

INTERNAL AUDIT COMMITTEE IN CO-OPERATIVES : COMPLIANCE TO THE CO-OPERATIVE SOCIETIES ACT 1993

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ABSTRACT

The framework of internal audit was introduced into the co-operative sector with the enforcement of the Co-operative Societies Act (CSA) 1993 in January 1994, which clearly spelt out the functions and powers of the Internal Audit Committee (IAC). The objective of this research is to study the extent to which the IACs are functioning in compliance with provisions of the co-operative law as well as provide an insight into the IAC's level of knowledge of their functions, experience as IAC members, attendance of mandatory training and frequency of audit and audit reports. Three IAC members were randomly chosen as respondents from a sample of 274 co-operatives. Data was collected using a self administered questionnaire. Responses were received from 473 IAC members from 176 co-operatives, a response rate of 64.2%. The findings indicate one third of the IAC have yet to attend the mandatory course. Those who have attended this training have a significantly better knowledge of their functions. One third (33.3%) are not complying with the legal requirement to audit once in 3 months. A substantial number of IAC are not submitting audit reports in compliance with the law. It is also found that those who have attended mandatory training, have more than one years' experience as IAC or receive allowances tend to carry out significantly more frequent audits.

INTRODUCTION

Audit, both external and internal audit form an important component of good corporate governance. External audit has long been a legal requirement for most businesses to provide assurance on the reliability of information contained in financial statements. Internal audit, though traditionally not mandatory, is now being recognised as an important element in enhancing governance, accountability and transparency. In Malaysia, the 1990's witnessed internal audit and audit committees being made a necessary best practice in companies as well as co-operatives through relevant legislation and administrative circulars.

In August 1993 it was made mandatory for all companies listed on the Kuala Lumpur Stock Exchange (now Bursa Malaysia) to form an 'Audit Committee', comprising of a minimum of 3 independent directors. The concept of internal audit was introduced into the co-operative sector with the enforcement of the Co-operatives Societies Act (CSA) 1993 on January 22, 1994.

INTERNAL AUDIT COMMITTEE IN CO-OPERATIVES

Under the CSA 1993 it was made mandatory for every co-operative to appoint at its Annual General Meeting (AGM) an Internal Audit Committee (IAC) comprising of not less than three and not more than six members. As at 31st December 2005 there were 4771 co-operatives in Malaysia with a membership of 5.68 million people and assets worth RM 34.86 billion. If each of the 2951 co-operatives (excluding 1820 school co-operatives) were to appoint the minimum of 3 members to its IAC there would be at least 8853 IAC members in the co-operative sector in Malaysia.

Section 49 of the CSA 1993 lists the powers and functions of the IAC. Among others the functions of the IAC are to:

- examine all accounting and other records for determining whether the affairs of the co-operative are conducted in accordance with its objectives, the provisions of its by-laws and the resolutions adopted at its general meeting, and, in particular, shall—
 - a) ascertain the authority and validity of all expenditures;
 - b) examine the accounts, or appoint competent persons to examine such accounts, at regular intervals which shall not in any case be less than once every three months; and
 - c) communicate to the board any discrepancies that may occur in the management of the co-operative.
- present at the annual general meeting a report on the management and affairs of the co-operative society, including any violations of its by-laws .
- Regulation 32(2) requires that "the Internal Audit Committee shall meet and table its recommendations not less than twice every year in any registered society and reports shall be submitted to the Registrar-General".

OBJECTIVES OF THE STUDY

The objectives of this study are to appraise the extent to which the IACs in co-operatives are functioning in accordance with provisions of Section 49, CSA 1993 and related regulations and to gain a better understanding of current audit practices in co-operatives. Specifically, the research aims to:

- i) ascertain the degree of compliance to provisions of the CSA 1993 in respect of the composition of the IAC, timely conduct of audit work and submission of audit reports;
- ii) obtain an insight into the demographic profile, experience and training background of the IAC;
- iii) study the IAC's level of knowledge and understanding of their functions; and
- iv) identify the current audit practices of the IAC.

SIGNIFICANCE OF THE STUDY

This research is the first study on the IAC since its introduction into the co-operative movement in 1994. The findings could provide valuable feedback to the Ministry of Entrepreneur and Co-operative Development (MeCD) and the Department of Co-operative Development (DCD) for policy planning and legislative changes that will enhance the functioning of the IAC. It would also help training providers like the Co-operative College of Malaysia (CCM) and National Co-operative Organisation of Malaysia (ANGKASA) to design appropriate training to cater for gaps in auditing knowledge and skills of the IAC.

RESEARCH METHODOLOGY

The study was carried out through a survey using a self administered questionnaire. The research instrument comprised of 5 sections. Section A gathered data on the IAC's knowledge of their functions, and Section B on respondent's perception of the importance of the IAC's role. Section C obtained data on audit practices and Section D the demographic data, experience and training attended by respondents. Section E obtained data on the size of the IAC and regularity of audit reports as required by the CSA 1993.

As at 31st December 2005 there were 2,332 active co-operatives (excluding school co-operatives) in Peninsular Malaysia which were selected as the total population of this study. This population was further clustered into 5 zones, namely the northern, north central, west central, southern and eastern regions. Adopting the purposive sampling method, the state with the largest number of co-operatives in each of the 5 identified regions was selected as the sample. In this context, the states selected as the sample were Kedah, Perak, Pahang, Wilayah Persekutuan Kuala Lumpur and Johor. Subsequently, from each selected state, only co-operatives within a particular district of supervision (as recommended by the

state level DCD) were selected as the final sample of the study. A total of 274 co-operatives or 11.75% of the total population (2,332 co-operatives) was finally selected as the sample for this study.

Data analysis was carried out using the computer software SPSS version 11.5. A descriptive analysis about the respondents' background information was made using frequency distributions and percentages. Besides percentages, the mean and median values were computed to rate the IAC's perception towards their roles, knowledge and skills.

The t-test was employed to identify whether factors such as mandatory training, years of experience, length of membership, other training attended and academic qualification have a relationship with the level of knowledge of the IAC relating to their functions and duties. The Chi-square statistic is used to find out whether frequency of audit is associated with attendance at mandatory course, the number of years of experience the IAC has and allowances paid to the IAC,

In order to study the effect of training on the knowledge and level of understanding of IAC functions, a one-way analysis of variance (ANOVA) was performed. Similarly, the test is applied to evaluate the effect of length of membership on the knowledge of duties of the IAC.

RESEARCH FINDINGS

Sample Characteristics

Completed questionnaires were received from 473 IAC members from 176 different co-operatives. The majority of sample co-operatives were found to be small in terms of total assets. As seen in **Table 1**, almost 40% of the sample have less than RM500,000 in assets of which 11.4% have less than RM100,000. Another 26.7% of the sample have assets ranging from RM500,001 to RM1.5 million. Nearly 35% or one third of the sample have assets exceeding RM1.5 million which can be considered as large co-operatives.

Table 1: Sample Size: Total Assets

Total Assets (RM)	No. of Co-operatives	%
< 100,000	20	11.4
100,000 - 500,000	48	27.3
500,001 - 1,000,000	34	19.3
1,000,001- 1,500,000	13	7.4
>1,500,000	61	34.7
Total	176	100

Demographic Profile of the IAC

The demographic statistics of the respondents show, the majority (82.2%) of internal auditors in co-operatives are males (Table 2). The respondents' age ranges from 19 to 78 years. The mean age is 51 years with the largest proportion or 71% falling into the 40-59 years age group. Only 10% of the IAC are below 39 years. This indicates that generally the IAC is comprised of experienced, matured individuals and in the employed age group.

Table 2: Demographic Characteristics of Respondents

Gender	N	Percent (%)
Male	389	82.2
Female	84	17.8
Total	473	100
Age		
Under 39	48	10.1
40 – 49	162	34.2
50 – 59	174	36.8
60 – 69	67	14.2
70 and above	22	4.7
Total	473	100
Education Level		
Lower Secondary	134	28.3
O-Level	196	41.4
A-Level	82	17.3
Degree and Professional	61	12.9
Total	473	100

In terms of the level of education, 58.7% of the IAC members possess only the Malaysian Certificate of Education (O level), Higher School Certificate (A level) or Diploma level qualification. A substantial 28.3% of the respondents only have lower secondary education or primary education. Only about 13% of the IACs possess any tertiary or professional qualifications. This low level of education among a large number of the IACs can affect the ability of the IAC to conduct quality and comprehensive audit work.

Length of Membership and Experience as IAC

The majority of IACs have been members of their co-operative for more than 10 years with 37.4% having been members for between 11-20 years (Table 3). Nearly one fourth or 23.5% are long serving members with more than 20 years of involvement with the co-operative. Interestingly, a significant 16.3% are relatively new members (1–5 years membership). The mean membership with co-operatives is 15.7 years.

Table 3: Length of Membership

No. of Years as Member	N	Percent (%)
1 – 5	77	16.3
6 – 10	108	22.8
11 – 15	105	22.2
16 – 20	72	15.2
> 20	111	23.5
Total	473	100

As seen in **Table 4** more than one fourth or 27% of the respondents have been on the IAC for one year or less, indicating they are relatively new to this job. The majority or 39.9% have been on the IAC for between 1-3 years, while one third or 33% have held this position for more than 3 years. This shows that the majority of IAC members have been reappointed at the annual general meeting.

Table 4: Experience of IAC

No. of years	No. of respondents	%
1 year	128	27.1
1- 3 years	189	39.9
>3 years	156	33.0
Total	473	100

Training of IAC

The Registrar General of Co-operatives has through a circular issued in 2002 made it mandatory for all IAC members to attend a specially designed two day training programme on Co-operative Accounting and Auditing Procedures within ten months of their appointment to the IAC. This research is also aimed at finding out the extent to which this directive has been complied with and whether attending this mandatory training has any relationship with good audit practices.

Table 5: Training Attended by IAC

Attendance \ Type of Course	Mandatory Course		Other Training	
	N	%	N	%
Yes	305	64.5	336	71
No	168	35.5	137	29
Total	473	100	473	100

Only 64.5% of the IACs have undergone this mandatory training (**Table 5**). It is disheartening to note that one third or 35.5% have yet to attend this course, though it is already more than 3 years since this circular came into force. Also to be noted is that 29% of the IACs have not attended any other training either.

Knowledge of the IAC's Functions and Duties

A primary objective of this study is to ascertain whether the IACs know their functions as provided for in the CSA 1993 and Co-operative Societies Regulations 1995. To assess this, 14 questions were formulated relating to provisions in Section 49 of the CSA which specifies the functions and powers of the IAC.

The percentage score of correct answers obtained by the respondents is tabulated in **Table 6**. A score of less than 64% is considered as not having enough knowledge regarding the functions and duties of the IAC. Only about half the respondents or 53.3% obtained a score of 85% and above, reflecting a good understanding of their functions while another 126 respondents or 26.6% have only a fair level of knowledge of their functions (65%-84% score). Sadly nearly one fifth or 20.1% of the IAC do not know their functions as reflected by the score of 64% and below. Obviously the IACs will not be able to perform their job if they do not know what they are supposed to do.

Table 6: Knowledge of IAC's Functions

Level of Knowledge (% score)	N	%
0 - 64	95	20.1
65 - 84	126	26.6
85 - 100	252	53.3
Total	473	100

Comparison of Level of Knowledge and Mandatory Training

Cross tabulation between attendance of mandatory training and score for knowledge of IAC functions was carried out to study the relationship of training with level of knowledge. Those who attended mandatory training have a higher score for knowledge compared to those without such training (Table 7). Nearly two thirds (62%) of those who attended mandatory training have a high level of understanding of their functions (more than 85% score), compared to only 37.5% of non trained IAC members with such a high score. While only 12.8% of trained IAC members still have little knowledge of their functions a substantial one third or 33.3% of non trained IAC members do not know their functions (score of less than 64%). Training thus has a positive relationship with the knowledge of the IAC members.

Table 7: Comparison of Knowledge and Mandatory Training

Score of knowledge \ Training	Attended Mandatory Course		Did Not Attend Mandatory Course	
	N	%	N	%
0-64	39	12.8	56	33.3
65-84	77	25.2	49	29.2
85-100	189	62.0	63	37.5
Total	305	100	168	100

Factors Related to Level of Knowledge

Further statistical analysis was carried out for a comparative study of the relationship between IAC's level of knowledge and the following five factors: mandatory training, length of experience as IAC, length of co-operative membership, other training attended and educational level. The findings are tabulated in Table 8.

As can be seen from Table 8, three of the five factors (mandatory training, length of membership and number of years as IAC) are significant at $p < 0.01$, while attendance of other training programmes is significant at $p < 0.05$. Though the mean score for knowledge is higher for those with a higher educational level, the difference is not significant ($p > 0.05$).

Table 8: Factors Related to Level of Knowledge

Characteristic	Mean by category	Test Statistics	P-value
Mandatory Training	Attended = 83.89 Did not attend = 73.98	7.113	0.000**
Number of years experience as IAC	< 1 year = 77.40 1 – 3 year = 80.08 > 3 years = 83.15	5.627	0.000**
Length of membership in co-operative	1 – 5 years = 75.33 6 – 10 years = 78.57 11 – 15 years = 80.91 16 – 20 years = 81.46 > 20 years = 84.17	4.534	0.001**
Other training attended	Yes = 80.67 No = 73.81	2.313	0.021*
Educational Level	Primary/LCE = 79.21 MCE/ SPM = 79.30 STPM/ HSC/ Diploma = 81.79 Tertiary = 81.7	2.141	0.094

* Significant at 0.05 level of significance

** Significant at 0.01 level of significance

IAC members who have attended the mandatory course have a significantly higher mean score for knowledge (83.89) compared to those who have not attended mandatory training (73.98). The results indicate attending the mandatory course has a positive influence in improving the IAC's knowledge of their duties. Similarly, IAC members who have held this position for more than 3 years have a higher mean (83.15) for knowledge compared to those with less than one year's experience (77.4) and this difference is found to be significant.

IAC members who have been long term members of the co-operative also have a significantly higher mean for knowledge of their duties. From a mean of 75.33 for those with less than 5 years membership, the mean increases to 84.17 for those with more than 20 years membership. This is probably because longer membership provides greater member education opportunities. There is also a significant difference in the mean score for knowledge between those who have attended other training (80.6) and those without other training (73.81). Educational level, though not significant is still a contributing factor to level of knowledge.

These findings clearly show that the most important contributory factor towards improving IAC's knowledge of their functions is attendance of mandatory training and length of service as IAC members. In third place of importance is length of co-operative membership, followed by 'other training attended'. Educational level, though not significant is still a contributing factor at fifth place.

Audit Practices in Co-operatives

One of the objectives of this research is to gain an insight into current audit practices in co-operatives. The main areas of audit practice analysed here are the frequency of audit, size of audit committees appointed by co-operatives and regularity of audit reports to the relevant parties.

Frequency of Audit

Only two thirds or 66.8% of the respondents carry out audit at their co-operatives in compliance with provisions of the co-operative law (Table 9). About 40% audit once in three months which is the minimum required under the CSA 1993. It is heartening to note that 20.3% audit monthly, while another 7% once in two months which should be the best practice in all co-operatives. However it is disheartening to note that one third or 33.2% of the respondents are in non compliance with provisions of the CSA 1993. As seen, 30% of the IAC only audit once or twice in a year while 3.2% have not carried out any audit at all. This high level of non compliance defeats the very purpose of establishing the IAC in co-operatives, that is to enhance accountability, governance and internal control.

Table 9: Frequency of Audit

Frequency	Audit Performed	
	N	%
Every 1 – 2 months	129	27.3
Once in 3 months	187	39.5
1 – 2 times per year	142	30.0
Never	15	3.2
Total	473	100

Relationship between Frequency of Audit and Level of Knowledge

A comparison of the frequency of audit and level of knowledge regarding IAC duties is carried out. The results (Table 10) clearly indicate that respondents with a high mean for knowledge carry out significantly more frequent audits than those with lower mean for knowledge. Those who audit once in 3 months (minimum required) or more frequently (every 1-2 months) have a high mean for knowledge of 82.77 and 84.94 respectively. IAC members who only audit once or twice a year, (non compliance) have a mean of 74.49 only for knowledge. Those with lower mean of 66.67 have never undertaken any audit work.

Table 10: Comparison of Frequency of Audit and Knowledge

Frequency of Audit	Mean	Test Statistic	P - value
Every 1 - 2 months	84.939	18.296	0.000**
Once in 3 months	82.773		
1- 2 times per year	74.497		
Never	66.667		

** Significant at 0.01 level of significance

Factors Related to Frequency of Audit

A comparative analysis was done to find out whether frequency of audit is associated with other factors such as attendance of mandatory course, number of years of experience as IAC and allowances paid to the IAC. Those who have attended mandatory training, have longer experience as IAC members and are paid some form of allowances have been found to be carrying out significantly more frequent audits at their co-operatives (Table 11). More than 70% of those who audit once in three months or more frequently (in compliance with CSA 1993) are those who have attended mandatory training. Those who have more than one year of experience as IAC, audit significantly more frequently compared to those with less than one year as the IAC. 96.1% who audit monthly or once in two months and 88.2% who audit quarterly are those who are paid some form of allowances. Whereas only 3.9% and 11.8% of those who are not paid any allowances audit as frequently.

Table 11: Factors Related to Frequency of Audit

Audit Factors		Frequency of	Every 1 to 2 months	Once in 3 months	1-2 times per year	Never
		Test Statistic	%	%	%	%
Mandatory Course						
Attended		76.0	70.1	47.9	53.3	
Did not attend		24.0	29.9	52.1	46.7	
- λ^2	27.855					
- p value	0.000**					
IAC Experience						
Less than 1 year		24.2	35.2	34.4	6.3	
1 - 3 years		19.6	40.7	37.0	2.6	
More than 3 years		39.1	41.7	17.9	1.3	
- λ^2	30.643					
- p value	0.000**					
Allowances						
Received		96.1	88.2	78.9	40.0	
Did not receive		3.9	11.8	21.1	60.0	
- λ^2	44.232					
- p value	0.000**					

**Significant at 0.01 level of significance

Size of IAC

Under the Co-operative Societies Act 1993, all co-operatives must appoint an IAC comprising of a minimum of 3 and a maximum of 6 members. The chairman of each IAC was asked about the size of the IAC in the co-operative. Feedback from the 176 co-operatives studied shows that for the majority of co-operatives the IAC is comprised of three (3) members only. As shown in Table 12, 61.4% of co-operatives have three (3) IAC members, while another 19.3% have 4 members on its IAC. Only 9.1% of co-operatives appointed the maximum 6 members to the IAC. What is surprising however is that 6.8% of the co-operatives have less than three (3) members appointed to its IAC. This non compliance to the Co-operative Societies Act 1993 seems to be happening even after 10 years of the implementation of the CSA 1993, and this needs to be addressed by the regulatory authorities.

Table 12: Size of IAC

No. of IAC members	No. of Co-operatives	Percent (%)
Less than 3	12	6.8
3	108	61.4
4	34	19.3
5	6	3.4
6	16	9.1
Total	176	100

Audit Reports

The CSA 1993 requires the IAC to report their audit findings to the board of directors (4 times a year), to the Registrar General of Co-operatives (2 times a year) and to the members at the annual general meeting (once a year). As can be seen from Table 13, there is a high level of non compliance in terms of submission of audit reports to the relevant parties. 15.3% make no reports to the BOD, 43% have no reports to the Registrar General (RG) and more than one third or 38% do not submit any report to the members at the annual general meetings.

Also to note is that not all IACS which submit audit reports comply in terms of the required number of reports per year to the relevant parties under the CSA. Only 34.1% of co-operatives comply with the requirement of submitting at least four audit reports per year to the BOD. Half the co-operatives (50.6%) make only 1-3 audit reports to the BOD, which is not in compliance with the legal requirements or best practices. Only one fourth (25.5%) of co-operatives comply with submitting at least two audit reports per year to the RG. One third (31.3%) submit only one report per year to the Registrar General (non compliance).

Table 13: Frequency of Audit Reports

No. of Reports per year	Report To		BOD		RG		Members	
	N	%	N	%	N	%	N	%
0	27	15.3	76	43.2	67	38.1		
1	37	21.0	55	31.3	109	61.9		
2	35	19.9	29	16.5	Na	Na		
3	17	9.7	5	2.8				
4	36	20.5	3	1.7				
More than 5	24	13.6	8	4.5				
Total	176	100	176	100	176	100		

Relationship between Audit Reports and Mandatory Training

A comparison was done between attendance of mandatory training and submission of audit reports as required under the CSA 1993. The results (Table 14) indicate that there is a significant difference in number of audit reports submitted between IAC with and without mandatory training. Those who attend mandatory training are more in compliance to submitting the required number of reports to the Board (95%) and to the RG (91.9%), indicating a significant relationship between attendance of mandatory training and compliance in reporting to the BOD ($p < 0.01$) and to the RG ($p < 0.001$). However there is no significant relationship between mandatory training and compliance or non compliance in reporting to the AGM.

Table 14: Relationship between Mandatory Training and Audit Reports

Frequency		Factor	Mandatory Course		λ^2	P - value
			Attended	Did not attend		
Report to BOD	≥ 4 (Compliance)		95.0	5.0	13.363	0.001**
	< 4 (Non compliance)		71.6	28.4		
Report to RG	≥ 2 (Compliance)		91.9	8.9	4.970	0.026*
	< 2 (Non Compliance)		75.6	24.4		
Report to AGM	1 (Compliance)		80.2	19.8	0.068	0.795
	0 (Non compliance)		78.6	19.8		

* Significant at 0.05 level of significance

** Significant at 0.01 level of significance

CONCLUSION

The IACs were introduced into the Malaysian co-operatives as a tool to help improve corporate governance, accountability and management in the co-operative sector. For the first time in the history of the co-operative movement in Malaysia the functions and powers of the IACs were clearly spelt out in the co-operative legislation. However the relatively high level of non compliance in terms of attendance of mandatory training for IAC members, frequency of audit work and submission of audit reports to the relevant parties indicates the desired objective of establishing the IAC is not being achieved. The finding that nearly half of the IACs do not know well enough the functions of the IAC (score of less than 85%) also does not augur well for the effective performance of the IACs.

A significant finding of this study that should be considered as an important feedback to the regulatory authorities is that those with a higher level of knowledge of the IAC's functions are more in compliance with the CSA 1993 in terms of frequency of audit work

and timely submission of audit reports. Also attendance of mandatory training, other related training and length of experience on the IAC has been found to have a significant positive effect in improving the knowledge of the IAC's functions and thereby greater compliance in performing the audit functions in co-operatives. Setting a shorter time frame of three months to attend the mandatory training and enabling appointments to the IAC for a period of 2–3 years are among some measures that could help the IAC members acquire the requisite skills, knowledge and confidence to perform more effectively as a mechanism of internal control in the co-operative sector.

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