objective, assurance and consulting activity designed to add value and improve on organization’s operations.

Fraud.

A false representation of a matter of fact whether by words or by contact, by false or misleading allegations or by concealment of what should have been disclosed that derives and is intended to deceive and intended to deceive another so that individual will act upon it to his or her legal injury.

1.1.3 Contextual Perspective.

. All Internal Control Systems, no matter how well have inherent limitations that they may not entirely eliminate misstatements. Also projections of evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate. However, control activities are ongoing processes that include identification, evaluation and management of significant risks.

1.2 Statement of the Problem

In the modern business world, most organizations have put in place internal auditing - nevertheless some have failed to detect fraud in their operations for - National Agricultural Research Organization (NARO), according to Mary Karugaba (2009), six National Agricultural Research Organization (NARO) officials were found liable over missing funds amounting to one hundred forty million (Shs140m). Due to increased manipulation,

falsification, alteration, and misrepresentation of accounting records has increased research in NARO, thus the aim of this research therefore was to establish the nature of the internal audit function in National Agricultural Organization.

1.3 Purpose of the Study

The purpose of the study was to establish the role of the internal audit function and fraud detection in organizations which enhanced financial performance of government agencies.

1.4 Objectives of the Study

1. To establish the nature of the internal audit function in National Agricultural Research Organization (NARO).
2. To establish the level of fraud detection in National Agricultural Research organization (NARO).
3. To examine the relationship between the nature of the internal audit function and the level of fraud detection in National Agricultural Research Organization (NARO).

1.5 Research Questions

- i. what was the nature of the internal audit function in National Agricultural Research organization (NARO)?
- ii. What was the level of fraud detection in National Agricultural Research organization (NARO)?
- iii. What was the relationship between the nature of the internal audit function and the level of fraud detection in National Agricultural Research Organization (NARO)?

1.6 Scope of the Study

The scope of research was about internal audit function and its Rationale in the government agencies. The research included analysis of fraud detection and prevention.

1.6.1 Subject Scope

The study was about the internal audit function and fraud detection in NARO National agricultural Research Organization.

The study was to cover literature about the relationship between the internal audit function, its

Rationale and fraud detection and prevention methods in government agencies from 1999 to date since there is availability of data related to the study topic readily available and up to date.

1.6.2. Geographical scope.

The study was carried out in National Agricultural Research organization as the apex body for guidance and combination of all agricultural research activities is national agriculture system in Uganda.

1.6.3. Time scope

The research was carried out between July and August

1.7 Significance of the Study

It was intended to help policy makers to improve on internal audit function and design an efficient fraud detection system.

The study was important to researcher since it was to lead to the fulfillment of research report Also it was to increase on knowledge about the relationship between the study variables.

Improve understanding of the role of the internal auditor in the achievement of organizational behavior.

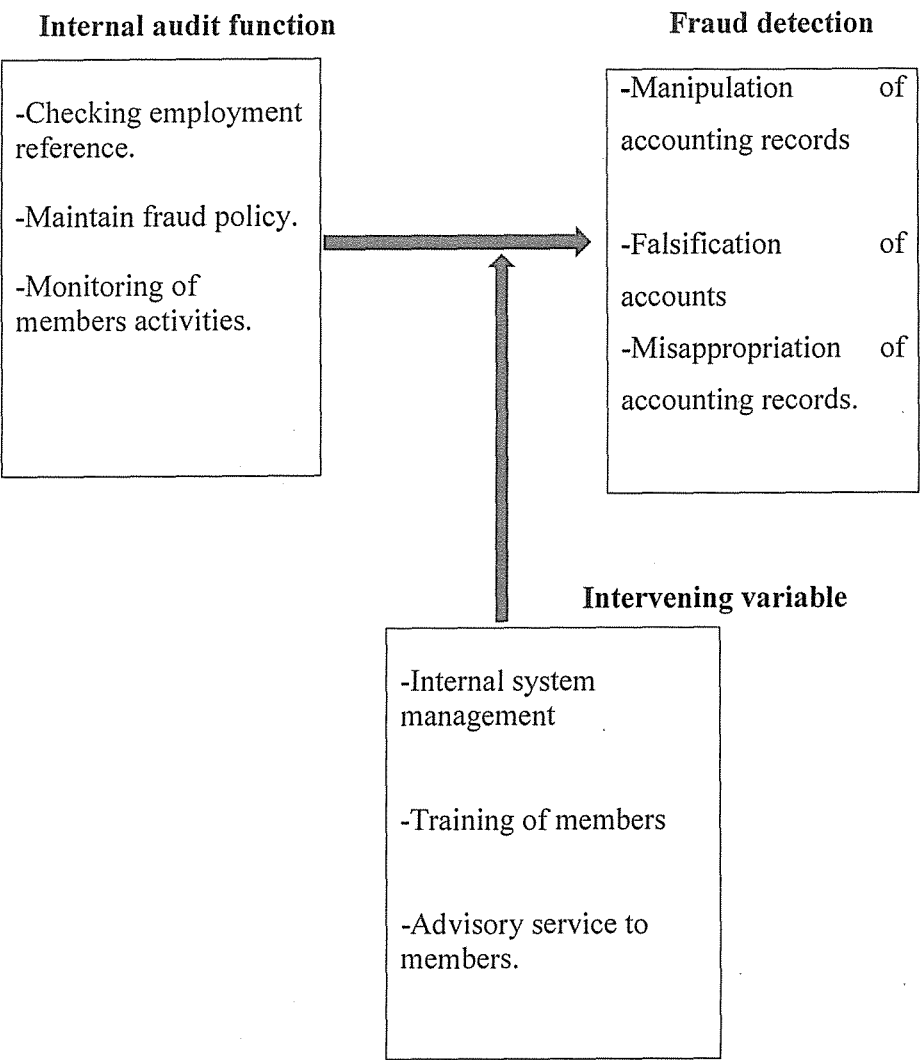
Fulfill the B degree in business Administration.

Improve literature on public sector internal auditing in Ghana.

1.8 Conceptual frame work

Defined the topic of research for your explanation of the variable of the topic. Independent variables determined, predicted and influenced the dependents variables (jack and Normane 2000 haim 2003) independent variables for this topic is internal audit functions, dependent variables were prone to be controlled by the independent variables for the purpose of this proposal, dependent variables were fraud detections

Figure 1: The conceptual Framework.



Source: Researcher 2010

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter will present, the conceptual framework, reviews existing literature on internal control and performance of financial institutions. And review of related literature, the relationship between literature review and the study objectives.

2.1 Theoretical Review.

According to miller (2003), poor internal controls lead to asset misappropriations, corruption, *organizational* fraud and fraudulent financial statements .Yale University guides (2000) defined internal controls as a process effected by the organization's board members ,administration and designed to effectively and efficiently achieve operational, financial and compliance objectives.

O s m o n d (2 0 1 1) indicates that organizations implement internal controls basing on the nature of BE ness and regularly audit them (internal controls) to ensure their adequacy. He (Osmond farther relates safety of financial transactions and information to an organization's internal controls by ensuring that all recorded transactions fairly represent the economic events that occurred, are lawful in nature, and have been executed in accordance with management's general authorization.

Amudo and Inanga (2009) state that an internal control system is usually responsible for the organization's failure to achieve efficiency and effectiveness, reliability of financial reporting and compliance with relevant laws and regulations and the organization therefore needs to ensure ire assigned to individuals in a manner that ensures that no one individual can control recording function and the procedures relative to processing the transaction.

Similarly Jong-Hag-et al (2009) indicates that the muscle of an organization's internal control determined by human capacity to handle internal control functions. Ensuring that all accounting transactions are fully and accurately recorded, that assets and liabilities are correctly red end valued, and that all costs and revenues can be fully accounted for to ensure that all transactions are approved by responsible personnel in accordance with specific general

authority before the transaction is recorded.

According to the AICPA (1963) a system of internal control extends beyond those matters which the functions of accounting and the financial statements. In addition, based on the ASOBAC (Committee on Basic Auditing Concepts, 1973) internal control is a systematic Procedure that will lead to evaluation the degree of correlation between those established criteria and the real results of the business.

According to the definition by Accountants and Auditors it is a process for assuring achievements of an organization's objectives in operational effectiveness and efficiency, reliable

re Ting and compliance with laws, regulations and policies, Cheung 1997 too added too added that is an organized amalgamation of functions and procedures, within a complete of controls established by the management and whose purpose is the successful functions of the business. In business organization like a commercial bank, internal control represents the guiding a relation to doing business and it is the primary function of management. According to miller and Billey 1989 internal control helps the company to achieve its goals using a systematic approach of assessing the effectiveness of handling dangers.

2.2 Conceptual Review.

According to the Institute of chartered Accountants of India, internal control is the plan of organization and all the methods and procedures adopted by the management of an entity to achieving management objectives of ensuring as far as possible the orderly and efficient conduct of assets prevention and detection of fraud and error, the accuracy and completeness of the accounting records and timely preparation of reliable financial information. The system of internal control extends beyond those matters which relate to the function of management for the smooth running of business for the accomplishment of its objectives.

According Schleifer and Green Walt (1996) internal control is the allowance of specific and *high level* of services offered towards the management and on the other hand, the allowance of assistance towards the members of the organization for the most effective practicing of their duties. The internal control systems are being implemented in business as tools that add up value to the company in this way, we can achieve a systematic approach towards the most effective organization as a unity.

Aldridge and Colbert (2004) as mentioned in the COSO report Committee of Sponsoring

organization of the Trade way Commission, defined internal control as a procedure which offers fundamental security to the business concerning the credibility of financial affairs .The report internal control and describe framework for internal control. But the difference of this report is that it also provides criteria for management to utilize so as to evaluate controls.

According to Miller and Bailey (2005) internal control is a systematic review and a subjective investigation of one element and encompasses the verification of the specific information as these are determined from the general practice. The internal control helps the company achieve its goals using a systematic approach of assessing the effectiveness of handling dangers.

2.3 Objectives of the Internal Audit Function in NARO

2.3.1 Internal Audit

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

This definition suggests that internal audit has continued to move away from financial And compliance audits to a broader value-adding role, embracing both assurance and consulting activities and focusing on improving performance and effectiveness. Since the definition is designed to embrace organizations in both the private and the public sectors, it is both timely and interesting to identify similarities and differences between internal audits in the two sectors since its release.

It has been argued that there were important differences between internal audit in the private sector and its counterpart in the public sector. Carhill and Kincaid (1989), for example suggest two reasons for these differences.

First public sector agencies operated in a rigid framework where activities are authorized by legislation. Second, these agencies are service-oriented and hence attach lower priority to cost factors and issues associated with profitability. Because of this, it is argued that public sector internal audit activities need to be of a much broader scope than in the private sector. Malan (1991) discusses two types of audit that are relevant to the public sector,

financial-related audits and performance audits. Financial- related audits examine the degree to which public resources are used by the organization to achieve its objectives. As such, they extend beyond the normal attestation function of audit.

Performance or value-for-money audits focus on whether public resources are being used efficiently and effectively, with an objective of identifying and reducing wastage. Copland (1993) argues that this type of audit has resulted in the adoption of a more sophisticated approach to internal audit work, requiring internal auditors in the sector to broaden their skills and the techniques used.

2.3.2 Internal Audit Function

Internal audit function has changed dramatically in recent years as it is increasingly acknowledged that the internal audit can foster a more proactive role within a continuous improvement philosophy. There is, however, a need for much greater enlightenment in this area of quality management activity.

2.3.3. Nature of internal audit activities in NARO

As previously noted, the role of internal audit in recent times has moved away from a traditional focus on controls to a value adding function that includes risk management, operational audits and consultancy projects (Institute of Internal audit, (IIA), 1999). The internal audit function spends on four categories of activity, financial audit and internal controls, Risk management, Operational and systems audit and Special projects and other work.

There has been considerable research on external auditor reliance on the work of internal audit (Felix et al., 2001) but this has generally been from the point of view of the external auditors. It is therefore interesting to explore internal audit interaction with external auditors from the perspective of the chief internal auditor.

Institute of Internal Auditors, (IIA) promoted the internal audit function as an independent function that provides value-added assurance and consulting services. Through this extended role the function has been promoted as the cornerstone upon effective corporate governance is built (Institute of Internal Auditors, (IIA) Professional Guidance, 2002).

This view has been supported by academic and practitioner research. Ramamurthy (2003), internal audit function, indicated that, over time, there has been a massive shift in focus to one that promotes and supports effective organizational governance.

This has been supported by Ruud (2003) who noted that, in today's business environment, the internal audit function has become a major support function for management, the audit committee, the board of directors, and other stakeholders.

This in turn, would suggest an expanded role for the internal audit function given that it comprises an integral component of the network of parties having corporate governance responsibilities (Gramling, 2004).

This expanded role essentially would involve the provision of additional services, which are initiated by the board (including the audit committee) and management as a means of ensuring that accountability requirements are met.

This raises the issues of credibility and integrity, given the close relationship between parties. Mutchler et al. (2001) touched on the importance of independence suggesting that, as the responsibilities of internal auditors grow, so does the demand for greater accountability, independence and objectivity.

They suggest that the broadened responsibilities of the internal audit function within environment of a changing business world, coupled with increasing economic petition and globalization, are creating pressure on the internal audit function, which can jeopardize its independence.

Independence and objectivity are to the profession of internal auditing what the Hippocratic Oath is to the practice of medicine.

They go on to define independence as freedom from material conflicts of interest that threaten objectivity. In other words, it is a state where threats to objectivity are managed to the extent that the risks of ineffective internal audit services are acceptably controlled.

The tension resulting from the pressure to provide value-added services while no independence prompts our primary research objective, which is to analyze critically whether internal audit functions in practice are operating independently, in line with theoretical best practice guidelines.

Management of National Agricultural Research Organization (NARO) has a strong influence in setting the overall tone for governance. Claybrook (2004) argued that upper management

has the broadest influence on stakeholders, and that management influences operations, as well as the board of directors and even the internal audit function. Nagy and Cenker (2002) confirm this, noting that management, and not internal auditors, ultimately determines the orientation of the internal audit functions. This is supported by Brody and Lowe (2000), who assert that the internal audit function sometimes is requested by management to assist it in advisory roles, such as in acquisitions, mergers and system development and Bou-Raad (2000) further supports this by suggesting that more can be accomplished with the internal audit function by reviewing and providing advice to management regarding business objectives.

Sarens and De Beelde (2006) also studied the internal audit function's relationship. Management, and concluded that management requires the internal audit function to take on an extended role to compensate for loss of control resulting from increased organizational complexity.

In addition, their study results infer that internal auditors are expected to safeguard corporate culture through personal contacts with people in the field (Cohen et al. (2002).

Chapman (2001) argues that the primary goal of the internal auditor is objectivity, which involves an unbiased attitude and the avoidance of conflicts of interest. This only can be achieved if the internal audit function is appropriately placed in the organizational structure. Chapman (2001) describes organizational independence as the placement of the internal audit function in the reporting structure so that it is free to determine the audit and perform audit work without interference.

Internal audit departments need to ensure an organizational posture which allows them to operate successfully on strategic issues. This means both the independence and mandate to deal with significant strategic business risks and issues. If inappropriately positioned within the company, internal audit deals with tactical issues and is viewed only at that level.

Inappropriate positioning can also raise serious concerns about the overall Independence of the function (PWC, 2002).

2.4. Internal Audit Committee in NARO

The policies and procedures for internal audit is to ensure that they meet the audit

requirements of the NARO as determined by the constitution, By-Laws and Board approved policies; the President's recommendation on the appointment of the Internal Auditor, the maintenance of reasonable degree of independence by the Internal in carrying out the duties of the office; the existence of adequate coordination and cooperation between the internal and external audit functions; the of reference, the budget, the audit plan and the annual report of the Internal Auditor, specific reports of the Internal Audit office as required, including management's response to findings and to and follow-up on action plans.

The Audit Committee's responsibility is to provide assistance to the Board of governors in fulfilling its legal and fiduciary obligations with respect to matters accounting, auditing, financial reporting, internal control and financially related legal compliance functions of the NARO The Audit Committee will review,

Comment upon and/or recommend to the Board of Governors on the financial reporting, Risk Management and Control Environment, External Audit, Clarifying governance, the monitoring of the quality and effectiveness of the External Auditor's relationship with management and make Communications Checklist.

The Audit Committee consists of at least four (4) Board members - other than the chairperson and Vice-chairperson of the Board - appointed by the Board of Governors, of whom shall be a member of the Executive Committee. Only those board members not employed by the all members of the Audit Committee shall be literate (sufficiently versed in financial matters to understand the NARO's practices and policies and the major judgments involved in preparing the financial statements) and at least one member shall have financial expertise.

The Audit Committee will meet sufficiently within a year to support its responsibilities and report to the Board at its regular meetings after each meeting held by the Audit Committee. The Audit Committee, in consultation with management and the external auditors, shall develop an annual work plan responsive to the Audit Committee responsibilities. Audit Committee meeting agendas shall be the responsibility of the Chairperson of the Committee in consultation with the Committee members, management, the External Auditor and Internal Auditor.

Minutes of the meetings of the Audit Committee is retained by the Secretary's office and

each and every member of the Board of Governors will have access thereto. The External Auditor and the Internal Auditor is always invited and such other NARO officers as may be invited from time to time may participate at meetings of the Audit committee. In general, members of the Committee shall meet in private sessions with the Internal Auditor, with the Internal Auditor, with management, and with the members only.

The presence of audit committees in NARO creates a perception of enhanced independence of the internal audit function, and more reliable financial reporting among financial statement users. Krishnan (2005) supports this view by asserting that in essence, the audit committee's status is enhanced because it can rely on the work of the internal audit function.

In addition to the presence of audit committees, and access to them, is a requirement that the internal audit function report directly to the audit committee to maintain independence. Hansen (1997) suggest that, in settings where the internal audit is independent, in terms of reporting level, an improved control environment and a reduction in reporting errors results.

Gramling(2004) confirms this by identifying that independence through an reporting relationship typically is viewed as the most important criterion describing objectivity. The importance of the independent status of the internal audit through an appropriate reporting line was reinforced by the Institute of internal auditors,(IIA) (2004), which strongly insists that the CAE should report functionally to the audit committee. The audit committee should have an important role to play in setting the responsibilities of the auditors and fine-tuning the structure, content and purpose of the audit report. This eventually could bring about a change in the attitude of the public towards the auditors and the report drafted by them; it also expected to change the auditors' attitude by transforming them into better professionals than they are now.

2.5 Fraud Detection and Prevention Methods

2.5.1 Key concepts

Fraud involves an intentional action, leading to a misstatement in the financial statements. The intentional act may entail misappropriating assets or fraudulent reporting in the financial statements.

The standards agree that fraudulent financial reporting encompasses manipulation,

falsification, or alteration of accounting records, misapplication of accounting principles, and misrepresentation in the accounting records.

Armed with an understanding of fraud, the auditor considers the risk of material misstatement arising from its occurrence. Both ISA 11 and SAS 82 mandate that the risk of fraud be considered when the auditor designs audit procedures. Each Standard suggests numerous factors which might be evaluated when assessing fraud risk. A review of the factors other than those specifically suggested in ISA 11 and SAS 82 should be considered if they are relevant in the specific circumstances.

When considering the factors impacting fraud risk, the auditor should also evaluate the implication of the presence of those factors on control risk. ISA 11 and SAS 82 both noted the presence of fraud risk factors affects the capabilities of the system in internal control. Fraud using, or against, an information system may be categorized as input tampering, throughput tampering, or output tampering. Input tampering involves entering false or fraudulent data into an information system. Throughput tampering involves the alteration of computer programs or code, and files.

2.5.2 Fraud Detection

One internal control that helps detect fraud is checking employment references. An employee with a history of perpetration of fraud schemes may move from one organization to another. When employee references are not checked, a dishonest person may be hired. A dishonest employee can defraud an unsuspecting organization of dollars and move on to a new job before the fraud is discovered.

As an overall consideration, surprise pre-emptive fraud audits should be a weapon in the arsenal of the internal audit staff. Surprise fraud audits have the potential to act as a deterrent to employee fraud. Ideally, these audits should be conducted by seasoned internal auditors because the audit trail often is nonexistent, incomplete, or difficult to follow. A surprise audit, however, gives fraud perpetrators less time to alter, destroy, or hide records and other evidence.

Another reason for using experienced internal auditors is that it is likely that members at t audit team will be interviewing many people, including those implicated. Internal auditors must

A hotline allows employees to provide confidential, inside information without the fear of reprisal that accompanies being a whistleblower (Pergola and Sprung, 2005). Hotlines may be supported in-house or provided by a third party. An example of a third-party hotline is a subscription service offered by the NARO Uganda. The annual subscription rate may be quite modest. The results of all calls are provided to the client within two or three days. A hotline is not only an effective detection tool but it also enhances deterrence. Potential perpetrators will likely have second thoughts when considering the risks of being caught.

Employee Reference Checks

NARO Uganda should conduct employee reference checks prior to employment. An employee with a history of perpetration of fraud schemes may move from one organization to another.

When employee references are not checked, a dishonest person may be hired. A dishonest employee can defraud an unsuspecting organization of thousands of dollars and move on to a new job before the fraud is discovered. Resumes should be scrutinized and information verified to determine that the information provided is legitimate.

An organization should not rely on the telephone numbers listed on the resume for prior employers, as they may be false. Employer phone numbers should be obtained by the organization independently.

NARO Uganda should conduct a second reference check six months after an employee starts work. The reason for a dishonest employee's recent dismissal from a previous job may not have had time to become part of the employee's record during the initial search. This may be discovered by a second check.

Fraud Vulnerability Reviews

A fraud vulnerability review that investigates the organization's exposure to fraud should be performed. This includes an assessment of what assets are held and how they could be misappropriated. For example if NARO Uganda get involved in electronic commerce, a vulnerability review should also include an assessment of exposure to employee misappropriation or destruction of such "non-balance" sheet items as confidential customer data and financial information. The purpose of such a review is to "outsmart the crooks."

A vulnerability review can help to direct an internal audit plan and, in particular, to highlight the most vulnerable assets. The review is considered a proactive step in fraud prevention and

detection. Consideration of each class of asset and the evaluation of the exposure to loss helps the auditor or accountant to see what the thief sees. Steps then should be taken to eliminate, minimize, or at least control the exposures.

Perform Vendor Contract Reviews

Review of NARO Uganda contracts and agreements can provide an indication of possible contract fraud, including kickbacks, bribery, or conflicts of interest by an organization's employees. Contract fraud can occur when a trade supplier fraudulently takes advantage of a contract to make illegal profits. Contract fraud may involve a conspiracy between entity personnel and a trade supplier or conspiracy among two or more vendors.

Analyzing contract files for the same contractor routinely bidding last, bidding lowest, or obtaining the contract may detect this type of contract fraud. Awarded contracts may also be scrutinized for evidence of a supplier regularly being awarded contracts without indication of a legitimate reason for the constant receipt of contract awards. Such a review may reveal that bribes or kickbacks are the reason for the awards. A review of various public records may reveal whether an employee has a covert ownership interest in the contractor.

Use Analytical Review

Fraud can affect financial statement trends and ratios. Accounts that are manipulated to conceal a fraud may manifest unusual relationships with other accounts that are not manipulated.

Also, erratic patterns in periodic account balances may occur because the fraudster may engage only sporadically in fraudulent activity. Financial analysis conducted by an accountant or investigator may reveal existing relationships that are not expected or the absence of relationships that are expected to be present.

Various analytical review techniques which the accountant or investigator may employ include, trend (horizontal) analysis, ratio analysis (vertical analysis or common size statements), budgetary comparisons, comparisons with industry averages, and review of general ledger and journal entries.

2.5.4 Other prevention methods pass

word protection

Gerard et al.,(2004)., highlighted that the growth of the internet and e-commerce has led to a rise in the number of dial-in ports to computer networks thus increasing the exposure of fraud. Accountants and investigators should assure that only legitimate users have access to the computer network and associated data.

Although passwords are the oldest line of computer defense, they still constitute the most efficient method of controlling access. The difficulty with password is that there is an inverse relationship between making the password effective and usable. If password requirements are too complex, users will write the password down, placing it at risk (Gerard et al., 2004).

Firewall protection

One necessary technique for controlling unauthorized access is the use of firewalls. Firewalls can be used at the software or hardware level.

At the software level, there are specific programs (Zone Alarm from zonelabs.com) that can be coordinated with internet- related software programs (browsers, e-mail, etc.) to protect the data being passed through them.

Hardware firewalls/routers basically prevent people from finding an organization's connection to the internet. The internet connection is known as an IP address. The hardware firewall' router basically hides the IP address so that hackers cannot find and access it (Gerard et al., 2004).

Digital analysis, which is based on Benford's Law, tests for fraudulent transactions based on whether digits appear in certain places in numbers in the expected proportion. A significant deviation from expectations occurs usually under two conditions.

The first is that a person has added observations on a basis that does not conform to a Bedford distribution. The second condition is that someone has deleted observations from a data set that does not adhere to a Bedford distribution (Durtschi et al., 2004)

Tax cheats, check forgers, and embezzlers simply cannot consciously generate random numbers.

Forensic accountants and auditors have depended on this human quirk for years and various

types of digital analysis software, including DAT AS, have proven themselves capable of pinpointing this habit (Lanza, 2000).

Discovery sampling

Discovery sampling is a form of attribute sampling. The latter is a statistical means of estimating the percentage of a population that possesses a particular characteristic or attribute.

Discovery sampling is based on an expected error rate of zero. It is employed when the accountant needs to know whether a population contains any error indicative of fraud. If a single case of significant error or fraud is found in a sample, the sampling process is stopped and the error or fraud is investigated.

An account should not include any payments made out to a vendor name that is known to be fictitious unless there is that type of fraud in the account. If there is no such fraud in the account, there should be no payments to fictitious vendors.

If an auditor were to test some of the payments in an account and were to find a payment made out to a fictitious vendor, the auditors would know that fraud existed but would not know the extent of the fraud. Conversely, if an accountant examined some account payments and did not find any illegitimate payments, he or she would not conclude that no fictitious payments existed in the account.

2.6. Relationships between Internal Audit Function and Fraud Detection in NARO

The correlation between internal audit function and fraud detection is reflected by an increased focus in NARO Uganda is placed by internal auditors on preventing fraud may serve to deter some employees from engaging in fraudulent activities.

Internal auditors, working with management, should aggressively pursue possible fraudulent conduct instead of waiting for situations to be brought to the forefront. A proactive stance on preventing and detecting fraud should increase employee perception of the likelihood of detection.

In addition to being aware of the common types and signals of fraud, certain steps can be taken by internal auditors to combat fraud. These strategies are identified "Internal auditor's fraud checklist" and a number of them are discussed below (Stoner, 2006).

Fraud can affect financial statement trends and ratios. Accounts that are manipulated to conceal a fraud may manifest unusual relationships with other accounts that are not manipulated. Also, erratic patterns in periodic account balances may occur because the fraudster may engage only sporadically in fraudulent activity.

Financial analysis conducted by the internal auditor may reveal existing relationships that are not expected or the absence of relationships that are expected to be present.

It may behoove the internal auditor to analyze several years of financial statement data using different techniques to obtain a clear picture of the financial impact of any fraud scheme. Various analytical review techniques which the internal auditor may employ include: trend (horizontal) analysis, ratio analysis (vertical analysis or common size statements), budgetary comparisons, comparisons with industry averages, and review of general ledger and journal entries. Unusual items should be pursued to determine if fraud could be the cause of an aberration.

Review of NARO Uganda contracts and agreements can provide an indication of possible contract fraud, including kickbacks, bribery, or conflicts of interest by the organization's employees. Contract fraud can occur when a trade supplier fraudulently takes advantage of a contract to make illegal profits. Contract fraud may involve a conspiracy between entity personnel and a trade supplier or conspiracy among two or more vendors. This type of contract fraud might be detected by analyzing contract files for the same contractor routinely bidding last, bidding lowest, or obtaining the contract.

Awarded contracts may also be scrutinized for evidence of a supplier regularly being awarded contracts without indication of a legitimate reason for the constant receipt of contract awards. Such a review may reveal that bribes or kickbacks are the reason for the awards. A review of various public records may reveal whether an employee has a covert ownership interest in the contractor.

A threat analysis that investigates the entity's exposure to fraud should be performed. This includes an assessment of what assets are held and how they could be misappropriated. For those organizations involved in electronic commerce, a threat analysis should also involve an assessment of exposure to employee misappropriation or destruction of such "non-balance" sheet items as confidential customer data and financial information. The purpose of such an investigation or assessment is to "outsmart the crooks". A threat analysis can help to direct an

internal audit plan and, in particular, to highlight the most vulnerable assets. The analysis is viewed as a proactive step in fraud prevention and detection. Consideration of each class of asset and the evaluation of the exposure to loss helps the internal auditor to see what the thief sees. Steps then should be taken to eliminate, minimize, or at least control the exposures.

It was suggested that poor internal controls led to almost 60 per cent of the frauds that occurred (KPMG Peat Marwick, 1998). This report highlights the significant role that an internal auditor can play in implementing, monitoring, and enforcing a strong internal control system. Two steps that can be taken by internal auditors to strengthen internal control are enforcement of mandatory vacations and periodic job rotation

CHAPTER THREE

METHODOLOGY

3.0. Introduction

This chapter presents the methods and tools that were used in the study, it presents, required and data procedures, the sources of information, how information is to be obtained and processed, how the findings are to be presented and the likely limitations. It also focuses on the sampling used, how data was collected, controlled and analyzed.

3.1 Research Design

The researcher used qualitative and quantitative research design in collecting, organizing and presenting data, where the analysis was based on the relationship between the nature of the internal audit function and the level of fraud detection in NARO.

3.2 Study Population

The population in the study was 100 people 80 being the sample size of the respondents which was elected to participate in the exercise.

3.3. Sample Size

Slovene's formula was used to compute the sample size. This formula was employed so as to sample fairly a large number of people. Slovene's formula states that, for any given population (N), the sample size (n) is given by;

$$n = \frac{N}{1 + N(e)^2}$$

here, n = required sample size

N = known population size

(e)² = 0.05 level of significance

$$n = \frac{100}{1 + N(e)^2}$$

$$\begin{aligned} n &= \frac{100}{1 + 100(0.05)^2} \\ &= 80 \end{aligned}$$

3.4 Data Collection Methods

The data was collected by reviewing related literature concerning variables under study. The research information was obtained by reviewing a lot of information document from books, published articles, journals and internet. Other methods include records kept by the organization in the study, public libraries and publication from institutions.

3.5 Data Collection

Primary data

The primary data was obtained through the use of questionnaire each one of the heads of department was requested to one and the rest was randomly distributed. This is data that was collected from newspaper, journals magazines textbooks and internet.

Table 1. Population and sample size distribution.

Category	Staff population(N)	Sample size(n)	sampling technics
Board of directors	6	6	purposive
manager	1	1	purposive
accountant	2	2	purposive
Credit officer	2	2	purposive
supervisors	10	7	Sample random
Field officers	30	26	Simple random
members	49	36	Simple random
Total	100	80	

3.6 Sampling procedure

The researcher two sampling technics which were simple random and purposive sampling. In using random sampling, the researcher first identified the respondent and after that the respondents were picked at random. This method was used to establish members who took part in the study from the category of quality assurance team.

3.7 Source of data

The researcher collected data from both primary and secondary data sources.

Secondary data

Secondary data was from according manuals records and also from the enterprises annual reports, the annual reports. The annual reports including the audit reports, profit and loss account records and balance sheet records.

3.8 Data Collection Instruments

This was a methods of data collection, where a questionnaire were sent to the person concerned, which a request to annual the questions and return the questionnaire.

Therefore questionnaires were distributed amongst respondents to collect data. The questions was designed in such a way that general information on fraud detection that was to be general from various respondents, establish the existence of an internal audit function and evaluate the effectiveness of the internal audit functions on fraud detections in the enterprise.

3.9 Validity and Reliability of the instrument.

Validity: Validity of instruments was tested using content Validity Index (CVI). The researcher established the validity of the instruments by using expert judgment method as suggested by Amin (2005). This involved judges scoring the relevance of the questions in the instruments in n to the study variables and a consensus judgment given on each variable.

This formula is given by

Content validity index is accepted for the items measured which have the average validity index of above 0.07 as recommended by (Amin, 2005).

Reliability: reliability was tested using Cronbach's coefficient alpha (α). Specifically, coefficient alpha typically used during scale development with items that had several response options (i.e. 1= strongly disagree to 5=strongly agree). To establish Cronbach's coefficient

alpha (α), reliability analysis using SPSS was used, According to Kline, (1999) for the instruments to be regarded as reliable, the average index should be 0.70 or above.

3.10 Data Management and quality Control

3.10.1 Data management

Two files were opened up one for original copies and another one for photocopies and will be kept in two different places for safety.

Data was in the computer. Quality data was ensured by pilot study and proper paging of the questionnaire was coded using a coding frame. Frequencies were printed and missing variables also was checked for from the raw data

3.10.2. Quality control

Trained interviewers were used and data collecting instruments were pretest before the beginning of the study. The researcher checked the data collected on the very day and ask the concerned interviewer for clarification there and then.

3.11 Procedures to be followed

The researcher prepared a proposal with details and steps to be followed. When approved, the researcher obtained an introduction letter from Kampala University School of Business and Management. To access the research area after designing the research instruments, the researcher embarked on data collection process.

3.12. Ethical Consideration

The researcher used principles that respect standards that do not affect respondent's rights by asking ethical questions as well as respecting their customers, beliefs and business regulations. Kampala University School of Business and Management processed an introductory letter for the research. The researcher also got permission from the NARO.

3.13. Data Processing and Analysis

Data presentation was done manually by arranging, coding and comparing various materials and coming up with reasoned conclusions.

Data was processed and analyzed using descriptive statistics. Qualitative data was analyzed

using a master sheet.

Quantitative data was analyzed from the tables, charts and graphs by relating the dependent variable to the independent variable in order to get the answers for research questions fully and to establish cause effect relationship of the study.

Data was screened edited and analysis was done by the researcher and cross checked, referencing and well as data comparison information was collected, sorted and organized using computer packages like Ms Word and printed out.

3.14 Limitation of the Study

The process of data collection was hindered by many problems and setbacks and this accounts for the delay of completing this research on time. One major setback was the financial constrains as faced by the researcher, with a major problem of ill health for about 2 months.

The researcher was limited by time resource factor because there was no sufficient time to gather information and others so as to ease the compilation of the report. The time that was allocated for the study was quite short and this further restricted getting more necessary data.

The study involved a lot of final spending in search for information through surfing on internet, visiting public libraries and concern institutions, stationary and printing.

The data found, was mostly not much relevant to the topic because it required lots of comparisons with the related data, to come up with the topic

CHAPTER FOUR

PRESENTATION AND INTERPRETATION OF FINDINGS

4.0. Introduction

In abide to answer the research question this chapter presents and interprets the findings.

This chapter is arranged under three major sub headings: the nature of internal audit function, Fraud detection and prevention methods and the relationship between internal audit function and fraud detection in NARO.

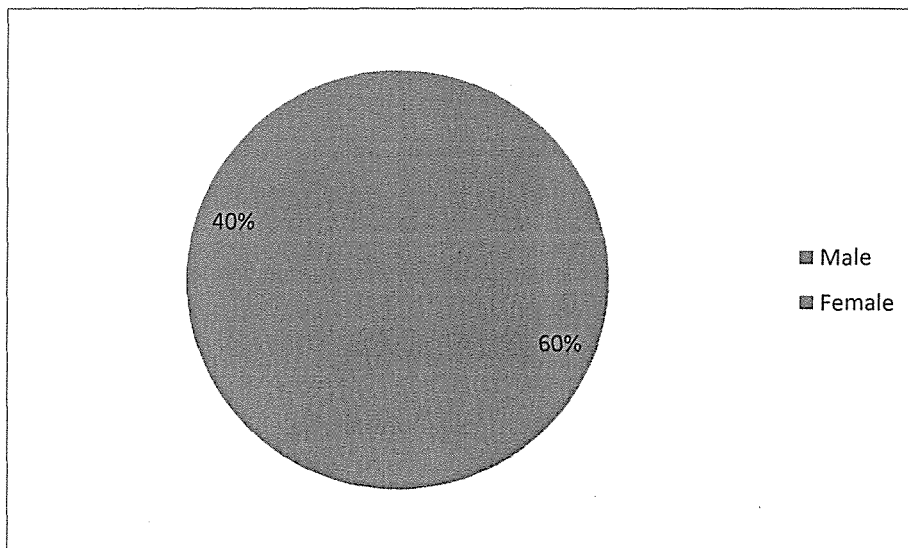
The total number of people who were given questionnaires were 35 and 30 were returned.

The percentage of respondents was 85.7% and those who did not respond were 14.3%.

The degree of the respondents were 309° and those who did not respond were 51°

Total number of female respondents was 40% and that of male 60% and 216° were male and 144° were female as illustrated in the pie-chart below.

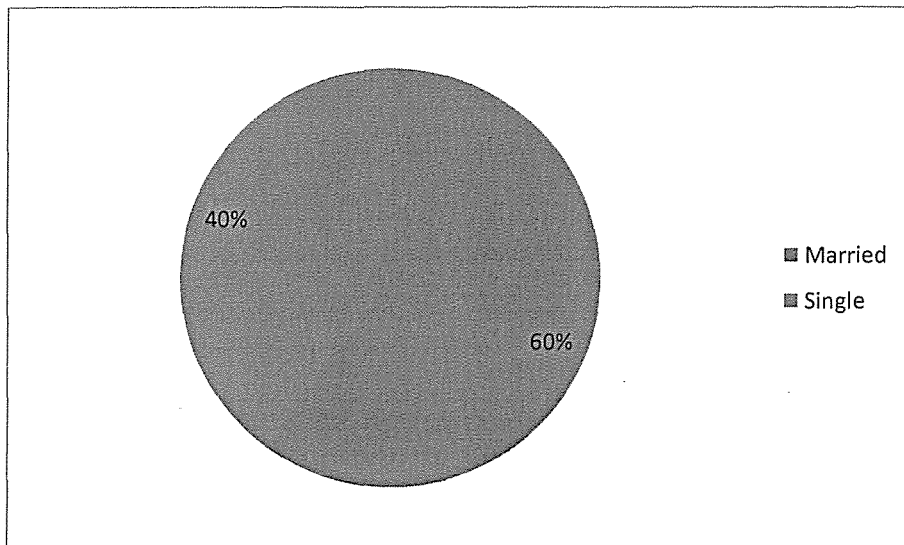
GENDER



Source: Primary Data

This indicated that in NARO, gender distribution among employees is highly recognized and reliability of data collected was expected.

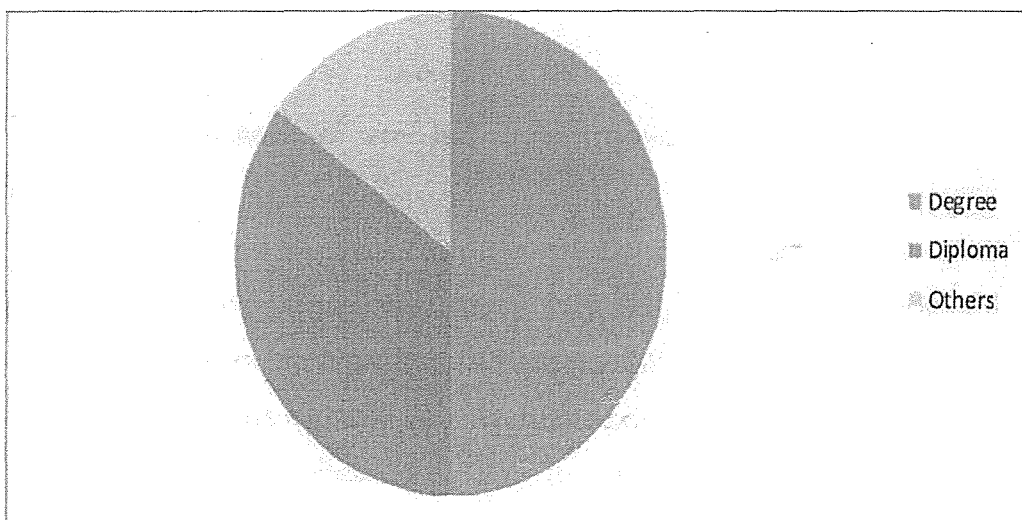
Marital status



Source: Primary data

Married respondents were 60% and single respondents were 40% were 216° were married and 114° were single.

Educational level

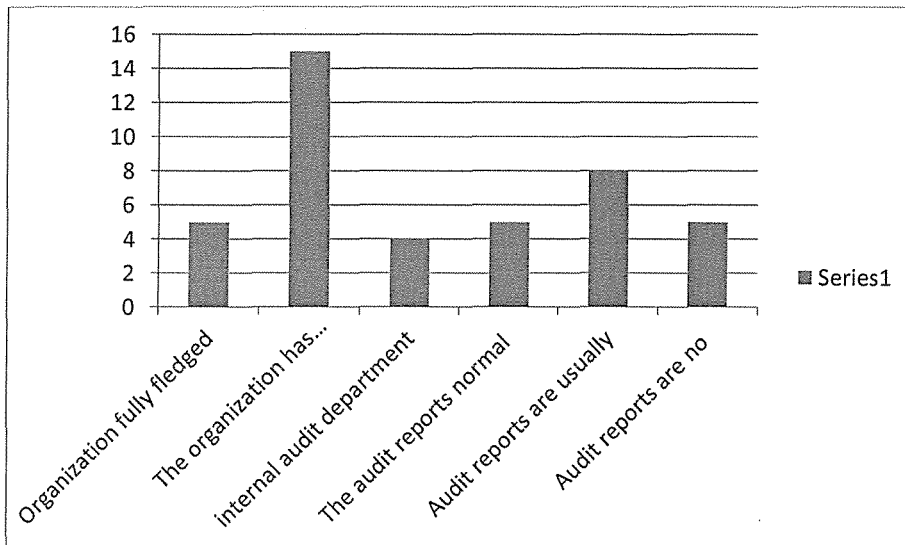


Source: Primary data

The level of professionalism of respondents was as follow: degree level was 180°, Diploma level was 126° and others were 54°.

4.1 Findings on the nature of Internal Audit Function

Graph 1:



From figure 1, audit measures were laid to the respondents on a well organised questionnaire.

Such measures included; organization has a fully-fledged audit department, the organization has adequate staff, the internal audit normally carries out audit work regularly, the audit reports normally have recommendations on the way forward, the audit reports are normally discussed in management meetings, audit reports are usually implemented by the management and audit reports are usually objective. The respondents were able to answer the questionnaires and got the above results.

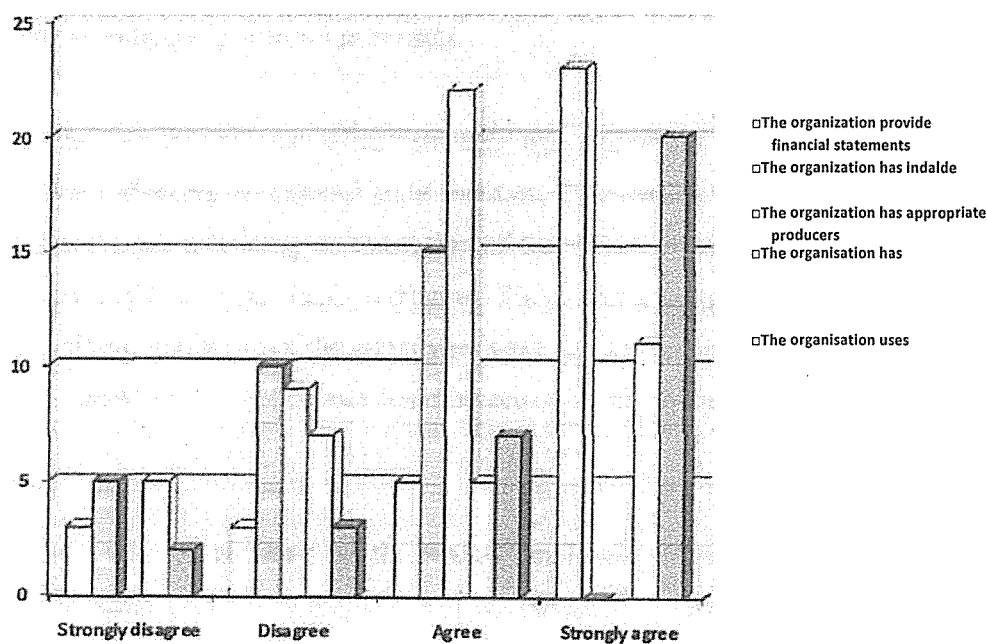
According to the respondents, organization having a fully-fledged internal audit department was observed as the best measure of internal audit. This measure provided over 80% compared to the others, Disagreement along the data was shown in when

the audit reports are normally discussed in management meetings; these provided a higher percentage of disagreement and disagreement though there was 10% strongly agreed that this measure should be used. Felix et al, (2001) agreed that the audit reports normally have recommendations on the way forward and this was also approved by the results got from the NARO employees implying that this is the best measure to be used in the internal audit.

4.2. FINDINGS ON THE FRAUD DETECTION AND PREVENTION

METHODS

Graph 2



Source: Primary Data

In figure 2, this demonstrates the fraud detection and prevention methods in NARO. A higher percentage believed that the organization should provide financial statements to avoid fraud followed by the organization having appropriate procedures to fight fraud then the organization should use reference checks to fight fraud. Most of the employees disagreed on the organization having a specific telephone line to detect

fraud meaning that NARO does not have the specific line for fraud because most employees strongly disagreed on the same.

This is in agreement with Wells (2003), he argued that organizations should provide financial statements to avoid fraud and that was strongly agreed upon by the biggest number of employees meaning that this is the best detection procedure of fraud in government agencies.

The findings represent the factors showing the relationship between Internal audit function and fraud detection in NARO and these included the increased focus reflecting the internal audit function. The financial statement trends and ratios affecting fraud function, the techniques used to obtain a clear picture of financial impact leading to fraud reduction and also the review of contracts of the organization providing an indication of fraud in NARO.

Among these set factors respondents strongly agree upon the increased focus in the organization reflecting the internal audit function, followed by the review of contracts of the organization providing an indication of fraud then obtaining a clear picture of financial impact leading to fraud reduction. There was a disagreement on all the factors implying that some of the employees were not conversant with the relationship between internal audit function and fraud detection in the organization.

In agreement with the results from the NARO employees Stonner, (2006) asserts that the financial statement trends and ratios affect the fraud function of the organization, this was strongly disagreed with the results got from NARO where the employees of NARO strongly agreed with the increased focus on the organization reflects the internal audit function implying that governmental agencies use a different relationship as compared to the one of the author.

The researcher therefore deduced that Uganda's government agencies do apply little fraud detection as compared to what is suggested by the authors and this hinders the use internal audit function and fraud detection in government agencies.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATION

5.0 Introductions.

This chapter involves the summary of major finding, conclusions and areas for further research.

5.1 Summary

According to the results got from NARO employees, the nature of the internal audit shown the highest levels on the audit reports normally having recommendations and the results strongly disagreed with the audit reports normally being discussed in management meetings.

The level of Fraud detection and prevention methods results show a strong disagreement with the organization having appropriate procedures to fight fraud yet few of the employees agree with the organization having internal audit departments to prevent fraud.

The results of the relationship indicates that there should be increased focus in the organization which reflects the internal audit function though most employees do not consider the review of contracts of the organization to be providing an indication of fraud in government agencies.

5.2 Conclusions

The overall purpose of the study was to find out the relationship between internal audit function and fraud detection in NARO. The main method of collecting data was purposive and questionnaires were structured to get the primary data. The findings got from NARO are important to many government agencies being affected with fraud.

The study confirmed that internal audit function can detect fraud in the government agencies using fraud detection measures got from the NARO employees after analyzing the nature of internal audit function.

The researcher also support the assumption, put forward by Stonner, (2006) that the financial statement trends and ratios affect the fraud function of the organization, since it was later confirmed by the results got from the NARO employees.

The study also suggested the establishment of the telephone hotline in order to detect the fraud in the government agencies though this was under looked by the NARO employees according to the results got and the use of reference checks was seen as the better method to fight fraud.

In general fraud can be detected in government agencies by the use of internal audit function according to the measures put forward in the study and this can be supported by the external auditors, Inspector general of government, and Public accounts committee among others.

5.3 Recommendations

NARO should implement all the required measures to detect fraud in government agencies.

This will increase the performance levels of the agencies.

NARO should also put forward strategies to detect fraud and this will help the internal auditors to know who is likely to carry out fraud in any government agency.

There should also be strict punishments for whoever is a victim of fraud in any government agency and these rules should be published and strictly followed by all the government agencies.

The government should also publish the victims of fraud to the people so that whoever follows under it knows that similar measures will be taken after him

5.4 Areas for Further Research

1. Accounting fraud, litigation and Auditor liability in an organization.
2. Litigation support review of audit working papers for notes payable in government agencies.
3. Management audit and fraud detection
4. Investigation in auditing and fraud detection.

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APPENDICES

RESEARCH INSTRUMENTS

APPENDIX A: QUESTIONNAIRES (TO BE FILLED BY THE EMPLOYEES)

I AM ACHARI BEATRICE REG NO BBA/37490/141/DU a student of Kampala international University pursuing a degree in Bachelor of Business Administration. I am conducting a research on Internal Audit Function and Fraud Detection in Government Agencies and my case study is NARO Uganda.

Kindly spare your valuable time and respond to the following questions. The purpose of the study is to gain a clearer understanding on how Internal Audit Function and Fraud Detection is done in government agencies.

Your answers will not be disclosed to any one and thus there is no need to write your name on the questionnaire.

(i) BACKGROUND INFORMATION

(Tick the most appropriate one)

1. Department/unit of work

Finance

Accounting

Procurement

3. Age group?

2. Sex []

20-25years []

Male []

Female []

26-30years []

36-40years []

41 and above []

4. Highest academic qualification

Masters level []

Degree level []

Diploma level []

“A” Level others []

5. How many years have you been working with NARO?

1-5years []

6-10 years []

11 and above years []

(ii) The nature of the

internal audit Please

tick the most

appropriate one

1. Strongly Disagree 2. Disagree 3. Not sure 4. Agree 5. Strongly agree

(i) THE NATURE OF THE INTERNAL AUDIT

Please tick the most appropriate one

1. Strongly Disagree 2. Disagree 3. Not Sure 4. Agree 5. Strongly Agree

	Establishing the nature of internal audit function	1	2	4	5
1	Your organization has a fully-fledged internal audit department				
2	The organization has adequate staff				
3	The internal audit department normally carries out audit work regularly				
4	The audit reports normally have recommendations on the way forward				
5	The audit reports are normally discussed in management meetings				
6	Audit reports are usually implemented by the management				
7	Audit reports are usually objective				

(ii) FRAUD DETECTION AND PREVENTION METHODS

Tick the correct one

1. Strongly Disagree 2. Disagree 3. Not Sure 4. Agree 5. Strongly Agree

	Establishing the level of fraud detection	1	2	3	4	5
1	Your Organization provides financial statements to avoid Fraud					
2	The organization has internal departments to prevent fraud					
3	The organization has appropriate procedures to fight fraud					
4	The organization has particular methods to prevent fraud					
5	The organization has a specific telephone line for detecting fraud					
6	The organization uses the reference checks to fight fraud					

(iii) RELATIONSHIP BETWEEN INTERNAL AUDIT AND FRAUD DETECTION

Please tick the most appropriate one

1. Strongly Disagree 2. Disagree 3. Not Sure 4. Agree 5. Strongly Agree.

	Examining the relationship between nature of internal audit and fraud Detection.	1	2	3	4	5
1	The organization is fully equipped with professional control measures.					
2	The organization is has quality and quantity work man ship.					
3	The organization is equipped with managerial techniques					
4	The organization takes action on the audit reports					
5	There is audit transparency in the organization.					
6	Issues raised in the audit report is implemented by the organisation.					

APPENDIX B: INTERVIEW GUIDE

What is the nature of the internal audit function in National Agricultural Research Organization (NARO)?

What is the level of fraud detection in National Agricultural Research Organization (NARO)?

What is the relationship between the nature of the internal audit function and the level of fraud detection in National Agricultural Research Organization (NARO)?