

## Opportunities and Challenges Facing Internal Audit in the Public Sector Administration in the North-West Province

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**Abstract:** This study reports on a study conducted to explore opportunities and challenges facing internal audit in the public sector administration in the North-West province of South Africa. The study consisted of 100 participants. From the participants 50 were from the provincial internal audit staff. The other 50 participants were from the employees in the internal control and risk management directorates as well as individuals who are in the management level within government departments and have been audited by the PIA before. The study used a survey design and data was collected through open and closed-ended questionnaire using a likert scale and analysed and interpreted descriptively through frequency tables, means and standard deviations. The results indicate that the audit section, among other opportunities has sufficient capacity and strong support from stakeholders to carry out its mandate. This audit section adds value to the overall management performance. On the other hand, the study also shows that there is a poor relationship between the management and the internal audit activity and sometimes with internal audit committee. The study recommends the promotion of a management integrated planning culture where by the audit section and management are integrated in the planning and implementation of departmental activities.

**Key words:** Provincial Internal Audit (PIA), internal control, risk management, North West Provincial Government (NWPG), Provincial Departments, South Africa

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### INTRODUCTION

The Institute of Internal Auditors (IIA) defines internal audit as an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. This activity helps an organisation to accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes. Internal auditing is a value-adding service that provides an independent appraisal of the diverse operations and controls within an organisation to determine the accuracy and reliability of information; ensuring that enterprise risks are identified and minimised; regulations and legislation are complied with; resources are efficiently and economically utilised and the organisation's objectives are effectively achieved. Audit findings and recommendations do not serve much purpose unless management is committed to implementing them (Gansberghe, 2005).

An important function of corporate governance is to control and discipline management. The same goal is

shared by democratic governments where disciplining public agents is a central task. In both areas of governance, a core problem is that persons occupying leadership positions tend to accumulate uncontrolled discretion. For centuries, democracies have developed various institutions to effectively restrict this accumulation of power (Gansberghe, 2005). Management support with resources and commitment to implementing the internal audit recommendations is critical in attaining audit effectiveness. Also, the organisational environment in which internal audit operates, i.e., the organisational status of the office, its internal organisation policies and procedures applied to each auditee, should enable smooth audits that lead to reaching useful audit findings. Furthermore, the capability, attitudes and level of cooperation of the auditee impact on the effectiveness of audits (Mihret and Yismaw, 2007).

### Literature review

**Internal audit office defined:** NWPIA defines the scope of work of the provincial internal audit as providing reasonable assurance that system risk, internal control

and governance processes, effected by various departmental management are in accordance with acceptable standards and that these function effectively to ensure that identification and management of risks are performed appropriately; strategic plans, objectives and activities are attained; recognition of critical laws is in place and that they are appropriately addressed within respective departments; resources are acquired in an economical way, utilised with minimum waste and adequately safe-guarded; relations with the various governance processes takes place whenever a need arises; critical information pertaining to finance, management and operations is complete, correct, credible and timeous and that behaviour demonstrated by employees is in line with the relevant policies, standards, procedures and applicable legislation. The internal audit unit was established as a shared function under sections 38 (1) (a) and 76 (4) (e) of the Public Finance Management Act (PFMA) and mandated by EXCO Resolution 4.4 of 18th May 2001 (as amended by EXCO Resolution 4.2 of 17th July 2006).

#### **The importance of internal audit**

**Control mechanism:** Due to the growing demand of internal audit services both in public and private organisations, the significance of internal audit was validated. Management is required to make an annual statement regarding the design and effectiveness of the organisation's internal controls. Thus, audit is a system used by an organisation to assess risk and analyse the gaps undermining achievements of the organisation's objectives (Sueyoshi *et al.*, 2009). A focus on high-profile corporate failures has recently been placed on corporate governance and also emphasised internal auditing as an important part of the governance process (Coram *et al.*, 2008).

Internal Auditing (IA) has become an essential internal assurer in both public and private entities. However, not many educational studies have been conducted on its effectiveness (Cohen and Sayag, 2010). It is common knowledge that service delivery in most of the public sector entities in South Africa is in a state of disorder. There are challenges which are directly linked to service delivery: fraud and corruption; insufficient capacity in terms of skill and human resources. Quality service delivery and value for money in the public sector has largely not been achieved. Best value is described as an emerging initiative that aims to improve the quality of public services (Bowen *et al.*, 2007).

**Sustenance of corporate governance structure:** In recent year, the importance of good corporate governance has

received significant public and regulatory attention. A vital part of an entity's corporate governance is its internal audit function (Coram *et al.*, 2008). Since then, there has been a worldwide move towards an enterprise wide approach to risk management with internal auditors playing a key role in providing both quality assurance and consulting services with respect to the management of risk within their organisations (De Zwaan *et al.*, 2011).

Internal audit is an important part of an organisation's corporate governance structure. This importance is highlighted by the Institute of Internal Auditor's (IIA) Practice Advisory 2130-1 on the role of the internal auditor in the ethical culture of an organisation which stresses that internal auditors should take an active role in support of an organisation's ethical culture and in this way detect misappropriation of an organisation's assets.

It is said that audit committees seek comfort with respect to the control environment and internal controls, two areas in which they confront considerable discomfort. Besides the internal audit function's traditional assurance role, its involvement in improving internal controls provides a significant level of comfort to the audit committee. Internal auditor's unique knowledge about risk management and internal control, combined with appropriate interpersonal and behavioural skills, enable them to provide this comfort (Sarens *et al.*, 2009).

**Agent for organisational renewal:** Fernandez and Rainey (2006) argued, based on a thorough literature review, that top management's support and commitment to change play a crucial role in organisational renewal as senior managers can set the tone that the entire staff needs to follow through on efforts launched by forward thinkers.

Legitimate roles are those the IIA has deemed an internal audit can undertake as long as there are safeguards in place to prevent any compromise of independence. These roles extend beyond the regular assurance activities into the consulting role of the internal audit.

**Enhancing accountability and improving performance:** In order to determine internal audit efficiency, evaluation principles are important to analyse the model of internal audit. Undoubtedly, the large amount of definitions that is given by researchers depicts the importance of internal auditing. More specifically, it is defined as an independent appraisal function, established within an organisation to examine and evaluate its activities as a service to the organisation. By measuring and evaluating the effectiveness of organisational controls, internal auditing itself becomes an important managerial control

device which is directly linked to the organisational structure and the general rules of the business (Karagiorgos *et al.*, 2011). In public sector organisations across the world, the internal audit activity is a preferred support provider, enhancing accountability and improving performance in government. Thus, more countries have developed policies aimed at strengthening the internal audit activity within the public sector for the purpose of improving their capacity for contributing to these goals. Measures in the policy should include, amongst other facets, the following: establishment of internal audit units; establishment of principles for the professional conduct of internal audit work; training and development; increase reporting arrangements such as widening authority to allocation of resources and broadening the mandate to make both internal and external auditors performance assessment champions. Additionally, due to the fact that internal auditing is seen as an important tool for accountability, the united states transferred internal audit activity to the inspectors general who report audit exceptions to both the executive and to congress. Thus, in the united states, internal audit is currently also a tool for external accountability and not simply a tool of internal accountability intended to assist senior management of the government departments (Ali *et al.*, 2011). Balakaran (2007) notes that the internal audit activity assists with key activities that fall within the audit committee's area of responsibility and that the reporting relationship is key to effective practice of audit, not to mention objectivity. In addition to that, it is the recommendation of the IIA that the internal audit activity reports directly to the audit committee. In this regard, independence of the internal audit is enhanced and an objective evaluation of internal controls accomplished. A fair statement would be to conclude that the CIA designation is a reflection of the perceived competence of internal auditors.

**Internal audit challenges:** The internal audit departments have several challenges linked to the changes in business operations; to the support of other assurance functions such as risk management, compliance, internal control and quality assurance; to the requirements of the different stakeholders' "continuous auditing and overall opinion" to the pressure on productivity and new legislations. The IIA further echoes that internal auditors have to work in an efficient way but also have to guarantee the full coverage of the major risks in the organisation. Working together with the external auditors and an overall approach of the risks helps achieving these objectives. Internal auditors must, more than ever, demonstrate their added value and provide reasonable assurance to the

executive about the efficiency of the risk management within the organisation and contribute, through their recommendations to the continuous improvement of the processes.

During an audit committee leadership summit, members of the audit committee leadership networks in North America and Europe Audit committee leadership networks met to address the pressing matter of challenges faced by internal audit functionaries. Resourcing the internal audit function was highlighted as a pressing issue. The challenges cited include staffing of the internal audit function with skilled people who have knowledge of the organisation and its general culture. The positioning of the internal audit within the organisation was also discussed as a challenge. From the range of challenges specified here, it is imperative that an internal audit have a strong position in the organisation and should be portrayed as a loyal and valued player. Since, it required the CEO to validate the position of the internal audit, a healthy relationship between the chief audit executive and the chief executive officer is encouraged. This ensures that the internal audit maintains its independence and objectivity.

Unlike western countries, China's internal audit was established and developed under the assistance of the government. However, compared to social audit and governmental audit, China's internal audit clearly lags behind on matters of institution set-up, together with the impact made by its functionality. Low emphasis on internal audit at management level is highlighted as a huge challenge in chinese governance. Even though IA has developed over two decades, people still cannot be convinced to adapt the culture of affording the IA the necessary respect it requires, especially with most of directors in private organisations who think internal audit is dispensable and perceive it as having no direct relationship with corporate economic benefit. Some corporate directors believe that internal audit restricts their self-business rights and weakens their authority. As a result, they either do not set internal audit departments, or they deprive it of essential rights even if it does exist. The officials in internal audit department end up being excluded and isolated, resulting in them not being able to perform their roles as expected.

Song continues to highlight low quality of corporate internal audit staff as another huge challenge in China. China's organisations pay little attention to internal audit and as such it ranks very lowly within the structures of the organisations. It is therefore very difficult to attract and maintain talent into internal audit teams in DPRC. Renewal of the team cannot be accomplished easily which results in single knowledge structures of audit staff

where lack of risk management knowledge and information technology knowledge are eminent limitations.

The failure of a public company is more often than not followed by a series of lawsuits. Audit firms are usually included in such lawsuits because in the aftermath of an organisational failure, the audit firm is generally one of the few solvent parties. Many audit firms that have picked up the smaller, riskier or financially weaker clients are regional and local firms with comparatively limited resources. The survival of these audit firms in the aftermath of organisation failure and major lawsuit settlements is a concern to the profession.

Auditing standards requires auditors to exude professional attitudes marked by a tendency to doubt what others accept to be true and forming independent opinions when assessing control deficiencies. If an auditor lacks this professional attitude marked by a tendency to doubt what others accept to be true, they are likely to be manipulated by management tactics to lower the assessed severity of a potential significant deficiency. Further, lowering the assessed severity to less than a significant deficiency eliminates the need to inform the audit committee of the deficiency in controls.

Wolfe discuss the adequacy of resources where technology is concerned. Lack of adequate technology poses a challenge in the internal audit process. Since, the changes in technology are accelerated, the technology used for internal audit should be updated or changed altogether in order to give the organisation a competitive advantage.

Norman *et al.* (2010) reviewed the effects of internal audit reporting on fraud risk assessment and came to the conclusion that auditors have a perception that their lives are endangered when they report high levels of risk to the audit committee and this coerces them into reducing the assessed levels of fraud risk which they report. This is a challenge and threatens to compromise the internal audit functionality.

Steward and Subramaniam (2010) argue that an audit committee is able to set a 'tone' that enables internal audit to have a certain degree of influence in the organisation. As such, an effective audit committee plays a critical role in supporting the internal auditor's position and strengthening internal audit independence. With an ineffective audit committee, the internal audit might face the challenge of strengthening its independence.

**Statement of the problem:** This research focuses on the internal audit effectiveness in the public sector. The extent to which an internal audit office meets its mandate is arguably a result of the relationship among four factors,

namely: the quality of the internal audit activity; support emanating from senior management and the management at large; client department's background and quality of the auditee. An internal audit function's capability to provide useful audit findings and recommendations raises management's interest in its recommendations (Mihret and Yismaw, 2007). Therefore, internal audit effectiveness should be viewed as a pro-active process that is continuously shaped by the interrelations among the four factors mentioned above (Mihret and Yismaw, 2007). This study therefore examined the factors which influence the opportunities and challenges connected to the internal audit activities of the public sector organisations in the North-West province.

**Significance of the study:** It is important for the North-West provincial departments to know value of service delivery and the role that internal audit plays in providing reasonable assurance that operational and strategic objectives are realised. This study serves as an informative reference to the provincial government and other stakeholders seeking greater insight into the effectiveness of internal audit in the public sector.

## **MATERIALS AND METHODS**

The population of the study was made of the members of the Provincial Internal Audit (PIA) and officials whose duties include Internal Control (IC) and Risk Management (RM) in the North-West Public administration. Officials who were in the management level and that had been audited by the PIA also formed part of the population. The reason for selecting this population was because internal auditing in the province is carried out by the PIA through the IC and RM directorates of the government departments. Since management are ultimately responsible for receiving audit reports and expected to respond to the findings, they were also eligible in the study. The total number of members of the North-West provincial internal audit was 112. The total number of officials working within internal control, risk management and senior management of the North-West provincial government was 324. The study consisted of 100 participants. The sample consisted of 50 from the Provincial Internal Audit (PIA) staff and another 50 the internal control and risk management directorates as well as individuals who are in the management level within government departments and had been audited by the PIA. Random sampling was used to select the participants because it is the purest structure of probability sampling and appropriate for the study. The researchers made use of survey design and used

questionnaires with the majority of questions close-ended and few open-ended questions to collect data. Descriptive statistics was used to analyse the data.

**RESULTS AND DISCUSSION**

**Opportunities:** Table 1 shows that 58% of the North-West Provincial Government respondents (NWPG) agree that the internal audit activity have sufficient capacity to implement the annual internal audit plan. On the other hand, 81.4% Provincial Internal Audit (PIA) respondents agree that the internal audit activity have sufficient capacity to implement the annual internal audit plan; this implies that the current capacity is sufficient but there is still room for improvement.

Table 2 shows that 73.9% of NWPG respondents believe that internal audit activity has strong support within their departments whereas 60.5% of the PIA felt the same. This is an indication that there is still room to improve the support base for internal audit activity.

Table 3 shows that 73.9% from NWPG and 90% of PIA respondents agree that internal audit activity adds value to the overall management performance of their departments. These findings reveal that the activity of internal audit is an important function within the public financial management system.

The majority of the North-West provincial government respondents (76%) as well as (95.4%) provincial internal audit respondents agree that the internal audit activity exude professional attitude and form an independent opinion when assessing control deficiencies data in Table 4 implies that the internal audit activity is executed independently with little or no interference from other departments.

Table 5 shows that 65.2% of NWPG and 65.2% from PIA respondents are of the opinion that their departmental management provides internal audit with the necessary support during the implementation of annual internal audit plan. This indicates that internal audit activity to some extent is viewed as an important process even though there is also a view that co-operation has to be improved and sustained.

Table 6 indicates that 60.5% of the PIA and 56.5% NWPG respondents agree that the audit committee has been able to set a tone that enables internal audit activity to have a certain degree of influence in the departments. The results show that there is the need to enhance further the audit committee authority to be able to exercise full influence on the departments it serves.

**Challenges:** Table 7 indicates that 67% of NWPG and 67.4% of the PIA respondents made comments on what they think are the main challenges experienced by the audit committee. This includes poor relationship between

**Table 1: Internal audit capacity to implement the annual internal audit plan**

NWPG	Frequency	Percent	Valid percent	Cumulative percent
<b>Valid</b>				
Agree	24	52.2	52.2	52.2
Strongly disagree	3	6.5	6.5	58.7
Disagree	14	30.4	30.4	89.1
Not sure	5	10.9	10.9	100.0
Total	46	100.0	100.0	
<b>PIA</b>				
<b>Valid</b>				
Strongly agree	15	34.9	34.9	34.9
Agree	20	46.5	46.5	81.4
Strongly disagree	1	2.3	2.3	83.7
Disagree	7	16.3	16.3	100.0
Total	43	100.0	100.0	

**Table 2: Support for internal audit activity support within departments**

NWPG	Frequency	Percent	Valid percent	Cumulative percent
<b>Valid</b>				
Strongly agree	1	2.2	2.2	2.2
Agree	33	71.7	71.7	73.9
Strongly disagree	2	4.3	4.3	78.3
Disagree	8	17.4	17.4	95.7
Not sure	2	4.3	4.3	100.0
Total	46	100.0	100.0	
<b>PIA</b>				
<b>Valid</b>				
Strongly agree	4	9.3	9.3	9.3
Agree	22	51.2	51.2	60.5
Strongly disagree	1	2.3	2.3	62.8
Disagree	9	20.9	20.9	83.7
Not sure	7	16.3	16.3	100.0
Total	43	100.0	100.0	

**Table 3: Value addition of internal audit activity to overall management performance**

NWPG	Frequency	Percent	Valid percent	Cumulative percent
<b>Valid</b>				
Strongly agree	5	10.9	10.9	10.9
Agree	29	63.0	63.0	73.9
Strongly disagree	1	2.2	2.2	76.1
Disagree	7	15.2	15.2	91.3
Not sure	4	8.7	8.7	100.0
Total	46	100.0	100.0	
<b>PIA</b>				
<b>Valid</b>				
Strongly agree	9	20.9	20.9	20.9
Agree	30	69.8	69.8	90.7
Disagree	1	2.3	2.3	93.0
Not sure	3	7.0	7.0	100.0
Total	43	100.0	100.0	

**Table 4: The professionalism of internal audit activity when assessing control deficiencies**

NWPG	Frequency	Percent	Valid percent	Cumulative percent
<b>Valid</b>				
Strongly agree	2	4.3	4.3	4.3
Agree	33	71.7	71.7	76.1
Disagree	6	13.0	13.0	89.1
Not sure	5	10.9	10.9	100.0
Total	46	100.0	100.0	
<b>PIA</b>				
<b>Valid</b>				
Strongly agree	18	41.9	41.9	41.9
Agree	23	53.5	53.5	95.3
Strongly disagree	1	2.3	2.3	97.7
Disagree	1	2.3	2.3	100.0
Total	43	100.0	100.0	

Table 5: Departmental management support to IA activity during implementation of annual audit

NWPG	Frequency	Percent	Valid percent	Cumulative percent
<b>Valid</b>				
Strongly agree	1	2.2	2.2	2.2
Agree	29	63.0	63.0	65.2
Strongly disagree	1	2.2	2.2	67.4
Disagree	7	15.2	15.2	82.6
Not sure	8	17.4	17.4	100.0
Total	46	100.0	100.0	
<b>PIA</b>				
<b>Valid</b>				
Strongly agree	7	16.3	16.3	16.3
Agree	21	48.8	48.8	65.1
Strongly disagree	4	9.3	9.3	74.4
Disagree	6	14.0	14.0	88.4
Not sure	5	11.6	11.6	100.0
Total	43	100.0	100.0	

Table 6: Audit committee influence in respective departments

NWPG	Frequency	Percent	Valid percent	Cumulative percent
<b>Valid</b>				
Agree	26	56.5	56.5	56.5
Strongly disagree	6	13.0	13.0	69.6
Disagree	9	19.6	19.6	89.1
Not sure	5	10.9	10.9	100.0
Total	46	100.0	100.0	
<b>PIA</b>				
<b>Valid strongly agree</b>				
Agree	8	18.6	18.6	18.6
Strongly disagree	18	41.9	41.9	60.5
Strongly disagree	4	9.3	9.3	69.8
Disagree	4	9.3	9.3	79.1
Not sure	9	20.9	20.9	100.0
Total	43	100.0	100.0	

Table 7: Main challenges audit committee experiences

NWPG	Frequency	Percent	Valid percent	Cumulative percent
<b>Valid</b>				
Comment	31	67.4	67.4	67.4
No comment	15	32.6	32.6	100.0
Total	46	100.0	100.0	
<b>PIA</b>				
<b>Valid comment</b>				
No comment	29	67.4	67.4	67.4
No comment	14	32.6	32.6	100.0
Total	43	100.0	100.0	

the management and the internal audit activity. There is also a general perception that the departments are not utilising internal and external assurer's reports fully. Management are often reluctant to consider internal audit recommendations. Budgetary constraints are also highlighted as a challenge. There is a lot of absenteeism during the audits by officials who should provide the internal auditors with information. There is no buy-in by the departmental management to the concept of internal audit. The fact that the departments do not seem to know the role that the internal audit plays is another challenge. Poor relationship between the management and the internal audit activity is cited as one of the reasons for such non-implementation. There is no buy-in by the departmental management to the concept of internal audit. These results show that there is much work to be done to raise awareness and knowledge among all stakeholders regarding internal audit activity.

## CONCLUSION

The study was split in terms of capacity to manage the internal audit activity to implement the annual internal audit plan. Some respondents believed that the unit is only able to undertake fewer audits, thus resulting in control deficiencies that are not timely detected and treated accordingly. Other respondents, however, were of the opinion that given the task at hand the internal audit is able to deliver their mandate. View Points indicted that internal audit faces challenges which include recruitment, training and retaining staff that can operate in a diverse environment. Ahmad *et al.* (2009) in their study conclude that the internal audit function in the public sector in Malaysia is challenged by understaffing and hampered by inadequate support from top management while the auditors seldom extend their full cooperation. It was however established that a sound relationship between the internal audit, management and audit committee increases effectiveness and efficiency to ultimately achieve the organisation's objectives and that internal audit activity adds value and improves an organisation's operations (IIA SA, 2014).

## RECOMMENDATIONS

Internal audit functions need to work on raising awareness of internal auditing in the public sector by establishing specific marketing plans. These plans, however, must be accompanied by improved internal audit service delivery and the introduction of a quality assurance programme. Once internal audit aligns itself to the priorities of its key stakeholders, the function needs to establish solid lines of communication with senior management and the audit committee. By maintaining good communication, internal audit also ensures that its priorities continue to match those of its key stakeholders as they evolve. Non-financial motivators should take a greater role in the public sector environment (e.g., recognition of staff members through awards ceremonies; travelling opportunities; offering choices of assignments, etc). The audit committee should also be alert to opportunities for senior management representatives to attend meetings so as to facilitate further discussion on action to implement audit recommendations or to explain why any recommendation has not been addressed appropriately or in a timely way.

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