The standing of internal auditing in South African national government departments

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ABSTRACT

South Africa's successive corporate governance codes have progressively increased their emphasis on internal auditing. This article had two aims, both resulting in specific contributions to the internal auditing literature in South Africa. Firstly, it aimed to provide a comprehensive overview of factors that could affect internal audit standing, based on the references to internal auditing in the King report on governance for South Africa 2009 (King III)*. Secondly, questionnaire data collected from relevant stakeholders were aligned with the review of the internal audit function standing obtained from* King III *in a comparative analysis of the standing of the internal audit functions of national government departments. The main finding of this article is that internal auditing in government departments lacks the standing that is envisaged in* King III*. Regular communication between chairpersons of audit committees (CACs), accounting officers (AOs) and the heads of internal auditing (CAEs) of each department should clarify the role that internal audit functions are expected to fulfil using the resources available. The agreed role should be reflected in the internal audit charter of each department. The National Treasury should play a prominent role in evaluating the reasonable nature of and compliance with government departments' internal audit charters.*

INTRODUCTION

South Africa's successive corporate governance codes and reports have progressively increased the emphasis on the importance of internal auditing for the achievement of an

organisation's strategy and business success. South Africa's first corporate governance code, the *King Report on Governance for South Africa* (*King I*), issued by the Institute of Directors (IoD) dealt only with very basic principles and procedures on the standing, role and functions, independence and scope of internal audit functions (IAFs) (IoD 1994:21, 22), but it is credited with putting internal auditing in the governance limelight in South Africa (Baker 2010:30). South Africa's second corporate governance code *King Report on Governance for South Africa 2002* (*King II*) gave further impetus to the IAF's corporate governance role by recognising that the IAF is an important part of corporate governance and an "integral part of the company" (IoD 2002:86). South Africa's third and current corporate governance code *King Report on Governance for South Africa 2009* (*King III*), which is applicable to all organisations in South Africa, regards the IAF as a significant role player in the governance process that should contribute to the achievement of an organisation's strategic objectives by challenging all aspects of its governance, risk-management and internal control environment (IoD 2009:94).

An IAF does not function in a vacuum. It is regarded as one of the four cornerstones of corporate governance, together with management, the audit committee and the external auditor (IoD 2009:62; Gramling, Maletta, Schneider and Church 2004:194). Various studies have emphasised the positive impact that an effective and independent IAF has on an organisation's corporate governance (Asare 2009; Carcello, Hermanson and Raghunandan 2005) and reporting quality (Prawitt, Sharp and Wood 2012; Prawitt, Smith and Wood 2009).

In the public sector, in terms of section 38(1)(a)(ii) of the *Public Finance Management Act (PFMA),1 of 1999,* the accounting officer (AO) of each South African national government department has to ensure that the department has an IAF, that an audit committee provides control over and gives direction to the IAF and that the related Treasury Regulations are complied with (RSA 1999). The requirements relating to internal auditing in *King III* are encompassed in the Treasury Regulations (National Treasury 2005) and in the *Internal Audit Framework* (National Treasury 2009).

The National Treasury's vision and mission statements refer to excellence in financial management and good governance (National Treasury 2013), but the South African public sector is prone to qualified audit opinions and poor service delivery (Auditor-General of South Africa 2013), and thus to failure to achieve its strategic objectives. In this article, it is argued that an effective independent IAF – and thus an IAF with high standing – contributes to an organisation's attainment of its strategic objectives through risk-based plans consistent with the organisation's goals (Asare 2009:15; IoD 2009:93,94,96; National Treasury 2009). Financial management and service delivery challenges in various departments possibly persist due to poor governance, including ineffective IAFs that do not function as prescribed by *King III*.

The literature and various pronouncements use different terms to refer to an IAF that functions optimally, including its "standing" (IoD 2009:63,97), "status" (IIARF 2010), "effectiveness" (Arena and Azzone 2009), and "quality" (Kasim and Hanafi 2012). In line with *King III*, this article uses the term "IAF standing". This article has two aims, making a pioneering contribution to the internal audit literature in South Africa. Firstly, it aims to serve as a literature review, providing a comprehensive review of the principles and recommendations that could affect internal audit standing on the basis of the references to internal auditing in *King III*. Secondly, the article aims to align questionnaire data collected

from relevant stakeholders with the understanding of IAF standing obtained from *King III* in a comparative analysis of the standing of the IAFs of public service departments. The discussion in this article combines the two aims in order to present a view of the standing of IAFs in departments, and the article therefore combines the literature review with a discussion of the findings.

In the next section, the methodology of this article is briefly outlined. Then a review is provided to enable an understanding of internal audit's standing on the basis of the references to internal auditing in *King III*, combining it with a discussion of the standing of IAFs in departments. The article concludes with recommendations and some suggestions for future research.

METHODOLOGY

This article uses data collected by the iKUTU research team, which investigated the status of and demand for internal auditing in South African national government departments. An overview of the research method used for the iKUTU study is included in the foreword of this journal.

This article posits that the implementation of *King III*'s principles and recommendations provides an understanding of IAF standing. Questionnaire responses from accounting officers (AOs), chairpersons of audit committees (CACs) and the chief audit executives (CAEs) of government departments to a large number of relevant questions were used. These questions reflect the implementation of *King III* principles and recommendations in departments, and thus the standing of their IAFs.

The relevant questions used tested the characteristics, functioning and responsibilities of IAFs. Three types of question were used. Firstly, some questions required a "yes", "no" or "unsure" as responses. For these questions, the percentages of "yes" or "no" responses were included in the discussion. Secondly, some questions required a rating based on a five-point Likert-type scale. For these questions, the weighted average scores were used in the discussion, unless otherwise stated. Thirdly, some questions required a distinction between "significant", "moderate", "limited" or "no". For these questions, these specific level descriptors were indicated in the discussion.

INTERNAL AUDIT STANDING–
KING III CONFORMANCE BY DEPARTMENTAL IAFS

References to internal auditing in *King III* can be grouped into three main themes, namely IAF characteristics, IAF functioning and IAF responsibilities (IoD 2009: Chapters 3 and 7). Each section below starts with a description of IAF standing, based on *King III*'s references to internal auditing, and then provides a comparative analysis of the perceptions of relevant stakeholders on the implementation of *King III* principles and recommendations in their departments. This section includes references to the prior literature to demonstrate wider acceptance of the principles and practices for internal auditing contained in *King III*.

IAF characteristics

King III refers to the staffing and budget, independence and authority of an IAF (IoD 2009:63). Research supports these recommendations by *King III*, and has found that the effectiveness of an IAF is directly affected by its staffing (Mohamed, Zain, Subramaniam and Yusoff 2012), budget (Raghunandan, Read and Rama 2011), independence (Roussy 2013), and authority (Van Peursem 2005).

Staffing and budget of the IAF

The audit committee should ensure that the IAF has sufficient numbers of competent staff and an appropriate budget (IoD 2009:63,96) to execute the internal audit plan and meet management's expectations. A competent IAF is able to apply appropriate technical and business skills and tools and techniques to add value by providing the whole spectrum of risk and internal control services, including in complex areas of the business, and to challenge issues when necessary (IoD 2009:93-98).

CAE respondents moderately supported the notion that their IAFs did not have sufficient numbers of in-house internal audit staff with appropriately diverse skill sets to audit all the major functions of their departments (score: 53.9%). CAC respondents provided high levels of support for the statements that the shortage of competent internal auditors in their departments resulted from an inability to find suitable candidates for vacant posts (score: 70.5%), as well as from insufficient approved post structures (score: 67.5%).

According to Mihret and Yismaw (2007), IAF effectiveness is hampered by a lack of technically proficient internal auditors. CAEs' responses highlight a catch-22 situation. On the one hand, CAEs provided moderate support for the perception that their IAFs were not able to retain sufficient competent staff (score 45.8%), and on the other hand, they strongly supported the notion that their IAFs needed additional skills in order to meet their current commitments (score: 75.8%). Having insufficient internal auditors in terms of numbers and skill sets may cause job pressure for current internal audit staff, and this pressure may be exacerbated by increased staff turnover and poor job performance (Fogarty and Kalbers 2006:51,75), and thus a loss of standing.

As many as 69% of the CAEs reported that their IAFs used a combination of in-house and outsourced IAFs, generally known as co-sourcing. CACs, AOs and CAEs mostly attributed co-sourcing to a shortage of competent internal auditors (scores of 83.3%, 67.9% and 69.3% respectively) and the need for specialised technical expertise (scores of 78.9%, 72.5% and 81.8% respectively). Van Peursem (2005) warns that buying in specialist internal audit skills could have a negative impact on an in-house IAF's authority and thus its standing.

In making sense of the staff constraints of these public service departments' IAFs, several possible explanations could apply. Firstly, the pool of available professionally qualified internal and external auditors in South Africa is skewed towards external auditing, with 1 704 certified internal auditors (IIA SA 2014), compared to 29 014 chartered accountants (SAICA 2014). The shortage of professional internal auditors available for employment seems to indicate that prospective auditing professionals opt for external rather than internal auditing careers. There may be a link between the preference for external auditing and the standing of internal auditors in South Africa, but an examination of this argument falls beyond the scope of this article.

Contrary to expectations, departments' IAFs did not appoint chartered accountants – fewer than 1% (181) of South African chartered accountants were employed in auditing positions in central government (SAICA 2014) as auditing professionals to compensate for the reported shortage of competent certified internal auditors. An investigation into the reason(s) why chartered accountants are not appointed by government to relieve the shortage of available certified internal auditors falls beyond the scope of this article, but it may be tentatively stated that there may be a lack of financial support for and a lack of standing of public sector IAFs, as reported below.

Secondly, CAC, AO and CAE respondents provided limited support for the statement that their IAFs had a poor image in the public sector (with scores of 37.1%, 29.3% and 30.8% respectively), which they thought made it difficult for the public sector to attract suitably qualified internal auditors. Although the values of the National Treasury (2013:4) include the aim to become "an employer of choice", that value has not materialised, as only 8.8% (150) (IIA 2014) of certified internal auditors in South Africa were employed in the public sector at the time of this study.

Thirdly, the shortage of internal auditors may be the result of insufficient budget allocations, a supposition which was moderately supported by CAC and CAE respondents (scores of 59.5% and 60% respectively), leading to the high support by CAC respondents for the statement that their departments had insufficient internal audit post structures (score: 67.5%). However, AOs apparently underestimated the magnitude of the budget constraints of their departments, as the AOs (score: 51.7%) provided less support than the CACs and CAEs for the statement that their IAFs received insufficient budget allocations.

Several IAFs may thus have been negatively affected by staffing and budget constraints. These standing problems caused CACs and AOs to provide limited support for the perception that their IAFs lacked commitment (scores: in-house 29.5% and 31.9% respectively; outsourced 29.7% and 30.6% respectively) and flexibility to accommodate management needs (scores: in-house 36% and 33.3% respectively; outsourced 28.3% and 33.8% respectively). It is then small wonder that the CACs and AOs expressed a moderate to high, but not a very high, level of satisfaction with the value added by their IAFs (scores: in-house 59.8% and 63.4% respectively; outsourced 67.2% and 65.3% respectively).

While an IAF requires sufficient resources to function optimally (IIARF 2011:6), the management and audit committees of departments apparently expected their under-resourced IAFs to add value through optimal performance. Since an IAF budget is positively related to its review by the audit committee (Carcello *et al.* 2005:69), audit committees need to address these constraints.

Independence of the IAF and the CAE

The audit committee should ensure that the IAF is independent of management. The CAE should report functionally to the audit committee, should have a strong working relationship with the audit committee, should annually confirm the independence of the IAF to the audit committee, and may not serve as a member of any other committee of the organisation. The pay, bonus and benefits of internal auditing should be determined separately from those of the rest of the organisation, and the audit committee should carry out an annual performance assessment of the IAF. The audit committee should have the final say in the appointment, performance assessment and dismissal of the CAE and outsourced internal

audit service provider in order to ensure that the CAE performs optimally (IoD 2009:63,93-98). The literature reports that an IAF's independence contributes to its effectiveness (Roussy 2013; Van Peursem 2013).

Agency theory posits that, by providing assurance services, internal auditing represents the stakeholders of an organisation (Adams 1994). Hence, the auditing postulate requiring that no conflict of interest should exist between the auditor and the management of a unit under audit (Mautz and Sharaf 1961:49) also applies to internal auditing. Almost all the CAEs, CACs and AOs (with scores of 94%, 100% and 90% respectively) reported that their IAFs reported to their CACs on functional matters, while the CAEs provided very high support for the statement that they had unrestricted access to their CACs (score: 96.1%). On the whole, the IAFs of departments thus functioned independently.

The literature cautions that, despite internal auditors' reporting to audit committees, the internal auditors may identify more strongly with their role to protect top management than with their role to provide support to the audit committee (ICAA, FRC and ICAS 2012; Roussy 2013:559,560). The lack of standing of IAFs reported in this article may indicate that the latter observation applies to the IAFs of government departments, as they may be politically driven, rather than governance driven.

Among the AOs, 66.7% reported that outside providers of their co-sourced internal audit work reported to the CAEs of their departments, as required by the *Internal Audit Framework* of the National Treasury (2009).

Authority of the CAE and the IAF

The audit committee should ensure that the IAF has the authority it needs to enable it to fulfil its responsibilities (IoD 2009:63). An effective IAF enjoys the respect and cooperation of the board and management of its organisation, as is evident from an open invitation to the CAE to attend any executive committee or other committee meeting of the organisation as invitee, and regular meetings by the chairperson of the board or the chief executive officer with the CAE to formally share the organisation's strategy and performance (IoD 2009:93-98). The literature supports *King III* in this regard, and indicates that the level of respect and cooperation that the board and management of an organisation affords its IAF has a direct impact on the IAF's ability to fulfil its responsibilities (Mihret and Yismaw 2007:479).

CAC respondents provided limited support for the statement that their IAFs' lack of status within their departments caused management to ignore recommendations made by their IAFs (score: 30.8%), and moderate support for the statement that their IAFs had an inferior status in their departments (score: 46.6%). CACs and AOs expressed limited to moderate support for the notion that their IAFs had inadequate support from the top management of their departments (with scores of 45.8% and 37.1% respectively). These negative perceptions caused the CAE respondents to provide very limited support for the statements that they were not regularly included in executive committee meetings of their departments (score: 25.8%) and that the value of their IAFs' services was not recognised by auditees (score: 25.8%), while they expressed moderate support for the statement that their IAFs had inadequate support from the top management of their departments (score: 41.7%).

IAF authority issues caused the CAEs to provide very limited support for the notion that their IAFs had inadequate access to information (score: 21.7%), and that improper scope limitations were applied to them (score: 23.3%). Only 12.5% of the CACs reported that

no limitation was placed on their IAFs' access to information. Responses by some CACs and AOs indicated that they were aware of and tolerated their IAFs' access (limited to very limited support, with scores of 31% and 18.3% respectively) and scope limitations (limited support, with scores of 25% and 26.7% respectively), possibly reflecting that they might have been in breach of their legal mandates to support their IAFs (National Treasury 2009; RSA 1999: sections 38, 76).

The implementation of an IAF's recommendations demonstrates the usefulness of the result of internal audit work and is regarded as an indication of the effectiveness of an IAF (Arena and Azzone 2009; Gramling and Hermanson 2009:38; Mihret and Yismaw 2007:475). Four questions on the implementation of IAFs' recommendations elicited implicit feedback about the CAC and AO respondents' views on the standing of their IAFs. These four questions determined that the CACs' and AOs' perceptions on the extent to which their departments' decision not to implement their IAFs' recommendations resulted from (1) a general tendency not to implement their IAFs' recommendations, (2) the inferior status of the IAF in the department, (3) the lack of cost-effectiveness and (4) lack of practicality of recommendations. Only 48% (outsourced 42%) of the CACs and 37% (outsourced 45%) of the AOs indicated that these four factors had no impact at all on their decision not to implement recommendations of their in-house (outsourced) IAFs. The fact that only half or less of the CACs and AOs expressed such implicit confidence in their IAFs may indicate that most departments' IAFs lacked standing.

In spite of the CAC and AO respondents' lack of implicit support for their in-house IAFs, the majority of these respondents provided high support for the notion that their departments' commitment to governance was showcased by their use of an in-house rather than an outsourced IAF (with scores of 66.7% and 72.2% respectively). Considering the lack of support by the CACs and AOs for their in-house IAFs, the appearance of strong governance seems to have outweighed their actual commitment to their in-house IAFs.

IAF functioning

An IAF should use a systematic, disciplined approach, contribute to combined assurance and understand its role in the organisation, and it is overseen by the audit committee (IoD 2009:93–98). Various authors have linked IAF standing to an IAF's use of a systematic, disciplined approach (Abdolmohammadi 2009; Leung and Cooper 2009), the external auditor's use of the work of the internal auditors as part of a combined assurance model (Bame-Aldred, Brandon, Messier, Rittenberg and Stefaniak 2012), internal auditors' role and expectations by management (Van Peursem 2005), and audit committee oversight of the IAF (Contessotto and Moroney 2013; Roussy 2013).

IAF's use of a systematic, disciplined approach to audit work

The IAF should function under a formal internal audit charter, approved by the board of its organisation on the recommendation of its audit committee, and should adhere to the International Standards for the Professional Practice of Internal Auditing (the ISPPIA standards). A risk-based approach, rather than a compliance approach, should be followed to carry out the audit plan approved by the audit committee. The CAE should develop and maintain a quality assurance and improvement programme that covers the entire IAF, and

the audit committee should ensure that the IAF is subjected to an independent quality review (IoD 2009:93-98).

While only 32% and 21% respectively of the CAC and AO respondents were fully satisfied that their in-house IAFs conformed to their internal audit charters, 52% of the CAE respondents were satisfied. In line with their in-house IAFs, 38% and 22% respectively of the CACs and AOs reported full satisfaction with their outsourced IAFs' compliance with contractual or chartered service agreements. By contrast, fewer CAEs (27%) were fully satisfied with their outsourced than with their in-house IAFs' conformance.

Of the CAEs, 34% reported less than extreme support for the statement that all engagements of their IAFs were conducted in accordance with the ISPPIA standards, despite the fact that these standards are mandatory principle-focused requirements for internal audit practice (IIA 2012; National Treasury 2009). Three CAC respondents (out of 29) and five AO respondents (out of 26) were not sure whether their IAFs complied with the standards, which may be an indication of their lack of interest in the role played by their IAFs.

Among the CAC respondents, 79%, and among the AO respondents, 76%, perceived their IAFs to make more than an average contribution to risk management by incorporating significant risks in the IAFs' engagement plans. However, only 41% of the CACs and 24% of the AOs regarded this contribution by their IAFs to be significant. Most IAFs therefore appear to neglect some significant risks in their engagement plans.

Only 23% of the CAEs reported that their IAFs had not been subjected to an external quality assurance review during the past five years, despite their audit committees' specific oversight role in this regard (IoD 2009:63).

The majority of the IAFs of the government departments surveyed thus seem to have followed aspects of a systematic, disciplined approach to some extent. An IAF that uses a systematic, disciplined approach is expected to deliver effective services to its organisation (Leung and Cooper 2009). However, only 39% (outsourced 62%) of the CACs and 35% (outsourced 67%) of the AOs expressed more than average satisfaction with the effectiveness of the services provided by their in-house (outsourced) IAFs, compared to 58% (outsourced 59%) of the CAEs who held such a view. The CAEs thus overrated the effectiveness of their in-house IAFs' services compared to the views of the CACs and AOs.

In light of the fact that the CAE respondents held more favourable views of their in-house IAFs than those held by the CACs and AOs, it seems that the CACs, AOs and CAEs of departments should regularly discuss the role, expectations and performance of their IAFs to avoid misunderstandings.

IAF's role in combined assurance

King III makes the audit committee responsible for overseeing combined assurance and requires the IAF to play a pivotal role in the combined assurance model. The IAF should have a clear understanding of its accountability and responsibilities in the combined assurance model and, through the audit committee, should provide assurance to the board that the organisation's combined assurance model has been properly coordinated to optimise costs, avoid duplication, prevent assurance overload and assessment fatigue (IoD 2009:93-98).

Although the majority of the CAC, AO and CAE respondents expressed more than average satisfaction with their IAFs' contribution to combined assurance (with scores for in-house IAFs of 58%, 48% and 73% respectively; and scores for outsourced IAFs of 61%, 65%

and 68% respectively), including to the mapping of their departments' combined assurance activities (with scores of 50%, 48% and 69.8% respectively), few of them were convinced that their IAFs added significant value to combined assurance (with scores in-house of 29%, 17% and 29% respectively; and outsourced of 17%, 8% and 17% respectively). Clearly CAE respondents overrated their in-house IAFs' contribution to combined assurance compared to the views of the CAC and AO respondents.

Of the CAE respondents 19% reported more than average support for the statement that their IAFs are used to reduce external audit fees. Low numbers of the CAC, AO and CAE respondents reported that their external auditors placed high reliance on the work of their IAFs (sores: in-house 24%, 16% and 26% respectively; outsourced 33%, 40% and 33% respectively), while some reported such reliance at a moderate level (scores: in-house 34%, 39% and 42% respectively; outsourced 17%, 40% and 33% respectively). With regard to the low incidence of high reliance by external auditors on the work of IAFs, low numbers of the CACs, AOs and CAEs perceived that extensive coordination occurred between their IAFs and their external auditors (scores: in-house 31%, 23% and 58% respectively; outsourced 23%, 33% and 37% respectively). External auditor reliance on the work of internal auditors requires a complex consideration process and many factors impact on that process (Gramling and Hermanson 2009). Since several factors highlighted in this article point to less than effective IAFs in some departments, low levels of external auditor reliance on the work of IAFs are not surprising. The CACs and AOs should enter into discussions with internal and external auditors to facilitate clarity on the combined assurance role to be played by each of these assurance provider groups.

The IAF's understanding of its role

King III requires the IAF to effectively challenge all aspects of the governance, risk-management and internal control environment of its organisation. Furthermore, by being flexible and dynamic, the IAF should address the emerging business and operational as well as assurance needs of the organisation (IoD 2009:93-98). An IAF should therefore understand its role in the context of the organisation's strategy, its risk-management framework and practices, and management's actions. Various studies have provided evidence that such understanding will enable IAFs to add value through suitable work and reporting, and thus gain the respect of auditees and the top management of their organisations (PricewaterhouseCoopers 2010; Van Gansberghe 2005:70; Van Peursem 2005:497).

Since the IAF should contribute to an organisation's attainment of its strategic objectives (IoD 2009:94; National Treasury 2009), the IAFs have to take cognisance of the content of their departments' vision, mission, value and objectives statements (National Treasury 2009). Overall, each department should deliver appropriate services to the nation, and the National Treasury (2013) aims to promote good governance. Van Gansberghe (2005:71) contends that "[u]nless internal auditing can consistently show that its work contributes to better service delivery, it will be difficult to ensure management backing for investment in the audit function".

Many departments suffer from service-delivery problems (Auditor-General of South Africa 2013), and a high number of the CAC, AO and CAE respondents reported that reportable fruitless and wasteful, irregular or unauthorised expenditure had occurred in their departments over the past five years (with scores of 73%, 90% and 81% respectively).

Low numbers of the CACs, AOs and CAEs expressed a perception that significant value was added by their IAFs in meeting these challenges (scores: service delivery: in-house 10%, 10% and 29% respectively; outsourced 42%,17% and 16% respectively; fruitless and wasteful, irregular or unauthorised expenditure: in-house 17%, 21% and 45% respectively; outsourced 27.6%, 17% and 43.7% respectively). More CAE respondents thus had a higher regard for the value added by their IAFs in responding to these challenges than the CAC and AO respondents did. These findings could indicate that IAFs did not address the main challenges experienced in their departments, and provided a reason for the CACs' and AOs' perceptions that their IAFs lacked commitment and efficiency of service and did not add sufficient value, as was reported earlier in this article.

Audit committee oversight of the IAF

Audit committee oversight empowers an IAF (Cohen, Gaynor, Krishnamoorthy and Wright 2011; Stewart and Munro 2007) and enhances an IAF's independence from management (IoD 2009:63, 97). Through the CAE's strong working relationship with the audit committee, the audit committee should provide optimum control oversight of the IAF (IoD 2009:96). The audit committee should meet privately with the CAE at least once a year, and the CAE should provide the audit committee with an objective set of eyes and ears across the company, as well as strategic advice (IoD 2009:96).

The majority of the CAC, AO and CAE respondents indicated high or very high support for several positive statements about their audit committees' conformance to the regulations for audit committees, including that audit committee members on average had adequate knowledge of public sector legislation (with scores of 79.2%, 72.6% and 80.5% respectively), were objective (with scores of 85.8%, 75.8% and 82.8% respectively) and independent (with scores of 90.8%, 83.9% and 87.5% respectively), attended audit committee meetings (with scores of 85.8%, 84.7% and 86.7% respectively), were sufficiently prepared for audit committee meetings (with scores of 79.2%, 76.6% and 78.1% respectively) and rendered valuable contributions at every audit committee meeting (with scores of 81.7%, 74.2% and 79.7% respectively). Most CAEs reported that their departments' CACs were accessible to them (score: 96.1%), that their audit committees properly discussed the findings in IAF reports (score: 79.7%) and appropriately monitored the implementation of recommendations made by IAFs (score: 78.1%). Some CACs, AOs and CAEs respondents did not fully agree with the statement that their departments' AOs always attended all audit committee meetings (with scores of 47%, 65% and 62% respectively), which could be an indication that some AOs lacked interest in or understanding of their own contribution to audit committee activities.

The previous paragraph indicates that most audit committees of departments adhered to the regulations applicable to them, but the discussions in this article suggest that some departments' IAFs lacked standing. Contessotto and Moroney (2013:19,20) report that compliance with regulated requirements does not ensure audit committee effectiveness, but they concur with Cohen *et al.* (2011) and Stewart and Munro (2007) that an audit committee that is willing to negotiate with and challenge management can be regarded as effective. The apparent lack of standing of the IAFs of the government departments surveyed may therefore be due to ineffective audit committees that are not willing to negotiate with and challenge the management of departments to improve their support to their IAFs.

IAF responsibilities

The IAF has a role in governance, in risk management and internal control, and in combatting fraud. The IAF should attend and report at all audit committee meetings on its assessment of the effectiveness of the organisation's governance, risk and control environment (IoD 2009:97). The literature reports that an effective IAF generally has a positive impact on the organisation's corporate governance and control environment (Gramling *et al.* 2004), risk management (Carcello *et al.* 2005; Sarens 2009) and financial reporting quality (Prawitt *et al.* 2012; Prawitt *et al.* 2009).

IAF's role in governance

The IAF should evaluate and provide a written assessment of the organisation's governance processes, including ethics and tone at the top, to the board and the audit committee (IoD 2009:93).

Overall, the IAFs of government departments did not fully meet their management's governance needs. Only 66% (outsourced 50%) of CACs and 47% (outsourced 63%) of AOs indicated high or very high satisfaction with their in-house (outsourced) IAFs' contribution to the governance of their departments, while comparatively more CAEs expressed such high or very high satisfaction with their IAFs' contribution to governance, especially with that of their in-house IAFs (scores: in-house 87%; outsourced 72%). Moderate to low numbers of the CACs, AOs and CAEs respondents expressed the opinion that their IAFs added significant value to the governance of their departments (scores: in-house 54%, 43% and 55% respectively; outsourced 46%, 33% and 44% respectively). Departments should seriously address the lack of value added to governance by their IAFs, as internal auditing is regarded as one of the key overall governance processes that should drive internal control (Auditor-General of South Africa 2013).

IAF's role in risk management and internal control

The IAF should perform an objective assessment of the organisation's risk management and internal control framework, including its control environment, and should report the outcome thereof to the board and the audit committee. This assessment and report should be based on a systematic analysis and evaluation of business processes and associated controls, and should identify risks that may prevent the organisation from meeting its strategic objectives. It should also identify the steps management should take or has taken to mitigate risks, in other words, controls. The report should specifically address the assessment of the effectiveness of the organisation's internal controls, including its internal financial controls. The IAF should provide independent objective assurance to the audit committee that the risk management and control considerations of the organisation are adequately considered and responded to by relevant personnel and that the level of management oversight and risk management is appropriate, relevant and reliable (IoD 2009:94,95).

Most of the CACs and AOs who responded perceived their IAFs to make more than average contributions to the provision of assurance on risk management (with scores of 67% and 55% respectively) and the risk-management process (with scores of 50% and 60% respectively) of their departments, while 67% and 73% of the CAE respondents held such views for these assurance activities. However, the CAC and AO respondents identified

several areas of risk management in which they perceived some of their IAFs to make little or no contribution. This lack of contribution pertained specifically to (1) strategic consulting activities, for example, assisting or co-ordinating the development of the overall enterprise risk-management strategy (with scores of 38% and 17% respectively), (2) operational consulting activities, for example, providing training on risk-related issues or assisting with the risk-management process (with scores of 54% and 26% respectively), (3) involvement in combined risk-assurance activities, for example, the preparation of the assurance map (with scores of 39% and 21% respectively) and (4) the updating of the risk register with the relevant outcomes of internal audit engagements (with scores of 31% and 25% respectively). The CAE respondents consistently underrated their IAFs' lack of contribution to the latter activities in comparison with the views of the CACs and AOs (scores: (1) 10%; (2) 9%; (3) 7%; (4) 14%). These findings may point to the lack of standing of the departments' IAFs.

Overall, only 24% (outsourced 29%) of the CACs and 32% (outsourced 47%) of the AOs reported that recommendations made by their in-house (outsourced) IAFs were always implemented, whereas 23% (18%) of the CAEs reported this. Some CACs and AOs supported negative statements about their in-house and outsourced IAFs to more than an average extent. They reported that (1) there was a general tendency not to implement their IAFs' recommendations (scores: in-house 12% and 7% respectively; outsourced 8% and 8% respectively); (2) recommendations were not cost-effective (scores: in-house 12% and 14% respectively; outsourced 17% and 23% respectively); (3) recommendations were not practical (scores: in-house 16% and 22% respectively; outsourced 17% and 31% respectively); and the inferior status of their IAFs resulted in the non-implementation of their recommendations (scores: in-house 23% and 11% respectively; outsourced 0% and 0% respectively).

These results indicate persistent problems experienced by departments' IAFs, as the literature maintains that internal audit effectiveness is linked to the implementation of IAF recommendations (for example, Arena and Azzone 2009). However, most of the CACs, AOs and CAEs indicated that they mostly or fully agreed with the statement that their audit committees monitored the implementation of the recommendations made by their IAFs appropriately (with scores of 86%, 72% and 82% respectively), possibly indicating that the status quo is regarded as acceptable. In his 2013 report on compliance with the *PFMA,* the previous Auditor-General of South Africa cautioned AOs to view internal auditing as an important partner in fulfilling their legislated responsibilities, and added that AOs should pay attention to their IAFs' reports and should have regular interaction with their IAFs (Auditor-General of South Africa 2013). Our findings do not include indications that AOs generally act in accordance with this caution.

IAF's role in combatting fraud

The IAF should be a source of information to the board and the audit committee on instances of fraud, corruption, unethical behaviour and irregularities (IoD 2009:93). The ISPPIA standards require internal auditors to evaluate the probability of significant fraud and how the organisation manages it, and to adapt their engagement objectives to take such risks into account (IIA 2012). Internal auditors should report significant fraud risk and control issues to senior management and the board (IIA 2012). Internal auditors are therefore expected to detect material fraud by adapting their engagement objectives, and also to contribute to the prevention of material fraud as a result of mitigating controls that

management may implement on the basis of internal auditors' reports on fraud risk and control issues.

More CAC, AO and CAE respondents perceived that that their IAFs had a responsibility to *detect* material fraud rather than to *prevent* it (scores: prevent 40%, 29% and 22% respectively; detect 73%, 61% and 56% respectively). This finding may indicate that IAFs' contribution to the prevention of material fraud may have been hampered, as their recommendations were not always implemented, as was reported earlier in this article. IAFs apparently did not meet expectations relating to the detection of material fraud either, as only 21% (outsourced 22%) of CAC and 13% (outsourced 10%) of the AO respondents reported that their IAFs provided significant comfort that fraud in their departments would be detected.

As many as 70% of the CACs and 77% of the AOs in this study indicated that their departments had in fact been victims of fraud over the past five years. Moreover, 54% (score: outsourced 16%) of the CACs and 58% (outsourced 30%) of the AOs reported that their in-house (score: outsourced) IAFs currently added little or no value to forensic investigations. However, fewer CAEs than CACs and AOs were of the opinion that their in-house IAFs added no or little value to forensic investigations (scores: in-house 30%; outsourced 15%). Since an effective IAF contributes to an effective control environment and risk management and thus to fraud prevention (Carcello *et al.* 2005:82; Gramling *et al.* 2004), fraud experiences of departments may reflect IAF ineffectiveness.

CONCLUSION

This article contributes to the internal audit literature in South Africa in two ways. Firstly, it presents a comprehensive list of factors that could affect internal audit standing on the basis of all references to internal auditing in *King III*. Secondly, it presents a comparative analysis of the standing of the IAFs of government departments by aligning questionnaire data collected from relevant stakeholders with the construct of IAF standing obtained from *King III*. The main finding of this article is that internal auditing in national government departments lacks the standing envisaged in *King III*.

The study found that the IAFs of the government departments studied functioned under pervasive staffing and budget constraints that hampered their ability to comply with their internal audit charters and meet their management's and audit committees' expectations. The IAFs thus lost authority, as the AOs' and CACs' perceptions suggested that the IAFs did not add the expected value to their departments.

The overall reason why the IAFs lost standing seems to be the absence of a shared understanding by the CAEs, AOs and CACs of the role of their IAFs. This has several implications for IAFs. The AO respondents underestimated the seriousness of the resource constraints on their IAFs. The CAC respondents, in spite of their apparent conformance to regulations, did not provide sufficient support to their IAFs, as was evident from insufficient IAF resourcing, the lack of IAF authority and a failure to have external quality assessment reviews performed on IAFs every five years. Compared to the AO and CAC respondents, the CAE respondents overrated the performance of their in-house IAFs, particularly their conformance to their internal audit charters, the effectiveness of their service, contribution

to governance and combined assurance, contribution to service delivery and unacceptable expenses, and the value added through forensic investigations.

The *Strategic Plan 2013/2015* of the National Treasury (2013) refers to the role of the IAF on three of its 40 pages. The plan highlights internal auditing's role in maintaining good governance and promoting exemplary leadership, and expresses the expectation that IAFs should improve their departments' control environments and thus contribute to unqualified external auditors' reports (National Treasury 2013). The plan also states that it is a strategic goal to improve financial reporting by improving the internal audit capacity in government (National Treasury 2013). In the light of the findings presented in this article, it is important that the CACs and AOs in government departments implement the strategy of improved internal audit capacity and continuously share their expectations of their IAFs with their CAEs. The National Treasury can use the findings and recommendations in this article to enhance the standing of the IAFs of departments in order to achieve its 2013/2015 strategic objectives (National Treasury 2013).

This article has some limitations. The data used do not address every single factor from *King III* that could have an impact on IAF standing. Also, since questionnaires were used for data collection, reasons for perceptions that impact on IAF standing were not always obtained. Future research should address both these limitations. In addition, future research should obtain clarity on the role that IAFs are expected to play in organisations, taking into account any resource limitations that prevail. The reasons for the shortage of professional internal auditors should also be addressed by future research. The link between audit committee effectiveness and internal audit standing is a further area for research. Lastly, future studies should investigate how the assurance overlap by internal and external auditors can be optimised. All these suggested research endeavours will provide a better understanding of how internal audit standing can be optimised to the benefit of organisations, IAFs and the internal audit profession.

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