The Role of Internal Audit Functions with Regard to Audit Outcomes at South African Municipalities

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Abstract: The internal audit functions are expected to assist their organisations, including the municipalities to identify and resolve the challenges faced by these organisations. The internal audit functions (IAFs) are expected to play a number of roles to add value to their municipalities, including oversight role, detection role, insight role and deterrence role. Although IAFs are instruments with the expertise to assess efficient utilisation of financial resources within the municipalities and help improve oversight and financial performance, research has paid little attention to the role of IAFs in the financial management process. As a result, South African municipalities have been obtaining negative audit outcomes from the Auditor general South Africa (AGSA) over the years. This paper relied on AGSA reports in South Africa in establishing what role the IAFs are playing in municipalities, and whether they have any role to play in assisting the municipalities in obtaining the desired audit outcomes. Therefore, the data was collected from the AGSA audit reports for the period of five years, being the period from 2013/2014 to 2017/2018 financial years. The paper suggests that there is limited contribution or no contribution made by the IAFs in South African municipalities towards the achievement of positive audit outcomes by the municipalities.

Keywords: Internal audit functions, Local government, Municipalities, Value-adding

1. Introduction

The IAFs staffed with the internal auditors that are well well-trained can play a significant role in assisting their municipalities in addressing the deficiencies and challenges facing their municipalities. It is expected that the professionally independent IAFs should report their audit findings to an unbiased audit committee, which should oversee any necessary implementations. Once the IAFs are able to identify and report the findings to the effective audit committees, the municipalities can easily mitigate challenges in all areas and end up achieving positive audit outcomes when audited by the AGSA.

The IAFs are regarded as effective and value-adding if they meet the intended outcome they are supposed to bring about (Mihret & Yismaw, 2007:1). The main objective of the paper was to determine the role played by IAFs with regard to audit outcomes in municipalities. Sawyer (1995) stated: "...the internal auditor's job is not done until the identified weaknesses are corrected and remain corrected". Van Gansberghe (2015:12) supported this statement by noting that internal audit effectiveness in the public sector should be evaluated by the extent to which it contributes to effective and efficient service delivery, as this drives the demand for improved internal audit services.

The IIA (2018:10-12) describes the IAF as a crucial internal assurance mechanism in public financial controls and a tool for monitoring and evaluating managerial activities prior to evaluation by external auditors. Internal auditors further enhance transparency and fairness, reduce corruption, and ensure value for money in public procurement. An IAF is an essential part of any public expenditure management system and should ensure that public spending is within budgetary provisions and that payments comply with specified procedures, as well as providing for the timely reconciliation of accounts and effective systems for management and accounting of physical and financial assets. Therefore, the role of internal auditing is undoubtedly crucial for any municipality and if the role is fully played positive audit outcomes can be achieved. This paper aims at determining what role the IAF can play in ensuring that their municipalities obtain positive audit outcomes.

2. Literature Review

2.1 The Expected Role of Internal Audit Functions

The International Professional Practices Framework (IPPF) (2014) defines internal auditing as "an independent, objective, assurance and consulting activity..."
designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management control and the governance process. This definition emphasises the aim of internal auditing, being to "add value" within organisations, and further indicates how effectiveness can be improved.

Based on the definition above, the IAFs should contribute to reducing risk exposure. In order to reduce the risks identified, the IAF needs to determine what areas of difficulty may stand in the way of accomplishing the company's stated objectives and also assess the controls that are in place to determine whether those controls are suitable and acceptable in light of the risks identified (Sawyer, Dittenhofer & Scheiner, 2003:141-142).

According to the Standards (IIA, 2009), the IAFs must evaluate the adequacy and effectiveness of controls in responding to risks within the organisation's governance, operations and information systems regarding the reliability and integrity of financial and operational information, the effectiveness and efficiency of operations, safeguarding of assets, and compliance with the laws, regulations, and contracts. De la Rosa (2007:52) argued that IAFs are responsible for the evaluation of the accuracy of an enterprise's risk management reporting, and should provide independent and value-adding recommendations to management. IAFs are adding value by responding to the risk impact through communication, controls, and contingencies (Pickett, 2005:59; Hermanson, Ivancevich & Ivancevich, 2008:14).

Lastly, the definition of value-added indicates that IAFs add value by rendering both assurance and consulting services. If all the functions discussed above are fully rendered, the municipalities will be able to operate smoothly and positive audit outcomes will be achieved.

According to Morse (2012:2) a good IAF should be the "eyes and ears" of senior management, giving honest and clear information about organisational affairs. Marks (2013:1) states that the IAF becomes effective if it provides the audit committee and executive management with the assurance they need, namely, that they can depend on the municipality's processes and systems to manage risks towards the achievement of the municipality's objectives. This means that the IAF must provide assurance in the form of the period, on the current risks of the municipality. Ackermann (2015:272) supports this by stating that IAF 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.

Barac, Plant and Motubatse (2009:983) further argued that the IAFs should identify operational improvement. This is echoed in the definition of internal auditing, which highlights that the IAF's activities should contribute to the improvement of the organisation's operations (IIA, 2009). According to the Standards, the IAF must evaluate and contribute to the improvement of governance, risk management and control processes, systems, and operations (IIA, 2009).

According to the Auditor General South Africa (AGSA) the IAFs in South African municipalities are to be partly blamed for auditees not obtaining clean audit opinions (AGSA, 2012:86). The AGSA stated specifically that the IAFs do not adequately evaluate the internal controls and therefore, did not fully communicate with the audit committees on matters such as accounting, risk management and loss control (AGSA, 2011:32; AGSA, 2012:86, AGSA, 2013:31, 35, 75, 103). This indicates the expectation by the internal auditing standards and that of the AGSA that the IAFs need to assist their municipalities in ensuring the achievement of clean audit opinions among others. Hence, the internal audit reports (whether negative or positive) provide a strategic direction to future public service delivery planning and controlling efforts in that they provide a kind of strength, weaknesses, opportunities and threats (SWOT) analysis of the municipal performances (Motubatse, 2016). The internal auditors are further considered as "information guardians" but their functioning impaired if their reports are inadequate (Stuebs & Alejandro, 2010:53; Lenz & Sarens, 2012:533; Ernest & Young, 2013:5; Jackson, 2014:43).

2.2 Regulations of Internal Audit

The IAFs in South Africa functions as recognise by the Public Finance Management Act (PFMA) and Municipal Finance Management Act (MFMA) which are the legislations complying fully with the South African constitution. The regulatory framework is further strengthened by the internal audit framework of the public sector (RSA, 2004) which provides the minimum guidelines for the development and
operation of internal auditing in the public sector. This framework proves guidance to the IAFs in the public sector to ensure that the IAFs comply with the PFMA, MFMA and the constitution.

2.3 Audit Outcomes in Municipalities

Figure 1 details the opinions provided by the AGSA to municipalities over the years.

Based on Figure 1 above, it is evident that a number of municipalities since the 2011/2012 to 2015/2016 financial years have received unqualified opinions with findings. One would expect to find these municipalities obtaining unqualified opinions with no findings, since most of them either have IAF in place, or outsourced to audit firms. Figure 1 further indicates the number of municipalities that obtained disclaimer opinions, which means that these municipalities cannot provide the necessary documentation to support their financial statements, raising the question of where these IAFs are in the municipalities, and what role do they play to ensure that this does not happen?

It is further evident from Figure 1 that the municipalities obtaining qualified opinions and adverse opinions remain constant, with no improvement. However, it is encouraging to note a declining trend, with municipalities obtaining disclaimers, the number declined from 78 in the 2011/2012 financial year to only 32 in the 2014/2015 financial year. Furthermore, the number of municipalities that obtained unqualified opinions with no findings improved from 10 municipalities in 2011/2012 to 72 municipalities in 2014/2015.

3. Methods and Materials

This is a qualitative research study conducted in which the AGSA’s reports for five consecutive years were analysed using a content analysis method to determine the role played by the IAFs in their municipalities in South Africa. This study was conducted with the use of the secondary data obtained through the analysis of the audit reports presented by the AGSA as from 2013/2014 to 2017/2018.

3.1 Data Collection

The AGSA’s reports for the period of five years, from 2013/2014 to 2017/2018 financial year 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 main theme formulated in gathering the data was on internal audit
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3.2 Data Analysis

The data was analysed through the use of Atlas.ti software, this was to ensure that the theme formulated is clearly followed and identified on the voluminous AGSA reports and unbiased analysis can be achieved. The data was 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. While considering the whole context, the data was coded.

4. Results and Discussion

After concluding the analysis of the AGSA audit reports for the five years' period, the following main findings were raised with regard to IAFs in municipalities per province in South Africa. Table 1 presents these findings from the AGSA audit reports.

Based on Table 1, it is evident that since 2013/2014 financial year the IAFs in municipalities in Eastern Cape province did not assist their municipalities in obtaining positive audit outcomes.

Based on Table 2, it is evident that since 2013/2014 financial year to 2017/2018 financial year the IAFs in municipalities in Free State province did not assist their municipalities in obtaining positive audit outcomes as they provided a limited or no assurance expected.

Table 3 on the next page provides evidence that since 2013/2014 financial year to 2017/2018 financial year the IAFs existed in more than 95% of the municipalities,
however, these IAFs provided little impact on the overall audit outcomes of the municipalities.

Based on Table 4 above, it is evident that since 2013/2014 financial year to 2017/2018 financial year the IAFs in municipalities in KwaZulu-Natal province did not provide positive impact on the financial statements of the municipalities resulting in a reduction in the level of assurance from these governance structures which is also indicative of regressions in the province.

Based on Table 5 above, it is evident that since 2013/2014 financial year to 2017/2018 financial year the IAFs in municipalities in Limpopo province did not provide the expected assurance and they lacked focus on the functions they need to perform.

Based on Table 6 on the next page, it is evident that since 2013/2014 financial year to 2017/2018 financial year the IAFs in municipalities in Mpumalanga province did not extend their scope of independent reviews to include all aspects of financial and
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Based on Table 7, it is evident that from 2013/2014 to 2017/2018 financial year the IAFs in municipalities in North West province did not have any impact in assisting their municipalities in changing the negative audit outcomes obtained by the municipalities.

Based on Table 8 on the next page, it is evident that since 2013/2014 financial year to 2017/2018 financial year the IAFs in municipalities in Northern Cape province did not have any impact in assisting their municipalities in changing the negative audit outcomes obtained by the municipalities.
Table 9: The AGSA Findings Regarding IAFs in Western Cape Province over Five Years’ Period

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<td>Ineffectiveness of IAFs.</td>
<td>Limited assurance by IAFs.</td>
<td>IAFs had little impact on audit outcomes.</td>
<td>Regression on the work of IAFs as the assurance provider.</td>
<td>Ineffectiveness of IAFs in assisting audittees to submit the financial statements on time.</td>
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<td>Non-compliance findings of IAFs included: Inadequate evaluation/advice on internal controls, accounting, risk and loss control.</td>
<td>Inadequate quarterly reviews of financial and performance reports.</td>
<td>Inadequate quarterly reviews of financial and performance reports.</td>
<td>Limited assurance by IAFs.</td>
<td>Limited or no assurance by IAFs.</td>
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<td>Lack of reporting to audit committees by IAFs on compliance with legislation.</td>
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year the IAFs in municipalities in Western Cape province were found to be ineffective and contributing to the failure of the municipalities to submit their financial statements within the legislated deadlines.

Based on Tables 1-9, the 2013/2014 – 2017/2018 financial years were dominated by the following findings from the AGSA (in summary):

A larger number of findings emanating from the IAFs were raised in the five years’ period. These findings raised were mainly that even though IAFs were well established in many municipalities in South Africa, they did not contribute positively to the audit outcomes received by those municipalities, meaning that they did not add the expected value, and were therefore redundant. This finding was raised in a number of the provinces, as indicated in Tables 1-9 above and dominated the findings raised by the AGSA. The root cause highlighted by this finding was lack of sufficient resources and competent, skilled internal auditors who would have assisted these IAFs to perform their functions optimally, and thereby assist their municipalities in obtaining better audit outcomes.

### 5. Discussion of Results

According to the data gathered through the content analysis. The results revealed that a number of IAFs in municipalities (varying from one province and municipality to another) did not provide sufficient assurance to their municipalities, did not assist their municipalities in obtaining desired audit outcomes and did not evaluate their compliance with laws and regulations. This again indicates another important deviation and neglect of the IAFs in performing their fundamental function of ensuring and assisting their organisations, in this case municipalities, in complying with rules and regulations. The question that arises here is: what is the function of the IAFs if they cannot assist their municipalities in complying with laws and regulations as required? The results further revealed that the AGSA found many IAFs in municipalities were dysfunctional not compliant with the MFMA, and were failing to implement proper control systems for the safeguarding and maintenance of assets. One of the key responsibilities of the IAF is to assist those in authority or management in safeguarding the assets of their organisations, and ensuring that those assets are protected from destruction and misuse.

### 6. Conclusion and Recommendations

This means that the IAFs in municipalities need to improve their performance drastically and add the expected value to their municipalities to prove the reason for their existence. The limited contribution could be one of the reasons why the IAFs are not taken seriously by the municipalities they serve. The findings of this paper can assist the IAFs and the general public in understanding the challenges faced by IAFs in South Africa and start assisting in addressing these challenges. This paper can further assist among others the stakeholders within the public sector to understand fully the role that needs to be played by the IAFs and how best can these functions be supported to maximize their contribution to their municipalities. It is recommended
that the IAFs source the necessary resources and training that can assist the internal audit staff members to perform their functions, thereby add value to their municipalities.

References


