

The Perception of Senior Municipal Officials in South Africa Regarding the Internal Audit Functions

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Abstract: The service protests in municipalities in South Africa have received increased publicity in recent years. Internal audit functions (IAF) have been suggested as one of the ways in which service delivery and municipalities' mandate can be reviewed to improve standards and procedures for financial accountability. Internal audit functions assist local government managers, which includes municipal managers and chief financial officers amongst others, in overseeing and monitoring the financial affairs and accountability processes. The internal audit functions are expected to assist the elected officials, municipal managers, and independent auditors in performing their functions within the municipalities. This study utilised a qualitative research design, using AGSA's reports as a research method, in order to achieve the research objective. This study relied on Auditor General's audit opinions for the period of five years in which the perception of the municipal officials was determined with regard to internal audit functions. This was conducted to examine the perception the municipal officials have on the role and work on internal audit functions in their municipalities. Interviews with the municipal officials were conducted to supplement AGSA's data to provide richer detail regarding the perception the municipal officials have on internal audit functions. The study reveals among others that, majority of the municipal officials in South Africa consider the internal audit functions as useless, not meeting the municipalities' expectations and not adding the expected value, therefore, not taken service serious.

Keywords: Internal audit functions, Local government, Municipalities, Perceptions

1. Introduction

This study looked into the perceptions of senior municipal officials in South Africa with regard to the internal audit functions. The discussion focused on what is the expected role to be performed by internal audit functions within the municipalities and the expected role of the senior municipal officials. The report III by the Institute of Internal Auditors (IIA) Global Internal Audit Survey on measuring the value of internal auditing (2011:2), suggests that the basic concept of the internal audit function (IAF) is that its value is determined by its usefulness to its organisation. The usefulness of internal audit services is further reflected through its perceived contribution to its stakeholders.

Internal auditors are responsible for assisting municipal managers to meet their objectives and execute their duties by providing an independent review of the adequacy and effectiveness of the controls that have been implemented by management (Strickland, 2011:18). Secondly, internal auditors in risk management assist to identify, evaluate and assess significant organisational risks to objectives, and to provide

independent assurance as to the adequacy and effectiveness of related internal controls and the risk management processes (IIA, 2012). Lastly, internal auditors assist management to maintain effective controls by making recommendations on how to improve or enhance their system of internal control (IIA, 2014).

Section 165 of the Municipal Finance Management Act (MFMA) strengthens the above discussion by requiring that each municipality and each municipal entity must have an internal audit function. This internal audit function is expected to be properly staffed and should perform among others the functions (MFMA): prepare a risk-based audit plan and an internal audit program for each financial year and advise the accounting officers and report to the audit committees on the implementation of the internal audit plan and matters relating to: internal audit, internal controls, accounting procedures and practices, risk and risk management, performance management, loss control, compliance with this Act, the annual Division of Revenue Act, and any other applicable legislation and perform any such other duties as may be assigned to it by the accounting officer (MFMA).

2. Literature Review

2.1 Internal Audit Functions in the Municipality

According to the definition of internal auditing explained earlier, the internal audit function should play an important role in evaluating and improving the effectiveness of risk management processes (IIA, 2012). In recent times, internal audit functions have proved to play an important part as a value-adding service in organisational structures (Al-Twaijry, Brierley & Gwillian, 2008; Arena & Azzone, 2009; Coram, Ferguson & Moroney, 2008; Goodwin, 2004; Yee, Sujun & James, 2007). Al-Twaijry *et al.* (2008) explain that there are two benefits in having an effective internal audit function within organisations. Firstly, it improves operations and assists in the management of risk. Secondly, it helps the organisation in the prevention and detection of errors or fraud, and in safeguarding the assets of the organisation.

The IIA (2012:10) further describes internal audit function as an important internal assurance instrument available in public financial controls, and as a device that can be used for monitoring and evaluating managerial activities before an audit is conducted by external auditors. Internal auditors are viewed as professionals who can boost openness and justice, decrease dishonesty, and ensure value for money in public spending (IIA, 2014). An internal audit function is perceived to be an important element of any public-disbursement-related management system, and should ensure that public spending is within controlled budgetary provisions (MFMA). Ackermann (2015:272) supports this by stating that internal audit function can only be regarded as adding value, ethical and competent in its core technical areas if it provides a product (report) which is informative, persuasive and calling for action.

According to Cohen and Sayag (2010:1) internal auditing has become an indispensable control mechanism in both public and private organisations, yet very few academic studies have been conducted on the effectiveness of internal audits within organisations. The effectiveness of internal auditing is worthy of attention because internal auditors are important, even crucial, in an economy that relies upon independently produced information (Van Peursem, 2005). Indeed, the internal audit function

has become an indispensable management tool for achieving effective control in both public and private organisations (Eden & Moriah, 1996). Control mechanisms are those processes set up to monitor and direct, promote, or restrain the various activities of an enterprise in achieving its objectives (Sawyer, Dittenhofer & Scheiner, 2003; Coram, Ferguson & Moroney, 2008). In recent years, the IAF has become a key corporate governance mechanism alongside audit committees, external audits, and management (Cohen, Krishnamoorthy & Wright, 2004; Gramling, Maletta, Schneider & Church, 2004; Schneider, 2009). As reflected in the Institute of Internal Auditors' (IIA, 2009), internal auditing is an assurance and consulting activity concerned with evaluating and improving the effectiveness of risk management, control, and governance processes. However, internal audit functions are facing the following challenges among others in their existence: lack of business knowledge, lack of business support, lack of audit action monitoring processes and the reluctance of the external auditors to rely on their work (Motubatse, Barac & Odendaal, 2014).

2.2 Role of the Municipal Officials

There are several building blocks that must be put in place for internal controls to be effective in municipalities. These include ensuring that councillors, mayors, municipal managers, internal auditors and audit committees play their role of being an overall oversight structure to which all others account (AGSA, 2014). The following section provides an overview of the role of municipal officials in overseeing the effectiveness of internal controls. This is done in order to check how the responsibilities of designing, implementing and monitoring internal controls are distributed amongst those charged with governance and those with oversight responsibility (AGSA, 2016:187).

2.3 Municipal Mayors and Councillors

In order to enable municipal councillors to meet their responsibilities, the municipal's council and councillors set standards, and municipal management implements systems of internal control (SALGA, 2015). These set standards, policies and structures provide guidance, division of responsibilities and accountability (SALGA, 2015). They form part of controls which are designed to provide cost-effective assurance that assets are safeguarded, and that liabilities are efficiently managed (MFMA).

Table 1: Study Participants

Rank occupied by the participant	Number of participants interviewed
Municipal managers	8
Chief Financial Officers	11
Financial officials	4

Source: Author's own summary

2.4 Chief Financial Officer (CFO)

Monitoring and oversight responsibilities in terms of Section 65 of the Municipal Finance Management Act (MFMA) and the Municipal Structural Act (MSA), which include reviewing the integrated development plan (IDP) and budget management. The CEO ensures that issues raised in audit reports are addressed, and that the municipalities manage the municipal manager's performance and that they are actively involved in key governance matters (AGSA, 2016:187) by performing the following:

- **Municipal officials must develop, implement and monitor a system of internal control that is adequate to:** secure municipal assets, secondly to ensure the reliability and accuracy of financial information (AGSA, 2011). In addition, to promote efficiency and effectiveness of service delivery activities and lastly, encourage compliance to management policies and procedures (AGSA, 2016).
- **Municipal officials should work in conjunction with management:** According to Sepuru (2017:20), the responsibility of municipal managers is to ensure that a risk assessment is regularly conducted in order to identify emerging risks at the municipality. To achieve this, a risk management strategy must then be developed and implemented by management to direct internal audit efforts and priorities (Sepuru, 2017). Moreover, management must propose areas of investigation for the internal auditor, and ensure that the internal audit function has access and they are not restricted to report to the municipal manager and the audit committee (AGSA, 2016). Furthermore, municipal managers are responsible for maintaining internal controls, including proper accounting records and other appropriate management information for running the municipality (MFMA). Internal audit reports must be reviewed within two weeks from the date of issue, recommendations are then implemented, and then undertake the prevention and detection of fraud and irregularities (Sepuru, 2017:20).

The constant monitoring of the internal control system will assist in determining whether prescribed policies are implemented and complied with, and that any changes made for whatever reason has not rendered the internal controls inadequate or obsolete. If breakdowns occurred in the internal control system, a prompt application of effective corrective measures is critical. Lastly, the responsibility of periodically updating the internal controls must be undertaken (Sepuru, 2017:20).

3. Methods and Materials

This study was conducted through the use of the secondary data obtained the analysis of the audit reports presented by the Auditor-General South Africa (AGSA) as from 2013/2014 to 2017/2018. A content analysis method was used to analyse the data gathered from the AGSA reports, and this data was important in solving the study's problem statement. In addition to the content analysis performed, the municipal mayors and councillors, municipal managers and the Chief Financial Officers were interviewed during the study. The municipal managers and chief financial officers are regarded as the senior municipal officials who have authority to manage the municipalities and are expected to rely on the work on the internal audit functions to assist in oversight, detection and deterrence roles. All participants were interviewed at their places of work for the sake of convenience. Table 1 above indicates the category and number of participants involved in the study.

3.1 Data Collection

The AGSA's reports for the period of five years, from 2013/2014 financial year to 2017/2018 were collected with the assistance of Atlas.ti software. These data were collected from all the three categories of municipalities existing in South Africa, namely, metropolitan municipalities, district municipalities and local municipalities. The qualitative data was further collected by means of interviews designed to require the participants to strengthen

the data collected by answering the research question (Kumar, 2011) and validating what the data presented. And 23 participants from different municipalities were interviewed during the study. The main question posed to all participants was "what is your view regarding the work performed by your internal audit functions within your municipality? This question was posed to validate what the data gathered through the AGSA reports as mentioned above. This was done in order to gain a better understanding of the perceptions of the municipal officials with regard to the functioning of the internal audit functions within the municipalities.

3.2 Ethical Clearance

Hence this was a quantitative study in which the participants were involved, therefore, seeking the participants' perception and experiences always poses an ethical challenge that need to be managed. Qualitative study requires ethical consideration (Creswell, 2013). The ethical considerations for qualitative research were taken into consideration in conducting this study. The essential ethical requirements regarding the informed consent of the participants and assurances of confidentiality were followed during the interviews and conducting the study. The ethical clearance was obtained through the University of Johannesburg's ethical committee process. The researcher also obtained signed consent letters from the participants as an assurance that their participation was voluntary and that the participants understood all the rights they had during the conduct of the study.

3.3 Data Analysis

The interviews were analysed by means of coding the collected AGSA's data to allow the identification of themes and subthemes. Coding in qualitative research consists of the assignment of short phrases to capture a meaning of a large portion of textual data (Yin, 2011). Babbie (2013:550) and Saldaña (2009:8) both define coding as a process of arranging raw data into a standardised form. The process started with a review of AGSA reports for five years' period 2012/2013 to 2017/2018 financial years and transcripts of the interviews. While considering the whole context, the data was coded. The coded data facilitated the comparison of the different views held by the participants, which were then built into the themes.

4. Results and Discussion

The following reveals the information gathered through content analysis using the Atlas.ti software with regard to the value added by internal audit functions in the municipalities as indicated by AGSA:

- The internal audit functions and the audit committees did not add to the credibility of financial statements reports, while monitoring and oversight by the political leadership did not have the desired results (AGSA, 2017).
- These role players also did not insist on strong controls to ensure compliance with key legislation and to prevent, detect and correct material misstatements (AGSA, 2017).
- Internal audit functions at 67% of auditees provided limited /no assurance (AGSA, 2016).
- Of concern is that although internal audit units and audit committees were in place at most auditees, not all these structures had a positive impact on the control environment. This originated from the lack of understanding and appreciation by management of the importance of implementing recommendations and action plans of internal audit units and audit committees (AGSA, 2017).
- Risk assessments performed by internal audit functions did not get the buy in from senior management to fill gaps in internal controls (AGSA, 2018).
- The capacity and focus of internal audit functions require immediate intervention, as these units are struggling to properly analyse risk and direct their scope of work to these areas, which directly affects the value added by the audit committees (AGSA, 2018).
- Even though all municipalities had internal audit functions and audit committees, these role players are not yet providing the required level of assurance to have a positive effect on the audit outcomes (AGSA, 2017).
- The internal audit functions did not function as required by section 165(2) of the Municipal Finance Management Act, in that it did not advise the accounting officer on matters relating to accounting

Table 2: Participants' Views

Participant	Description of the views
1	".....I consider internal audit function useful if it can be resourced".
2	"...internal audit as a whole plays an important role and needs to be supported, however, the role they plan is not clear enough".
3	"I think the municipality can easily run without this unit, it has no impact from where I am standing"
4	"Internal auditors need to be well trained to ensure that they deal with all the challenges in the municipality, if this can happen the internal audit departments can function".
5	"the challenge of the functioning of the internal audit units lies with the political interference and people who do not understand its functioning"
6	"I will say, the internal audit function in my municipality manage to reveal 50% of the corrupt cases, which is good".
7	"There is no role played here, except excessive budgets....."
8	"honestly, I see no value in this unit within my municipality"
9	"The internal audit unit needs to report where it should to be effective"
10	"They don't assist us in addressing the challenges we are facing as municipal officials".
11	"this unit managed to reveal the fraudulent activities which were taking place over the years".
12	"this unit is useless as it contributes nothing to the municipality"
13	"No comment"
14	"The internal audit unit appears to be assisting to a certain extend but needs to be aligned with the work of external auditors"
15	"This department contributes very less in the functioning of the municipality"
16	"It needs to focus on all operational areas to be relevant than looking only at financial compliance".
17	"this unit adds limited value to the functioning of the municipality in the area of financial compliance".
18	"It was supposed to assist us in performing well as the municipality and obtain good financial reports, which it does not do...."
19	"It needs to stand alone as the department and not report internally"
20	"It can assist if it can be well resourced and capacitated with the right people"
21	"It is partially contributing towards the better operations but not always".
22	"It has a role to play especially if it can be given a chance"
23	"Let the internal auditors be trained to understand the environment and its controls to be effective".

Source: Researcher's own summary based on interviews

- procedures and practices and risk management, (AGSA, 2017).
- The internal audit functions did not report to the audit committee on matters relating to the compliance with the Municipal Finance Management Act, the Division of Revenue Act and other applicable legislation, as required by section 165(2) (b) of the Municipal Finance Management Act (AGSA, 2018).
- The internal audit functions did not audit the results of performance measurements, as required by section 45(1)(a) of the Municipal Systems Act and Municipal Planning and Performance Management Regulation 14(1)(a). (AGSA, 2016).
- The internal audit functions did not assess the extent to which the performance measurements were reliable in measuring the performance of the municipality on key and general performance

indicators, as required by Municipal Planning and Performance Management Regulation 14(1)(b) (ii) and (iii) (AGSA, 2018).

- The internal audit functions did not audit the performance measurements on a continuous basis and submitted quarterly reports on their audits to the municipal manager and the performance audit committee, as required by Municipal Planning and Performance Management Regulation 14(1)(c) (AGSA, 2017).

To validate and test the data gathered, the semi-structured interviews were conducted and analysed using the descriptive research approach. The participants were categorised into municipal managers, chief financial officers and other officials in answering the question: what is your perception regarding your internal audit function in your municipality? Table 2 on the previous page reflects the views of the participants.

5. Interpretation of Results

According to the data gathered through the content analysis. The internal audit functions were found not adding enough credibility on financial statements reports at municipalities. This means the internal audit functions did not review and make corrective comments on the financial statements prepared by the management of municipalities. This function if manage to perform their expected roles could have assisted the municipalities in South Africa to correct their financial statements before submitting such statements for external audit. Therefore, the IAFs need to be capacitated and resourced to ensure that they deliver all the expected services in order for them to be seen relevant and adding value by those they serve.

As indicated on Table 2, the study revealed that that majority of the municipal officials in South Africa consider the internal audit functions as useless, not meeting the municipalities' expectations and not adding the expected value, therefore, not taken service serious. The study further reveals that as the result of the above mentioned finding the municipalities in South Africa face challenges ranging from negative audit opinions, public protests and service delivery challenges.

6. Conclusion and Recommendations

This means that the internal audit functions in municipalities are perceived by those in authority as

departments/units as not playing their expected role as prescribed by the Institute of Internal Auditors (IIA) due to various reasons outlined in the paper. According to IIA the internal audit functions are expected to play an important role in their organisations, in assisting those in authority in achieving the goals set for their organisations. It was however, revealed that the AGSA reports revealed that the internal audit functions are not capacitated as a result not playing their expected role. This is further strengthened by the sentiments made by the participants who are in authority in municipalities who consider these functions to be adding less value. Further studies, can be conducted in the areas that the participants consider important, which in their views can ensure that the internal audit functions add value if well conducted. A further comparison of internal audit functions' value can be compared from three different categories of municipalities' existing in the South Africa.

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