

Perceptions on the objectivity of local government internal auditors

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ABSTRACT

Internal auditors in the local government sector in South Africa must adhere to the Institute of Internal Auditors' Standards and Ethical Code, both of which regard objectivity to be one of the core principles of internal audit behaviour. This article reports on a study that intended to establish whether or not internal auditors employed in local government understand the IIA's requirements regarding objectivity, and how they perceive and manage their own objectivity. The results show that the majority of internal auditors surveyed do understand the concept, and do realise its importance. Furthermore, perceiving that compromising their objectivity can impact their own effectiveness and that of their internal audit units, they take steps to manage and protect it.

Key words

internal auditor; internal audit unit; objectivity; local government; Institute of Internal Auditors; International Standards for the Professional Practice of Internal Auditing; IPPF, Code of Ethics

1 INTRODUCTION

Internal auditors must clearly separate themselves from management. They must do this by remaining objective in mind and in appearance. Being one of the core principles of the internal auditing profession as portrayed by their Standards and Code of Ethics (IIA 2000:1; IIA 2012:3), this statement is a common belief held by internal auditors - often surfacing when internal auditors are justifying their position in the organisation and refusing to accede to a request from management to assist with certain management or operational functions.

Maintaining objectivity becomes an even bigger challenge as stakeholders in organisations expand their expectations of internal auditors (Verschoor 2012:46). Following the violent death of Lawrence Moepi, a forensic auditor with SizweNtsalubaGobodo based in Houghton, South Africa on 18 October 2013 (Anon 2013), Duncan (2013:1) commented that "Moepi has earned a reputation of being a fraudster's worst nightmare: a fearless, principled, incorruptible auditor" and that "it is widely suspected that he was killed to shut him up". Although Moepi's murder could eventually not be linked to his involvement in fraud investigation, the comments by Duncan regarding his character remains: Objectivity requires internal auditors to be "fearless, principled and incorruptible". The question raised by Mugattash (2011:92), whether internal auditors are still able to maintain objectivity and manage the threats brought about by the expanded expectations, can be rightfully raised again.

2 BACKGROUND

2.1 Professional guidance on objectivity

The Institute of Internal Auditors (IIA) (2012:3) regards objectivity to be one of the fundamental

attributes all internal auditors should possess. The IIA's International Professional Practices Framework (IPPF) includes objectivity as part of its Code of Ethics, and reiterates this in their International Standards for the Professional Practice of Internal Auditing (hereafter referred to as Standards). **Principle 7.1.4 of the King report on corporate governance for South Africa (King III) (IOD 2009) recommends that internal auditors comply with the Standards and since the Municipal Finance Management Act (MFMA) require adherence to the recommendations of King III**, it is imperative that every internal auditor possesses an understanding of this concept.

The purpose of the Code of Ethics is to promote an ethical culture in the profession of internal auditing (IIA 2000:1). The second principle of the IIA's Code of Ethics states that 'Internal auditors [must] exhibit the highest level of professional objectivity in gathering, evaluating and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interest or by others in forming judgments' (IIA 2000:1).

The Standards have been set and are maintained by the Institute of Internal Auditors to define the basic principles of the profession, and to provide a framework for performing value adding services, with the objective of bringing about improvements in the organisation's processes and operations (IIA 2012:1). The Standards have been rewritten on a number of occasions, to maintain their current relevance and practical value (Erasmus, Steyn, Fourie & Coetzee 2013:44). However, the application of the Standards has been subjected to a degree of interpretation, according to the perceptions of individual internal auditors, and internal audit units (Erasmus *et al* 2013:50).

Standard 1100 stipulates that “the internal audit unit must be independent and internal auditors must be objective in performing their work”. In practice ‘objectivity’ and ‘independence’ are often used interchangeably, or worse, they are considered to be synonyms. This might be due to the definitions of the two concepts not being stated clearly enough in the IIA’s Standards, or because the concepts are not fully understood by practitioners. Paape (2007:37) supports this second observation, adding that independence and objectivity are difficult concepts to apply as each situation has its own merits and justifications, and the auditor’s behaviour will be influenced (or nuanced) by his/her response to the situation.

Different views exist regarding the importance for internal auditors to remain objective. Marais, Burnaby, Hass, Sadler and Fourie (2009:897) believe that the internal audit profession stands to contribute greatly to the well-being of their employer organisations, but only if they have the necessary skills and competences to comply with and implement the provisions of the Standards which includes Standard 1100 on independence and objectivity. A willingness and ability to comply with the Standards is regarded as a crucial step in ensuring that internal auditors are effective and best serve their organisations. This is why King III recommends that internal auditors should comply with the Standards. (Sadler, Marais & Fourie 2008:137; IOD 2009). It also seems that South African internal auditors in general make an effort to comply with the Standards. Results from both the CBOK 2006 and the CBOK 2010 studies show that South African organisations achieved high scores in terms of complying with the Standards when compared to other regions across the world (Marais *et al* 2009:890; Erasmus *et al* 2013:50). This was considered remarkable as other regions received lower scores despite having bigger and more sophisticated economies than South Africa, and having been part of the IIA for far longer (Erasmus *et al* 2013:50). In the CBOK 2010 study 81.54 % (CBOK 2006: 92.7%) of South African organisations surveyed reported compliance with the Independence and Objectivity Standard (Standard 1100) (Marais *et al* 2009:890; Erasmus *et al* 2013:50).

A notion however exists among management and boards of some organisations that strict compliance with the Standards would not add value to the organisation. (Erasmus *et al* 2013:46-47). This is evident from the reasons offered for non-compliance with the Standards during the CBOK 2006 study which included views that “management of the organisation don’t think it adds value” and “management of the organisation do not support compliance” (Sadler *et al* 2008:136). Fourie Plant, Coetzee & Van Staden (2013:82-83) later also observed that both in South Africa and globally, internal audit managers do not perceive objectivity to be overly important, and that a standard definition of what objectivity entails was lacking.

Despite the differences of opinion that may exist, internal auditors in the local government sector adhere to the Standards and the IIA’s Code of Ethics (see Section 2.2 below). Their adherence to the

Standards and ethical principles, as they relate to supporting objectivity, may however put them in a position of conflict with the views of their stakeholders referred to above.

22 Internal auditing in the South African local government sector

The purpose of the local government sector in South Africa is accurately articulated by the Auditor General South Africa in his 2014 report on local government institutions (Auditor General South Africa 2014:22):

“The Constitution of South Africa determines that local government must structure and manage its administration and budgeting and planning processes to give priority to the basic needs of the community, promote the social and economic development of the community and participate in national and provincial development programmes”. Legislation, such as the Municipal Finance Management Act, 2003 (Act No 56 of 2003) (MFMA) and the Municipal Systems Act, 2000 (Act No. 32 of 2000) adds definition to the manner in which local government must function in order to achieve these developmental objectives, by insisting on sound financial and performance management, and on accountability to the communities it serves (RSA 2000; RSA 2004).

Internal auditing is still a fairly new professional practice in South Africa’s local government sector, only achieving widespread practice after the promulgation of the MFMA (Act No. 56 of 2003). Internal audit units assist managers and the chief executive officers of municipal entities in the execution of their duties by providing independent assurance on internal controls, financial information, risk management, performance management and compliance with legislation (Auditor General South Africa 2014:87). Section 62(1)(c)(ii) of the MFMA requires internal auditors to comply with any prescribed norms and standards (RSA 2004). The Act does not indicate which “norms and standards” legislators had in mind, but the King Code on Corporate Governance for South Africa (IoD 2009), that applies to local government organisations, recommends in Principle 7.1.4 that internal auditors should abide with the Standards and the Code of Ethics of the IIA at a minimum.

The findings published in the Consolidated general report on the audit outcomes of local government 2012-13 (Auditor General South Africa 2014:87) attest to the immaturity of the internal auditing function in local government, and the negative impact that this has on its effectiveness; almost 80% of local government internal audit units are not achieving the expectations of the Auditor General. The report however also draws approving attention to the contribution made by 22% of the internal audit units in improving internal controls and impacting positively on audit outcomes (Auditor General South Africa 2014:87). The fact that internal auditing in the local government sector in South Africa is still in its infancy implies that internal audit practices may be prone to mistakes that may arise from misinterpretations or being unaware of certain Standards.

This section of the article aimed to provide background information on two core concepts underlying the study, i.e. the importance of objectivity and internal audit practices in local government. The purpose and significance of the study as well as the research design and methodology will be described next, followed by a discussion of the literature review and the results of the empirical research.

3 PURPOSE AND SIGNIFICANCE OF THIS STUDY

Considering the value attributed to objectivity by the internal audit profession, this article describes a qualitative study of local government internal auditor's perceptions on their objectivity. The overall aims of the study was to examine four key areas: whether or not internal auditors understand the concept of objectivity; how they perceive their own objectivity; how they perceive their objectivity to impact on their own effectiveness, and how they perceive their objectivity to impact on the internal audit unit's effectiveness. The study also sought to determine what types of threats to objectivity internal auditors in local government institutions are exposed to, and how internal auditors manage these threats to their objectivity. Research on internal auditing in local government in South Africa is limited. This article sheds light on current practices of internal auditing in this sector specifically pertaining to internal auditors' objectivity. The findings of the study may assist local government authorities and the Auditor General to address threats to objectivity generally, and specifically to improve the objectivity of their internal audit functions. The findings may also be useful to organisations in other sectors of government, and in the private sector, to subject the objectivity of their internal auditors to scrutiny. Individual internal auditors may benefit from the study by using it as a reference point against which to evaluate their own perceptions, and thus enabling them to correct any misperceptions they may have regarding their objectivity.

4 RESEARCH DESIGN AND METHODOLOGY

4.1 Methods of data collection

The research upon which this article is based consisted of a literature review and an empirical study. Internal auditing standards and practices relating to the objectivity of internal auditors were examined and served as a theoretical background to and basis for the empirical study. The empirical study followed a quantitative approach which according to Creswell (2009:3) is "a means of testing objective theories by examining the relationship among variables". A cross-sectional survey method was used whereby questionnaires were sent out to local government internal auditors to obtain the perceptions of their objectivity. A computer aided, self-administered survey (Tustin *et al* 2005:20) was conducted whereby questionnaires were sent (via e-mail) to 65 out of a 110 internal auditors cumulatively employed by one metropolitan municipality, 5 district municipalities and 18 local municipalities, all situated in one of South Africa's nine provinces. A clustering

sampling method was used by which the questionnaires were sent to the heads of the internal audit units and the heads then distributed the questionnaires to their subordinates fulfilling different roles and at different levels of seniority within the different internal audit units: i.e., senior internal auditors audit supervisors and junior internal auditors. The responses were collected and returned through the respective heads of the internal auditing units. A probability sampling method was used for selecting the internal audit units to participate in the survey as they were selected merely because of accessibility for research purposes and not for any other particular reason. Because the agreement between the researchers and the participating internal audit units included an undertaking to maintain the anonymity of respondents, no data was sought regarding the specifics of the institutions in which the respondents worked.

The questionnaire was compiled by an MPhil student in the Department of Auditing at the University of Pretoria and presented to an academic and senior staff in the local government institutions for their revision and input before it was distributed to the participants. The questionnaire has four sections. The first section aims to determine the profile of the respondents and to establish their levels of awareness of the Standards. Section 2 serves as an objectivity awareness assessment, while Section 3 aims to establish how objectivity is being managed within the respondents' local government institutions. Section 4 requires respondents to reflect on their own objectivity and how they perceive their objectivity to impact on their individual effectiveness and on that of the internal audit unit they work for.

4.2 Responses

The survey resulted in 45 usable responses which represents a 69% response rate. The response rate is considered reasonable considering that Tustin *et al* (2005:193), quoting Sudman & Blair 1998:166, claim that a response rate of 70% or more is possible where "highly educated response groups such as doctors, lawyers and accountants are surveyed about topics relevant to their professions". Of the 45 responses received, 22% were completed by the head of the internal audit unit (CAE), 40% by senior internal auditors or supervisors, and 38% by junior internal auditors. After proper codification of the completed questionnaires, the responses were captured on an excel spreadsheet for statistical analysis. A descriptive analysis approach was followed, the aim of which is described by Tustin *et al* (2005:103) as "to provide a summary of the population in terms of the variables of interest".

4.3 Limitations of the study

The study is limited to investigating the perceptions of internal auditors in the local government sector of a single province in South Africa. It may therefore not be representative of internal auditors in other provinces or the South African public sector in general, nor the private sector or internal auditors in other countries. The selection of the population

surveyed was based exclusively on accessibility considerations, meaning that auditors who were on leave or on remote assignments at the time of the survey were excluded from the population. Responses should therefore not be regarded as automatically representative of all local government internal auditors as cultural, economic and geographic circumstances amongst others could well affect perceptions of internal auditors in different regions.

The objectivity awareness assessment (Section 2 of the questionnaire) included questions with one correct answer. Participants did however not necessarily complete the questionnaire in privacy and could have consulted with other participants to test their answers and returned their completed assessments via the head of internal audit. Although the result of the assessment serves as an indication of the internal auditors' awareness, knowledge and understanding of objectivity, the test should be written under examination conditions and returned directly to the researcher to provide a more accurate and reliable assessment.

5 LITERATURE REVIEW

According to the IIA's Standard 1100, "The internal audit unit must be independent, and internal auditors must be objective in performing their work." (IIA 2012:4)

The glossary section of the Standards defines objectivity as a state of mind that is required from internal auditors for them to be able to perform their duties diligently and without having to compromise the quality of their work (IIA 2012:22). Internal auditors are required to resist subordinating or deferring their judgement to that of others when it comes to audit matters. Independence, on the other hand, is defined as freedom of the internal audit unit from conditions that can cause bias (IIA 2012:21). From the definitions it is noticeable that **objectivity** has to do with each individual internal auditor whereas **independence** has to do with the internal audit unit as a whole.

The IIA's Code of Ethics also requires that internal auditors uphold the principles of integrity, competence, confidentiality and *objectivity* and failure to uphold any of these principles is considered a breach of the Code (IIA 2000:1).

Objectivity is one of the most critical behavioural skills expected of internal auditors and it is essential to the maintenance of their credibility, the quality and reliability of their work, and to ensure the effectiveness of the internal audit unit (Brody & Lowe 2000:171, Fourie *et al* 2013:76; Ridley 2009:72; Soh & Martinov-Bennie 2011:615). Mutchler (2003:233) attests to this, writing that without objectivity the other three principles, i.e. integrity, confidentiality and competency, are insufficient to allow internal auditors to provide value-adding services. In addition, Barret (1999:8) regards objectivity as one of the essential attributes that enables colleagues to regard internal auditors as valuable members of the organisation, well-equipped to contribute to its efficient operation.

However, Feltern (1995:30) remarks that internal auditors do not need to distance themselves from auditees for fear that, should they become accustomed to the auditee and their issues, they will become overly sympathetic and lose objectivity. The consequence of a distant approach was found by Feltern (1995:32) to manifest as a breach of trust and a failure to generate a culture of mutual cooperation between the auditor and the auditee.

The Standards (Standard 1110, 1120, 1130 and 1130.A1) provide guidance to internal auditors on how objectivity should be maintained and managed. Views prevalent in the literature regarding these standards are discussed next.

Standard 1110: states: "The chief audit executive must report to a level within the organization that allows the internal audit unit to fulfil its responsibilities." (IIA 2012:4)

Internal auditors' lack of independence from senior management in the organisation is automatically seen to threaten their objectivity (Gallegos 2004:37; Stewart & Subramaniam 2010:330). Gallegos goes on to explain that a situation where the internal auditors report to the chief financial officer (CFO) may be an effective breach of objectivity as the CAE will be seen to be in a position where s/he needs to be overly mindful of the internal audit function's findings and the opinions they issue, as the CFO controls their budget and may terminate the employment of the CAE (Gallegos 2004:37).

Chun (1997:247), noting that auditors have a duty to make managers accountable for their functions in the organisation, recommends that the organisational status of internal auditors should enable them to report to a level higher than that of their auditees.

The implementation of Standard 1110 usually has the CAE reporting functionally to the board (which normally implies the audit committee) and operationally to management (usually the CEO) (IIA 2012:4). Some authors have positive views regarding this reporting relationship, stating that the audit committee is supposed to serve as a safeguard of the internal auditor's objectivity (Stewart & Subramaniam 2010:333), and that an effective audit committee is said to strengthen the objectivity of internal auditors (Muqattash 2013:30). However, it is also suggested by others that reporting to an ineffective audit committee may compromise the internal auditor's objectivity, (Rose & Norman 2008:9) as such circumstances may allow the internal auditors to make their own decisions regarding what they include in their reports to the audit committee (O'Leary & Stewart 2007:796). Dual reporting is however recommended in Practice advisory 1110-1 (IIA 2012) and common practice in many organisations.

Standard 1120 stipulates: "Internal auditors must have an impartial, unbiased attitude and avoid any conflict of interest." (IIA 2012:4)

Ahluwat and Lowe (2004:156) offer a notion that objectivity is a myth. They believe that the relationship between employer (senior management and/or

directors) and internal auditor inevitably creates an environment that can potentially influence or distort the judgement of the internal auditor. This was evident in their study of internal audit's role in a merger transaction where it was found that internal auditors favoured their current employers. Stefaniak, Houston and Cornell (2012:42-43) almost concur with Ahlawat and Lowe when they posit that the employer/internal auditor relationship can fall into a state that psychologists refer to as "social identification". According to Stefaniak *et al* (2012:42) this theory says that the extent to which a person feels attached to a particular group will affect their objectivity as it pertains to that group.

There are recognised circumstances that can induce bias in an internal auditor's opinions. Gallegos (2004:38) records that an internal auditor's desire to partner with management has been known to distort audit opinions. Dezoort, Houston and Peters (2001:265) posit that where internal auditors are performing a consulting engagement that is subjective in nature, and includes a compensation incentive, their objectivity may be affected. Ridley (2009:72) further points out that a breach of the objectivity requirement comes about when internal auditors fail to apply a systematic process to evaluate and recommend improvements to the area audited.

These situations, however, also depend on the individual internal auditor's attitude. A study was conducted by Church & Schneider (2011:15) to determine whether there was substance to an observation made by the General Accounting Office of the United States that participating in decision-making in current operations or in areas soon to be audited would result in the internal auditor being impartial. The outcome of the study was that the auditors may still remain objective despite having been involved in the design of the process they were then called on to audit (Church & Schneider 2011:22).

Standard 1130 stipulates that: "If independence or objectivity is impaired in fact or appearance, the details of the impairment must be disclosed to appropriate parties" (IIA 2012:5).

Objectivity is difficult to measure and for that reason independence is often looked at as an alternative to determine if there is a potential for bias (Mutchler 2003:243). To management, generally, internal auditors exist to serve their interests, and reporting to the audit committee is merely to satisfy a governance requirement (Christopher, Sarens & Leung 2009:203). Van Peurse (2005:507) claims that internal auditors are expected to use the standard lines of communication to clear any ambiguity they may face in their audit roles, and it is up to the internal auditor to educate management on potential threats to objectivity, and to report to the audit committee and to request its intervention wherever there is a need.

Finally, Standard 1130.A1 states: "Internal auditors must refrain from assessing specific operations for which they were previously responsible." (IIA 2012:8)

Providing both assurance and consulting services to the same audit client has frequently been raised as

an issue that threatens objectivity (Stewart & Subramaniam 2010:328) although it was pointed out by Selim, Woodward & Allegrini (2009:21) that the threat is dependent on the nature of the consulting services provided. Since internal auditors, through consulting, may engage themselves in operations that they may later have to audit they need to ensure that they tread carefully and ensure that their competence and independence will not eventually be questioned (Bou-Raad 2000:184).

From the foregoing discussion it is evident that maintaining objectivity is a challenge for internal auditors due to the changing environment that they find themselves working in. It is for this reason that the IIA developed its *Practice Guide: Independence and objectivity*. This practice guide identifies instances that can affect objectivity and provides a framework for evaluating and managing threats to objectivity. The framework also provides tools that can be applied to manage threats. Whilst the tools are not meant to be exhaustive, they do cover a wide spectrum of the threats (IIA 2011:1).

Internal auditor objectivity can be threatened in various ways by factors such as social pressure, economic interest, personal relationships, familiarity and bias related to culture, gender, age and cognitive abilities. (IIA 2011:7-8). The Practice Guide places responsibility for identifying and managing threats to objectivity on individual internal auditors, and expects them to mitigate the threats identified. The preservation of objectivity thus depends on the individual internal auditor's professionalism as well as that of their supervisors (IIA 2011:4).

There are a variety of ways in which threats can be managed. The following mitigation factors may be considered: Having hiring policies that provide for screening of applicants for potential objectivity threats, such as family relationships with senior management or main suppliers; training internal auditors to identify threats; enhancing supervision of internal audit engagements to reduce internal auditors' bias; quality assurance reviews; implementation of a team approach to internal audit engagements including rotation of teams or reassignment of members, and outsourcing. (IIA 2011:9).

From an organisational level the threats could be managed through positioning the internal audit unit at an organisational level that assures them of independence; introducing and vigorously implementing policies that identify the importance of objectivity and protect it; creating an environment and mind-set within the organisation that is receptive to internal audit findings and recommendations, so that internal auditors are not inhibited from raising contentious issues; offering rewards for objective thinking and applying punitive process for biased conduct. The use of teams, peer review and internal consultation can mitigate the risk of individual breaches of objectivity. (Mutchler 2003:253-255). Where none of the mitigation factors and tools are successful in managing the threat, the threat and the failed remedies should be disclosed to the audit committee (IIA 2011:9).

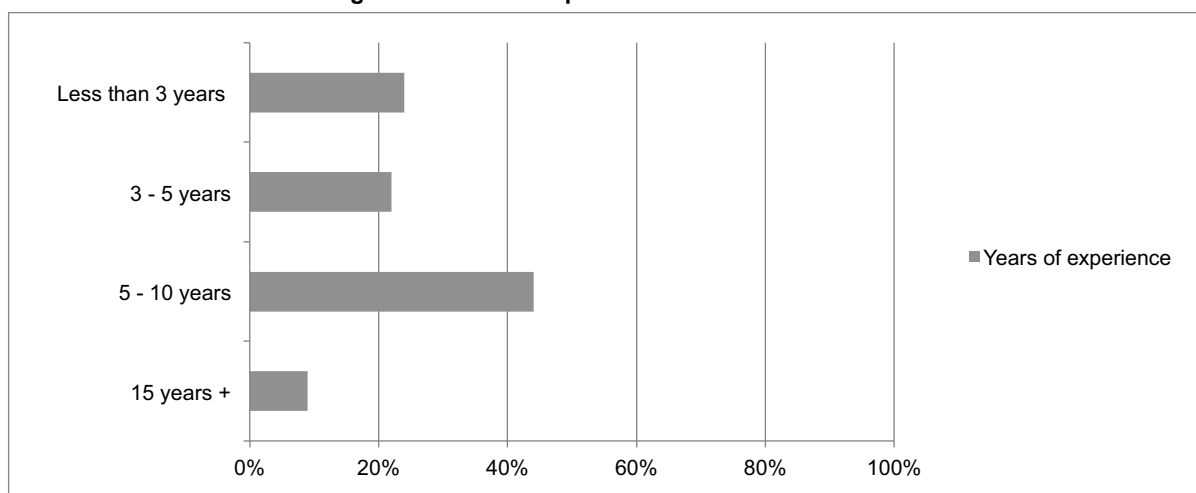
6 EMPIRICAL RESEARCH FINDINGS

6.1 Profile of respondents and general awareness of the internal auditing standards

The first section of the questionnaire aimed to determine the professional and demographic profiles of the participants. Respondents were requested to indicate their employment level in the internal audit unit, their years of experience as internal auditors, whether they have a qualification in internal auditing, and whether they are members of the IIA. The majority of the responses came from senior and supervisory level internal auditors (reflected, as

expected, in the significant number of respondents with between 3 and 10 years' experience), followed by junior internal auditors (with less than 3 years' experience). The years of experience claimed by the internal auditors and shown as Figure 1 does reflect that internal auditing in the local government sector is still in its infancy as 46% of respondents have less than 5 years' experience. Considering that the MFMA was only promulgated ten years ago, and that the supply of qualified internal auditors is limited, the fact that internal auditors have amassed as much experience in the public sector as they have indicates that local government is in fact doing quite well in recruiting experienced internal auditors.

Figure 1: Years of experience as internal auditors



Further analysis indicated that 90% of CAEs have between 5 and 10 years' experience, 72% of senior internal auditors and audit supervisors have more than five years' experience and all respondents with less than 3 years' experience are on the junior internal auditor/officer level. Offering additional encouragement is the fact that 91% of the total respondents (and 88% on the junior/officer level) have a qualification in internal auditing, suggesting that although they may have limited practical experience, the majority have been introduced to the field of internal auditing through their studies.

As indicated earlier in this article, local government internal auditors must comply with the Standards. Furthermore, internal auditors who are also members of the IIA are also required to uphold the IIA's Code of Ethics, and are regularly kept abreast of changes and developments in the profession. It is concerning therefore that only 71% of the total number of respondents indicated that they are members of the IIA. Although more than 80% of the respondents employed at a senior or supervisor level indicated that they were members of the IIA, it is particularly worrying that 30% of CAEs and 41% of junior internal auditors are still not IIA members.

Membership of the IIA should be encouraged for all internal auditors, regardless of rank. Group membership for internal audit units and student membership for its junior internal auditors may be considered and negotiated, perhaps by the provincial

chapters of the local government association (SALGA), so that more internal auditors can afford to become IIA members.

The majority of internal auditors surveyed confirmed that they have access to the IPPF (89% of all respondents), and rated their own understanding of the Standards to be good (78% of all respondents; CAEs - 90%; senior internal auditors - 89%, and junior internal auditors - 59%). Junior internal auditors perceive themselves to understand the Code of Ethics, with 76% responding that they have a *good understanding* (CAEs - 90%; seniors -89%), and 13% of all internal auditors indicating that they have a *fair understanding*. This is logical as internal auditors' understanding of the Standards grows with practical experience, while the Code of Ethics, as a set of more abstract concepts, is less reliant on practical experience for full understanding to be achieved.

Respondents were requested to indicate to what extent they were able to apply the IIA's Standards and Code of Ethics in the performance of their day-to-day responsibilities as internal auditors. 91% of the respondents indicated that they were able to apply the IIA's Standards in their day-to-day activities as internal auditors at the municipalities (either *always* or *most of the time*). 9% of respondents only managed to apply the IIA Standards *sometimes*. No respondents chose the *seldom* response option. Even more respondents (93%) indicated that they were able to apply the Code of Ethics in their day-to-day

activities as internal auditors at the municipality (69% *always*, and 24% *most of the time*). However, 7% of the respondents opted for the *seldom* option. 100% of senior auditors and supervisors were confident that they could apply the IIA's Code of Ethics in their day-to-day responsibilities, of which 78% responded *always*.

The last two questions in Section 1 of the questionnaire required the respondents to report on the frequency of receipt of updates or training on the Standards and on internal audit practice. Responses indicated that more emphasis is placed on training related to internal audit practice than on the Standards. While not ideal, this is acceptable as most of the internal auditors have a qualification in internal auditing, and also indicated that they have access to the IPPF. 56% of respondents indicated that they receive training on the Standards at least once a year, and 69% of respondents claimed to receive training on internal audit practice at least once a year. Training seems to occur more often at the senior auditor and supervisor level where 83% of respondents indicated that they receive *frequent* training on both the Standards and internal audit practice.

6.2 Objectivity awareness assessment

The second part of the questionnaire intended to assess the respondent's knowledge of and ability to give effect to objectivity. Each of the 14 questions in this section has a correct answer. Seven questions are purely knowledge-based and tested the respondent's knowledge (recall) of the Standards and Code of Ethics regarding objectivity, and ability to distinguish the difference between independence and objectivity. Four questions tested the respondent's interpretation and understanding of the IIA's Standards and Code of Ethics: i.e. did the respondent know how the knowledge should be applied in practice. Four other questions tested the respondent's grasp of the concept of objectivity as applied in practical situations.

Respondents in total scored 77% for the awareness assessment (CAEs - 81%; senior auditors and supervisors - 77%, and junior internal auditors - 74%). Further analysis of the responses explored respondents' facility with theory, interpretation and ability to apply concepts. The junior internal auditors achieved an "average" score for the theoretical questions compared to the with distinction level achieved by CAEs and seniors. In addition juniors did less well in the questions that tested interpretation of the Standards and ability to utilise the concept of objectivity. CAEs showed a higher level of understanding of the concept and interpretation of objectivity than their juniors, while senior auditors obtained the best score for knowledge of objectivity component of the Standards. The response to Section 2 of the questionnaire presents an encouraging level of awareness and knowledge of the concept of objectivity amongst the local government

internal auditors surveyed. This awareness includes an ability to differentiate between objectivity and independence, which the literature study indicated is challenging.

6.3 Managing objectivity

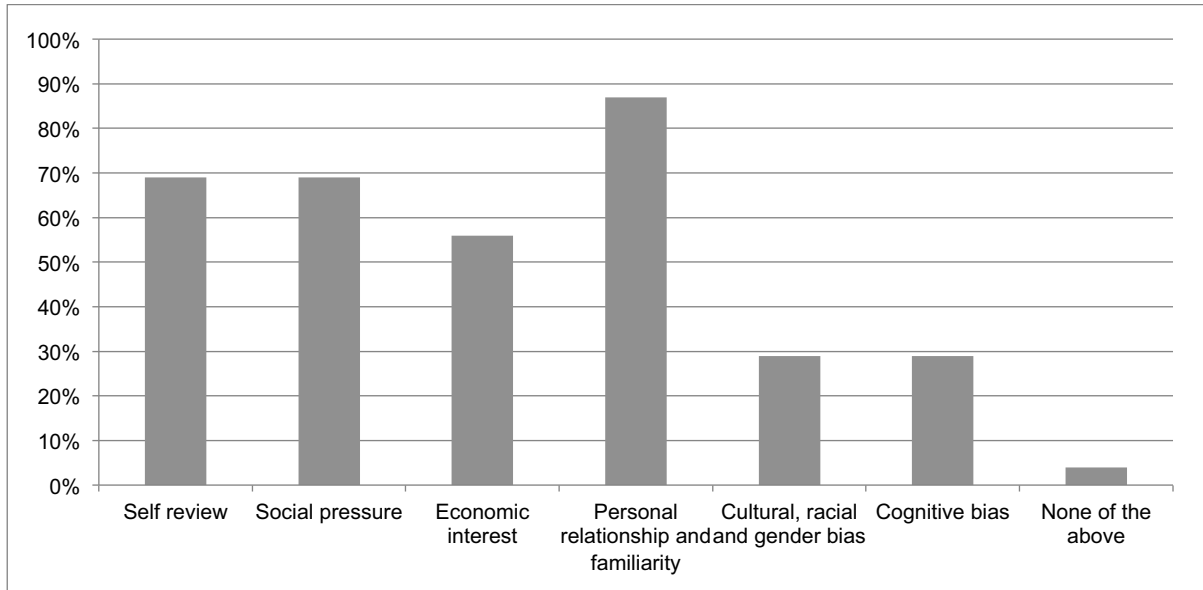
The third section of the questionnaire set out to determine how respondents perceive their responsibility to remain objective, what internal auditors perceive to be threatening their objectivity, and what is being done to manage these threats and to promote objectivity either by the organisation or by the internal audit unit itself. Most of the questions in this section used criteria from the IIA's Practice Guide on objectivity, and additionally prompted respondents to provide more information where appropriate.

One of the questions asked respondents to indicate whether or not the IIA's framework for managing threats was being applied in their organisation. Responses indicated that there appears to be a low degree of familiarity with and application of the framework as such. However, CAEs appear to be more familiar with the framework than are their subordinates.

The majority of the respondents (82%) understood that they (collectively) have a responsibility to manage threats to their objectivity. However, only 13% perceived the managing of threats to objectivity to be their individual responsibility, while 69% perceived it to be a combined effort involving the CAE and the individual auditor. Some respondents (30% of CAEs and 17% of senior auditors and supervisors) perceived the responsibility to manage threats to objectivity to be that of an outside party such as the audit committee and/or accounting officer. Although none of the junior level auditors selected either of these options, 88% of them indicated that the responsibility was either shared by the CAE and the internal auditor, or was the sole responsibility of the CAE.

Of the threats to objectivity listed in the IIA's Practice Guide (IIA 2011:7-8), respondents saw *personal relationships/ familiarity with the auditee* to be the greatest. This was followed by *self-review* (auditing work for which you had operational responsibility) and *social pressure* (pressure arising when the auditor is too close to the auditee). *Economic interests* also received a fairly high response (56%) while *cultural, racial and gender biases*, as well as *cognitive biases* received responses below 30%. Two respondents from the senior auditor/supervisor level (4% of all responses) do not perceive any of the items listed as threats to their objectivity. Respondents' perceptions regarding possible threats to their objectivity are presented in Figure 2. Respondents identified using the services of independent consultants to complement the services of the internal audit activity (co-sourcing) as another possible threat.

Figure 2: Rating of possible threats to objectivity

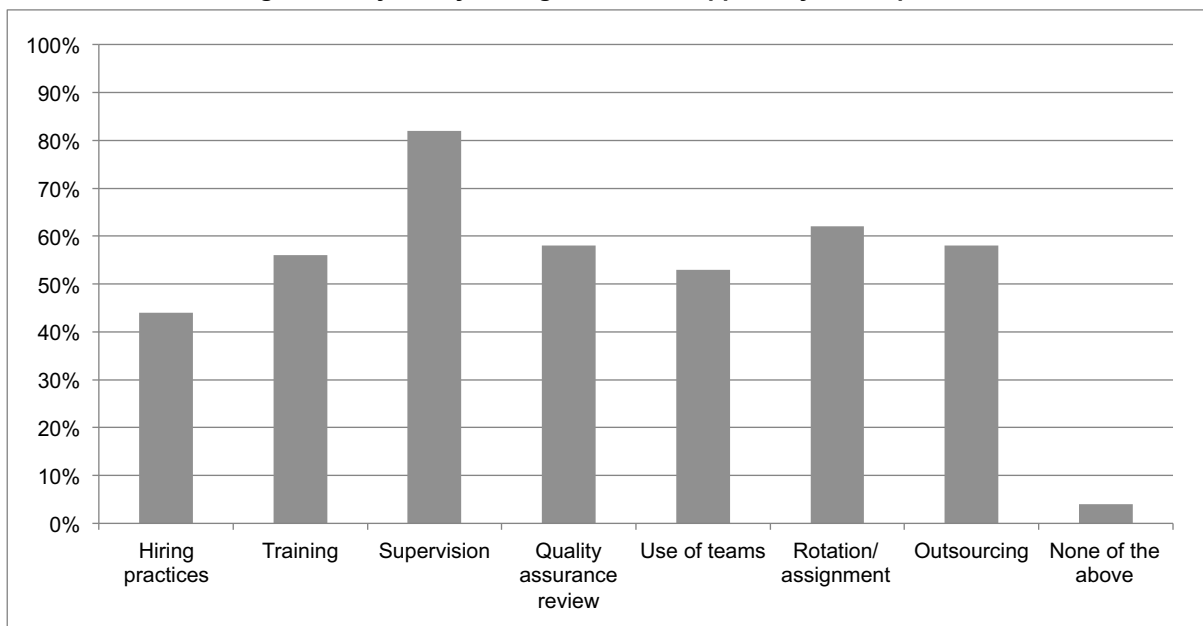


Most of the respondents (60% of the total) indicated that management does not apply specific tools to manage threats to objectivity since they regard the task to be the responsibility of the individual internal auditors. The balance of the respondents indicated that management does apply tools to manage threats to objectivity, and mentioned *reporting lines*, *declaration of interests*, *internal methodology*, and *management support* as those tools most frequently applied by their management teams.

used by the municipality. The list was obtained from the IIA's Practice Guide (IIA 2011:8-9). The most frequently selected tool was *supervision*. If seen together with the response to the earlier questions where it was evident that buy-in from a superior is regarded as an important component in managing threats to objectivity, the preference for this tool is logical. Figure 3 presents the management tools that were reportedly being used at organisational level. No further suggestions were made by any of the respondents.

Respondents were then required to identify the objectivity management tools they observed being

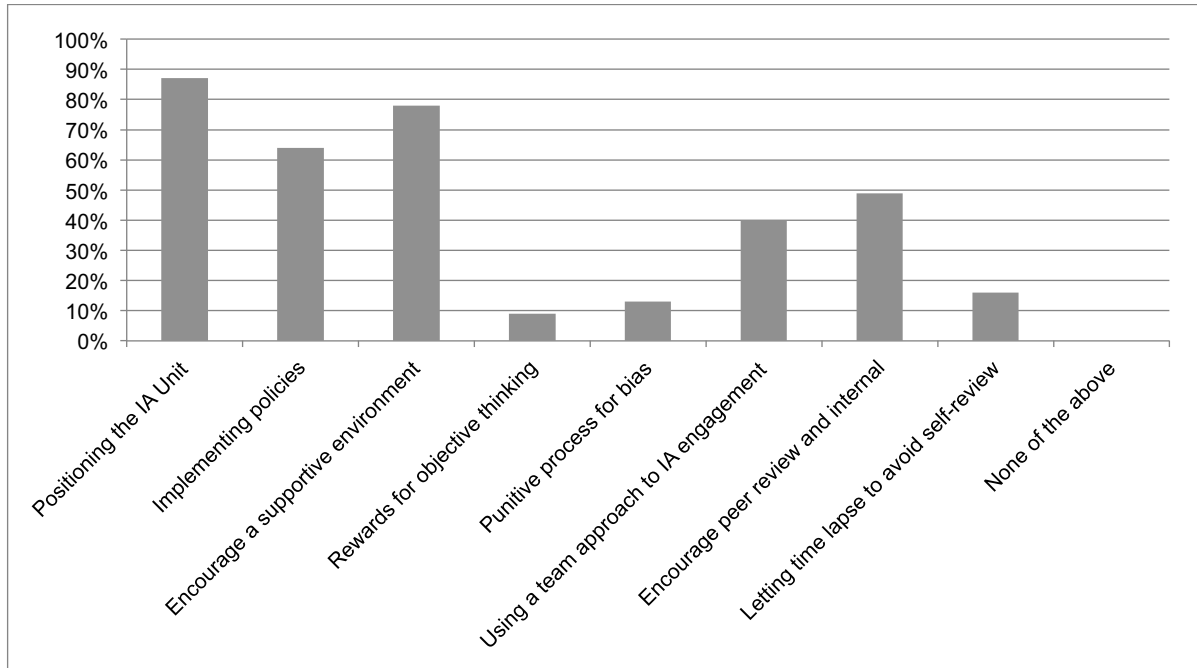
Figure 3: Objectivity management tools applied by municipalities



Respondents were also asked to identify the initiatives applied by their organisations to promote the objectivity of internal auditors. The list of initiatives offered was obtained from the IIA's Practice Guide,

and respondents were also invited to identify initiatives not listed. The response is depicted in Figure 4.

Figure 4: Initiatives applied by municipalities to promote the objectivity of internal auditors



The initiative most frequently recognised as having been implemented by the municipality to promote the objectivity of internal auditors was *positioning the internal audit unit to ensure their independence and authority*. This was followed by *encourage a supportive environment for accepting internal audit findings and recommendations, implementing policies and encourage peer review and internal consultation*. Junior internal auditors identified the *supportive environment for accepting internal audit findings*, while the majority of CAEs identified the *positioning of the internal audit unit and policies and procedures* as their preferred initiatives. Senior internal auditors identified a *team approach* and *encouraging peer review and internal consulting* as important initiatives. *Outsourcing* and *quality assurance reviews* were mentioned as tools that could also be applied to promote the objectivity of internal auditors. *Rewards for objective thinking, punitive processes for bias and letting time lapse to avoid self-review threats* were less-frequently observed initiatives.

As was reported in the literature review, the independence of the internal audit unit has an effect on the objectivity of the internal auditors. Following up on this, respondents were asked who their internal audit units report to. All (100%) of the internal auditors indicated that their IA units had dual reporting relationships - with the accounting officer and the audit committee. As this is required by section 165 (2)(b) of the MFMA the fact that one respondent did not answer this particular question was not deemed material.

6.4 Effect of objectivity on the effectiveness (accomplishing of objectives) of internal auditors and internal audit activities

The first question in this section asked respondents whether they were able to remain objective while performing their-day-to-day responsibilities as an

internal auditor in their organisation. Whilst respondents had admitted to experiencing challenges to their objectivity in the previous section of the survey, in this section 98% of respondents recorded that they were able to maintain objectivity at least *most of the time* (this included the 62% who claimed that they were *always* able to maintain objectivity). It is interesting to note that CAEs admitted to finding it more difficult to *always* remain objective than did the other levels of internal auditors. Only 30% of CAE respondents indicated that they were *always* able to remain objective, while 72% of senior auditors and 71% of junior auditors claimed they had perfect records. 60% of CAEs were able to maintain objectivity *most of the time* and one CAE admitted that it was achieved only *sometimes*. All the internal auditors on the other levels claimed to be able to maintain objectivity at least *most of the time*.

In response to the final questions the majority of respondents from all levels believed that their objectivity has an impact on their own effectiveness as well as on the effectiveness of the internal audit unit as a whole.

7 CONCLUSIONS AND RECOMMENDATIONS

The purpose of this article was to report on a study that aimed to determine whether or not internal auditors in the local government sector in South Africa understand the concept of objectivity, how they perceive their own objectivity, and what they perceive the impact to be of their objectivity on their own effectiveness, and on that of the internal audit unit. The article also reported on the types of threats to objectivity that internal auditors in local government institutions are exposed to, and concluded with perspectives on how these threats to objectivity are managed. To this end, internal auditors in various positions in the internal audit units of local government institutions located in one of the nine

South African provinces were surveyed. A total of 65 questionnaires were sent to internal auditors in these institutions, and 45 usable responses were received.

The results showed that internal auditors at local government level are aware of, and have a good understanding of the IIA's Standards, and the requirements of its Code of Ethics as they relate to objectivity. This result is in agreement with the CBOK 2006 and 2010 studies, which also indicated a high level of understanding of and compliance with Standard 1100 (dealing with independence and objectivity) amongst South African respondents (IIA 2012:3).

The overall conclusion is that local government internal auditors collectively have an adequate knowledge of objectivity. They understand its components and fragility, and the need to manage threats to it. They perceive objectivity to be a factor that, if lost, can compromise the effectiveness of the internal audit unit. However, there are significant differences in responses evident between the levels of seniority of internal auditors when determining the levels of understanding of the IIA's Standards and of the concept of objectivity and its practical manifestations. In spite of these differences, the majority of the internal auditors understand their individual responsibilities to manage threats to objectivity. Whilst they do face common threats to their objectivity (and some more than others), they are however able to maintain their objectivity through implementing some of the IIA-recommended objectivity management tools. Of these tools, support from the organisation's senior management was seen as the most important in managing threats to objectivity.

The infrequency of training opportunities was highlighted in the summary of the results, and could

be the cause of the discrepancy in the perceptions of the different levels of seniority of internal auditor. Training sessions usually have financial implications, with long term positive returns on investments being required by the MFMA amongst others. In that light, spending the training budget on senior staff members who are more likely to stay in their positions than their junior counterparts makes sense. The CAE and audit supervisors indicated that they attend training sessions more frequently than do their junior colleagues. This should then place them in a position to train their juniors. However, this question was not specifically researched.

Municipalities should take the steps necessary to ensure that the internal audit unit has a staff complement that embodies and practices the principles set out in the IIA's Standards and Code of Ethics. Membership of the IIA has a requirement that members comply with the Standards and the Code of Ethics, and that members should keep abreast with developments in the profession. Municipalities, would thus, by encouraging membership of the IIA (SA) ensure that their entire internal audit team is afforded all possible assistance to keep their professional competence current. Membership of the IIA is however not the only way to improve the understanding of internal audit concepts. By introducing specific training on the implementation of both the Standards and the International Professional Practices Framework (IPPF) internal audit practice could also be protected against attacks on its objectivity. This could also bridge the gap between the perceived competencies of the CAEs and their subordinates, from the point of view of their respective abilities to understand the concepts of objectivity and independence, and to interpret them and then to apply them.

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