

**PROFESSIONAL INTERNAL AUDITING  
IN THE PUBLIC SECTOR**

**by**

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## Declaration

I, the undersigned, hereby declare that the work contained in this study project is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

SIGNATURE

DATE

## Abstract

### Professional internal auditing in the public sector

In this study the assumption is made that the delivery of a professional internal audit service has a direct bearing on the improvement of effectiveness of services delivered.

Internal auditing in the public sector, compared to the private sector, is still at an early stage of development. A change in emphasis brought about by the new Constitution has led to a demand for stronger accountability and transparency. The internal audit profession has an important role to play by assisting management in the effective, efficient and economic reaching of goals and objectives. To fulfil this role successfully it is necessary for the internal auditor to possess specific skills and knowledge to perform audit tasks unique to the public sector.

The hypothesis as formulated emphasises the relationship between professional internal auditing and organisational effectiveness. Through the content of this study project it is endeavoured to prove this point.

An investigation into the field of internal auditing was undertaken by means of a study of the available literature, including the Standards for Professional Practice of Internal Auditing. Opinions and information were obtained from management and other persons involved with auditing by means of a questionnaire. The opinions and information were integrated to obtain a comprehensive picture.

A study of the literature revealed that internal auditing is supported by four pillars, namely:

- Achieving objectives
- Safeguarding and using of assets
- Economic, effective and efficient execution of functions
- Compliance with policy, prescripts and regulations.

The literature also describes a definite process followed during an audit. During the audit process risk factors must be taken into account. Technical aspects relating to internal auditing is covered in the literature, but references to examples in the public sector are lacking. This deficiency was identified during the field study by means of a questionnaire.

Respondents indicated in questionnaires that effectiveness of management, financial information and compliance with controls must be subjected to internal auditing. Management views the internal audit as a source of information on the activities of every department.

The recommendations for professional internal auditing in the public sector are aimed at promoting accountability and transparency in the organisation. To ensure effective internal auditing it is necessary for the internal auditor to take note of the environment in which the organisation's activities play a role.

A study of public administration as a management science is therefore important for the internal auditor to obtain insight into a holistic approach regarding the activities of public sector organisations.

## Opsomming

### Professionele interne ouditering in the openbare sektor

In hierdie studie word as uitgangspunt die aanname gemaak dat daar 'n verband bestaan tussen die lewering van 'n professionele diens deur die interne ouditeur en die effektiwiteit van dienste wat aan interne ouditering onderwerp word.

Interne ouditering in die openbare sektor in vergelyking met die private sektor, is nog in 'n begin stadium van ontwikkeling. 'n Klemverskuiwing wat teweeggebring is deur die nuwe Grondwet het daartoe gelei dat groter rekenpligtigheid en deursigtigheid vereis word. Die interne oudit beroep het 'n belangrike rol te speel deur bestuur by te staan in die effektiewe, doelmatige en ekonomiese bereiking van doelwitte. Om hierdie rol suksesvol te vervul is dit nodig dat die interne ouditeur oor bepaalde vaardighede en kennis sal beskik om oudittake uniek aan die openbare sektor professioneel uit te voer.

Die hipotese soos geformuleer beklemtoon die verband tussen professionele interne ouditering en organisatoriese effektiwiteit. Met die inhoud van die werkstuk word daar gepoog om die punt te bewys. 'n Ondersoek na die gebied van interne ouditering is onderneem deur 'n studie te maak van beskikbare literatuur, insluitend die Standaard vir Professionele Praktijkvoering van Interne Ouditering. Deur middel van 'n vraelys is menings en inligting van bestuur en persone betrokke by ouditering verkry. Die menings en inligting is saamgevoeg om 'n geheelbeeld te verkry.

'n Studie van die literatuur toon dat interne oudit deur vier pilare ondersteun word naamlik:

- Bereiking van doelwitte
- Beveiliging en aanwending van bates
- Ekonomiese, effektiewe en doelgerigte uitvoering van funksies
- Nakoming van beleid, voorskrifte en regulasies.

Die literatuur beskryf 'n bepaalde proses wat gevolg word tydens ouditering. Gedurende die ouditproses moet risikofaktore in ag geneem word. Tegniese aspekte verbonde aan interne ouditering word gedek, maar verwysings na voorbeelde uit die openbare sektor ontbreek grootliks in die literatuur, vandaar die noodsaaklikheid vir 'n veldstudie wat deur middel van 'n vraelys gedoen is.

Respondente het in die vraelyste aangedui dat effektiwiteit van bestuur, finansiële inligting en die nakoming van kontroles aan interne ouditering onderwerp moet word. Bestuur beskou die interne ouditeur as 'n bron van inligting oor die aktiwiteite van elke departement.

Die aanbevelings vir professionele interne ouditering in die openbare sektor is daarop gemik om rekenpligtigheid en deursigtigheid van 'n organisasie te bevorder. Om effektiewe interne ouditering te verseker is dit noodsaaklik dat die interne ouditeur ook kennis dra van die omgewing waarin die organisasie se aktiwiteite 'n rol speel. 'n Studie van Publieke Administrasie as 'n bestuurswetenskap sal dus vir die interne ouditeur van belang wees om insig te verkry in 'n holistiese benadering tot aktiwiteite van openbare sektor-organisasies.

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## Chapter 1

### Introduction

#### 1.1 Issues and context of the study

Implementation of an internal audit entity in any government department in South Africa is the responsibility of the accounting officer or the chief executive officer in order to strengthen accountability to the members of cabinet and to enhance organisational performance. Financial regulations and administrative practice, in fact, make it compulsory for an accounting officer to implement an internal audit function.

This study is an investigation into how internal auditing is viewed and performed in the public sector; how it is related to organisational effectiveness and efficiency as a goal; what the principles and techniques of internal auditing are; and relevant contemporary issues regarding internal auditing. A hypothesis probing the link between professionalism of internal auditing and organisational effectiveness, a vast array of literature, and opinions acquired through questionnaires form the base of this study. Finally, there is a discussion of issues and recommendations seen by the writer as being important in promoting professional internal auditing, which will lead to improved organisational performance and ultimately excellence.

The public sector encompasses an organisation of immense size delivering services to all citizens of the country within a dynamic and broad-ranging environment. Management is required to be accountable and transparent regarding activities of departments and institutions. To ensure integrity and a professional standing in the organisation, and at the same time render a support service to management, internal auditors and everybody involved in the process should be aware of the scope of their task and what organisational effectiveness and efficiency entail. The ultimate goal of internal auditing is to add value to the organisation's service delivery, as described later in this chapter.

The study presents definitions of internal auditing and a conceptualisation of how internal auditing is described in the literature. Because of the wide scope covered by internal auditing, and to illustrate the range of skills and knowledge

required, a concise summary of theory and information related to technical issues is provided in Chapter Two to conceptualise the task of the internal auditor.

To further explore these issues the views of management and persons involved in internal auditing in the public sector were obtained through questionnaires. Due to the nature of internal auditing, these questionnaires obtained information that was subjective, but after processing a more objective picture emerged, as is described in Chapter Three.

The recommendations made to enhance professional internal auditing in the public sector are based on shortcomings as seen in the views of respondents who answered the questionnaires as well as on related matters which require detailed elaboration. In the final chapter an internal auditing approach for the public sector is discussed, as well as what aspects/issues should be addressed to ensure that internal auditing is supported by a professional body.

## 1.2 Hypothesis

For the purpose of this project the following hypothesis will be used as the base for theoretical deliberations and further explanations:

**“The professional standing of an internal audit function, including that of individual internal auditors, will be valued and maintained, based on the value of effectiveness and efficiency added to the achievement of goals and objectives.”**

“Professional standing” and “effectiveness/efficiency” are the cornerstones of this definition and need further clarification.

Professional status is linked to the standing of the internal auditing department in the organisation, as well as affiliation to a professional body which instil personal attributes of specialised skills and knowledge. Mitchell (in Sawyer 1988:42) views professionalism as follows:

“... professionalism is an attitude of mind. Whenever outrunning the desire for personal profits, we find joy in work, eagerness for service, and

a readiness for co-operative process; then trade has been left behind and professionalism entered.”

Efficiency and effectiveness can be described by using a two-dimensional approach. Firstly, the organisation should strive to achieve goals and objectives as planned by using resources to the best of their ability for optimum delivery of services. Secondly, the internal auditors, as a department, should provide a service to management which contributes to the overall efficiency and effectiveness of the organisation. This should lead to cost savings, improved utilisation of assets, and improved delivery of services.

### 1.3 Auditing in the public sector

#### 1.3.1 Introduction

This section serves as a background to internal auditing in the public sector, which forms the basis for the rest of this study.

In terms of the hypothesis professionalism in the public sector, as far as internal auditing is concerned, is viewed as important and necessary to ensure and enhance the effectiveness and efficiency of organisations.

The views held by Loots (1996) on internal auditing are quoted and discussed in relation to the difficulty of measuring effectiveness and efficiency in the public sector. Problems related to the assessment of performance due to the lack of quantitative financial information is discussed.

#### 1.3.2 Achieving professionalism in the public sector

The history and the future of the public sector in South Africa require an intricate combination of values and factors which, due to the task of internal auditing, cannot be ignored. The organisational culture prevailing before the elections in 1994 can be described as being authoritarian and highly bureaucratic. Management used a top-down approach to lead and concentrated on compliance with laws and regulations. With the new South Africa came a constitution that shifted the emphasis to the rights of individuals, including the right to services and support provided by state departments. A natural result of this shift was a quest for greater accountability and transparency in the public

sector. The internal audit profession in the public sector has an important role to play by assisting management in the task of attaining goals and objectives with efficiency, effectiveness and economy, which must support accountability and transparency as conceptualised under section 1.4.

The Standards for Professional Internal Auditing as prescribed by the Institute of Internal Auditors of the United States (1995) provides a wide range of guidelines. These guidelines are based on proper staffing, acquisition of the necessary knowledge, skills and disciplines, and the proper supervision of audit work (Ratliff et al. 1996:74). Without these attributes an internal auditor will not be in a position to attain and maintain the status of a professional internal auditor.

Loots (1996) defines the scope of internal auditing as "encompassing the examination and evaluation of the adequacy and effectiveness of the organisation's system of quality of performance." To further clarify this statement, Loots provided the following general guidelines:

- Review the reliability and integrity of financial and operating information, and the means used to identify, measure, classify and report such information.
- Review the systems established to ensure compliance with these policies, plans, procedures, laws and regulations, which could have a significant impact on operations and management information.
- Review the means of safeguarding assets and, as appropriate, verify the existence of such assets.
- Appraise the degree of economy and efficiency with which resources are employed.
- Review operations or programmes to ascertain whether results are consistent with established objectives and goals and whether the operations or programmes are being carried out as planned.

### 1.3.3 Internal auditing for effectiveness in the public sector

The above are comprehensive guidelines placing high expectations on the work performed by internal auditors. [According to Fox (in Fox et al. 1991:119 - 120) personal observation, statistical reports, oral reports and written reports are methods which can be used for measuring results. In most cases the measurement of results is of a subjective nature and not always prone to produce effective measurements and evaluation.] The environment of the public sector, and its responsibilities, functions and operations are uniquely different from those of the private sector for the following reasons:

- Classifying, measuring and reporting information is very complex due to the various types of services being provided. Assessment of effectiveness and efficiency can only take place subjectively, for example, a decrease in motor accidents ascribable to improved road conditions, or a decrease in the mortality rate which follows improved medical services.
- Policies, plans, procedures and laws are mainly formulated to regulate the activities of the society and the public sector. Policies are not formulated to achieve results, but rather to provide a framework for the reaching of goals, and related to compliance to ensure order and stability in society.
- Reporting on activities, including financial reporting, is done yearly in the form of an appropriation account, which provides little information on the effectiveness, efficiency and economy of operational activities of an organisation or departments.
- The size of provincial administrations and national departments means that the public sector is one of the biggest holders of assets compared to the private sector. Although the safeguarding and verification of assets can be effectively done with the support of a computerised system, such a system must still be maintained by adequately trained and experienced personnel. The internal auditor is faced with the problem that in most departments such asset registers are either non-existent or very poorly maintained, which is a reflection on the competence of personnel.
- The appraisal of the degree of effectiveness and efficiency with which resources are employed requires measures and guidelines which are not subjective. A thorough understanding of the goals and objectives to be



met with the resources is necessary to make a worthwhile comment from an auditing perspective.

According to Henley et al. (1993:196-197, 1287) the measuring of performance has to be handled with great care for the following reasons:

- Trends need to be interpreted in the light of changing commercial circumstances and government policies.
- International comparisons are fraught with difficulty because of circumstances particular to each country and the fact that the organisations are rarely comparable in what they do means that adjustments have to be made to figures.
- Targets and results give a guide to action and not definite answers as to what must be done.

The above points clearly indicate that the internal auditor is faced with a very complicated challenge in the public sector environment. A new democratic country, exposed to the global economy and new ways of thinking, infused with altered goals and objectives, requires the internal auditing profession to act even more professionally in a dynamic way, keeping abreast of the latest technology, management techniques and paradigms. Internal auditors should possess personal qualities and knowledge to perform professional auditing assignments which are unique to the public sector.

#### 1.3.4 Summary

The need for efficiency and effectiveness is vital for substantive accountability by management. The following section of this chapter provides a discussion which highlights the meaning and requirements of organisational efficiency and effectiveness. A professional internal auditor should be aware of what influences and leads to effectiveness and efficiency.

## 1.4 Organisational efficiency and effectiveness

### 1.4.1 Introduction

In this study, organisational effectiveness and efficiency is the dependent variable of the hypothesis, and internal auditing the independent variable. Efficiency refers to how the goals and objectives will be achieved, while effectiveness refers to the attainment of goals and objectives as planned within preset norms and standards.

As a background, the different approaches to organisational efficiency and effectiveness are discussed as found in the literature. This includes theoretical aspects such as measurement, excellence and future service delivery.

Finally, the concepts and theory are brought into line with the task and vision of the internal auditor. As a supportive tool to management the internal auditing department needs to be aware of the goals and objectives of the organisation, as well as ways of determining whether they have been attained successfully, and will continue to do so in the future.

### 1.4.2 The basis of organisational efficiency and effectiveness

Organisational effectiveness, according to Harvey and Brown (1996:44), can be increased by creating a culture that achieves organisational goals, and at the same time satisfies members' needs. Furthermore, Harvey and Brown (1996:44) state that empowering the individual employee by letting workers make decisions can often improve quality, productivity and employee commitment.

There is always a more effective way of performing work from the viewpoint of recognising the desire of people to use their intelligence and imagination and to develop their skill and talent more fully (Albanese 1981:16). Managers routinely assess individual effectiveness through performance evaluation processes to determine who should receive salary increases, promotions or other rewards available in the organisation (Gibson et al. 1997:13). The same would apply to all the different levels of management as each level plays an integral part in the effectiveness and efficiency of an organisation.

According to Osborne (1994:136), the biggest innovation in the public sector needs to come in the area of human resources. Osborne (1994:136) states that government managers need the tools to mobilise resources in line with their goals without feeling hemmed in.

According to Gibson et al. (1997:14) group effectiveness is the result of cohesiveness, leadership, structure, status, roles and norms. Within the framework of groups, Harvey and Brown (1996:179) view communication, members' roles and functions in groups, group problem solving and decision making, group norms and growth, and leadership and authenticity as the five areas crucial to effective organisational performance.

Individuals on their own, in addition to being part of an organisation, form a crucial part of the attainment of goals and objectives. According to Albanese (1978:348) the environmental settings within which groups function are physical, personal, social and task. Continuous interaction exists within and between groups and environmental settings to achieve the goals and objectives of an organisation effectively and efficiently.

#### 1.4.3 Different approaches to efficiency and effectiveness

According to Gibson et al. (1997:18-21) three approaches can be conceptualised, namely a goals approach, a systems theory approach, and a multiple-constituency approach. The goals approach, being the oldest and most widely used evaluation approach, reflects purposefulness, rationality and achievement. The systems approach, according to Gibson et al. (1997:19), consists of elements or characteristics that interact, which can be categorised as conceptual systems (a language), concrete systems (machines), and abstract systems (culture of an organisation). The systems theory also includes input and output within an environment. Furthermore, according to Gibson et al. (1997:19) the systems theory also stresses the organisation's connection to the larger system of which it forms a part. In the public sector this is very relevant, as Schwella (in Fox et al. 1991:18-22) distinguishes between the general and specific environments in which the public sector has to fulfil its responsibilities and tasks.

The multiple-constituency approach, as seen by Gibson et al. (1997:21), adds to goals and systems the roles of stakeholders, which in the context of the public

sector could entail the population as a whole or, for example, specific categories such as hospital patients or road-users.

According to Mott as cited in Albanese (1978:570) single prescriptions of effectiveness are like mirages: "desirable but distant, receding, unreal, which leads to the framework of reference given by the said author as being an inside perspective and outside perspective."

The inside perspective refers to examples of measures such as productivity, increase in market share and labour turnover rates. On the other hand, the outside perspective refers to the evaluation of effectiveness by people who are on the outside of the organisation where there is more likely to be more of an emphasis on the role the organisation plays as part of the larger system of which it is part (Albanese 1978:572).

The internal auditor needs to view the situation of the organisation internally and externally in a holistic way to obtain the complete picture.

#### 1.4.4 A conceptualised view for the internal auditor

The function of the internal auditor is to assist management in reaching goals and objectives by critically appraising the activities of management. As managers are accountable for effective performance, the internal auditor can only measure to appraise this performance by evaluating organisational effectiveness starting with individual and group behaviour.

In the public sector the wage bill represents by far the biggest part of the total budget. Wide-ranging decisions are taken and executed by employees which therefore require more emphasis to be placed on all factors related to or caused by human resources. The internal auditor will, as far as the public sector is concerned, need to be able to objectively determine the performance of human resources.

From a more practical point of view the internal auditor should break the organisation and its environment down into logical concepts such as tasks and goals, departments, technology, resources and the environment. The nature of the services delivered or the business activities will play a role in the creation of a framework.



#### 1.4.5 Summary

Organisational effectiveness and efficiency should always go hand-in-hand to achieve the best possible mix. Individual employees at different levels throughout the organisation each play an integral part, being managed and managing themselves while striving for the attainment of goals and objectives. Managers and employees need to be entrusted with authority and room to work in order to deliver to the best of their ability.

The multi-dimensional nature of organisations, and especially those as big as in the public sector, requires that managers, and also the internal auditor, observe in breadth and depth the functions and activities of an organisation. Accountability towards the public at large places a burden of substantiated measurement and evaluation on the shoulders of the managers in the public sector, as well as the internal auditor, although the ultimate responsibility remains that of management.

The most basic assumption that will lead to optimum organisational effectiveness and efficiency starts and ends with the role of individuals and the way they are managed. To deliver a service currently and in the future, efficiency and effectiveness must be measured continuously as the organisation operates in a functional and dynamic world with ever-changing demands.

Organisational efficiency and effectiveness is influenced by many factors, of which human resources plays the most important role in the public sector. In order to enhance organisational performance, the internal auditor will place the most emphasis on human resource utilisation.

#### 1.5 Research Methodology

Internal auditing in the public sector is a relatively new field about which not much has been written, apart from short references in public sector accounting textbooks. The research methodology used for the writing of this study project was the following:

- Extensive reading of and gathering information from literature was undertaken to gain a thorough understanding of internal auditing as it is

practised in the private sector. The literature included the "Standards for the Professional Practice of Internal Auditing" as issued by the Institute of Internal Auditors (1995).

- A questionnaire was compiled to gain opinions, and to test the attitude of different parties involved in internal auditing. The questions were formulated to cover the following aspects:

- perceptions of the internal audit function;
- effectiveness of internal auditing;
- auditing procedures;
- knowledge and skills required for internal auditing; and
- personal attributes.

- The questionnaires were completed with the co-operation of senior management of the Provincial Administration Western Cape, the Office of the Auditor-General, the internal audit department of the Cape Town Metropolitan Council, private sector auditors and senior officials of the Department of State Expenditure. Information and a wide array of opinions on different issues were obtained.

## 1.6 Content of the study project

The aim of this study project is to explain and prove that organisations can improve their overall performance by being subjected to scrutiny and evaluation of a professional internal auditing entity.

This introductory chapter provides a hypothesis which refers to the above comparison. A discussion of the reason for internal auditing in the public sector, as well as an organisation that functions and delivers services effectively, efficiently and economically lays the foundation for the rest of the study project.

The second chapter deals with internal auditing issues to provide the reader with knowledge and insight which are deemed necessary to fully understand and appreciate the following chapters. Definitions, principles and techniques, and the process and factors regarding the execution of audits are presented.

Chapter Three provides a description of how research was undertaken to obtain information and views from executive management officials in the public sector and that of other respondents involved in internal auditing. The compilation of the questionnaire is explained with references made to the scientific research methodology of O'Sullivan & Rassel (1989:142-166), Czaja & Blair (1996:51-91), and Mouton & Marais (1988). The opinions and information acquired from the respondents are summarised for each category, after which a critique is provided regarding shortcomings and inadequacies as personally identified by the researcher

Chapter Four leaps ahead by providing recommendations for professional internal auditing in the public sector. The role and scope, as well as the knowledge and skills required to perform internal audits professionally, are under-rated and undervalued by the respondents if their views and opinions are compared to the recommendations made in this chapter. Internal auditors should perform tasks, appraisals and reporting which can be viewed as the unearthing of new theories, values and ideas. This is the reason for providing recommendations which are to keep internal auditors abreast of the latest ideas and techniques.

## Chapter 2

### Internal auditing issues

#### 2.1 Introduction

The reason why internal auditing is necessary to enhance organisational effectiveness and efficiency was explained in the introductory chapter as the basis to formulate and clarify the hypothesis. The purpose of this study, as stated in the hypothesis, is to prove that organisational performance can be improved by a professional internal auditing service. Organisational performance, which includes effective, efficient and economic service delivery, is seen as the dependent variable, whereas internal auditing is viewed as the independent variable.

In this chapter internal auditing is defined, principles and techniques of internal auditing is presented, as well as a conceptualisation of related contemporary issues. This background information is necessary to draw a comparison between the findings of the field study and the recommendations made based on the findings of the field study.

The definition of internal auditing is discussed as being primarily an appraisal function as a service to management and in the end to the organisation. To achieve its goals and maintain professionalism, the internal audit entity must always be in a position to function independently.

Appraisal of management activities entails an evaluation of internal controls as instituted by management. Internal controls are discussed as the responsibility of management within the objective of employing resources economically, efficiently and effectively in order to achieve goals and objectives.

#### 2.2 Principles and techniques of internal auditing

The performance of individual internal auditors and the internal audit entity collectively depends on independence, professional proficiency, scope of work, and the management of the internal auditing department.



### 2.2.1 Defining internal auditing

The following three definitions are quoted from different authors to illustrate the standardised degree of describing internal auditing, and common elements in these definitions:

- "An independent appraisal function established by management for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources" (Auditing Practices Committee (British) 1990, in Jones and Pendlebury, 1992:211).
- "Internal auditing is an independent appraisal function established within a department which operates as a service to management by measuring and evaluating the effectiveness of the internal control system" (Government Internal Auditing Manual (HM Treasury 1988), in Archibald, 1994:173).
- The primary objective of internal auditing is to provide an appraisal of the organisation's controls to ensure that business risk is addressed, and that goals and objectives are achieved effectively, efficiently, and economically (Ratliff et al. 1996:7).

The following three elements are present in all three definitions:

- independent appraisal function;
- internal control system; and
- economic, efficient and effective use of resources to achieve goals and objectives.

### 2.2.2 Independence of the internal audit function

Standard 100 of the Institute of Internal Auditors of the United States of America (1995:9), requires independence for the internal auditing entity in order for it to carry out its work freely and objectively. Furthermore they advise that independence is achieved through organisational status and objectivity.

Two factors influence the independence of the internal audit function and its activities. These are the organisational placing of the function and the individual independent attitudes of internal auditors.

In the organisational structure the chief executive officer and senior management are parties with whom the internal auditing entity will have to deal with. Internal auditing has a dual responsibility in reporting to the audit committee and the chief executive officer and should get the support and co-operation of senior management and auditees to perform their work free from interference.

According to the Institute of Internal Auditors (USA) (1995:21) the head of the internal auditing entity should highlight significant audit findings by means of reports to the main governing body and senior management. Significant audit findings could include irregularities, illegal acts, errors, inefficiency, waste, ineffectiveness, conflicts of interests and control weaknesses. The internal auditing entity is placed in a conflicting situation where the co-operation of management is sought for activities of internal auditors, which could place them in a negative light. This negative situation is intensified when the head of internal auditing has to communicate significant audit findings to the main executive body, explaining their significance and whether they have been addressed satisfactorily or not. In order to maintain total independence the head of internal auditing should report only to the chief executive officer and an independent audit committee.

In national departments, provincial administrations and local authorities the audit committee should be appointed from members of the board or cabinet, including nominated persons with the necessary experience and standing from outside the cabinet or board. As members of cabinet or a council (board) are assigned portfolios which are linked to line functions of departments, the audit committee must be in a position to criticise the activities of those office-bearers assigned specific responsibilities. The findings of internal auditors will be discussed and debated at the highest level of an institution, and it is therefore of the utmost importance that audit findings are obtained and reported very effectively. No mistakes, incorrect assumptions or unsubstantiated findings should be left to chance as that could badly impair the professional standing of the internal auditing department and the individual internal auditors.

According to the Institute of Internal Auditors (1995:14-15), internal auditors should be objective in performing audits. Under the heading "Professional Proficiency" the Institute of Internal Auditors (1995:21) also requires that internal auditors should exercise due professional care in performing internal audits. Furthermore the Institute of Internal Auditing prescribes that exercising due professional care means using audit skill and judgement in performing the audit. To this end, the internal auditor should consider:

- the extent of audit work needed to achieve audit objectives;
- the relative materiality or significance of matters to which audit procedures are applied;
- the adequacy and effectiveness of internal controls; and
- the cost of auditing in relation to potential benefits.

Article VI of the Code of Ethics of the Institute of Internal Auditors (1995:94) prescribes that internal auditors shall undertake only those services which they can reasonably expect to complete with professional competence. Article IX of the Standards of Conduct of the Institute of Internal Auditors (1995:95), also prescribes that when reporting on the result of their (internal auditors) work, they shall reveal all material facts known to them which, if not revealed, could either distort reports of operations under review or conceal unlawful practices.

### 2.2.3 Internal controls

Internal controls cover all activities and information related to the achieving of objectives by an organisation, and they therefore imply that internal auditing should transversely cover all staff and line functions.

Internal controls were defined as far back as 1947 by the American Institute of Certified Public Accountants as follows:

"Internal control comprises the plans of an organisation and all the co-ordinate methods and measures adapted within a business to safeguard its assets, check the accuracy and reliability of accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies (Chambers, 1992:45)."

The Committee of Sponsoring Organisations of the Treadway Commission (COSO), Internal Control - Integrated Framework, American Institute of Certified Public Accountants, United States, 1992, refers to the following matters related to internal control (Chambers 1992:45):

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

The objectives of internal controls, or control systems, as stated by Ratliff et al. (1996:99-100) are the following, which can be viewed as a concise yet comprehensive list:

- the reliability and integrity of information
- compliance with policies, plans, procedures, laws and regulations
- the safeguarding of assets
- economy and efficiency of operations
- accomplishment of organisational objectives and goals.

Appraisal of the effectiveness of most functions in the public sector requires imaginative yet practical actions. For further explanation of this point reference is made to the following diagram as compiled by Ratliff et al. (1996:14), which illustrates the responsibilities for internal controls:

**Table 2.1: Responsibilities of Management and Internal Auditing**

Nature of Audit Responsibility	
<u>Possible responsibilities for controls</u>	<u>Area of management primarily concerned</u>
Formulation of controls	Administrative Management Operational Management
Implementation of controls	Operational Management
Testing compliance with controls	Internal Auditing Operational Management
Evaluation of controls	Internal Auditing Administration Management Operational Management

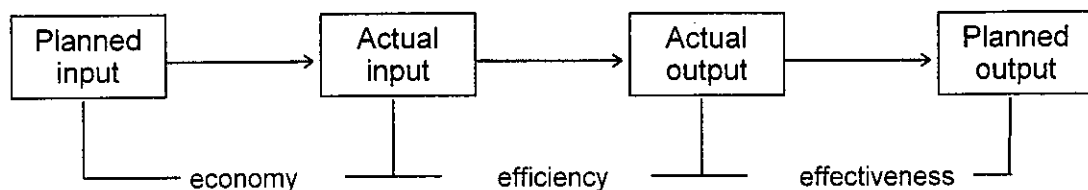
Functions of management, according to Henri Fayol (Chambers, 1992:12), can be divided into planning, organising, staffing, leading and control. Management is also regarded by Fayol as only one of the six activities of industrial enterprises, the others being technical, commercial, financial, security and accounting (Chambers 1992:47). This can be equally applied to all spheres of the public sector. According to Koontz and O'Donnell, as quoted by Chambers (1992:47), the exclusion of internal auditing from commercial and technical activities would be regarded as unsound, as there is more to be gained from reviewing these activities.

Ratliff et al. (1996:15) state that the evaluation of controls can be made at the formulation stage as well as the post-evaluation stage, or a review can also be done prior to implementation. In the public sector controls will be based on laws, policies, standards and procedures. These controls will be influenced by management style, views and organisational objectives.

#### 2.2.4 Economic, efficient and effective use of resources employed to achieve goals and objectives

##### Diagram 2.1: The three "Es"

The following diagram is used to explain the three "Es":



According to Chambers (1992:23) the following definitions apply:

- Effectiveness: The ratio between what was set as objectives and what we actually achieved.
- Efficiency: The ratio between the resources used and the output of our work.

- Economy: The ratio between what we plan on our inputs and what their price actually turns out to be.

Jones and Pendlebury (1992:9) view the three concepts as important analytical tools which must be used in conjunction with each other with caution and common sense. There is also a trade-off between the three "Es"; for example, the most economical or cheapest input will not always lead to the most efficient production process, and therefore neither to output as planned. Cost incurred compared against the budget, the level of service delivery or production, and the achieving of objectives all form part of the measurement of the three "Es". Jones and Pendlebury (1992:19) refer to these collectively as "value for money".

Jones and Pendlebury (1992:14) identify five principal stages which management follows when planning to meet fundamental aims and objectives, of which one is referred to as the control and measurement stage. They also state that the task of measuring activities in the public sector is faced with a lack of output measurement methods and tools (Jones and Pendlebury 1992:16). It is a well-known fact that effectiveness in reaching aims and objectives is only measured indirectly by comparing budgeted figures with the real expenditure at the end of the financial year. In certain instances, for example, with staff functions, there is no means of measuring effectiveness due to the nature of the service provided.

## 2.3 Conceptualisation of contemporary internal auditing issues

### 2.3.1 The control structure

Ratliff et al. (1996:101-120) distinguish between types of internal controls, methods of internal control, threats to internal control and the design of general and specific controls, which can be summarised as follows:

**Table 2.2: Controls**

Types of Internal Controls	Methods of Internal Control	Threats to Internal Control	Designing General and Specific Controls
Preventative controls	Organisational controls	Management override	Risk assessment monitoring
Detective controls	Operative controls	Access to assets	Selecting transactional controls
Corrective controls	Personnel controls	Form over substance	Planned redundancy
Directive controls	Periodic reviews	Conflicts of interest	Cost/Benefit considerations

Internal auditors should have acquired the skills and proficiency to analyse and describe internal controls and functions using flowcharts and narrative descriptions. Management should be made aware of the importance of internal controls, and the threat to controls, with emphasis on the risks related to non-compliance or pure ignorance in this regard. For more elaborate examples of internal controls, see also De Paula and Attwood (1977:42-58).

### 2.3.2 Audit evidence

The Institute of Internal Auditors (1995:49), Standard 420, states that:

- Information should be collected on all matters related to the audit objectives and scope of work.
- Information should be sufficient, competent, relevant and useful to provide a sound basis for audit findings and recommendations.
- Audit procedures, including testing and sampling techniques employed, should be selected in advance, where practicable, and expanded or altered if circumstances warrant.
- The process of collecting, analysing, interpreting and documenting information should be supervised to provide reasonable assurance that the auditor's objectivity is maintained and that audit goals are met.

- Working papers that document the audit should be prepared by the auditor and reviewed by management of the internal auditing department. These papers should record the information obtained and the analyses made, and should support the basis for the findings and recommendations to be reported.

Audit evidence, whether obtained internally or externally, should be competent, relevant, sufficient, and unquestionably support the findings of the internal auditor (See also Sawyer 1988:281). It should be borne in mind that audit evidence can be used in many situations, even during legal proceedings.

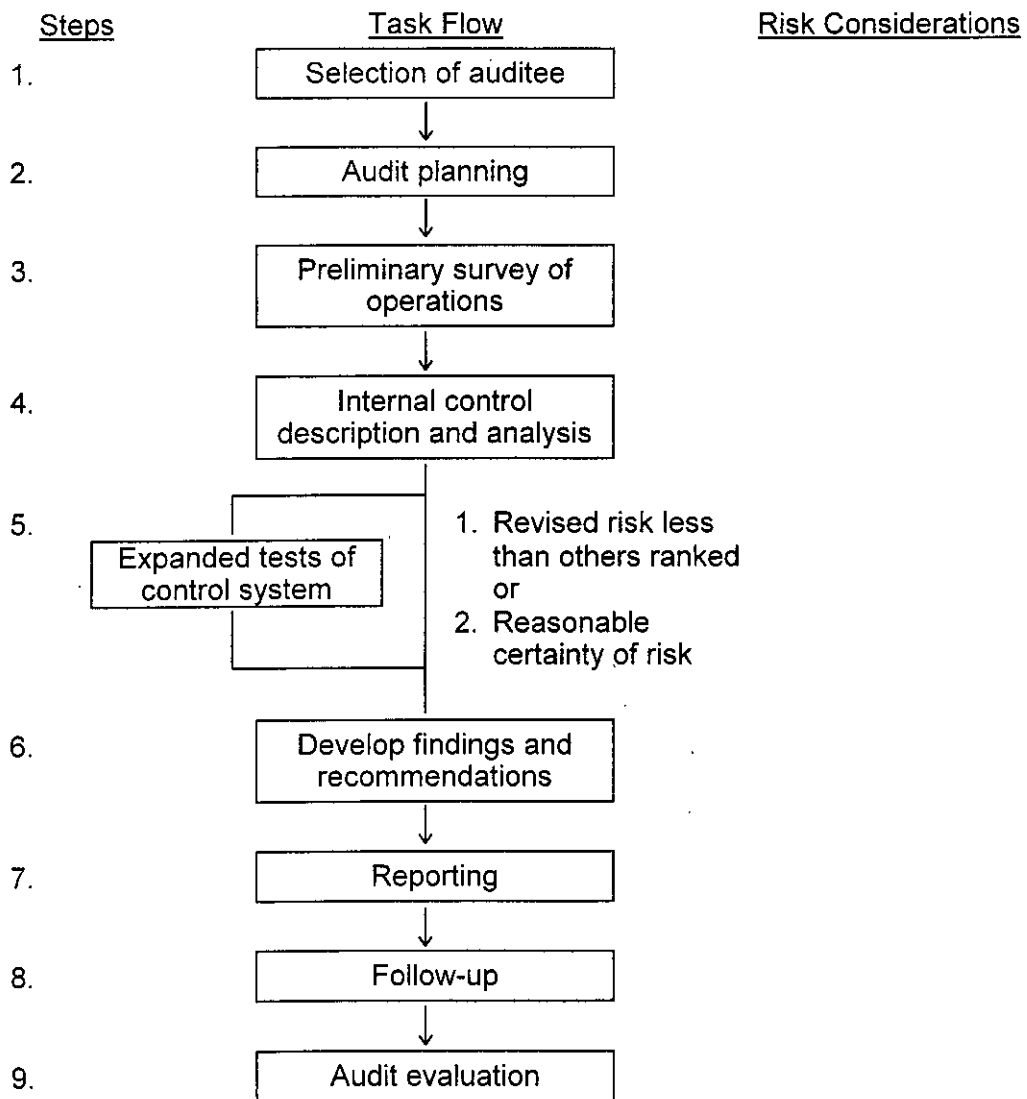
According to Ratliff et al. (1996:145-152) audit evidence can be obtained using some of the following methods: interviews, recomputation, detailed testing, observation/inspection, scanning, statistical sampling, confirmation and analytical procedures. According to Sawyer (1988:279) the nature of audit evidence can be categorised as physical, testimonial, documentary and analytical. Applying analytical procedures requires skill, insight and knowledge of the business functions, as well as the objectives of management.



2.3.3 The Internal auditing process

Nine steps are identified by Ratliff et al. (1996:184) which constitute the complete auditing process as follows:

**Diagram 2.2: Nine steps of the auditing process**



A concise explanation of each step is provided to illustrate what it entails according to the literature:

Step 1: Selection of auditee

In most organisations the internal auditing entity will not be able to audit every part and function of the organisation because of lack of funds, time and

resources. The selection of auditees is part of the planning process which must be documented, motivated and approved by the audit committee.

Guideline 520.04 of the Institute of Internal Auditors (1995:69) prescribes that the following matters be considered in establishing audit work-schedule priorities:

- (a) the date and results of the last audit;
- (b) financial exposure;
- (c) potential losses and risk;
- (d) requests by management;
- (e) major changes in operations, programmes, systems and controls;
- (f) opportunities to achieve operating benefits; and
- (g) changes to and capabilities of the audit staff.

According to Ratliff et al. (1996:25) the most important determinant in ranking potential auditees is risk related to activities. This ranking should take into consideration the above eight points, as well as risk factors inherently linked to the business of the organisation. The following are examples of risks applicable to the public sector:

- (a) competence of management;
- (b) quality of the internal control systems;
- (c) changes in laws, policies and organisational structures, including a re-organisation of new functions; and
- (d) pressure on management to meet objectives.

## Step 2: Audit planning

The Institute of Internal Auditors, Standard 410 (1995:43) advises that the following should be taken into account during the preparation of an internal audit:

- (a) establishing audit objectives and scope of work;
- (b) obtaining background information about the activities to be audited;
- (c) determining the resources necessary to perform the audit;
- (d) communicating with all who need to know about the audit;
- (e) conducting, as appropriate, a survey to become familiar with the activities and controls to identify areas for audit emphasis, and to invite auditee comments and suggestions;
- (f) writing the audit programme;
- (g) determining how, when and to whom audit results will be communicated;  
and
- (h) obtaining approval of the audit work plan.

Ratliff et al. (1996:282-283) view audit objectives as the examination and evaluation of operations and internal controls. Examination is further divided into "review" and "compliance", where review refers to the work performed to understand the auditee, and compliance is indicative of how the organisation complies with established policies, plans, procedures, laws and regulations. Evaluation refers to the execution of operations, which could be one of the following:

- judgement of quality of performance, and
- appropriateness and effectiveness of policies.

Based on this evaluation, and taking auditing risks into account, the auditor will be in a position to determine the scope of the audit and the time and resources required to cover that scope thoroughly.

Audit scope is divided into two approaches by Ratliff et al. (1996:284), namely "scope of audit interest" and "scope of audit activity". According to General Standard 300 of the Institute of Internal Auditors (1995:31), scope refers to adequacy, effectiveness, system of internal control, and quality of performance. This description is very wide and covers the complete organisation. It is not always possible to undertake a comprehensive audit and for that reason the head of internal auditing can limit the scope of the audit or reduce the examination of compliance, or effectiveness of controls or objectives. As mentioned previously such a decision will be taken based on risk factors, which can only be determined with careful analysis and insight.

### Step 3: Preliminary survey of operations

Ratliff et al. (1996:311 - 312) sees this step as following on the previous preparations, with the difference being that the internal auditor will perform specific activities on site. These activities, viewed as the preliminary survey, enables the auditors to review the best approach to the audit, consider possible new information that was not available during the audit preparation, and evaluate comments and suggestions by the auditee.

The following five types of preliminary survey activities, as well as related objectives are mentioned by Ratliff et al. (1996:312 - 324):

- The opening conference
  - elicit a spirit of co-operation;
  - convey information that will help the audit go well;
  - obtain information needed for the audit; and
  - promote a feeling of credibility.
- On-site tour

- first hand observation of the auditee's facilities, equipment, personnel and operations;
  - "scan" the operations for unusual activities, indications of inefficiency, unused facilities, idle workers, poor maintenance of machinery and facilities, and so forth; and
  - observe and gain an idea of attitudes of employees towards their jobs, to each other and management.
- Study documents
    - obtain updated information that indicates changes in organisational structure, responsibilities and operations; and
    - determine how well documentation is organised and maintained.
  - Written description of the auditor
    - update documentation on the permanent file, such as narrative explanations, flowcharts, organisation charts, as well as financial and operating performance information.
  - Analytical procedures
    - obtain an understanding of the auditee's operations expressed in quantitative terms.

#### Step 4: Internal control description and analysis

The internal control system evaluation should be done as a preliminary survey using internal control questionnaires, flowcharts, narrative descriptions of controls, walk-throughs, limited testing, and testing of information systems (Ratliff et al. 1996:347). These activities should be concluded with a final risk reassessment. According to Ratliff et al. (1996:349) the decision on whether to continue the audit with expanded testing or to go directly to the development of

findings, recommendations and the reporting process will depend on this risk reassessment.

#### Step 5: Expanded testing

Standard 420 of the Institute of Internal Auditors (1995:53), requires that internal auditors should collect, analyse, interpret and document information to support audit results, providing audit information that should be sufficient, competent, relevant, and useful to provide a sound basis for audit findings and recommendations. Sawyer (1988:242-253) views evaluation as giving meaning to the information that the auditor has gathered by observing, questioning, analysing, verifying, investigating and evaluating. This would still form part of expanded testing. According to Ratliff et al. (1996:363) expanded testing examines methods of internal control where one or more of the following five kinds of risks are present:

- (1) the reliability and integrity of information are low;
- (2) there is inadequate compliance with policies, plans, procedures, laws and regulations;
- (3) operations are uneconomical and inefficient;
- (4) assets are inadequately safeguarded;
- (5) the auditee jeopardises the achievement of the organisation's objectives and goals.

Ratliff et al. (1996:373) furthermore state that expanded testing should be direct, efficient and feasible. The main purpose is to obtain information and evidence which adheres to standards of sufficiency, competence and relevance (Sawyer 1988:281).

#### Step 6: Developing findings and recommendations

Ratliff et al. (1996:374) recommend that audit findings should be clearly documented under the following five components:

- (1) Condition
- (2) Criteria or expected practices
- (3) Effect
- (4) Course
- (5) Recommendations.

Recommendations made by the internal auditor should be effective and purposefully practical to implement. Ratliff et al. (1996:379) provide the following factors which can be considered by the internal auditor as examples: (Also see Sawyer 1988:300-313):

- (1) Does the recommendation solve the problem, for example, resolve the risk?
- (2) Is the auditee capable of implementing the recommendation? Are the necessary technology and expertise available?
- (3) Are the recommendations compatible with the rest of the auditee operations?
- (4) Is the recommendation cost effective; for example, will the benefits exceed the cost of implementation?
- (5) Do the recommendations present a long-term, short-term, or merely a stop-gap solution to the problem?

#### Step 7: Reporting

Audit reports should be professionally prepared and discussed with the auditee.

Ratliff et al. (1996:401) agree on the following effective writing techniques to enhance audit reports:

- Gather the necessary information before starting.

- Use a conversational or relaxed style.
- Keep most sentences short and simple, and use short paragraphs.
- Favour the active voice
- Use clear, familiar words.
- Use appropriate captions.
- Use underlining or italics for emphasis and white space for attractive appearance.
- Use graphics and footnotes.

Another contentious issue for the internal auditor lies in providing an opinion as a summary to the audited activities. Guideline 430:04 of the Institute of Internal Auditors (1995:61), states that reports should present the purpose, scope and result of the audit, and where appropriate, reports should contain an expression of the auditor's opinion.

The internal auditing department, in conjunction with the audit committee, should decide on standards for including an opinion which must be substantiated by the findings contained in the audit report.

#### Step 8: Follow-up

During the follow-up phase the internal auditor should bear in mind that management is ultimately responsible for the implementation of recommendations, and should maintain independence in this regard.

To ensure that auditors do not get involved in the decision-making process, it is important to have a follow-up policy based on ground rules contained in the Audit Charter.

Ratliff et al. (1996:467) see the following characteristics as part of an effective follow-up policy:

- The policy is in writing.
- The statement is clearly identified as coming from the highest level of authority within the organisation.
- Audit follow-up is required for all audits for which exceptions are reported.



- The roles and responsibilities for follow-up are outlined for auditors, the auditee and executive management.
- Internal auditors are given the authority and the responsibility to evaluate and report on the effectiveness of corrective actions.
- The policy states executive management's commitment to the principle of follow-up reviews.
- The auditee responds in writing to audit findings and recommendations within a specific period of time, and says who is accountable for implementing corrective action.
- The policy specifies to whom auditee responses and follow-up reports are to be addressed and distributed.
- The policy statement is addressed to all management level executives.

#### Step 9: Evaluation

The audit evaluation will take place during a meeting with the auditee. It is important that all comments and critique be documented for further discussion.

## 2.4 Technical matters related to internal auditing

### 2.4.1 Skills and knowledge requirements

Guideline 250:01 of the Institute of Internal Auditors (1995:19) requires that internal auditors should possess the following skills and knowledge:

- (1) Proficiency in applying internal auditing standards, procedures and techniques while performing internal audits.
- (2) Proficiency in accounting principles and techniques.
- (3) An understanding of management principles.

- (4) An appreciation of the fundamentals of subjects such as accounting, economics, commercial law, taxation, finance, quantitative methods and computerised systems.

The requirement of point number (1) was discussed in previous paragraphs, and no further deliberation is needed as the theory and practice apply equally to the public as well as the private sector. Management and accounting principles and techniques are studied during graduate or diploma courses, as well as during postgraduate courses.

Human relations, sampling, quantitative methods, and computer auditing are seen by Ratliff et al. (1996:541-574) as technical matters, which will be discussed briefly (See also De Paula and Attwood 1977:26-29,77-109.)

#### 2.4.2 Human relations

According to Ratliff et al. (1996:541) it seems universally accepted among people connected with auditing that good human relations skills are essential for professional success. The reason is that internal auditors work throughout the organisation at all levels of administrative authority, examining and evaluating how people do their work. Internal auditors need to display a professional attitude in dealing with auditees by acting with self-confidence, understanding people, and communicating effectively - verbally and non-verbally.

According to Sawyer (1988:1074), people are willing to assist others when they feel they will share in the benefits and when they are working toward the same goal. Furthermore, it is stated that fear, distrust and the sense of mystery are dissipated when auditor and auditee work together in a spirit of co-operation and self-evaluation.

Mints quoted in Sawyer (1988:1074) suggests the following methods for establishing teamwork relationships so that auditees may have a real share and interest in audit projects.

Use as recommendations

The auditor should:

- take the auditees into his/her confidence at the beginning of the examination by discussing the programme along with objectives and the reasoning behind the approach;
- solicit suggestions and assistance from them;
- discuss all findings currently with those directly concerned, and actively seek their help in developing proposed solutions;
- provide the auditees with interim reports of findings so that steps toward implementation of corrective action might be taken before the final report is issued; and
- review reports with all those concerned at each level and carefully consider their suggestions for modifications before going to the next higher level (of management).

Internal auditors should maintain sound human relations with the auditee with the goal of getting participation and co-operation which will ultimately lead to improved organisational effectiveness and efficiency.

#### 2.4.3 Sampling

Very large volumes of information, especially in the public sector, must be gathered, analysed and interpreted to present substantiated findings. There is a wide variety of publications on this topic, but they mostly deal with examples applicable to the private sector.

According to De Paula and Attwood (1977:74) sampling remains a matter for judgement, exercised by the auditor on the basis of experience and influenced in individual circumstances by the following factors:

- the relevant importance of the control to be tested;
- the overall adequacy of internal control in the area as a whole;

- the size of the population; and
- the extent to which there are to be other audit tests in the same area.

The process of sampling entails the population definition, sampling plan, sampling units, sample size determination, sample selection and interpretation of findings. These steps are complicated because of a number of risks involved and further cost/benefit considerations and implications.

#### 2.4.4 Quantitative methods

Following the sampling of data, quantitative methods are used to analyse information. The use of quantitative methods is a very effective tool for internal auditors as analyses of information take place scientifically, which enables the internal auditor to determine risks and provide substantiated findings and therefore also recommendations.

Ratliff et al. (1996:672-682) cite the following types of quantitative methods:

**Table 2.3: Types of quantitative methods**

Reasonableness Tests	Financial Trend Analysis	Correlation Analysis
Fluctuation analysis	Liquidity	Correlation trend analysis
Ratio analysis	Activity	Graphic analysis
Actual to Budget comparisons	Profitability	Trendline projections
Variance analysis	Capital structure	Exponential smoothing
Flexible budgeting	Nett present value	Regression analysis
High-low method		
Trend analysis		
Model building		

Project Scheduling Techniques	Decision-making	Risk Analysis
Programme Evaluation	Decision-tree analysis	Cost/benefit studies
Review technique	Sensitivity analysis	Dynamic programming
Critical path methods	Monte Carlo simulations	
Gantt or Bar Charts	"What if" analysis	

This is only an overview to demonstrate the various quantitative methods and techniques which can be used by the internal auditor to analyse information. To provide a substantial and professional analysis the internal auditor will need to develop a thorough knowledge of and skills in applying such methods.

#### 2.4.5 Computer auditing

Auditors involved in computer auditing should possess a certain amount of specific knowledge of this field and its use in the organisation. Weber (1982), Watne & Turney (1984), Lay & Still (1987) and Porter & Perry (1984), concentrate mainly on fields such as hardware, software, internal controls, risks, system development and environmental factors. Furthermore, most of the time the auditing of computerised systems is designed and written with the external auditor in mind, whose main objective is to test and evaluate accounting information in the financial statements.

This viewpoint is supported by the seven steps cited by Porter & Perry (1984:275):

- Step 1 - Preliminary phase of the review
- Step 2 - Preliminary review assessment
- Step 3 - Completion of review of general controls
- Step 4 - Completion of review of application controls
- Step 5 - Completion and assessment of review
- Step 6 - Tests of compliance
- Step 7 - Evaluation of accounting controls.

The literature currently available on this topic, including the sources mentioned in this section, covers wide-reaching subjects for auditing and provides a good

background to information systems. Further comment related to the public sector will be provided later in this paper.

## 2.5 Summary

This chapter provided background on how internal auditing approaches the functions of the organisation and the activities of management. Internal controls and objectives/goals are the main responsibilities of management, and it is necessary for the internal auditor to be in a position, with the required skills and knowledge, to effectively assess the execution of responsibilities by management.

A concluding comment regarding the views of writers on internal auditing is called for at this stage. Ratlif et al. (1996), Chambers (1992) and De Paula & Attwood (1997) concentrate very broadly on how the internal auditor should execute an internal audit starting off with an investigative approach and ending with findings and recommendations. Application of the theory is explained in the literature with reference to examples, which are in most cases private-sector related, and not always applicable to the public sector.

A sound knowledge of the theory and principles of internal auditing is required to understand the complexity of professional internal auditing in the public sector. For that reason this chapter is important as it provides the foundation for the building of professionalism and subsequently improving organisational performance. The internal auditor needs to know his/her task, tools, scope, methods and principles in order to provide a professional service and by doing so adding value to organisational efficiency and effectiveness as stated in the hypothesis.

The following chapter provides the findings of research done on the meaning of professional internal auditing in the public sector. In the subsequent chapter more updated and new ideas will be discussed, which could lead to more effective internal auditing with increased organisational performance.

## Chapter 3

### A field study of internal auditing in the public sector

#### 3.1 Introduction

The views of officials involved with financial management and auditing at local, national and provincial government levels were obtained to determine how the internal audit function is valued. These views are based on the scope, role, knowledge and skills, and status of internal auditing in the public sector. Respondents representing the views of management and internal auditing play an important role as the driving force behind organisational performance. With the hypothesis in mind, seen from a different angle, internal auditing can only justify its existence if value can be added to organisational performance. Internal auditors find themselves in the situation of having to support, and at the same time be critical of, the activities of management and the organisation.

The purpose of this chapter is to provide an insight into the level of intimate knowledge and views of respondents and relating those views to what is or will be expected of the internal auditing department. Furthermore, as professionalism leads to improved organisational performance, the issue of professionalism as stated in the hypothesis is tested and evaluated during the study project to prove that point.

#### 3.2 Research methodology

##### 3.2.1 Theoretical training in public sector research

As a registered Masters degree student, the author started the project by attending a course entitled "Research Methods for Public Managers" as presented by Dr JJ Muller at the School of Public Management, University of Stellenbosch. The course objective was to gain a sound working knowledge of the basic concepts and tools of research methodology to enable the author to conceptualise and plan the research and complete the study project successfully.

During this course the following themes were covered:

- The Research Debate: Public Administration as a Science?
- What is Scientific Research? Beginning a research project.
- Conceptualising: Designing a research project.
- Operationalisation: Data-gathering techniques.
- Analysis and interpretation.
- Phenomenological and case study methods.
- Writing the research report.

### 3.2.2 The project proposal

After an extensive study of the literature combined with personal knowledge of internal auditing, a project proposal was compiled and handed in. This proposal was based on a verbal presentation made to Dr Muller and fellow students beforehand. The proposal was accepted with certain reservations, and a study leader was appointed.

The study is focused on organisational issues which, being partially subjective and objective, can be viewed as part of the organisational learning process and constitutes administrative controls within the organisation. It was foreseen that theory and assumptions would be based on personal opinions, ideas and practical experience which added a degree of subjectivity to the study. Notwithstanding this subjectivity, internal auditing still has an important role to play in improving organisational performance. This process should be ongoing, which also justifies the future existence and enhancement of an internal auditing entity, and make internal auditing an objective field of study.

### 3.2.3 Compiling the questionnaire

In order to compile a questionnaire which would obtain the information and opinions of the required quality and depth regarding internal auditing, it was necessary to undertake two types of literature studies.



Literature on research methodology (including Mouton & Marais, 1988, Czaja & Blair, 1996) and internal auditing was studied. From the outset it was realised that the research would be based on a qualitative methodology. The reason for taking this course of action can be found in the element of subjectivity involved in measuring the results of professional internal auditing in the form of increased organisational performance. With the concepts referring to internal auditing and organisational performance, and a hypothesis identified and formulated, the next step was to compile the questionnaire.

To be able to draw up a questionnaire covering the broad-ranging field of internal auditing, the subject was divided into the following classifications after a thorough study of the literature had been undertaken:

- scope/role of internal auditing;
- knowledge and skills required for professional internal auditing;
- status of internal auditing dealing with fraud; and
- dealing with fraud.

The questions formulated consisted of open- and close-ended questions (see O'Sullivan & Russel 1989, 149-155). Open-ended questions were asked to obtain factual information related to the knowledge and views of respondents. Close-ended questions were asked to test opinions as to what type of behaviour would be followed, or seen to be of importance, by the respondents.

The questionnaire is attached as Annexure B. It should be noted that the classifications of the questions were not included.

### 3.3 Views and opinions of respondents

Respondents were asked to give their views and opinions on internal auditing in the public sector through personal and telephonic interviews. In certain cases respondents requested permission to complete the questionnaire on their own as they needed time to think matters through. In two instances the respondents responsible for completing the questionnaire obtained views and opinions from colleagues in a group-think effort.

The following respondents made time available to complete the questionnaires:

Mr KP Pretorius: Departmental Accountant: Finance, Provincial Administration Western Cape, Cape Town

Mr WG Swart: Office of the Auditor-General, Cape Town

Mr TH Geldenhuys: Departmental Accountant: Western Cape, Education Department, Provincial Administration Western Cape, Cape Town

Mr L Geldenhuys: Internal Auditor, Cape Metropolitan Council, Cape Town

Mrs J Grobler: Senior Manager, Price Waterhouse, Cape Town

Mr N Dutton: Internal Auditing (Training), Department of State Expenditure, Pretoria

The following points present a summary of opinions and views obtained from the respondents.

### 3.3.1 The scope of internal auditing

Internal auditors should, according to respondents, investigate and evaluate the activities of management in reaching goals and objectives. The activities of management were seen to be the following:

- "value for money" which can be linked to efficiency, effectiveness and economy;
- evaluation of results;
- goals achieved within target dates;
- comparing results to original policy decisions;

- internal controls, including feedback to management as a control measure;
- reliable information for decision-making.

Management efficiency, financial information and compliance to and effectiveness of internal controls are viewed as fields that should be audited. In the end management is responsible for the daily operations of the department and would like to be informed of any irregularities, fraud, risks and deviations from policies, laws, rules and regulations. Follow-up inspections, and in certain cases, recommendations are seen as part of the service the internal audit will render to management.

### 3.3.2 The role of the internal auditor

Management sees the internal auditing department as a management tool: supportive in being part of the solution. The view was also held that the internal audit entity should be part of management, which would also include participation in the reaching of objectives. Distinctly separate roles were identified for the internal and external auditors. In the case of provinces the external auditor reports and is responsible to the legislature, and the internal auditor must be responsible to management only. The internal auditor is mainly responsible for the evaluation of internal controls and fraud investigations, whereas the external auditor audits information contained in the financial statements, performance audits and accounting compliance. A more simple distinction between the external and internal auditor is that internal auditing is future orientated regarding controls, and the external auditor concentrates more on history.

### 3.3.3 Knowledge and skills required for professional internal auditing

The internal auditor working in the public sector is exposed to a dynamic world of change. This requires knowledge of new laws, policies and procedures. The Exchequer Law is seen as the most important, taking second place only to the Constitution. Other laws and policies of interest are those regulating labour, health, social welfare, transportation and educational issues.

Wide-reaching management issues are seen by all the respondents as having the following levels of significance:

Very important:	Strategic Management
	Financial Management
	Information Management
	Planning
	Organising
Important:	Policy Analysis
	Personnel Management
	Communication
	Negotiation

From a different perspective regarding training and further development programmes to enhance and maintain the internal auditor's ability to perform audits, the following points were also seen as important:

- risk analysis by internal auditors;
- planning and managing auditing projects;
- auditing strategic management processes;
- control self-assessment;
- development related to accounting principles;
- understanding of management principles and business practices.

The question was also asked as to whether procurement of staff should take place from within its own ranks or from universities and technikons, as well as which criteria would carry the most weight during this process.

Selection from its own ranks was the preferred option because these appointments would already have a knowledge of the organisation, its operations and policies. Respondents also indicated that selection should take place by appointments from its own ranks, whilst training university/technikon graduates at the same time on an equal footing. This will naturally be influenced by supply and demand. It was felt that the time of the year and the practicable functioning of internal auditing would dictate which alternative would be used.

Qualifications, related experience, age and leadership abilities were given as criteria to choose from in the questionnaire. Interestingly, leadership abilities was given the highest preference, with related experience as runner-up, and qualifications in the third place. Leadership abilities are gained by a combination

of experience and qualifications. The question still remains: should experience or qualifications be given preference?

### 3.3.4 The status of internal auditing

Conceptualisation of the status of internal auditing in the questionnaire was tested through questions based on the status of individual internal auditors, the internal auditing department, membership of a professional body, and periodic evaluation of the effectiveness of the internal auditing department.

Internal auditors should abide personally by the Code of Ethics as laid down by the Institute of Internal Auditors as part of the Standards for the Professional Practice of Internal Auditing (1995:95). For further reference purposes the Code of Ethics is attached as Annexure A. This code could be amended to provide reference to a suitable professional body of internal auditors working for the public sector. The respondents unanimously indicated that membership of a professional body for internal auditors must be made compulsory.

The audit committee is seen to play an important role by providing a base for the status of the internal auditing department. Respondents indicated that the audit committee should be responsible for the following activities:

- receive and review all reports;
- appointments, salary determination and promotion of internal auditors in conjunction with the accounting officer;
- approval of the Audit Charter with the co-operation of the cabinet;
- regular evaluation of the internal auditing department's activities;
- final approval of audit plans; and
- approval of internal control and accounting policies.

The evaluation of the internal auditing department's activities should be undertaken by an independent source from outside the organisation. The following criteria for such an assessment can be used:

- quality of reports;
- costs incurred measured against impact on objectives; and
- work executed according to plans.

The audit committee should be a vehicle for interaction between the internal audit entity and members of the executive authority. Due to the level at which this committee will interact and perform its task, only members with an appropriate background and standing in the community should be appointed.

### 3.3.5 Dealing with fraud

The questionnaire dealt with procedures to be followed when evidence of fraud or indicators of fraud in the public service are discovered, and the role and responsibility of internal auditors regarding the investigation of fraud cases.

From a practical point of view the assumption was made that a fraud section will be responsible for the dealing with and finalising all fraud cases. The head of the internal audit entity should ensure that there is sufficient evidence and report the incident to the head of the department involved, head of finance, auditor-general and the accounting officer.

The function of the internal audit entity should be to obtain sufficient evidence and determine the amounts involved in the first place. Investigation should only take place until fraud is proven, after which the case is handed over to the South African Police Services. After that has been done, the case must be handed over to a fraud section for finalisation, which could entail disciplinary action, legal action and recovery of money fraudulently embezzled.

Indicators of fraud, or "red flags", were seen by respondents as the following:

- deviations from procedures, rules and instructions;
- poor supervision;
- unauthorised expenditure;
- incompetence of personnel;
- involvement of personnel in projects;
- reconciliations not done timeously;
- inadequate substantiation of balancing entries; and
- inadequate explanations on financial transaction documentation.

In conclusion, the internal auditor should act as a specialist and, if needed, a specialist forensic auditor must be employed. Involvement of the internal auditor should never impair independence.

### 3.4 Shortcomings and issues identified

As stated in the preamble to the questionnaire (Annexure B), the aim was not to test the knowledge and insight of respondents, but rather to determine how professional internal auditing is viewed by management.

Management views the internal audit entity as a tool which should be supportive in bringing about solutions. The internal auditing entity is viewed by management as a department responsible for the evaluation of controls, compliance, and organisational effectiveness and efficiency. This view, however, restricts the scope of the internal auditor to functional areas of operations, thereby excluding the auditing of management activities. Internal auditors report to the accounting officer and the audit committee, and should therefore be in a position of independence to report in such a way that accountability and transparency is addressed. Management should therefore only be informed of shortcomings and issues which impair the accountability of the accounting officer. The scope of internal auditing should be of a holistic nature taking into account all the environmental factors which could influence service delivery and objectives, as well as the influence of operations on the environment. Accountability and environmental issues are referred to in more detail in the following chapter.

The knowledge and skills required for professional auditing were identified as knowledge of laws and applicable rules and regulations, and skills related to various management issues, including those related to the execution of audits. The thorny issue of qualifications versus experience is still an issue which will need to be debated until an amicable solution is found as is discussed in the following chapter. A clear and definite policy needs to be formulated and applied consistently. Auditing of information systems was viewed as a highly specialised field. A framework for the development of specialised internal auditing of information systems is provided in the following chapter to supplement the views of the respondents and lay the foundation for further research of this field.

The warning signs of fraud and the way internal auditors should deal with fraud were identified by respondents. Management cannot expect to rely on internal auditors to detect fraud, and for that reason it remains the responsibility of management to take precautions in this regard. In the following chapter dealing

with fraud this is discussed with reference to how a fraud prevention strategy should be developed and maintained which focuses on the fact that fraud is committed by people inside and outside the organisation.

### 3.5 Summary

Respondents mostly revealed a sound knowledge of what internal auditing entails and what they would expect. In most cases the answers were given based on information obtained from the literature, which can be ascribed to the fact that in most national departments and provinces internal auditing departments still need to be established.

Information, skills and knowledge, and procedures will be viewed in greater depth and complexity once fully-fledged internal auditing departments are in place. This is necessary to improve the professional status of internal auditors, leading to value-adding audits and organisational efficiency and effectiveness as stated in the hypothesis. A more proactive approach in this regard could be more productive and lead to professional internal auditors, proud of their task. Related issues are discussed in the following chapter to illustrate the depth of internal auditing required to ultimately improve organisational effectiveness and efficiency.



## Chapter 4

### Recommendations for professional internal auditing in the public sector

#### 4.1 Introduction

The hypothesis supports the notion that the continual improving of professional internal auditing will lead to improved organisational performance that will never be restricted by any boundaries. Although not stated explicitly in the hypothesis, this will always be true in a dynamic society with increasing living standards, placing more and more demands on the public sector to deliver the best services with limited resources as restrained by economic and environmental realities.

Selected contemporary internal audit issues which are seen as crucial to effective and efficient service delivery are discussed in this chapter in support of the hypothesis.

#### 4.2 A "new look" for the dimensions of internal auditing

A traditional view of internal auditing entails auditing the reaching of goals and objectives, and internal controls with regard to achieving economy, efficiency and effectiveness. Chapter Ten, section 195 of the Constitution, Republic of South Africa, 1996 (Act 108 of 1996) added a new dimension to public administration. Public administration must be accountable, and transparency must be promoted to provide timeous, accessible and correct information to the public.

##### 4.2.1 Accountability

Public accountability, according to Gildenhuys (1993:56), is a very important requirement in public financial management as it is one of the traditional cornerstones of a democracy. Accountability includes all other areas of management in the public sector. In practical terms accountability would be divided into the different levels of management in the organisation. Each level of management is accountable to the next higher level, with the accounting officer in the end being accountable to the cabinet. The cabinet is accountable to the entire population of the Western Cape.

According to Albanese (1981:15) accountability should not be thought of as being a problem, but rather as providing an opportunity to participate in the identification and solution of problems, and an opportunity to contribute positively to effectiveness. The internal auditor should evaluate the accountability of management as a positive contribution and not from a negative point of view.

#### 4.2.2 Transparency

The Constitution, Republic of South Africa, section 195 (Act 108 of 1996) requires transparency in public administration. To give substance to the term transparency a definition is called for. "Transparency" can be defined as being able, without doubt, at all times to expose or explain, at all the different levels of an organisation, the manner and reason for services rendered, and decisions taken in order to be accountable. Accountability should therefore always be supported by transparency.

#### 4.2.3 Accountability auditing

In order for the internal auditor to be effective and provide a professional service, auditing should never be restricted to one level of management or only to operational levels. Auditing of compliance with controls and the attainment of goals should preferably commence on a predetermined level and be taken to all the higher levels involved. Internal auditors should take a holistic approach by auditing vertically, horizontally and transversally, taking all related factors into account. Generally management tends to look after its own department's interests first and foremost. The internal auditor should be alert to any duplication of services or inadequate support services.

### 4.3 Development of internal auditors

#### 4.3.1 Procurement and policy

As mentioned in the previous section, respondents indicated a preference for procurement and appointment of personnel with experience from its own ranks. The reality in the public sector today paints a different picture. Due to downsizing and voluntary service packages, officials with expertise have left the service. Appointing graduates will therefore be a definite option to be exercised.

These graduates must be supported and motivated to undergo further professional development.

#### 4.3.2 Professional development

##### 4.3.2.1 A structured approach

Professional development will be supported by the following:

- Tertiary education
- External courses/training interventions
- Internal courses/training
- On-the-job training

The following is a representation of the four levels of competence with level 1 as the entry level:

- Level 1 - Bachelor Degree/National Diploma
- Level 2 - Postgraduate Degree
- Level 3 - Professional Qualification, i.e. CIA or CA
- Level 4 - Specialised Level

The question at this stage is: how can these levels be employed by the public sector?

Three basic guidelines must be laid down and strictly adhered to by all involved:

- Certification to move up to the next level should be controlled by a professional institute (for example, Institute for Public Finance and Auditing).
- All internal auditors must be tested and evaluated against the same standards.
- Moving on to levels 2, 3 and 4 must be accompanied by certified practical experience.

The structured approach as described above would be the ultimate solution to develop highly qualified, experienced and therefore professional internal auditors. By using this approach standards will be on par with those exercised in most foreign countries. This will also be in line with what is advocated by the Institute of Internal Auditors.

#### 4.3.2.2 Current issues

Another point which still needs to be debated is the question of whether there should be internal auditors trained along the same lines as in the private sector, or specially trained public service internal auditors. It would be unrealistic to expect a student to study internal auditing and additionally also study public administration, including related subjects, and to apply for a post in the public sector considering the current levels of remuneration on offer. On the other hand, the public sector will never be able to pay salary packages which are on a higher level than those of the private sector. The result of such a step will only be an increase of salary packages offered by the private sector.

This issue was also addressed at a congress hosted by the Department of State Expenditure (25 - 27 November 1996) by Prof. DB van der Schyf of the Pretoria Technikon. The biggest problem identified was that staff capable of performing internal auditing tasks lacked academic qualifications.

The following points of concern and the latest developments were mentioned by Professor Van der Schyf:

- Restructuring of the accounting profession (inclusive of internal auditing) is taking place in South Africa to create one representative body. The FAESA project (The Future of Accounting and Education in South Africa), initiated by the Public Accountants' and Auditors' Board has made thirty proposals regarding education.
- The exact place of the Institute of Internal Auditors and the Institute for Public Finance and Auditing in the new structure is still uncertain.
- The Public Accountants' and Auditors' Board will be replaced by the Representative Council of Accountants (RCA).

- This will lead to internal auditing receiving statutory status, increasing the prestige and credibility of the profession.
- The RCA will be responsible for implementing the following (only examples):
  - “Learning to learn” - the learning process continues.
  - A competence-based approach to training programmes - output-based.
  - Mobility between different tiers providing that candidates fulfil the necessary educational and training requirements at each tier.
- The following four main developments will impact on future education:
  - Recognition of prior learning in co-operation with the National Qualifications Framework.
  - Competence-based education and training.
  - Portability of vocational education - unrestricted movement of the individual's economic earning potential within the organisation, the industry and the economy as a whole.
  - Liberalisation of entry requirements.

It is not known whether all levels of the public sector are represented in the discussions and restructuring, except that the Department of State Expenditure will play a role. With such a major restructuring still being debated and discussed, it is not worth contemplating how well internal auditors in the public sector must be qualified and experienced at this stage. Another concern is whether all the major role-players will accept the restructuring, seeing that a lot of effort has been invested in maintaining high standards of professionalism.

#### 4.4 The auditing of information and information systems

##### 4.4.1 Conceptualisation

In this modern age large volumes of information are required for taking accurate and split-second decisions. It is important that information systems should always function effectively and efficiently, catering for the needs of users. Watne & Turney, 1984, Porter & Perry (1984), and Weber (1982) have already devoted

vast volumes of literature to this field and, although in some cases it has become outdated because of rapid changes, it still provides a sound theoretical background. The internal auditor needs to conceptualise the fields that can be audited and determine which skills and knowledge are required to perform an internal audit which meets pre-determined audit standards. The audit standards referred to will be determined in accordance with the audit plan, the charter and the business and objectives of the organisation.

For audit purposes information systems auditing is divided into the following:

- Master System Plans (MSPs)
- Development of systems;
- User information;
- Software applications, and
- Hardware.

In the following sections these points will be discussed briefly, based on current practices and experience:

#### 4.4.2 Master System Plans (MSPs)

In the business world the term "corporate plan" is used, but the purpose and objectives are still the same as contained in a MSP. According to Fine (in Ford 1984:31) a corporate plan is a key document identifying opportunities from corporate plans for strategic planning, with an analysis of strengths and weaknesses.

Every department or organisational entity should draw up an MSP with the assistance of all officials involved. Systems analysts from the information technology department should facilitate the documenting of an MSP during workshop sessions. During these sessions the following steps should be taken:

- Revisit objectives and the mission statement.
- Redefine the main activities of the organisation.
- Identify information used, as well as other needs for information.

- Identify and investigate links to information from transversal systems and other departments.
- Prepare a thorough SWOT analysis.
- Investigate the current hardware and systems in use, as well as their effectiveness and efficiency.
- Determine the needs for new or upgraded systems.
- Determine the cost involved and prepare a cost-benefit analysis.
- Document and make a presentation to management for comment and approval.

The document will provide valuable information to the internal auditor to ensure effective auditing of the activities of departments, including that of the department of information technology. Auditing should start off by evaluating the information contained in the MSPs against the overall objective and goals of the organisation and departments. The quality of the MSPs should be evaluated thoroughly against set norms and standards before any reliance is placed on them.

#### 4.4.3 Development of systems

Today, because of the volumes of data involved, databases are created to store and transform data into the form of information, which is one of the most important resources of any organisation. According to McBeth (1985:35) the initial objectives of a database include data independence, no redundancy, no inconsistency, data-structuring facilities and integrated support for multi-files. This statement is indicative of the complexity of developing a modern-day database with relational capabilities.

Firstly, internal auditors should be sure that they have sufficient knowledge of the development of systems and the "tools" used for this job. Systems are being developed by systems analysts and programmers using a "fourth-generation programming language". The internal auditor should also have a knowledge of the management and administration of a database, as well as of the tasks which

are performed by a database administrator and a data administrator. A clear distinction must be made between the responsibilities of the database administrator and the data administrator. The database administrator is responsible for the technical functioning of computers, networks and programs, and the data administrator is responsible for the information captured on the system.

Secondly, the profession is still debating the following issue:

Auditing Systems under Development

versus

Auditor Involvement in Systems under Development

During an internal audit conference, Hermann Nell (1997), a computer auditor from Foschini presented the following model to illustrate the role and functions of the internal auditor in the development of systems:

#### The Model

- |   |  |
|---|--|
| <ul style="list-style-type: none"> <li>• Services</li> <li>- None</li> <li>- Risk Identification</li> <li>- Controls Identification</li> <li>- Controls Review</li> <li>- Controls Audit</li> <li>- System Data Logic Code (SDLC) review</li> <li>- Full involvement</li> </ul> | <ul style="list-style-type: none"> <li>• Activities</li> <li>- Consult on request</li> <li>- Facilitate brainstorm</li> <li>- Review control requirements</li> <li>- Review design</li> <li>- Test controls</li> <li>- Attend user groups</li> </ul> |
|---|--|

Involvement in the development of systems could easily impair the independence of internal auditors. This could lead to a situation where the auditor is required to audit his/her own contribution made during development. Internal auditors should therefore only be involved in the auditing of controls, risks, efficiency and the effectiveness before implementation takes place.

#### 4.4.4 User information

The users of information from any system can be divided into two groups. Firstly, the entry-level or lower-level user will use information in the execution of operational activities, such as patient information in hospitals. Secondly, management will require information as the end user to take decisions and plan



activities. In both cases the information must be accurate, available on time and user friendly.

The internal auditor must be able to audit information in the public sector to ensure that management and departments can fulfil their responsibilities effectively, efficiently and in the most economical way. Applying quantitative methods, such as data-simulation, will require a thorough knowledge and well-developed skill.

#### 4.4.5 Software applications and hardware

There is a continuous upgrading of software and hardware by developers, and suppliers are always trying their best to sell a package or computer which works a little better. The internal auditor should remain up to date about the risks involved and controls instituted by management, as well as new domains such as the Internet, Intranet and the YEAR 2000. This can only be attained by reading widely and attending conferences.

#### 4.4.6 Skills and expertise

The internal auditor assigned to the auditing of information and information systems will have to be a specialist in this field. What has been said in this section represents only the tip of the iceberg. A lack of expertise in the public sector to audit this highly sophisticated field will lead to outsourcing, especially during the first few years of a new internal audit department. A transfer of skills must, however, take place because continual outsourcing will be very costly, and external auditors or specialists will not be able to cover the whole sphere of information and information systems auditing.

#### 4.5 Fraud investigations

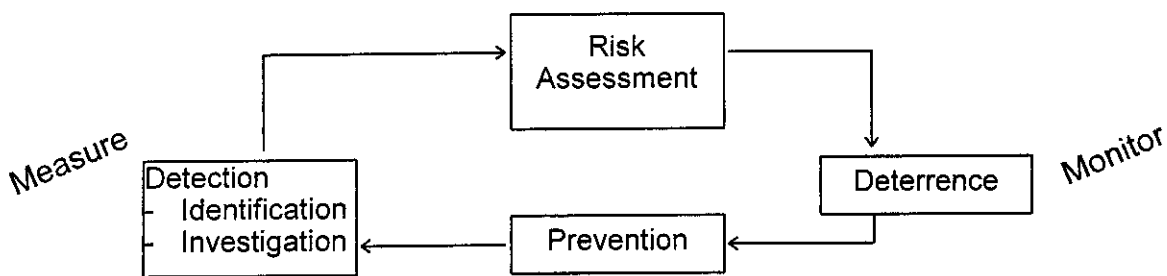
It has been stated that an internal audit is aimed at prevention of risks which could arise in the future. Fraud is the only exception to the rule because fraudsters and embezzlers are always coming up with new ideas for committing fraud. Fraud also occurs where it is least expected. A study performed in the United Kingdom, according to Ratliff et al. (1996:879), estimated that only 19 percent of fraud cases were uncovered by auditors, while 51 percent were uncovered by accident. Furthermore, only 10 percent were uncovered by

management controls, and over 20 percent were tips from disgruntled associates or outsiders.

Sawyer (1988:1038) advises that one of the control measures to control fraud, including management fraud, is to establish a professional internal audit department. It is impossible to provide a foolproof recipe for dealing with fraud. The opinion is held that to provide a professional internal audit service, even as far as fraud goes, management should place more emphasis on proactive prevention and deterrence. The internal audit department should also work along the same lines.

A proactive approach will require the organisation to follow an integrated fraud strategy. At an internal audit conference (1 - 3 October 1997) Jacqui Record presented the following model which represents an integrated fraud strategy.

**Diagram 4.1: Integrated Fraud Strategy**



The internal auditor should be aware of the following:

- Integrity risks:
  - Management fraud
  - Employee fraud
  - Illegal acts
  - Unauthorised use
  - Reputation
- Deterrence and Prevention
  - Clear principles, policies and procedures applied consistently
  - Deterrent consequences for perpetrators
- Detection
  - Identification: processes and procedures
  - Investigation: policies and procedures

Management and internal auditors should always bear in mind that fraud can only be committed by people. Auditing should therefore take place around the actions or omissions of people, who could involve management, employees and people outside the organisation.

#### 4.6 Environmental auditing

The general environment in which the public sector functions consists, according to Fox et al. (1991:4) of the political, social, economic, technological and cultural fields. To these fields can be added the "green" environment, which will include all natural resources. Departments in the public sector are concerned with the provision of services, such as health or education, and the issuing of regulatory laws, policies or regulations which covers all these environments.

In most cases the internal auditor will only evaluate the direct effect of management activities based on whether they have been effective, efficient and economically performed. Activities of the public sector have such wide-ranging effects that auditing should transcend the normal boundaries to assess their impact on the environment.

Specialised internal auditors will be required to assess the impact of laws, policies, rules and regulations on the above-mentioned environments. Environmental auditing is a wide-ranging field which cannot be discussed in the framework of this study project.

Further research and articles on the topic could lead to more effective auditing and improve the professional standing on the internal auditing profession.

#### 4.7 Summary

The intention of this final chapter, bearing in mind the conception of internal auditing as described in the previous chapters, was to focus on issues which are important to the internal auditor. It should therefore only be viewed as a foundation for further research and discussion.

Three fields of interest were identified:

Firstly, a new concept of accountability auditing was introduced which is highly applicable to the public sector to ensure increased organisational performance and excellence.

Secondly, the organising, regulating and development of internal auditing as a profession forms part of the wider accountancy and auditing professions. This is a national issue on which consensus has to be reached by all the stakeholders involved. An important prerequisite is that standards and norms should be maintained within a framework conducive to future improvement.

Thirdly, the fields of information/systems auditing, fraud and environmental auditing are highly specialised technical fields. Due to the shortage and complexity of methods for the appraisal of service delivery in the public sector, these fields will require further research, which can take place with the co-operation of the private sector.

The complexity of issues dealt with in this chapter in relation to the requirements for professional internal auditing as mentioned in the previous chapters serves as a motivation for internal auditors to become members of a professional institute and to attend seminars and conferences. Attendance of functions arranged by professional institutes can be viewed as an investment in organisational efficiency and effectiveness in the long run.

## Chapter 5

### Summary

The issue raised in the hypothesis probes the existence of a link between organisational effectiveness and efficiency, and professional internal auditing in the public sector.

Auditing in the public sector is seen as being different from that in the private sector because of a unique environment, types of goals, and the lack of objectivity in measuring the reaching of goals and objectives. Evaluation of management activities can frequently be subjective, which poses a difficulty for the internal auditor. Whilst auditing internal controls in combination with the economic, efficient and effective use of resources to achieve goals and objectives, the internal auditor will have to develop a yardstick appropriate for the function or activity.

The internal auditor executes audits within a framework of guidelines acquired and developed through experience, which is unique to each individual. References to the literature on the execution of audits and related technical matters were kept as concise as possible to provide a condensed overview. Auditing is a broad-ranging subject, taking information and theory from other fields of study. An internal auditor can therefore easily read other related topics, articles and books to acquire the necessary insight and knowledge to provide a professional internal auditing service.

Respondents who completed the questionnaires provided a managerial view of internal auditing. The function is seen as a management tool. Management has a good idea of what internal auditing is, or should be, but in most cases this is not related to practical experience.

Organisational placing of the internal audit function will depend on the scope of the audit. The wider option of auditing controls and the achievement of goals and objectives would be the most desirable as it does not curtail the abilities and performance of the internal auditor. Auditing as widely and thoroughly as possible, with independence and the necessary support of the audit committee, accounting officer and the director of internal auditing, the internal auditing function should be able to secure and sustain a professional standing in the organisation.

The professional standing of the internal auditing department will only be maintained if auditing is done with the necessary skill and knowledge combined with a professional attitude. Internal auditors will not be a tool for management, but rather assist the accounting officer to maintain accountability. Management will therefore be scrutinised for accountability and transparency. The professional development of internal auditors, as for financial accounting personnel, is in disarray, leading to a time-lag in the training of urgently needed personnel.

In Chapter Four recommendations were included referring to three fields of interest, namely accountability auditing and transparency, development of internal auditors and information systems auditing, fraud and environmental auditing. The need for a knowledgeable, skilled and thus a professional internal auditor to report thoroughly on accountability to the chief executive officer requires that the internal auditor must be able to function independently of other management levels. To uphold and maintain an independent, professional status, collectively in public as well as in the organisation, it is important that internal auditors will be supported by a recognised professional body.

Environmental auditing, fraud investigations and the auditing of information systems are only a few fields of specialisation for the internal auditor. For these fields of interest the recommendations illustrate two important dimensions. Firstly, the internal auditor must be aware of the complexity of these issues caused by dynamic change and new ideas. Secondly, at the same time the internal auditor has to think holistically, bearing all related factors and influences in mind. This leads to a very complex and somewhat contradictory situation. Specialists must take the time to develop study material on technical skills and important issues to be audited. Personally internal auditors need to advance their own knowledge and skills continually to provide an auditing service which will lead to improved organisational performance because of a professional attitude. This will only be possible with the support of a professional body whose responsibility should be to evaluate the performance of individual internal auditors, and see to the enhancement of skills and knowledge.

This study logically explains and proves that organisational effectiveness and efficiency can be improved by implementing and maintaining a professionally orientated internal auditing entity. Although professionalism can influence effectiveness and efficiency, management must bear in mind that these two aspects are not interdependent and require individual development and evaluation.

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## STANDARDS OF CONDUCT

- I. Members and CIAs shall exercise honesty, objectivity and diligence in the performance of their duties and responsibilities.
- II. Members and CIAs shall exhibit loyalty in all matters pertaining to the affairs of their organisation or to whomever they may be rendering a service. However, Members and CIAs shall not knowingly be a party to any illegal or improper activity.
- III. Members and CIAs shall not knowingly engage in acts or activities which are discreditable to the profession of internal auditing or to their organisation.
- IV. Members and CIAs shall refrain from entering into any activity which may be in conflict with the interest of their organisation or which would prejudice their ability to carry out objectively their duties and responsibilities.
- V. Members and CIAs shall not accept anything of value from an employee, client, customer, supplier, or business associate of their organisation which would impair or be presumed to impair their professional judgement.
- VI. Members and CIAs shall undertake only those services which they can reasonably expect to complete with professional competence.
- VII. Members and CIAs shall adopt suitable means to comply with the *Standards for the Professional Practice of Internal Auditing*.
- VIII. Members and CIAs shall be prudent in the use of information acquired in the course of their duties. They shall not use confidential information for any personal gain nor in any manner which would be contrary to law or detrimental to the welfare of their organisation.
- IX. Members and CIAs, when reporting on the results of their work, shall reveal all material facts known to them which, if not revealed, could either distort reports of operations under review or conceal unlawful practices.

- XI. Members and CIAs shall continually strive for improvement in their proficiency, and in the effectiveness and quality of their service.
  
- XI. Members and CIAs, in the practice of their profession, shall be ever mindful of the obligation to maintain the high standards of competence, morality, and dignity promulgated by The Institute. Members shall abide by the Bylaws and uphold the objectives of The Institute.

## ANNEXURE B

### QUESTIONNAIRE

#### PROFESSIONALISM OF INTERNAL AUDITING IN THE PUBLIC SECTOR

Completion of this questionnaire will be greatly appreciated as it will assist me in compiling a quality and informative dissertation on the subject. This questionnaire is not aimed at testing knowledge, but rather to obtain information to conceptualise ideas which could lead the way towards professional internal auditing in the Public Sector with National Departments and Provincial Administrations in mind.

The environment of the Public Sector differs from that of the Private Sector. Results and the attainment of objectives in the Private Sector are measured in profits and returns on investment. Use of taxpayers' money to provide services requires accountability of services rendered and the effective and economical execution/rendering thereof. It is for this reason that the specific needs to ensure professional and effective internal auditing must be determined.

*Please complete in either **English** or **Afrikaans**.*

1. Scope/role of internal auditing

What is the most important for the internal auditor to investigate: (Mark the most important with an x)

- activities of management, or

- attainment of goals

Comment: \_\_\_\_\_

2. Status of internal auditing

How can an internal auditor measure the effectiveness of a line function or a staff function?

\_\_\_\_\_

3. Knowledge/skills

Keeping in mind continuous changes in Government policy, what will be the most important areas of management the internal auditor must investigate and evaluate? (Please clarify/motivate)

\_\_\_\_\_

4. Status of internal auditing

In terms of benefits to the Department/Province, how would you describe the overall contribution of internal auditing towards the accomplishment of goals and objectives?

\_\_\_\_\_

5. Knowledge/skills

What procedures should an internal auditor follow if he discovers significant deviations from controls or policy?

\_\_\_\_\_

6. Scope/role of internal auditing

Which of the following approaches will provide the best results, taking into account your own organisation as a part of the Public Sector, namely a National Department or a Provincial Administration?

- Auditing of accounting procedures

- Auditing of management efficiency
- Auditing of financial information
- Auditing of compliance to internal controls
- Auditing of the effectiveness of internal controls

7. Knowledge/skills

Presuming knowledge, skills training and opportunities for all internal auditors are equal, how should internal auditors be evaluated regarding performance and merit?

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8. Knowledge/skills

The following laws are a short selection of a vast array of laws administered by the Public Sector. In fact there are too many to be studied thoroughly. Please indicate by means of the following categorising the importance of each act: 1 - important; 2 - less important; 3 - not very important:

- Exchequer Law
- Constitution
- Labour Act

9. Knowledge/skills

Which of the following areas related to Public Management is of importance for studying by the internal auditor to ensure a good knowledge base, as well as a development of insight:

- Policy Analysis
- Strategic Management
- Information Management
- Personnel Management
- Financial Management

- Communication

- Negotiation

- Planning

- Organising

10. Status of internal auditing

How would you as the auditor perceive the status of the internal audit department and the individual internal auditor in the organisation, bearing in mind the expectancy of a professional and thus independent service?

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11. Status of internal auditing

How should the approach of the audit be different towards the internal auditor as opposed to the external auditor?

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12. Scope/role of internal auditing

How could the activities of the internal auditor and the external auditor be co-ordinated to prevent duplication and ensure a constructive approach to auditing of activities and controls?

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13. Knowledge and skills

Staffing of the internal audit function can be done by recruiting and appointing from within a department's own ranks, or employing and training of university/technikon graduates. Please indicate which would be the most preferred option:

- Selecting and appointing from own ranks

- Employing and training only technikon/university graduates

14. Status of internal auditing

To whom must the head of the internal audit department report irregularities discovered during investigations?

- Head of Finance
- Head of the investigated department
- Auditor-General
- Accounting Officer
- Audit Committee

15. Status of internal auditing

If the head of the internal audit department suspects serious wrongdoing, to which of the following roleplayers must it be reported if further specialist investigation is required?

- Head of the Department under investigation
- Head of Finance (Financial Manager)
- Internal Audit Committee
- Accounting Officer

16. Status of internal auditing

Whom of the following should be responsible for the approval of appointment, salary determination and promotion of internal auditors?

- Audit Committee
- Accounting Officer
- Head of Personnel
- Financial Manager
- Head of Treasury

Other: \_\_\_\_\_

17. Knowledge/skills

Which of the following should the Audit Committee assess before appointing the director of Internal Auditing? (Please prioritise from 1 (most important) to 4 (least important))

- Qualifications
- Related experience
- Age
- Leadership abilities

18. Scope/role of internal auditing

Shortcomings and problems identified and reported by the internal audit department are often not thoroughly addressed by management.

Can the Internal Auditor be held responsible for corrective steps not taken/implemented? 

YES	NO
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Can internal auditors be held liable if services are inadequate or losses occur? 

YES	NO
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19. Knowledge/skills

A code of ethics could dictate that internal auditors exercise their duties with honesty, objectivity and diligence. Could you add any particular aspects related to Public Sector auditing?

If you can, please list them and if possible add a description to each:

---

20. Status of internal auditing

Who should be part of the approval of the audit charter, bearing in mind that each National Department or Province should have its own internal audit charter?

---

21. Status of internal auditing

What should the responsibility of the Audit Committee be in order to ensure and maintain a professional internal audit service?

---



22. Dealing with fraud

What procedures should an internal auditor follow if he discovers evidence of fraud being committed, or that fraud has been committed?

---

23. Dealing with fraud

What indicators of fraud cases in the Public Sector must be identified by internal auditors to ensure timeous detection and investigation of fraud?

---

24. Knowledge/skills

What training (specific) or programmes will equip the internal auditor with knowledge, alertness and the ability to identify and investigate fraudulent transactions and perform audit tests to their best ability? Please list/describe:

---

25. Dealing with fraud

What should the role and responsibility of the internal auditor be regarding the investigation of fraud cases?

---

26. Status of internal auditing

An institute or a professional body for internal auditing in the Public Sector could provide support in the form of presentations and publications.

- Do you view this as a crucial element of enhancing and maintaining the professional status of internal auditing in the Public Sector?

YES	NO
-----	----

- Must membership be made compulsory to officers employed as internal auditors?

YES	NO
-----	----

27. Knowledge/skills

The auditing of computerised management information systems and applications provide its own challenges in the new and dynamic field of computers.

What skills and/or knowledge is required for a professional internal auditor to do successful auditing in this field?

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28. Status of internal auditing

What steps must be taken against an internal auditor who transgresses the rules as laid down in a Code of Ethics?

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29. Knowledge/skills

By which method and against which norms and standards must the effectiveness and efficiency of an internal audit department be evaluated? How often should this take place?

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