

Internal audit in state-owned enterprises: Perceptions, expectations and challenges

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ABSTRACT

State-owned enterprises are critical vehicles for the delivery of goods and services, and can contribute to the sustainable economic growth of developing countries. The business environments in which these state-owned enterprises operate pose risks to the enterprises, which then rely on internal audit, amongst other options, to managing these risks. The objective of this study was to determine the perceptions of, expectations for and challenges experienced by internal audit functions in today's state-owned enterprises. A qualitative research approach was selected, utilising a case study method, and data was collected through interviews with important role players associated with the internal audit function of three South African state owned enterprises.

The findings of the study revealed that internal audit functions are perceived in a positive light and that participants do place reliance on internal audit. The internal audit functions act as business partners to management, and expect support from the audit committees and management in terms of ensuring the internal audit functions' independence, and the provision of required resources and skills. The internal audit functions face diverse challenges. These relate to the relative novelty of performance auditing and combined assurance in state-owned enterprises, the differences in methodologies and auditing systems used by outsourced functions, repeat (negative) audit findings, a lack of business knowledge and insight on the part of the entity, and non-compliance with quality assurance and improvement Standards.

Key words

State-owned enterprises; internal audit function; chair of audit committees; chief audit executive; risk management; emerging risks; internal audit skills

1 INTRODUCTION

The ongoing water crisis in Gauteng and the national electricity crisis during the latter half of 2014, and the resultant public outcry, focused attention on the critical need for reliable basic services to the general public, businesses and industries, and on the greater South African economy's dependence on them (Faku 2014; Mapumulo 2014; Fin24 2014). The situations emphasised the critical importance of state-owned enterprises (SOEs) as strategic providers to all sectors of the economy, thus clearly demonstrating the relevance of SOEs in emerging economies, particularly where they operate in strategic sectors with responsibility for the provision of services that are deemed to be of national interest (Aproskie, Hendriksz & Kolobe 2014:2) and fundamental to the government's development agenda (Ngonini 2014: 406).

A large number of SOEs in South Africa effectively operate as private sector companies and depend on international markets for funding (Adam 2013:166). These SOEs have to adhere to sound corporate governance principles. The need for SOEs is well

explored in the literature (Fourie 2001:206; PwC & IoDSA 2011:2); however, literature on internal audit in SOEs is scarce. Okibo and Kamau (2012:109) show that management and the audit committee expect internal audit in SOEs to evaluate and improve risk management, but the role of an SOE's internal audit function (IAF) in a developing economy such as South Africa remains unexplored. This results in a gap in the literature, and the objective of the study reported in this article is to address this gap. This study thus aims to obtain an understanding of the role of IAFs in SOEs in a developing economy. This has been done by determining the perceptions and expectations of, and challenges experienced by IAFs in today's SOEs.

The study adds substantially to the current body of knowledge, as limited research has been done on internal audit within SOEs. The focus of this study is SOEs which, in developing countries such as South Africa, form the backbone of the economy (Octavia 2013:77; Balbuena 2014:6). SOEs are facing challenges because the business environment in which they function is changing due to accelerated globalisation and advancements in technology (Crosby 2014:47;

Hass, Adolmohammadi & Burnaby 2006:835). The current economic downturn resulting from the financial crisis is also taking its toll (Beasley, Branson & Hancock 2010:29), because external funding opportunities for SOEs are decreasing.

As it is a relatively under-explored topic, a study of the role of internal audit in a SOE could beneficially inform the executive and middle management of SOEs on how internal audit can assist them to overcome challenges they face in their complex operating environments. Similarly, internal auditors of SOEs could benefit by benchmarking their roles and responsibilities against those reported in the article. Lastly, the study could benefit the Institute of Internal Auditors (IIA), as the IIA could use the findings of the study to inform future guidance on internal audit in SOEs.

The next section presents an overview of the literature study component, and is followed by an explanation of the research methodology. Thereafter findings from the study are presented, and, after the conclusion, recommendations are made and areas for future research are identified.

2 LITERATURE REVIEW

SOEs are created to deliver strategic goods and services to the country's citizens (PwC & IoDSA 2011:2), thereby contributing to improving the standard of living of the population (Fourie 2001:206). Strategic goods and services include the delivery of electricity, transportation (Thomas 2012:449), and water and sanitation (Balbuena 2014:6; Vaglasindi 2008:2). SOEs focus on the economic development of infrastructure and utilities (Balbuena 2014:6) in these strategic sectors. This serves as a clear demonstration of the relevance of SOEs in emerging economies, where SOEs are responsible for the provision of strategic services that are deemed to be in the national interest (Aproskie, *et al* 2014:2) and fundamental to the government's developmental agenda (Ngonini 2014:406). SOEs support the government in addressing matters of social and economic transformation, and in closing the gap between rich and poor, and rural and urban populations (PRC 2013:7). In developing countries these strategic sectors need to expand in order to support economic growth and social development goals (NDP 2011:161), and their operational well-being is dependent on external funding, other than from government, particularly for capital investments. To achieve this, SOEs seek (and are required) to emulate private-sector governance practices while retaining full state ownership (Frederick 2011:9).

Business environments in which SOEs function are characterised by changes brought about by advancements in technology (Crosby 2014:47; Hass *et al* 2006:835), by global competition for access to international markets (Allen & Mawn 2011:31; Mintz & Krishnan 2009:60), and complex financial instruments (Odoyo, Omwono & Okinyi 2014:169) needed to compete for investor funding (Maharaj, Hei & Van Rensburg 2006:19). All of these changes bring about uncertainties and exposure to related risks, which are sometimes perceived as "emerging economy risks"

(Chambers & McDonald 2013:4). Such an environment demands effective corporate governance systems (Taufiqurrahman 2011:31; Mintz & Krishnan 2009:60) and risk management processes (Schneider, Sheikh & Simione 2011:29; Liu 2012:287) at enterprise level. Previous research on private sector organisations has shown that management and the audit committee rely on internal audit to evaluate and improve risk management (Msiza 2011:27). The same expectation exists for internal auditing in SOEs (Okibo & Kamau 2012:109).

Berg (2010:81) describes risk management as "a systematic approach to setting the best course of action under uncertainty by identifying, assessing, understanding, acting on and communicating risk issues". The literature supports the view that internal auditing has to play a role in risk management (Stewart & Subramanian 2010:345; Hass *et al* 2006:835; Sarens & De Beelde 2006a:71). While acknowledging that risk identification, evaluation and monitoring are the responsibility of top management and the board, internal auditing could nevertheless contribute as consultants and assurance providers on risk management processes and systems (Allen & Mawn 2011:31; Stewart & Subramanian 2010:345), roles which Sarens & De Beelde (2006b:219) deem to be of a supportive nature. They can offer consulting services to help the organisation in identifying, assessing and implementing risk management methodologies and controls to address significant risks (Odoyo *et al* 2014:174; Arena & Azzone 2009:46) by suggesting steps likely to mitigate the consequences of not achieving the organisation's objectives (Turlea & Stefanescu 2009:213).

As the environment in which SOEs function is changing, internal audit is required to proactively adapt to changing business demands (Octavia 2013:79). Yee, Sujan and James (2007:17) regard today's internal auditor as a strategic partner to business, requiring internal auditors to share risk-related insights and analysis prior to strategic decisions being made. Their contribution to risk management, according to Bekiaris, Efthymiou and Koutoupis (2013:63), forms a critical part of an organisation's management function. This is in line with the prediction made by Anderson and Svare (2011:1) that internal auditors will focus on risk management, and governance processes will become the foundation of the internal audit profession. However, as pointed out by Lindow and Race (2002: 28), where there internal audit lacks understanding of the risks faced by the organisation, they will only be able to follow a traditional checklist approach, and will fail to monitor the organisation's risk profile, and to identify risk management processes needing improvement.

Dissenting views have been expressed about internal auditing's involvement in relation to risk management; for example, Griffiths (2005:45) questions how far internal auditing should go – a valid question which is especially pertinent with regard to addressing emerging risks. Most companies which failed during the 2007/8 economic meltdown did not focus enough on identifying, assessing and managing the emerging risks that ultimately destroyed stakeholder value (McShane, Naira & Rustambekov 2011:641; Marks

2011:2; Beasley *et al* 2010:29). Msiza (2011:27-28) is of the view that internal audit should have played their part by bringing to the fore the risks that compromised the financial sustainability of some SOEs, when they had to request additional funding from banks and the government to continue with their operations. The question therefore remains whether management of SOEs should create an opportunity for internal audit to address this risk-management vacuum.

Although the internal auditing profession believes that as partners to management, internal auditors “are positioned to help protect the organization against both traditional and emerging risks” (IIARF n.d.), a recent Ernst & Young (2013:1) study shows a contrasting view. Only 27% of internal auditor respondents to their survey indicated that they participated fully in identifying, assessing and monitoring emerging risks, whilst 54% were expecting to become fully involved within the next two years (ending in 2015) (Ernst & Young 2013:1).

Some explanations for such low involvement in addressing emerging risks are to be found in the literature, and suggestions have also been made for the changes that are needed in order for involvement to gain momentum. These include suggestions on changes to internal audit practices, the role and responsibilities of internal auditors and their current and future skills sets. Within the limited body of research about internal audit in SOEs, no attention has yet been given to emerging risks. As the focus of this study is to determine the role of internal audit in today’s SOEs, its role in relation to emerging risks is explored in relation to the existing literature on private sector entities. SOEs and other organisations are operating in environments characterised by rapid change (due to globalisation and advances in technology), where funding sources have decreased. One could argue that the challenges faced by internal auditors in the private sector correlate well with challenges that internal auditors in SOEs face. This is supported by Van Gansberghe (2005) and Goodwin (2004:648), who claim that internal auditing in the private sector and the public sector is very similar. Thus published suggestions for improvement gathered from the literature, for internal auditors to play a more prominent role in managing emerging risks, would also be relevant for internal auditors in SOEs.

In order for internal audit to assume a more prominent role in identifying the risks that are constantly emerging, the internal audit charter should be flexible enough to allow internal audit to take a proactive and forward-thinking approach (Cavaleros 2013:21; Deloitte 2012:3), and it has to be aligned strategically with the needs and priorities of all stakeholders, including the audit committee and senior management (Piper 2014:30; Hass *et al* 2006:839). The annual audit plan should therefore be adapted to provide for a balance between assurance and advice on strategic business initiatives (Ernst & Young 2013:4).

Internal auditors need to present a forward-looking perspective to top management and the board, highlighting exposures and assisting to prevent disruptions or losses to organisations that could arise should the threats materialise (Accelus, Thomson &

Reuters 2013:3; Msiza 2011:28). Tabuena (2012:30 & 31) believes internal auditors not only have to understand the business environment in which their organisations operate, they should also be able to relate the potential impact of the emerging risks to recognised causes, both individually and in combination. Bota-Avram, Pop and Bota-Avram (2009:208) suggest that this could require internal audit to amend its role in the process of risk management into one with a more strategic outcome. Msiza (2011:29) is of the view that the operations of the IAF should be aligned with the changing risk profile of its organisation and the increasing and changing needs of the organisation’s stakeholders.

Internal auditors must expand their skill sets in order to meet these demands (Boyle & Boyle 2013:4; Hass *et al* 2006:842). Cavaleros (2013:22) similarly questions whether internal auditors have the requisite skills mix and resources to proactively identify and address emerging risks, as the role of a strategic advisor on emerging risks requires enhanced strategic thinking capabilities (Protiviti 2013:1) and the ability to respond quickly to emerging events (Tabuena 2012:30). The role demands business insights, good communication skills and analytical thinking skills. Tabuena (2012:30) believes that organisations are overly optimistic, expecting the IAF to cultivate skills and to leverage specialists in order to provide support in areas in which it does not have the breadth and depth of expertise to provide the required insight. Boyle and Boyle (2013:8) also identify the need for internal audit to master other attributes, pointing out that for internal audit to obtain access to strategic deliberations, it must be viewed by both senior management and the board as reliable, knowledgeable and trustworthy; and in order to be viewed in this way it needs to demonstrate its willingness to accept the challenge. In order to succeed it is imperative that the IAF be strengthened through allocation of sufficient resources to enable it to attract the required skills.

3 METHODOLOGY

In order to achieve the objective of this study, an understanding of IAFs in SOEs was required and therefore a qualitative research approach utilising a case study method was followed (Hennink, Hutter & Lailey 2011:16; Yin 2011:6; Patton 2002:14). Three SOEs in South Africa were selected, because of the strategic nature of their operations in the country’s developing economy: energy, transport and water. In selecting the individual participants for this study, three stakeholders identified by the literature (Sarens, De Beelde & Everaert 2009:90; Goodwin 2003:265) as important role players in internal audit were considered, namely chairs of the audit committees (CACs), chief audit executives (CAEs) and chief financial officers (CFOs). In addition to their organisational importance, they also have a close working relationship; the CAE, as the head of an IAF, reports functionally to the CAC (Cavaleros 2013:20), and many of the services performed by the IAF relate to financial matters under the direction of the CFO (Sarens & De Beelde 2006b:222).

For the three SOEs selected, internal audit in the first is an in-house function; the second is an in-house function with an element of co-sourcing of the specialist areas, while the third has a fully outsourced IAF. This added dimension enabled the study to examine three different forms of IAFs.

The intention was to have interviews with Eskom (representing energy), but as a result of the aforementioned electricity crisis this became impossible. Eskom was therefore replaced by a SOE falling under the office of the Presidency that deals with youth development issues. The interviews with all three SOEs were conducted from 10 October 2014 to 12 December 2014.

The limitations of following a case study method are that it could be seen as lacking rigour (Yin 2009:14; Neale, Thapa & Boyce 2006:4) These limitations have been managed in this research by striving to optimise the quality of the research and the validity (Shenton 2004:63) of the data. This was done by ensuring that the study examined what was actually envisioned, and that a correct depiction of the phenomenon under scrutiny was presented (Morrow 2005:251). However, the findings are not generalisable in the conventional sense (Flyvbjerg 2006:219; Hodkinson & Hodkinson 2001:9) as they are not necessarily representative of the wider population of SOEs. Efforts were also made to ensure that the reliability (Seuring 2008:131) of findings was consistent with reality (Patton & Appelbaum 2003:65). These outcomes were largely achieved by utilising guided interview questions (so that a similar line of questioning was applied to all interviewees), and by following a structured approach (recording interviews, having them externally transcribed, communicating with interviewees to review transcripts and analysing the data using ATLAS.ti software). The study was nevertheless based on views of only eight participants from only three SOEs, and so the findings cannot automatically be assumed to have widespread and general applicability.

4 FINDINGS OF THE STUDY

(1) Background

In obtaining an understanding of the internal audit function in today's SOEs, the views held by CACs,

CAEs and CFOs of three SOEs in strategic sectors of the economy – namely water, energy and transportation – were sought. As explained above, Eskom had to be removed from the study due to the unavailability of the intended participants, and was replaced by another SOE that does not operate in a strategic sector. It was established through observations and detailed interviews with the participants from this enterprise that when compared with SOEs in the strategic sectors of the economy, the maturity of its IAF was less than that of the enterprises in the strategic sectors, with reference to combined assurance and quality assurance reviews (internal and external), and in terms of the experience and maturity of the CAE heading the IAF.

Of the three SOEs selected, the first SOE has an in-house IAF; the second has an in-house IAF with an element of co-sourcing to address the specialist areas, while the third has a fully outsourced IAF. This enabled the study to address three different forms of IAFs. As indicated earlier, the CAEs, CFOs and CACs of the selected SOEs were invited to participate in the study. Table 1 shows the participants in the study.

Table 1: Participants in the study

SOE	CAE	CFO	CAC
SOE 1	1	1	1
SOE 2	1	1	1
SOE 3	1	1	0
*Eskom	1	0	0
Total	4	3	2

**Eskom was replaced by another SOE because of unavailability of participants as a result of the electricity crisis.*

Eight interviews were conducted with the participants identified above. Participants were classified as follows: category A (CAEs), category B (CACs) and category C (CFOs).

The data was transcribed from the interviews' audio recordings, thus reflecting participants' verbatim responses. The data was coded and analysed using the Atlas.ti program and subsequently interpreted. This resulted in themes (reported in Table 2) being identified that enabled proper alignment to findings. Detailed findings are reported in accordance with the themes shown in Table 2.

Table 2: Themes emerging from the data obtained during the interviews

Themes		
Perceptions	Expectations	Challenges
Sub-themes	Sub-themes	Sub-themes
<ul style="list-style-type: none"> General perceptions (how internal audit is perceived) CAE perceptions CFO perceptions (experienced through working with the IAF) CAC perceptions (experienced through working with the IAF) 	<ul style="list-style-type: none"> IA business partner to management Supports audit committee and management Independence Playing a role in emerging risks IA skills set meeting expectations on emerging risks Providing insights into strategic initiatives IAF functioning at the level of a strategic advisor 	<ul style="list-style-type: none"> Performance auditing Uniform methodologies/ systems Repeat findings Business insight Combined assurance External quality review (QAR)

(2) Perceptions of IAFs by the participants

Participants were requested to share their perceptions of their SOE's IAF. This question was raised with the intention that it would provide information on how internal audit was seen in the organisation in relation to value-adding, advice and partnering with business for continuous improvements towards achieving strategic objectives.

General perceptions about internal audit

The CAE participants from the three SOEs believed that their IAFs are taken seriously in their organisations, are seen as advisors and are respected. This perception is illustrated in the following quotations:

Internal audit here is seen as an advisor. [A]s much as we are also [an] assurance provider we are [a] key stakeholder in strategic initiatives.

Whatever client, need[s] business survival [advice] they call us. Audit here is well respected, clients call us and we help where we can when resources are available.

I think we have the new board and [it] is very focused ... on governance, and the IA [function] is taken more seriously. In the past we were not taken seriously.

The CAC participants perceived internal audit to be serving a critical function within their SOEs, as CACs rely on internal audit to highlight new risks, and to inform the audit committee proactively. There is consensus that internal audit is highly regarded, as reflected in the following quotations:

Internal audit in SOEs play[s] a critical function as they ensure that there are governance process[es] and that the enterprise is accountable in ensuring service delivery.

The audit committee sees internal audit as a critical function in the business, as they rely more on internal audit to highlight and inform the audit committee about issues proactively.

As can be seen from the above quotations, the CAC participants are generally satisfied with the IAFs. However, one of the CAC participants commented that the effectiveness of internal audit also depends on the effectiveness of the audit committee, as the committee is expected to provide leadership and direction to the IAF.

The CFO participants perceived internal audit as supportive, assisting management to implement strategies and achieve objectives. The following quotations convey this perception:

Internal audit is perceived as a very critical stakeholder in the organisation.

I think the value that internal audit brings is that [it] is very important that internal audit find the support. They are a critical business partner.

From the above quotations it can be seen that there is general satisfaction with internal audit by this

category of participants, and that internal audit is seen as a positive and critical asset for the business.

(3) Expectations of IAFs by the participants

There is the expectation that internal auditors need to give a forward looking business perspective to top management and the board, proactively pointing out exposures that may arise from future threats (Msiza 2011:28). To do this effectively, they have to understand the business environment in which their organisations operate.

IA as business partner to management

The CAE participants agreed that their IAFs partner with business in order to achieve continuous improvements in their SOEs. The following quotations illustrate their opinions:

That's how we want our clients to perceive us: we are here to partner with you, [and] as much as we have to remain independent ... we are partnering with [you] in making sure that you improve.

But in this case the business is welcoming internal audit in their operations, which is becoming a problem. They want them to be involved upfront so that they are assured at inception [that] their processes [are appropriate], rather than waiting for them at completion, to be able to give an opinion whether the internal controls are intact.

These quotations clearly illustrate two respondents' views, that internal audit should partner with management for continuous improvements. The other participant, from the non-strategic sector of the economy, felt that internal audit should not partner with business as it would compromise their independence. This contradiction could be ascribed to the fact that the risk and IAFs of that particular SOE are managed by the same person, whose background is mainly in risk management, suggesting that his awareness of the wider scope of internal audit is still limited. This finding could also point to an area for future research, which could investigate the state of cooperation between IAFs and risk functions in SOEs.

A CAC respondent agreed that there is a need for internal audit to partner with business for continuous improvement. He asserted:

The head of internal audit should build relations with everyone in the business so that the auditee see[s] the internal audit [function] as an advisor so that there is [a] trust element.

All three CFO respondents agreed, and supported the notion that internal audit should partner with business for continuous improvement, as can be seen from the following quotations:

They need to be business partners in terms of validating the management assertions and whatever initiatives which management put[s] in place with regard to the development of the strategy, because if those assertions are not validated we can end up spending the money on things which are not critical to the [required] outcomes.

Another CFO participant asserted:

IA is part of the strategic process. They also participate in [determining] what should be our priorities. And for an auditor to audit they must first understand the environment; in fact they must understand it at the level of the expert so that they will be able to issue sound findings and sound advice. What it does, it makes the IAF that area [of the business] that have the mastering [(understanding)] of the entire value chain of the whole organisation.

A CAC participant agreed:

Internal audit should be knowledgeable about the business because if you are not knowledgeable about the business you go and audit admin issues and lose a bigger picture of organisational strategy. You need business insight, the knowledge of what ... you advising on.

Audit Committee and management support

From the above analysis of the views of participants it is clear that IAFs in the three SOEs are supported by both management and their audit committees: they have the resources to meet their mandates, and management support is demonstrated in that IA's recommended corrective actions are implemented.

A CAE participant explained:

I don't think there is anyone who can say they have enough budget ... [even though] the media say [my SOE] has the biggest internal audit in the world. If you have a budget you can do more, but I am not complaining [about] the budget that I have: [it] is sufficient to cover [the] amount of work because even the [private sector] firms have limited resources in terms of people. We [manage to] cover strategic audit, high risk areas, so I am comfortable with the budget that I have.

A CAC participant of another SOE agreed with the above notion:

The audit committee will take a key [recommendation] from internal audit in terms of resource requirements, and does ensure that internal audit is fully resourced. As it happened with internal audit of [my SOE], when a request was put forward for specialists within internal audit, the audit committee supported the motivation for the specialists' resources.

A CFO participant largely concurred with the above mentioned views, albeit with some reservations:

I think there is support from management in terms of the budget allocation. ... [Internal Audit] can never have enough resources to address the risks of the company, it's a dilemma but with[out] adequate support [it is not possible] to address the medium and low risks of the organisation. The appetite is there from management and the board but it can never be enough.

IAFs in these SOEs are seen as important; they are therefore not the first ports of call when it comes to organisational cost-cutting.

Independence

The backbone of the internal audit profession is the union of auditor independence and objectivity (Stewart & Subramanian 2010:328), which gives rise to value and credibility in the profession, and is manifest as independence of thought and action. The IIA's Standard 1100 for the professional practice of internal auditing requires, that the internal audit activity be independent, and that this independence requires that the chief audit executive reports to a level within the organisation that allows the internal audit activity to fulfil its responsibilities.

From the analysis of the views of participants in the three seniority categories, it becomes clear that the IAFs in the selected SOEs comply with the IIA's Standards relating to independence and objectivity.

A CAE participant reported:

I report directly to the chairperson of the audit committee. Actually the CEO doesn't even want [to] review my reports.

As another CAE participant explained: *Internal audit reports to the audit committee and that's what sits in their charter. Internal audit has direct access [to] the chairperson of the board, external auditors, and audit committee chairperson.*

A CAC participant perceived the IAF to be in "a powerful position within the organisation". He/she therefore believed:

It is imperative that CAEs are pitched at an executive level within the organisation. Internal audit should be the ears and eyes of the audit committee, and must function like the executive of the audit committee...[They] should not be afraid to raise issues with the audit committee: that is the reason why the head of internal audit has to be able to meet separately with the chair of audit committee.

A CFO participant shared his/her perceptions:

I think our internal audit [function] is independent in terms of structure. [The] reporting line of the chief audit executive is directly to the chairperson of the audit committee. Actually, there is really no interference from the group chief executive, none at all. She/he reports directly to the chairman.

Another CFO participant explained his/her SOE's unique reporting lines that also strengthen the IAF's independence:

We had discussions about the level of independence of internal audit and took a decision that because we are unique from other state entities (we have executive chairman and deputy executive chairman of the board), then for administration purposes, ... [the] IAF will be taken away from the chief operating officer. ... [W]e will go to the deputy chairman of the board (to make sure that the independence is strengthened), and functionally they report to the audit committee.

From the above quotations the participants highlighted that the IAF has a functional reporting line directly to the audit committee.

Playing a role in identifying and managing emerging risks

The literature suggests that internal audit should play a prominent role in risk management (Cavaleros 2013:21; Deloitte 2012:3; Goodwin 2004:648). From the analysis of the views of participants, it becomes clear that the participants believe that internal audit should play a role in managing emerging risks.

A CAE participant explained the conduct of her/his IAF in relation to emerging risks:

We have a risk management committee [meeting] at [my SOE office] every month where we discuss key risks and emerging risks and so on, and we use that to update our audit plan and our consulting plans. So, we play ... very significant roles especially on emerging risks. We invest enough time to discuss particular emerging risks and say what our response is on this one.

A CAC participant supported the notion that internal audit has a role to play in managing emerging risks, and explained by providing examples:

There are different forms of SOEs and [they are] classified in terms of schedule 2, or 3a or 3b, [of the Constitution], and some are geared towards the strategic sector of the economy ... [and positioned a long way along the] continuum towards commercialisation, and are self-funding. These SOEs compete on the same footing as the private sector. As they expand into other areas like taking over another SOE in the same sector [as my SOE is doing], brought about huge risks which might have affect[ed] [my SOE's] balance sheet. These require that internal audit play a proactive role in identifying these risks. Similarly with the water crisis that happened in Gauteng, internal audit should be highlighting the emerging risk.

Another CAC participant shared his/her expectation regarding combined assurance, but acknowledged that it has not been fully met:

IA can work closely with other assurance providers so that there is combined assurance. We are not yet there, but I think IA should play a critical role and identify the emerging risks.

A CFO participant highlighted his/her expectation as follows:

We expect them [IA] to participate in the risk identification process for the whole organisation. If new risks emerge, or in their plan [they] start identifying new trends which will bring new risks [to our attention], ... the expectation is that in their reports they will be highlighting those risks to risk management, so that we can respond or even provide corrective measures.

From the above it can be observed that there is support for the idea that internal audit should play a

role in managing risks, as they are already doing. However, a contrasting view was raised by a CAE participant from the non-strategic sector SOE, who believed that the role in identifying and managing emerging risks should be played by the risk function and not the IAF. Again, the fact that the risk function and the IAF are managed by the same person in this SOE, and that his/her background is risk management-orientated, could serve as an explanation, as this attitude also applies to emerging risks.

IA skills set

From the literature review it is evident that there is an expectation that internal audit will cultivate skills and leverage specialists to support areas where it does not yet have the breadth and depth of expertise to provide the required insight (Protiviti 2013:1; Tabuena 2012:30).

From an analysis of the views from participants from all three categories, it becomes clear that the in-house IAF has technical specialists within the function, in line with the business requirements. The outsourced IAF has technical skills provided by the service providers as and when the business requires them, whilst the other SOE has chosen to co-sourced the technical skills as and when required.

A CAE participant explained how he/she manages his/her skills requirements:

Actually the meeting that we had before you came in, that project is led by an engineer from KPMG. So, as much as this is an outsourced [service], [in] the model that I am using to manage the consortium, the only difference between an in-house and outsourced function in my approach is that I don't pay their salaries, but I manage them as if they are my people. A junior auditor on the floor - I want to know if they are being trained; I need to know if there is skills plan, clearly documented, to make sure that they are focused on [my SOE] Like I say, as much as they are outsourced, I manage them like they are employed here.

A CAC participant shared his/her advice as follows:

What is required of IAF is to attract and retain the specialists with skills, [the people] who understand the technical nature of the core business of the organisation, complemented with business insight.

A CFO participant indicated his/her expectation:

You have already answered, appropriate skills, competencies that are aligned to the organisational requirement even appropriate capabilities even resources and tools. Having infrastructure that can compete with the best practice requirements out there ... in order to gain [the] confidence of management and even [the] audit committee, that means we should be recognised by external parties (being both external auditing and the entire [assurance] fraternity...

Providing insight into strategic initiatives

From the analysis of the views expressed by participants in all three seniority categories it was

apparent the IAFs of SOEs participate in strategy sessions, mostly through the CAE, as he/she is a member of the executive committee of the SOE. This can be seen in the following quotes.

A CAE participant stated his/her IAF's position:

We have access to minutes to check any strategic decisions that have to be taken, [and] to also define our roles. Like I said, we prefer a proactive approach. Two things: whenever [my SOE] come up with a new strategic objective already, when I come back from that meeting I get a team together which will zoom into that specific issue [to] try and define our role within that initiative.

A CAC participant maintained that:

Internal audit should take its rightful place and participate in the strategy session and offer advice, and must conduct research on strategic initiatives undertaken by the organisation, and be ... [already] prepared to offer support as things happen.

A CFO participant expressed a concurring view:

Internal audit is part of the strategic process: they also participate in [determining] what should be our priorities, and for an auditor to audit they must first understand the environment. In fact, they must understand it at the level of the expert so that they will be able to issue sound findings and sound advice.

From the above quotations there is apparently consensus that the IAF should give insight into SOEs' strategic initiatives.

Internal audit functioning at the level of strategic advisor

Analysis of the views of the participants from all three respondent categories show that IAFs of the SOEs in strategic sectors function at a level where they are able to provide insight into strategic initiatives. However, there was consensus amongst the participants representing the SOE from the non-strategic sector that the IAF still needs to employ additional staff who possess consulting and advisory skills, in order to function at such a level.

(4) Challenges experienced by the IAF

IAFs in SOEs experience challenges relating to a lack of skills to conduct performance auditing; the use of different methodologies and auditing systems by outsourced functions; repeat findings; a lack of business knowledge and insight; participation in combined assurance; and non-compliance with quality assurance and improvement programme standards.

Performance auditing

The Auditor General (AG) normally conducts performance audits of those government entities in whose audits they are directly involved, even though these are classified as discretionary audits and are not regulatory. However, for the SOEs in the strategic sector of the economy, the external audit is

conducted by external (private sector) audit firms on behalf of the AG. Thus the AG does not conduct performance audits in these SOEs. Although performance audits are conducted on a non-recurring basis (ad hoc), they are important as a management tool that provides information and feedback leading to improvements to the organisation. One CFO participant expressed the view that IAFs in SOEs need to introduce performance auditing, as this would greatly assist in the achievement of strategies and the optimal use of resources. In addition, it would educate the business around achieving operational economy, effectiveness and efficiency. The participant said:

The area that I feel SOE internal auditors can improve is around performance auditing. I think performance auditing needs to be introduced; it needs to be mandatory. It will really greatly assist in the achievement of the strategy and the optimal use of resources.

Uniform audit methodology and management system

The IAF of one of the participating SOEs is outsourced to different external audit firms at different times, but the audit system remains a manual exercise and the files are also kept manually. A participant from this SOE suggested the introduction of an electronic working paper system, with the SOE owning the intellectual property for the total system. This, it was believed, would enable the different audit firms to use one system, that of the SOE, which would thereby standardise audit processes and improve productivity.

He/she explained:

I am in the process of developing an internal audit methodology for [my SOE]: I don't want the firms to come with their methodology.

He/she further stated:

I am also in the process of acquiring [an] audit management system because currently the audits are completely manual files. So, we are going to have [my SOE's] system so that each firm has to come and use the [SOE's] system, so the intellectual property and whatever, is owned by [my SOE].

Repeat findings

A CAE participant expressed concern about the issue of findings that keep arising:

I mean, yesterday I ... managed to summarise the three years' worth of audit findings until March 2014, comparing the three years, to say "these were the key functions, findings and all that". And I said to them, "I am opening discussions with management", and they said "why?". I want them to stop and reflect and [to] say, "Why are these issues coming back now? What are the root causes? Is it the people issue, or [a] culture issue, [a] system issue, [a] management issue or process issue?" so that we can come up with solutions, [so] that we will help us remove the recurring issues, you understand.

He/she explained further:

You can see from the previous years that it is similar issues coming up. And I said, "I want us to come up with lasting solutions which forces management... [to] embed whatever changes need to be embedded, so that we focus on strategic issues. Then the operational matters - let's just embed [solutions] and sort out the root causes and move on."

Business insight

The CFO and CAC participants raised a concern that internal auditors lack insight into the business aspect of their organisations.

A CFO participant attributed the IAF's lack of business knowledge in his/her SOE to their limited experience within the organisation:

You need to have sufficient knowledge of the business, and in our case they are all new. So they are all in their first year, and to acquire knowledge of this type of business, the uniqueness, complexity, it takes time. But there is value that you can add as an auditor, as there are basic things that you can question.

From the above quotation it is clear that management is of the view that IAFs in their SOEs do not have sufficient knowledge of the operations of their organisations, nor of the environments in which the SOEs are functioning. Their expectation goes beyond the mere technical knowledge of auditing related matters, and extends to knowledge of the operations of SOEs and their business environments.

Combined assurance

Principle 3.5 of the King III report (IoD 2009:62) introduced combined assurance as a recommended governance practice. The report also recommended that the IAF should take a leading role in the implementation of combined assurance (IoD 2009:96). The IAFs in the SOEs involved in the strategic sectors of the economy have been involved in the implementation of combined assurance in their organisations; however a concern was raised by a CAC participant of the SOE in the non-strategic sector that combined assurance still has to be implemented and that it could prove a challenge for the IAF.

Internal audit can work closely with other assurance providers so that there is combined assurance. We are not yet there, but I think internal audit should play a critical role and identify the emerging risks.

External quality review (QAR)

In terms of the IIA Standard 1300 for the professional practice of internal auditing, the quality assurance improvement programme (IIA 2012:7) obliges the IAF to develop a quality assurance and improvement programme that covers all aspects of the internal audit function, which should include internal and external assessments. The external assessment has to be conducted at least once every five years (IIA

2012:7). One of the CAC participants raised a concern that his/her SOE had not conducted quality assessment in terms of the Standard, as can be seen in the following quote:

I think most organisations have not gone for external quality assurance as per Standard. Even [my SOE], they have just done peer review, and it is a Standard requirement.

5 CONCLUSION

In the literature review the important role played by SOEs in the economy was made clear. Similarly, from the literature review the important role played by the internal audit functions of SOEs is recognised. But, studies of IAFs in SOEs are in short supply. In an attempt to fill this gap, this study aimed to obtain an understanding of the role of IAFs in SOEs by determining the perceptions of, expectations for and challenges experienced by IAFs in today's SOEs.

The research methodology followed was a qualitative one, utilising a case study method. Three SOEs in South Africa were selected, and the views of important role players associated with the internal audit function, namely the CACs, CAEs and CFOs, were solicited.

The findings of the study show that IAFs in SOEs are perceived in a positive light. The IAFs are expected to act as management's business partners, in efforts to achieve continuous improvements. Additionally, they are supported by both management and audit committees: their independence is not negotiable; they are adequately resourced, and they comply with IIA Standards in this regard. The findings further indicate that some IAFs of SOEs play a role in addressing emerging risks, with the in-house functions being augmented with the employment of technical specialists, all of which enable the IAFs to provide insight into the strategic initiatives of their SOEs.

From the above it is clear that the participants place significant reliance on internal audit. However, IAFs in SOEs face specific challenges: there is a lack of performance auditing in SOEs; methodologies and auditing systems used by outsourced functions differ from those used in and preferred by the SOEs; the issue of repeat findings still recurs; the IAFs lack essential business knowledge and insight; combined assurance is in its infancy, and there is a high degree of non-compliance with quality assurance and improvement programme Standards.

Even though these findings should be considered against the limitations of the study reported earlier (particularly using case studies that draw on the views of a very limited number of participants), the findings do provide insight into an essentially unexplored area. Future research directions could also be identified: for example, to determine whether performance auditing is beneficial for SOEs; to examine how SOEs should most effectively coordinate their in-house, outsourced and co-sourced IAFs; to determine how internal auditors should be educated and trained so that they obtain the desired business acumen and insights

most effectively; quantify the status of combined assurance within SOEs, and examine the level and effectiveness of cooperation between IAFs and risk functions in SOEs.

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