

A survey of the standing of and demand for internal auditing in South African companies – an overview

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ABSTRACT

This article explores the standing of and demand for internal auditing within South African companies. Central to the paper is a study of the changing profile of the internal auditor as well as the expanded roles of internal audit functions (IAFs). Key areas investigated include current academic and professional literature; the Chief Audit Executives' (CAEs') perceptions regarding the functions and activities of the Institute of Internal Auditors (IIA) in South Africa; the composition of the IAF's staff complement and the demand for the services of the IAF; the IAF's structure, standing, functions and roles in corporate governance, and risk assessment and risk management within the company. Data was gathered from the CAEs as well as the main users of internal audit services, namely the Chairperson of the Audit Committee (CAC), the Chief Executive Officer (CEO), the Chief Financial Officer (CFO), and/or the Chief Operating Officer (COO) of 30 large, listed South African companies. The findings of the study reported in this article indicate that IAFs have a high standing within South African companies and that there is a demand for all levels of internal auditors.

Key words

Internal audit standing; internal audit demand; South Africa

1 INTRODUCTION

Since the democratisation of South Africa there has been a significant number of changes not only on the political field but also in the broader economic environment. One of the areas impacted by these changes is the discipline and profession of internal auditing. These political and economic changes have influenced the development of internal auditing in South Africa through recommendations and demands for the improvement of accountability and governance, and more significantly through regulation requiring internal audit services (King 2002:86-90; Sawyer, Dittenhofer & Schneider 2003; South Africa 1999).

This article provides an overview of the iKUTU study, the full details of which are still to be published in a detailed research report. An overview of the preliminary results was presented as a conference paper and this article incorporates the presentation and feedback received at the conference (Plant & Steyn 2009). The purpose of identifying the standing of and demand for internal auditing in large listed South African companies is to address a lack of knowledge in three specific areas, namely the impact of the new definition of internal auditing on the

industry, the revised International Standards for the Professional Practice of Internal Auditing (Standards), and recommendations on the role of internal auditing in corporate governance in South Africa (Institute of Internal Auditors (IIA) 2009; King 2002:86-90).

Limited information on the practice of internal auditing in South Africa is available in the literature. There are some international studies that also used information gathered from South African internal auditors who are mostly also members of the international Institute of Internal Auditors (IIA) (Powel, Strickland & Burnaby 1992; Burnaby, Hass & Abdolmohammadi 2006).

The iKUTU study builds on the global survey that was conducted by the Institute of Internal Auditors Research Foundation (IIARF) in 2006 to refine the common body of knowledge (CBOK) of internal auditing. The iKUTU study is different from the 2006 CBOK study as it elicits the views and perceptions of both the chief audit executives (CAEs) and the users of internal audit services. The 2006 and prior CBOK studies focused on eliciting the views of internal auditors only (Abdolmohammadi, Burnaby & Hass 2006). However, the views of the users of internal audit services were considered critical to this study as their views would help to identify the perceived

standing of and demand for internal audit services. The users, for this research, included the chairpersons of audit committees (CACs) and chief executive officers (CEOs), chief financial officers (CFOs) and/or chief operating officers (COOs) of listed companies in South Africa that have amongst the largest market capitalisations on the JSE.

The aim of the study on which this article is based was to determine the standing of and demand for internal auditing in South Africa as perceived by the above-mentioned stakeholders in some of the largest listed companies in South Africa. To identify the standing of and demand for internal audit services the following were considered:

- Profiles of the CAEs of the internal audit functions (IAFs);
- Perceptions regarding the functions and activities of the South African Institute of Internal Auditors (IIA(SA));
- Perceptions regarding the composition of the IAF's staff complement and the demand for the services of the IAF;
- Perceptions regarding the IAF's structure, standing and functions;
- Perceptions regarding the IAF's role in corporate governance; and
- Perceptions regarding the IAF's role with regard to risk assessment and risk management.

2 LITERATURE REVIEW

Since the acceptance of the new definition of internal auditing, issued in 1999 and revised in 2009, the role of the internal auditor has changed significantly (Goepfert 2006; Harrington 2004; IIA 1999; Jackson 2007). Jackson states that the focus of the IAF has shifted from performing governance and financial reporting work to a greater responsibility in assisting organisations in managing global risks in many areas, including governance and financial reporting. This change is in line with the latest revision of the definition of internal auditing:

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of governance, risk management, and control processes" (IIA 2009).

The new definition illustrates the broader responsibilities of the IAF (whether in-house or outsourced) in assurance and consulting roles, with specific reference to the value added with regard to evaluating risk management, control and governance processes. These broader responsibilities of the IAF apply to both the private and public sectors in South Africa. The current practice of internal auditing does not reject the traditional view of internal auditing as a discipline derived from accounting. It does, however, extend the view of internal auditing beyond the traditional narrow view to include risk, control and governance (Sumners 2005). This includes internal

auditors' roles with regard to the rendering of specialised services amongst others, forensic and environmental audits and involvement in mergers and acquisitions. This expanded role of internal auditing has also expanded the circle of benefactors of internal auditing services to specifically include senior management as the recipients of value-adding advisory and consulting services (Jackson 2007). Management in South Africa is also increasingly looking to internal auditors to perform non-traditional functions, such as risk assessment and management, taking into account amongst others, an environment characterised by a high crime rate, significant unemployment and inhibited growth (Van Wyk, Hodson, Marx & Du Toit 1998).

There are various factors contributing to the changing role of internal auditors. These factors include an increasingly vigorous global call for improved governance and accountability after significant business failures at the start of the 21st century. These lead to increased regulation in the United States of America that increased the number of companies required to have internal audit departments. Oxner & Oxner (2006) in particular, highlight the renewed emphasis on corporate accountability, a process initiated by the Sarbanes-Oxley Act of 2002, and which has resulted in greater visibility for IAFs and a growing demand for internal audit services.

In South Africa, a need existed for more effective corporate governance, but this was not initially addressed because there was only limited regulation. The demand for enhanced corporate governance was addressed through the different King reports that recommended and described good governance practices. The 2002 King (King II) report specifically recommended the establishment of an audit committee and an IAF as well as compliance with the Standards for the Professional Practice of Internal Auditing (King 2002:38-39 & 86-90). The 2009 King report (King III) takes the IAF function further as it highlights the responsibility of the Board to implement an effective IAF and to establish an audit committee. In addition, the IAF should also "furnish an assessment to the board generally on the system of internal controls and to the audit committee specifically on the effectiveness of internal financial controls" (King III 2009:14).

In the South African public sector legislation promulgated in the late 1990s also emphasises the need for improved governance and accountability. The Public Finance Management Act (PFMA) and the Municipal Finance Management Act (MFMA) both highlight the need for improved governance as well as the requirement to establish effective IAFs within government enterprises (South Africa 1999; South Africa 2003).

The changing profile of internal auditors also influenced the number of members of the IIA globally as well as in South Africa. Globally the IIA membership grew from approximately 42 000 members in 1991 to more than 120 000 members in 2006, including 50 000 Certified Internal Auditors

(CIAs) (Goepfert 2006). According to the IIA(SA), membership has grown from approximately 1 500 members in 1998 to more than 7 000 members in 2009, which includes 700 certified CIAs.

It is evident from the literature that internal auditing has evolved into a totally integrated management tool, employed to enhance and sustain the success of an organisation. Internal auditors are compelled by statute and best practice internationally, to render value-adding services with regard to evaluating the effectiveness of risk management, control and governance processes within organisations.

This study is the first South African attempt to identify the impact of the evolution of internal auditing since the turn of the century on the practice of internal auditing in 30 large listed companies in South Africa. These results can be used as a benchmark by stakeholders in the public sector as there is a close correlation between the governance principles and mechanisms applicable in the private and public sectors.

3 RESEARCH METHODOLOGY

Data was gathered from 30 large listed South African companies through the use of three survey questionnaires. The companies were selected primarily on their market capitalisation and drawn from all main industries listed on the Johannesburg securities exchange (JSE). Three questionnaires were used to collect the data from the Chief Audit Executive (CAE), as well as the users of internal audit services, namely the Chairperson of the Audit committee (CAC) and the Chief Executive Officer (CEO), the Chief Financial Officer (CFO), or the Chief Operating Officer (COO). The questionnaires were developed after performing a detail literature review, and conducting discussions with other academics in the field of internal auditing, with practitioners in internal auditing, and with staff of the IIA(SA). The questionnaires were finally tested in a pilot study. The main findings are described below.

4 FINDING

The aim of the study on which this article is based, was to determine the standing of and demand for internal auditing in South Africa as perceived by the above-mentioned stakeholders. The results are described in the next section mostly using percentages based on the actual responses to the specific questions. However, some sections show the responses on a five point Likert scale and in those instances an explanation of the scale is added to the description.

4.1 Profile of the CAE

The profiles of the CAEs show that despite the relatively new field of internal auditing and the shortage of professional accountants in South Africa (SAICA 2008), professional qualifications and higher degrees are important. The respondents to the CAE

questionnaires indicated that 66.7% of the CAEs hold honours degrees. However, the relative newness of internal auditing as a specialisation is still evident as only 30% of the CAE respondents are qualified as CIAs.

Although 68.9% of the CAE respondents have more than five years experience in internal audit, only 41.4% have been CAEs for more than five years. This relative lack of experience linked to the small number of CIAs can be seen as an indication that the practice of internal auditing, as a specialised discipline within businesses, and similar to the academic discipline, is in its infancy in South Africa. Despite the relative newness of the discipline, the activities of the IIA(SA) are widely known, as is discussed in the next section.

4.2 The function and activities of the South African Institute of Internal Auditors (IIA(SA))

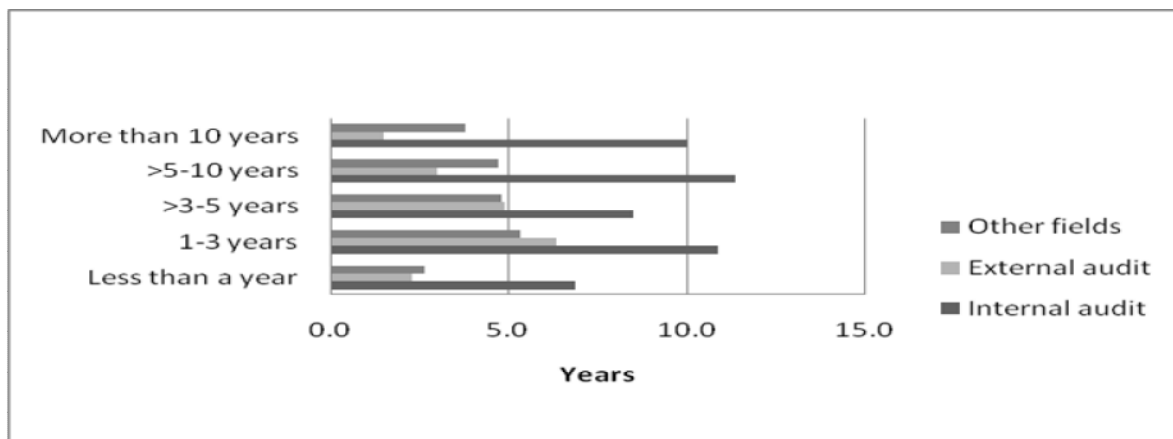
Despite the low number of CIAs the existence of the IIA(SA), has been successfully promoted. 96.7% of the CAC and 93.1% of the CEO/CFO/COO respondents confirm knowledge of the existence of the IIA(SA). Even knowledge of the CIA certification is significantly widespread as 82.8% of the CEO/CFO/COO respondents were aware of the qualification. 93.1% of the CAC and 76.7% of the CEO/CFO/COO respondents indicated that their IAF complied with the Standards for the Professional Practice of Internal Auditing. The latter is not unexpected as compliance with the Standards is a specific recommendation of the King report on corporate governance (King 2002:89). The recommendation that the IAF should adhere to the Standards is also included in King III (King 2009:44). As knowledge of the IIA(SA) and the Standards is already widespread it is not unreasonable to expect an increase in the demand for internal auditors.

4.3 The composition of the IAF staffing and demand for internal auditing services

The increased demand for knowledgeable internal auditors is impacting on the desired academic qualifications of internal auditors as shown by the perception of the CAE respondents. In an average IAF 46% of the staff already have degrees or higher academic qualifications, while only 17% are CIAs. This would indicate that despite the fact that the professional certification is known, the IIA(SA) still needs to promote broader acceptance of its certification amongst role players in internal auditing.

The average in-house IAF, according to the CAE respondents, has 47 employees, of which 45 are permanently employed, 39 have a national higher diploma or a lesser academic qualification and only five are professionally certified as CIAs. Despite the relatively low prevalence of academic or professional qualifications, internal audit experience is the predominant form of work experience gained by practising internal auditors as indicated in Figure 1 below.

Figure 1: Work experience



The perceived demand (identified as vacant positions) for internal auditors according to the CAE respondents stands at an average of 30.9 people. The demand is based on the number of vacancies over a twelve month period as indicated in Figure 2. In an average department of 47 people this translates into a desired 65.7% increase in staff, or an average

total staff complement of 77.9 people. When the demand is broken down into the different levels of staffing the highest demand is for audit managers with the lowest for trainees. This could indicate unwillingness on the part of the participating companies to be part of the internal audit training process.

Figure 2: Demand for internal auditors

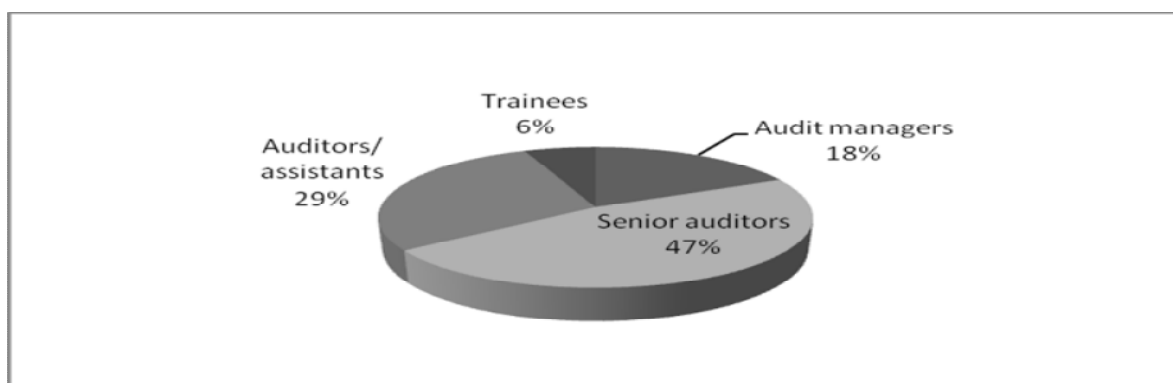
Staffing levels	Average number of staff required
Audit manager	12
Senior auditor	8.3
Auditor/assistant	7.6
Trainee	3
Total	30.9

4.4 The structure, standing and functions of the IAF

The CAEs' perceptions of how a typical IAF is structured, using rounded averages, show audit

managers at 18%, senior auditors at 47%, auditors or assistants at 29% and trainees at 6%, leading to a structure dominated by senior auditors as shown in Figure 3 below.

Figure 3: IAF structure



The main structure used by companies is the deployment of an in-house IAF supplemented through outsourcing and co-sourcing. According to the CAC respondents only 10% of IAFs were completely outsourced. According to the CAE respondents 64% of the IAFs are outsourced and/or co-sourced.

The main factors that are driving the trend to outsource are the shortage of technically competent

staff and insufficient capacity or resources within the company. The main reasons given for the establishment of an in-house IAF are that the internal audit staff have superior knowledge of the company and that the complex business processes of the company are beyond the ability of outsiders to fully understand in the time available to them. In essence outsourcing is used where there is a shortage of skills and capacity within the company's own IAF. The

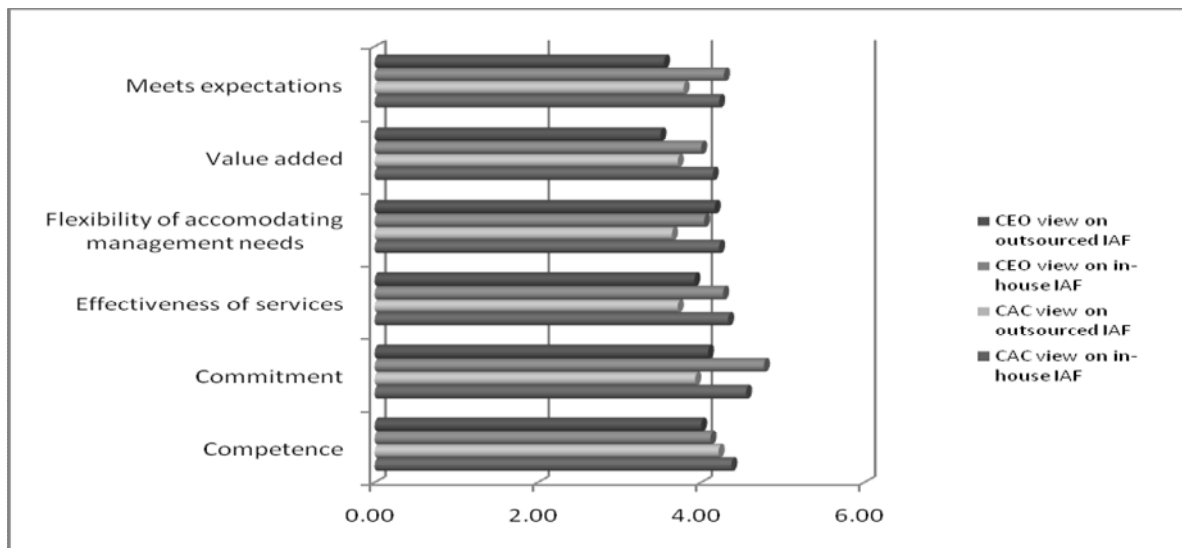
shortage in skilled staff linked to a high turnover in staff is a typical symptom of a fast growing internal audit environment.

According to the CAE respondents the activities most frequently engaged in by an IAF include operational/performance audits, information systems audits, financial audits, responding to *ad hoc* management requests and risk assurance. Interestingly, no respondent indicated a current or future provision for the IAF to assist with operational activities, indicating that internal audit is viewed as a function that should remain independent of the operational activities they are required to audit. The CAE respondents' expectations of the most frequent engagement activities include risk assurance, information systems audits, operational/performance audits, financial audits and corporate governance audits.

The intensified focus on risk management in the new definition of internal auditing is reflected in the higher emphasis being placed by respondents on using a risk-based approach to internal audit. This practice mimics the international trend that records a risk-based audit approach as the approach most frequently followed.

Various attributes of the IAFs were investigated. These attributes include their competency, commitment, service, performance, flexibility and the value added. The CAC and CEO/CFO/COO respondents expressed their satisfaction with the in-house and outsourced IAF's attributes on a five point Likert scale with 1 as extremely dissatisfied and 5 as extremely satisfied, the results are shown in Figure 4 below.

Figure 4: User satisfaction on IAF attributes



The CAEs strongly support the view that auditees recognise the value that is added by their IAF's services. One of the aspects used to assess the standing of an IAF, was to determine the extent to which its recommendations are implemented by the company concerned. 90% of the CAC and CEO/CFO/COO respondents agree that the recommendations that are made by an in-house IAF are either "always", or "frequently", implemented.

61.5% of the CACs are of the opinion that the external auditors of a company place a high reliance on the work done by an in-house IAF, with 41.2% of these respondents sharing a similar view with regard to an outsourced IAF. This difference could be attributable to the focus of an in-house IAF being mostly on rendering assurance on the normal business processes of the company, whereas outsourced IAFs focus on more unusual areas or events which might not be recurring or might be an exceptionally technical or specialised part of a normal

internal audit engagement such as that performed by information systems auditors.

4.5 IAF's role in corporate governance, risk assessment and risk management

The level of satisfaction expressed by the CAC was higher than that of the CEO/CFO/COO as indicated in Figure 5, suggesting that IAFs have sufficient standing in the companies to contribute to corporate governance at a high level. The level of satisfaction with the role played by the in-house IAF is perceived to be higher at 4.3 (CAC) and 4.1 (CEO/CFO/COO) (using a five point Likert scale with 1 as extremely dissatisfied and 5 as extremely satisfied) when compared to the level of satisfaction with the role of the outsourced IAF at 4 (CAC) and 3.6 (CEO/CFO/COO). The reporting structure also supports the perception of the high standing of the IAF as 83.3% of IAFs report functionally to the CAC.

Figure 5: Contribution to corporate governance

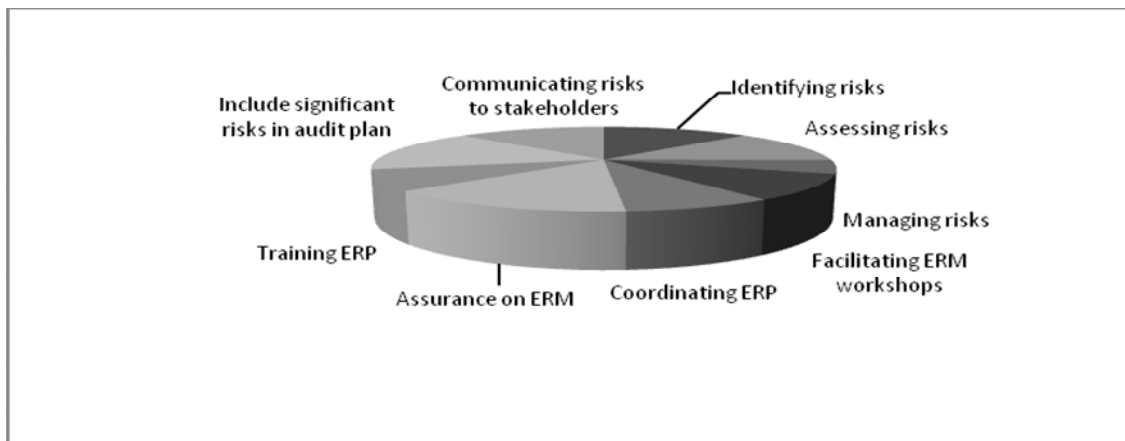
	CAC CEO/CFO/COO
Audit committee	4.6
	4.4
External auditors	4.4
	3.8
In-house IAF	4.3
	4.1
Outsourced IAF	4.0
	3.6
Board of Directors	4.6
	4.2
Management	4.4
	4.1

4.6 Risk management and the IAF

As described earlier the IAF now predominantly uses a risk-based audit approach. However, the definition of internal auditing allows for a significant expansion

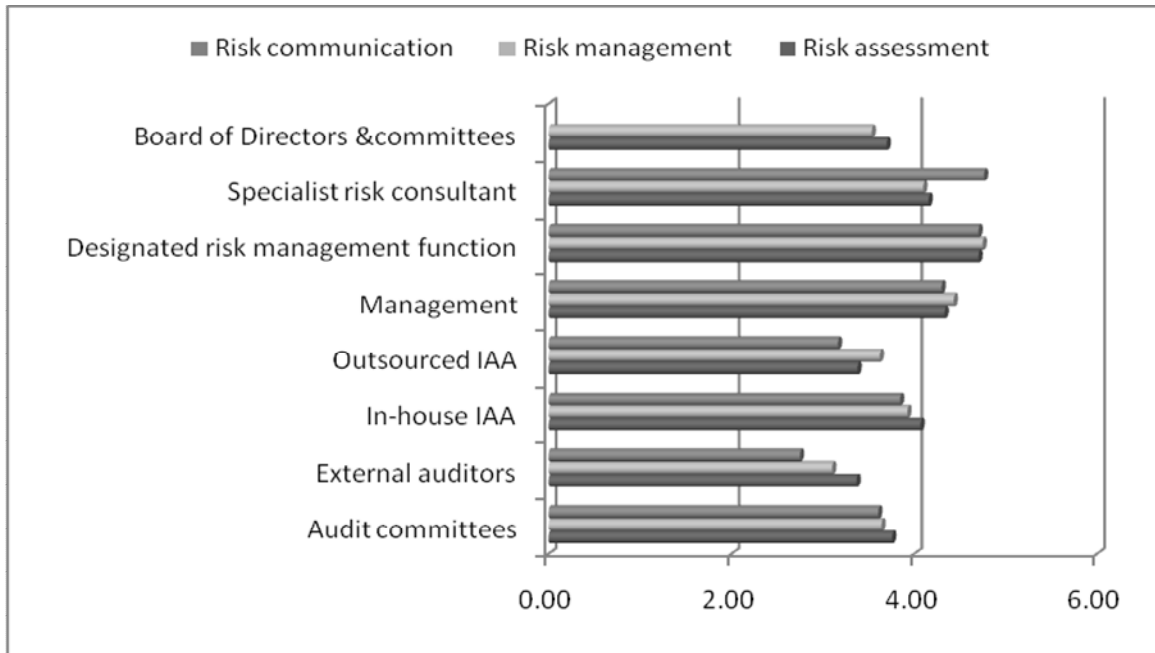
of the role of the IAF in the analysis and audit of risk in the enterprise. The broad scope of the involvement of the IAF in risk activities in companies, according to the CAE respondents, is shown in Figure 6.

Figure 6: CAE view on IAF involvement in risk activities



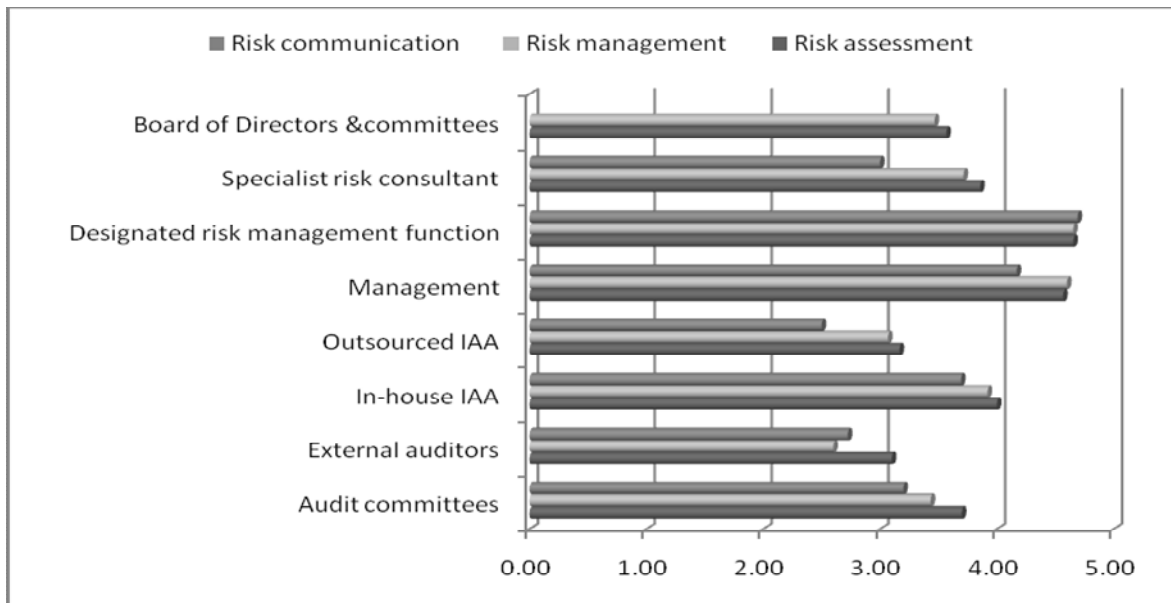
The CAC view of the contribution of the IAF to risk assessment, management and communication on a scale from 0 as “no contribution” to 5 as a “significant contribution” is shown in Figure 7 below.

Figure 7: CAC view on the contribution of the IAF to risk management



The CEO/CFO/COO views of the contribution of the IAF to risk assessment, management and communication on a scale from 0 as “no contribution” to 5 as a “significant contribution” is shown in Figure 8 below.

Figure 8: CEO/CFO/COO view on the contribution of the IAF to risk management



The views of the CAE and the users of internal audit services all indicate that the IAF does contribute to risk management in line with the definition of internal auditing.

5 CONCLUSION

This article explored the standing of and demand for internal auditing within South African companies. The changing profile of the internal auditor as well as the expanded and expanding roles of IAFs was studied in the literature review. The article also investigated the following key issues: the profiles of the CAEs’

perceptions of the functions and activities of the IIA(SA); the composition of the IAF’s staff complement and the demand for its services; the IAF’s structure, standing and functions as well as its role in corporate governance; and risk assessment and risk management. Data was gathered from the CAEs as well as from the main users of internal audit services of 30 of the largest listed South African companies in order to determine the standing of and demand for internal auditing.

The findings of the study reported in this article indicate that IAFs have a high standing within South

African companies and that there is a high demand for the services of all levels of internal auditors. With regard to the profile of the CAE, the findings indicate that the majority have postgraduate academic qualifications, but only 30% are CIAs, although the functions and activities of the IIA(SA) are well known amongst the users of internal audit services.

The study identified the average IAF as consisting of 47 personnel, but with a demand (or need) for a further 30.9, the majority of which demand (12) is for audit managers, while the lowest demand (3) is for trainees. The structure of the IAF shows senior auditors as its biggest staff grouping at 47%, with trainees the smallest at 6%. With outsourcing and co-sourcing being popular methods to assist the IAF to achieve its objectives 64% of the IAFs make use of outsourcing and co-sourcing.

The good standing of the IAF is clearly indicated in the high incidence of acceptance of internal audit

recommendations. The CAC and CEO/CFO/COO respondents agree that in more than 90% of the cases internal audit recommendations are "always" or "frequently" implemented. This acceptance and implementation of their recommendations together with the functional reporting line to high levels within the company, and most frequently to the CAC, is an indication of the importance of IAFs in and to their companies. The generally high standing with which IAFs are viewed applies especially to in-house IAFs.

It can therefore be concluded that IAFs have a high standing within South African companies. The findings of the study also indicate that there is a high demand for skilled internal auditors in South Africa. This study was limited to the private sector and therefore an investigation into the standing of and demand for internal auditing within the South African public sector, is an area for future research.

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