# Elements of the internal audit capability model addressed by South African public sector legislation and guidance

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**ABSTRACT**

Internal auditing plays an important role in any country's public sector. South Africa is no exception and the role of internal auditing in the South African public sector has come to the fore in recent years. This article considers the extent to which the elements and key process areas identified by the Institute of Internal Auditors' internal audit capability model are addressed by applicable South African public sector legislation and guidance. The internal audit capability model comprises a comprehensive international guide to assist any public organisation's internal audit function to measure its capability in terms of the Institute of Internal Auditors' six elements of internal auditing. A literature review was conducted to consider the inclusion of the key process areas within the six elements of the internal audit capability model to the most prominent applicable South African legislation and guidance. The results of this research may assist the South African government to identify the significant shortcomings in legislation and guidance as it relates to internal auditing. The study, as presented in this article, found that although most of the elements of the internal audit capability model are addressed to some extent by South African legislation and guidance, significant shortcomings still exist, especially on the higher capability levels of the model.

**Key words**

Internal auditing; capability model; public sector; legislation; guidance

## 1 INTRODUCTION

In South Africa, the internal and external environment of government has changed dramatically over the last two decades: a new political party has ruled the country since 1994; a new constitution was promulgated in 1996, followed by new acts and codes, and changes in the structure of the government (Van der Waldt & Du Toit 2005:104). In the public sector, management is accountable, or answerable, for how resources are utilised (Pauw, Woods, Van der Linde, Fourie & Visser 2002:29,136-137, 229; Du Toit, Knipe, Van Niekerk, Van der Waldt & Doyle 2002:219), both to external parties (for example, the taxpayers) and internal parties (for example, to supervisors, directors and senior management). The government is facing increasing demands for better quality and higher quantity of service delivery, whilst at the same time having to keep track of and reign in its expenses in order to produce results (Curristine 2005:127). One of the parties that can assist the government to address this problem is the internal audit function (IAF). In South Africa, legislature such as the Public Finance Management Act (PFMA) and the Treasury

Regulations makes it compulsory for government institutions to have an effective and efficient IAF that report to audit committees (South Africa 1999:S76(38)(a)(ii) & S77; National Treasury 2005:S3.1 & S3.2).

Internal auditing is a relatively new discipline compared to most other business-related disciplines, with practitioners active in both the private and public sectors world wide (Dittenhofer 2001:458; Chapman 2004:42). The IAF of government institutions must add value by contributing to the improvement of service delivery through the providing of assurance to management that risks are addressed appropriately, control systems are effective and efficient, and that governance and business practices are sound (Carhill & Kincaid 1989:51; Coupland 1993:4; Lapointe 2004:64-66; Van Gansberghe 2005:70). The profession's evolution has reflected the ongoing changes in both the methods and philosophy of conducting the affairs of organisations (Chapman 2004:42). Currently, the profession is at a crucial stage as a result of the rapidly changing environment in which internal auditors operate. Studies indicate that internal auditors need to understand who they

are, what is expected of them, and where they are going (Deloitte & IIA (UK and Ireland) 2003; PwC 2008:2; PwC 2010:5). The Institute of Internal Auditors (IIA) identified that the IAFs within the public sector needed guidance and in 2009 the IIA Research Foundation (2009) developed a capability model for the public sector to be used by IAFs to measure their level of capability.

The main objective of this study is to assess the extent to which South African public sector legislation and guidance address the six elements of the IIA's Internal Audit Capability Model (IACM). The results of the study could be useful to the South African government should they consider revising applicable legislation and rectifying the weaknesses and limitations of the IAF identified by this study.

The paper is set out as follows: background information including the discussion of the relevant literature; the research methodology used; analysis of the applicable legislation and guidance; the conclusion, and recommendations.

## 2 BACKGROUND

In this section the two main areas that this study reflects on, are briefly discussed. The first section identifies applicable South African public sector legislation and guidance that incorporates issues that relate to internal auditing. The second section provides a brief overview of the development of the IIA's capability model, to determine whether it is based on a sound foundation.

### 2.1 Internal auditing in the South African public sector

The South African public sector has seen significant changes during the last two decades. The first democratic elections in 1994 marked not only transformation in the presidency and ruling party, but also in public sector approaches to governance, fiscal and managerial legislation and guidance (Pauw *et al.* 2002:229). Prior to 1994 public sector officials were mostly governed by rule-based instructions through the Exchequer Act, No 66 of 1975 rather than principle-based guidelines (Van der Waldt & Du Toit 2005:156,302). However, as a result of the government transformation, and strongly influenced by the publication of the first King Report on Corporate Governance in 1994 (IOD 1994), the PFMA was developed and promulgated in 1999, under which the issue of governance was legislated for the South African public sector (South Africa 1999).

The directive for the public sector is to deliver services to the citizens of a country (South Africa 1996; Du Toit *et al* 2002:17-19; Pauw *et al* 2002:1; Van der Waldt & Du Toit 2005:47). The extent and complexity of these services is based on the needs of the public (Du Toit *et al* 2002:11-12). As the needs of the public increase, the required level of service delivery also increases. The government has the mandate to meet these needs but has a limited amount of resources available. The funds necessary

to meet these needs are received from the national revenue fund, which is ultimately collected from the taxpayer (Du Toit *et al* 2002:130). It can, therefore, be argued that the government is ultimately accountable to the taxpayer. In South Africa, the PFMA laid the foundation for the level of accountability to be achieved in the various public sector organisations. One of the main objectives of the PFMA is to provide a strong framework where managers are allowed to manage as they see fit, yet are still held accountable for their actions (Pauw *et al* 2002:129, 138; Luyinda, Herselman & Botha 2008:30).

The introduction of the PFMA and the Treasury Regulations (National Treasury 2005), along with subsequent legislation such as the Municipal Finance Management Act (MFMA), had a significant impact on internal auditing in the South African public due to legislative requirements. The PFMA requires that the accounting officer ensures that his/her government organisation (national department, provincial department or public entity) has and maintains an IAF (South Africa 1999:23; National Treasury 2005:9). This same requirement has been applied to municipalities as well as municipal entities by provisions in the MFMA (South Africa 2003:74). The existence of an IAF is therefore a legislated requirement for all spheres of government.

The following key legislation and public sector-specific guidance applicable to the field of internal auditing have been identified for the purposes of this study.

### 2.1.1 Legislation

The South African public sector is subject to a wide range of legislation. This study will, however, only review South African legislation that specifically refers to internal auditing in the public sector. The following acts and/or regulations have been identified as being the most pertinent in this regard:

- **The Public Finance Management Act, No 1 of 1999 (South Africa 1999)**

    The PFMA was promulgated in 1999 and is mainly focused on the provision of sound financial practices to promote effective service delivery to the people of South Africa through the effective, efficient and economical use of existing resources (Luyinda *et al* 2008:30). The Act is applicable to all national and provincial departments, including all public entities (South Africa 1999:8). Section 38 of the Act specifically requires that the accounting officer of each government organisation to which the Act applies, must ensure that the organisation has an effective IAF. For the purpose of this study, the PFMA should be viewed in conjunction with the Treasury Regulations and the IIA International Standards for the Professional Practices of Internal Auditing (hereinafter referred to as the *Standards*) as the stipulations in these documents are included in this Act (refer to the discussion below).

- **The Treasury Regulations (National Treasury 2005)**

  Section 76(1) of the PFMA, as well as section 216(1) of the Constitution of South Africa (South Africa 1996), instructs the National Treasury to develop regulations that will provide a framework of uniform treasury and accounting norms and standards. The purpose of these regulations is to ensure transparency and accountability in all the spheres of government. The 2001 National Treasury Regulations, a revised edition of which came into effect in March 2005, fulfilled this instruction. These regulations are applicable to all departments and constitutional entities, as well as public entities (National Treasury 2005:3). The regulations not only reiterate the requirement for internal auditing, but also provide more specific guidelines and instructions to the IAF (National Treasury 2005:9-10).

- **The Municipal Finance Management Act, No 56 of 2003 (South Africa 2003)**

  The MFMA was developed in 2003 in order to apply the principles of the PFMA to the local government environment. The main objective of the Act is to secure the sound and sustainable management of the fiscal and financial affairs of municipalities and municipal entities (South Africa 2003:22). The requirement for an IAF is re-established for all local government organisations in sections 62, 95 and 165 of this Act. The MFMA, although developed on the principles laid out in the PFMA, provides more specific requirements and detailed guidance for the IAF in the municipal financial environment.

- **Local Government: Municipal Planning and Performance Management Regulations (South Africa 2001) - hereinafter referred to as Regulation 796**

  Section 120 (read with sections 37, 43 and 49) of the Municipal Systems Act, No 32 of 2000 (South Africa 2000), mandates the Minister responsible for local government to develop any additional regulations required in terms of the Act. Such regulations were developed and released in August 2001 for municipal planning and performance management activities. These regulations are therefore also applicable to all the categories of municipalities as well as municipal entities. The purpose of the regulations is to provide more specific guidance for municipal integrated development planning, performance management (including the development and measurement of performance indicators), and community participation with regard to the integrated development planning and performance management processes. The regulations specifically direct the IAF to implement processes for auditing the results of performance measurements (South Africa 2001:13-14), for example, by auditing the functionality of the performance management system, determining the level of compliance with the Municipal

Systems Act, and ascertaining the reliability of performance measurements.

### 2.1.2 Public sector-specific guidance

Although extensive guidance exists for the public sector, this study will only focus on the most prominent frameworks that specifically refer to internal auditing, and scrutinise its requirements to determine the extent to which the elements of the IACM are included. The following guidance that is applicable to the public sector has been selected:

- **King III Report on Corporate Governance (IOD 2009)**

  The third King Report on Corporate Governance (King III) came into effect in March 2010. The report superseded the first report, King I, published in 1994 (IOD 1994), and the second report, King II, published in 2002 (IOD 2002). The purpose of these reports was to present a code of corporate best practices that considered the larger community in which a private sector organisation operates (Barrier 2003:68). King I mainly applied to the private sector, focusing mostly on companies listed on the South African stock exchange, the JSE Limited (IOD 1994:5). King II expanded its application to include public sector enterprises and agencies (IOD 2002:21). The third King Report applies to all business entities regardless of the sector in which they operate (IOD 2009:17), thus the principle defining the role of internal audit within an organisation is now also applicable to the broader public sector.

- **Protocol on Corporate Governance in the Public Sector (Department of Public Enterprises (DPE) 2002)**

  In 2002 the Department of Public Enterprises (DPE) published the revised Protocol on Corporate Governance for the South African public sector. The purpose of this document is to provide a corporate governance framework for state-owned entities (SOEs), as the South African government recognises that these organisations play an important role in delivering services to the people of South Africa (DPE 2002:2-4). The protocol therefore applies to all SOEs and their subsidiaries (DPE 2002:3), and reiterates the importance, role, reporting structure and independence of an effective IAF (DPE 2002:46).

- **National Treasury Internal Audit Framework (National Treasury 2009)**

  The revised framework was published in March 2009 and its development was mandated by both the PFMA and the MFMA. The main purpose of the framework (National Treasury 2009:6) is to provide the public sector with a minimum directive for the development and operation of internal auditing. It also aims to assist public sector IAFs in complying with the main public sector legislation (such as the PFMA and the MFMA) and the IIA *Standards*, as well as the Committee of

Sponsoring Organisations of the Treadway Commission (COSO) framework on internal control (COSO 1992) and their risk management framework (COSO 2004). The main topics discussed include legislation and guidance, audit committees, establishment of an IAF, risk management, control and governance, the audit process, and consulting activities.

- **International Standards for the Professional Practices of Internal Auditing (IIA 2009)**

The IIA is the global professional body for the internal audit profession. The *Standards* were developed by the IIA in order to provide the internal audit profession with a set of professional guidance, including a code of conduct. The latest version of the *Standards* was published in 2009. The *Standards* are applicable to internal auditing in the South African public sector as the Treasury Regulations specifically require all public organisations to whom the regulations apply to conduct internal audit activities in accordance with the *Standards* (Treasury Regulations 2005:S3.2.6).

### 2.2 The use of a capability model

The concept of capability models has been developed over the last decade and is well accepted by organisations (Hillson 1997:36; Persse 2001; Chapman 2009). In 1973, Nolan published a model focusing on the various stages of growth within an information technology environment and in 1979 Cosby developed a quality management capability grid (Nolan 1973; Cosby 1979). A capability maturity model (CMM) was developed during the late 1980s to early 1990s by the Software Engineering Institute (SEI) of the Carnegie Mellon University in the United States of America (USA) (SEI 2010). The CMM focuses on capability, maturity and business excellence (SEI 2010) and is based on a framework of process capabilities that was developed by Watts (1988). The CMM was originally developed to advance software engineering methodologies and processes using data from organisations contracted with the USA Department of Defence (Hillson 1997:36). However, the model has since been adapted for various other fields. An example of this is the well known Risk and Insurance Management Society risk maturity model (RIMS 2006), which is based on this model (Liebowitz 2007:44). It seems that most modern capability or maturity models have been developed using the SEI model as a starting point (Hillson 1997:36; Liebowitz 2007:44; McDonald 2007:29; Chapman 2009).

The SEI model suggests that a well-structured CMM should be in the form of a matrix that comprises the following elements (Persse 2001; Chapman 2009; Wikipedia n.d.):

- a few levels of capability describing the stage of development;
- the assessment criteria or attributes describing the quality of the practices within each capability level; and

- the competencies describing the incremental improvements or desired capabilities linking the levels to the criteria.

After comprehensive research, the IIA Research Foundation (2009) developed the IACM, based on the SEI model (Ziegenfuss 2010:68), for public sector internal auditing (refer to Annexure A for the one-page matrix summary of the model). The model was developed to assist internal auditors and other internal audit stakeholders to identify the fundamentals needed for an effective IAF within a government structure and within the broader public sector (Ziegenfuss 2010:68).

Although it could be argued that the private and public sectors function differently, internal auditing for these two sectors is very similar (Du Toit *et al* 2002:24; Goodwin 2004:643-648; Van Gansberghe 2005:70-73). The similarities include the requirement that internal audit engagements should be performed consistently; that internal auditing is a principle-driven profession; and that the internal audit function should assist management in both sectors to achieve the organisation's objectives. However, a major difference between the private and public sectors, is that the public sector operates within strictly and legislatively defined parameters, and it is this factor that underpins this research paper. This fact, as well as the increasing international trend mandating internal auditing within their legal structures for government, for example, in South Africa, the Netherlands, the USA and Sweden (Sterck & Bouckaert 2006:51), has necessitated the need for additional guidance for the public sector with regard to implementing an effective and efficient IAF. The IACM could be a valuable aid for the enhancement of public sector internal auditing and the development of future legislation and guidance for IAFs in the public sector, provided the IACM complies with the criteria of a well-developed model, such as the SEI.

To determine whether the IACM is in fact a well-developed model, it is compared below with the elements of the SEI capability model, which has already been proven to be a quality model. All three areas, as set by the SEI model, are present, namely:

- Level of capability: the IACM has five progressive capability levels with a description of the characteristics and capabilities of the IAF within each level (IIA Research Foundation 2009:7-9);
- Essential elements: the IACM identifies the six essential elements that are present in any IAF (IIA Research Foundation 2009:9-12); and
- Key process areas (KPA): the main indicators that must be present within each element for a specific capability level (IIA Research Foundation 2009:18-25) are present in the IACM.

This model, developed on the SEI model methodology, that is accepted and used worldwide, could be the ideal tool to assist internal auditors in the public sector when developing and implementing an effective and efficient IAF that can be recognised and accepted by management. However, the question remains as to whether the legal environment within

which the South African public sector operates includes the principles addressed in the model.

## 3 RESEARCH OBJECTIVES, METHODOLOGY, SCOPE AND LIMITATION

This study's objective can best be formulated in the following research question:

> To what extent are the elements and KPAs of the IACM (as discussed in section 2.2) addressed by the relevant South African legislation and guidance (as discussed in section 2.1)?

The research methodology consisted of three activities.

- Firstly, the six elements of the IACM were studied; a short summary explaining the outline of each is provided under six sub-sections (refer to sections 4.1 to 4.6).

- Secondly, the legislation and other guidance as discussed in sections 2.1.1 and 2.1.2 was scrutinised for information applicable to the six elements of the IACM. This step was performed according to the following methodology:

  o Words or concepts in the IACM were identified and searched for in the applicable legislation and guidance.
  o These concepts or words were linked to the key processes per KPA.

- Thirdly, the capability level was determined according to the IACM matrix (refer to Annexure A).

Although great care was taken to identify and obtain all the relevant public sector-specific legislation and guidance addressing internal auditing, (refer to section 2.1) it is possible that some guidance was not included, for example, a specific department may have developed its own guidance. However, the most important legislation and most widely used regulations are included (Erasmus 2010). It should also be noted that although the various pieces of legislation and guidance are applicable to specific governance spheres as discussed in section 2.1, the outcome of the analysis is presented for the public sector as a whole. A further aspect to consider is that the inclusion of the elements of the IACM within the applicable South African legislation and guidance was not scientifically measured, and although great care was taken to eliminate biased opinions, it is possible that this could have occurred.

It is important to note that the scope of this study is limited to South African legislation and guidance only. Future studies could include other countries' public sectors, as well as empirical evidence of the current capabilities of the various South African government

organisations. This study aims at determining the gaps in the current legislation and guidance that are hindering our public sector organisations' efforts to fulfil their potential. This is important as the public sector is legislation-driven and full potential, therefore, will only be reached if the applicable legislation is congruent with the required capability elements. The results from this study could be used by the legislator and other bodies within government that are developing internal audit-specific guidance for the public sector.

## 4 RESULTS OF THE ANALYSIS

In this section, the analysis of each of the six elements of the IACM is presented in the structure below (refer to section 4.1 to 4.6):

- a brief summary of the elements of internal auditing as discussed in the IACM;
- an analysis (in table format) of the extent to which each element is covered by South African legislation and public sector-specific guidance; and
- a conclusion.

### 4.1 Services and role of internal auditing

The 'services' of internal auditing refer to the type and extent of services that the IAF provides to a government organisation. Internal auditors typically provide assurance services, consulting services or a combination of the two. The types of audit engagements could include, *inter alia*, compliance reviews, performance audits, financial audits or information technology audits (IIA Research Foundation 2009:37).

The 'role' of internal auditing refers to the responsibility of the internal auditor to assist the organisation in achieving its objectives and improving its operations by providing audit assessments that are independent and impartial (IIA Research Foundation 2009:37).

The model describes the role and services of the IAF as falling between the following two extreme capability focus points (IIA Research Foundation 2009:14, 37):

- On the highest capability level internal auditing is recognised as a key contributor to change, specifically with regard to the governance processes of the government organisation.

- On the lowest capability level (level 2) internal auditing merely reviews compliance with policies, contracts and legislation. Please note that level 1 is not included, as the IACM matrix (refer to Annexure A) refers to this level as "*ad-hoc*" and/or "unstructured".

**Table 1:   Analysis of South African legislation and guidance with regard to the services and role of internal auditing**

| Legislation & Guidance (*) | Level 1 | Level 2 | Level 3 | Level 4 | Level 5 |
|---|---|---|---|---|---|
| PFMA | · IAF is mandatory | | | | |
| Treasury Regulations | | · Perform compliance audits on laws, regulations, controls and financial transfers | · Assist management on controls and objectives | · Develop a charter in line with the IIA definition<br>· Coordinate with other assurance providers<br>· Evaluate and recommend controls and strategic objectives | |
| MFMA | | · Perform compliance audits on various aspects | · Advise management on performance management<br>· Advise management on various aspects | · Report to audit committee on certain governance issues, risk management and control | |
| Regulation 796 | | | · Perform performance measurement audits | | |
| King III | · If the board decides not to implement an IAF, reasons and explanation how assurance will be obtained must be disclosed | · Adequate assurance on business processes and controls | | · Develop a charter<br>· Coordinate with other assurance providers<br>· Provide over-all assurance on governance, risk management and control<br>· Written assessment on control and risk management effectiveness | |
| Protocol on Corporate Governance | | · Monitor various compliance activities | · Assist management on controls and accounting procedures | · Develop a terms of reference document<br>· Coordinate activities with external audit<br>· Evaluate and recommend controls and accounting procedures | |
| IIA *Standards* | | · Comprehensive guidance on assurance services | · Comprehensive guidance on advisory services<br>· Evaluate the adequacy of effective and efficient operations | · Comprehensive guidance on overall assurance on risk manage-ment, governance and control<br>· Develop a charter in line with IPPF | |
| National Treasury Framework | | · Refer to IIA *Standards* | · Refer to IIA *Standards* | · Refer to IIA *Standards* | |

*(*) Refer to sections 2.1.1 and 2.1.2*
*Key: IPPF = International Professional Practices Framework*

The element 'Services and role of internal auditing' is well presented in the various legislation and guidance. However, on level 3, although reference is made to performance management and performance measurement, the audit of economy, effectiveness and efficiency is not properly addressed. The level 5 KPAs are not addressed at all (refer to Annexure A).

### 4.2 People management

'People management' constitutes the establishment of a working atmosphere that endeavours to promote the most effective use of internal audit human resources (IIA Research Foundation 2009:37-38).

The model depicts the people management of the IAF as falling between the following two extreme

capability focus points (IIA Research Foundation 2009:14, 71):

- On the highest capability level the IAF practices workforce projection, which involves the development of a strategic workforce plan in accordance with the strategic objectives of the government organisation.

- On the lowest capability level (level 2) the IAF employs skilled internal auditors and practices individual professional development. Please note that level 1 is not included, as the IACM matrix (refer to Annexure A) refers to this level as "*ad-hoc*" and/or "*unstructured*".

**Table 2: Analysis of South African legislation and guidance with regard to people management**

| Legislation & Guidance (*) | Level 1 | Level 2 | Level 3 | Level 4 | Level 5 |
|---|---|---|---|---|---|
| PFMA | · IAF is mandatory | | | | |
| Treasury Regulations | | · Skilled people identified and recruited based on risk strategy | | | |
| MFMA | · IAF is mandatory | | | | |
| King III | | · Staff competencies support risk and control spectrum<br>· Staff adhere to the Code of Ethics and IIA *Standards* | · Staff planned to serve complex business areas and provide greater value<br>· Staff has technical and business skills | | |
| Protocol on Corporate Governance | | · Personnel knowledgeable on Code of Ethics and IIA *Standards* | · Qualified CAE | | |
| IIA *Standards* | | · Collectively the IAF has staff with the necessary knowledge, skills and other competencies<br>· Continuous professional development of staff managed | · The IAF plan must be linked to the resources available<br>· If the IAF lacks in skills or knowledge, these should be obtained | | |
| National Treasury Framework | | · Recruitment, placement, training and staff retention programme to ensure appropriate skills are available<br>· Clear job descriptions, goal setting, performance evaluation and training programmes at all levels | · The IAF plan linked to the resources available<br>· If the IAF lacks skills or knowledge, the activity is out-sourced or co-sourced, whilst skills transfers are developed<br>· Retention programme to retain competent staff<br>· Minimum experience, skills and knowledge levels required for the CAE<br>· Emphasis placed on qualifications, skills and experience | | |

*(*) Refer to sections 2.1.1 and 2.1.2*
*Key: CAE = Chief Audit Executive*

This is one of the elements with the lowest endorsement rate. Neither level 4 nor level 5 KPAs are addressed in the legislation and/or guidance documents. In addition, on level 3, team building and competency is not addressed at all. This is a major weakness as most internal audit engagements are conducted by internal audit teams.

### 4.3 Professional practices

'Professional practices' refer to all the policies and procedures that enable the IAF to perform its duties effectively and professionally. These include the ability of the IAF to align its own strategies with the larger corporate strategies of the applicable government organisation (IIA Research Foundation 2009:38).

The model depicts the professional practices of the IAF as falling between the following two extreme

capability focus points (IIA Research Foundation 2009:14):

- On the highest capability level the IAF practices strategic internal audit planning, which entails the adaptation of the IAF's scope of services to the government organisation's future needs. Furthermore, the highest capability level also requires that the IAF continuously endeavours to improve its professional practices in such a way as to develop its capacity.

- On the lowest capability level (level 2) the IAF's plan is based on stakeholder and management priorities as well as having some sort of professional practices framework in place. Please note that level 1 is not included, as the IACM matrix (refer to Annexure A) refers to this level as "*ad-hoc*" and/or "unstructured".

**Table 3: Analysis of South African legislation and guidance with regard to professional practices**

| Legislation & Guidance (*) | Level 1 | Level 2 | Level 3 | Level 4 | Level 5 |
|---|---|---|---|---|---|
| PFMA | · IAF is mandatory | | | | |
| Treasury Regulations | | · Conducted in accordance with IIA *Standards* <br> · Management and other stakeholders provide input into IAF plan | · Efforts based on risk-based plans <br> · Effectiveness of IAF and activities reviewed by audit committee | · Align IAF's plan with risk management strategies | |
| MFMA | | · Conducted as per prescribed norms and standards | · Develop a risk-based IAF plan | | |
| King III | | · Conducted in accordance with IIA *Standards* <br> · Base IAF plan on manage-ment's risk assessment | · Develop a risk-based audit plan <br> · Implement an independent quality review | · Align IAF's plan with risk management strategies | · Flexible and dynamic processes to address emerging issues |
| Protocol on Corporate Governance | | · Staff know-ledgeable on IIA *Standards* | | | |
| IIA *Standards* | | · Base IAF plan on manage-ment's risk assessment and other input <br> · Comprehen-sive guidance on professional practices | · Develop a risk-based IAF plan <br> · Implement a quality and assurance improvement programme | | |
| National Treasury Framework | | · Refer to IIA *Standards* | · Refer to IIA *Standards* | · Incorporate strategic risk management outcome into IAF's strategies and plans | · Develop IAF's strategic plan based on stra-tegic overview and detailed analysis of organisation |

*(*) Refer to sections 2.1.1 and 2.1.2*

This element is addressed comprehensively, with the exclusion of continuous improvement in professional practices on level 5, which refers to the improvement of the IAF to be able to deliver world-class internal auditing.

### 4.4 Performance management and accountability

This element of internal auditing refers to the information required to successfully manage and control the IAF as well as the extent to which the performance of the IAF is reviewed and reported on (IIA Research Foundation 2009:38).

The model presents the performance management and accountability functions of the IAF as falling between the following two extreme capability focus points (IIA Research Foundation 2009:14):

- On the highest capability level the IAF should have public reporting structures in place to account for the effectiveness of its operations.

- On the lowest capability level (level 2) the IAF has an operating budget and business plan in place. Please note that level 1 is not included, as the IACM matrix (refer to Annexure A) refers to this level as "*ad-hoc*" and/or "unstructured".

**Table 4:** **Analysis of South African legislation and guidance with regard to performance management and accountability**

| Legislation & Guidance (*) | Level 1 | Level 2 | Level 3 | Level 4 | Level 5 |
|---|---|---|---|---|---|
| PFMA | · IAF is mandatory | | | | |
| Treasury Regulations | | · Develop a 3-year rolling plan | · Audit committee reviews IAF performance against the plan | | |
| MFMA | · Develop an internal audit programme for the financial year | | | | |
| King III | | · Audit committee ensures sufficient budget | · Audit committee reviews IAF performance | | |
| Protocol on Corporate Governance | · IAF is mandatory | | | | |
| IIA *Standards* | · CAE ensures that resources are appropriately deployed | | · CAE reports on IAF performance against plan | | |
| National Treasury Framework | | · Management and audit committee ensure sufficient budget reflecting on capital and operational expenditure | | | |

*(*) Refer to sections 2.1.1 and 2.1.2*
*Key: CAE = Chief Audit Executive*

This element is insufficiently addressed in the various legislative and guidance documents, with no KPAs achieved on levels 4 and 5, cost information and internal audit management reports not addressed on level 3, and on level 2, only limited information on the internal audit operating budget and business plan.

### 4.5 Organisational relationships and culture

'Organisational relationships and culture' refers to the relational, organisational and cultural structures within the IAF, as well as the position of internal auditing within the government organisation it serves (IIA Research Foundation 2009:39).

The IACM presents the organisational relationships and culture of the IAF as falling between the following

two extreme capability focus points (IIA Research Foundation 2009:14):
- On the highest capability level the IAF should not only have an effective relationship structure in place within the function itself, but also maintain strong and effective relationships with all the main stakeholders outside of the function, including management and the audit committee.

- On the lowest capability level (level 2) the IAF only focuses on its internal relationship structures and operations. Please note that level 1 is not included, as the IACM matrix (refer to Annexure A) refers to this level as "*ad-hoc*" and/or "unstructured".

**Table 5: Analysis of South African legislation and guidance with regard to organisational relationships and culture**

| Legislation & Guidance (*) | Level 1 | Level 2 | Level 3 | Level 4 | Level 5 |
|---|---|---|---|---|---|
| PFMA | • IAF is mandatory | | | | |
| Treasury Regulations | | • IAF within the organisation structure<br>• Annual plan conducted | • Coordinate with other assurance providers<br>• Audit committee reviews coordination with external auditors<br>• Communicate risk strategy to all to ensure incorporation in organisation's culture | | |
| MFMA | | • IAF within the organisation structure<br>• Annual plan conducted | | | |
| King III | | • Annual plan conducted<br>• Resources based on execution of responsibilities | • Provide assurance on combined assurance framework<br>• Coordinate activities with other assurance providers | • CAE has standing invitation to attend executive meetings<br>• IAF has the respect and cooperation of board and management | • CAE has working relationship with audit committee including reporting and meetings held |
| Protocol on Corporate Governance | | | • Coordinate with external audit<br>• Independent from external audit | | |
| IIA *Standards* | | • Comprehensive guidance on managing the function | • Coordinate with other assurance and consulting providers<br>• CAE communicates and interacts with the board | | |
| National Treasury Framework | | • Refer to IIA *Standards* | • Coordinate with other assurance and consulting providers<br>• Coordinate with external audit<br>• CAE communicates with management, the board and other governing bodies | | |

*(*) Refer to sections 2.1.1 and 2.1.2*
*Key: CAE = Chief Audit Executive*

Although the analysis reveals that the KPAs are addressed up to level 5, this is not an accurate reflection of the element as a whole. The third King Report is the only document addressing the level 4 and 5 KPAs and then only to a limited extent.

### 4.6 Governance structures

'Governance structures' refers to the reporting structures of the IAF within the government organisation. This includes the extent to which the IAF's administrative and functional reporting

structures have been established in the organisation (IIA Research Foundation 2009:39).

The model depicts the governance structures of the IAF as falling between the following two extreme capability focus points (IIA Research Foundation 2009:14):

- On the highest capability level the IAF should be totally independent, without any interference from political or the organisation's management. The

power and authority of the IAF should also be clearly in place to enable the internal auditors to perform their duties effectively.

- On the lowest capability level (level 2) the IAF should at least have full access to the government organisation's data, assets and people and should have some sort of reporting structure established. Please note that level 1 is not included, as the IACM matrix (refer to Annexure A) refers to this level as "*ad-hoc*" and/or "unstructured".

**Table 6: Analysis of South African legislation and guidance with regard to governance structures**

| Legislation & Guidance (*) | Level 1 | Level 2 | Level 3 | Level 4 | Level 5 |
|---|---|---|---|---|---|
| PFMA | | · Formal administrative and functional reporting | | | |
| Treasury Regulations | | · Independent of the auditee<br>· No limitation on access to information<br>· Report to accounting officer (administratively) and audit committee (functionally) | · Audit committee oversight | · Report to accounting officer (administratively) | · Purpose, authority and responsibility defined in charter according to IIA definition |
| MFMA | | · Report to audit committee (functionally) | | | |
| King III | | · Independent of the auditee<br>· Report to level allowing independence from management (administratively) and audit committee (functionally) | · Audit committee oversight<br>· Continuous meetings with audit committee<br>· Standing invitation to executive committee meetings | · Audit committee appoint, assess and dismiss the CAE | · Strategic-ally positioned to achieve objectives<br>· Comply with independent requirements |
| Protocol on Corporate Governance | | · Report on management level that allows the accomplish-ment of duties | · Unrestricted access to audit committee<br>· Direct and unrestricted access to the board | · Under direction and control of the audit committee | |
| IIA *Standards* | | · IAF free of interference regarding activities<br>· Report to a level that allows the IAF to perform its responsibilities | | | |
| National Treasury Framework | | · Report to accounting officer (administratively) and audit committee (functionally)<br>· Unrestricted work environment | · Support from senior manage-ment and the audit committee<br>· Continuous communication with audit committee<br>· Audit committee oversight | · Report to accounting officer (administratively)<br>· Recommended that the audit committee appoint, assess and dismiss the CAE | · CAE appointed in senior position |

(*) Refer to sections 2.1.1 and 2.1.2
Key: CAE = Chief Audit Executive

The element 'Governance structures' is well represented in the various pieces of legislation and guidance. However, on level 3, no mention is made of funding mechanisms, referring to funding processes that will ensure that resources are adequate.

## 5 CONCLUSION AND RECOMMENDATION

This study considers the extent to which the elements and KPAs identified by the IIA's IACM are addressed by applicable South African public sector legislation

and guidance. In this section, the results of the identification and analysis of KPAs included in legislation are interpreted, appropriate conclusions are drawn and recommendations made. In table 7, the overall capability levels of each of the six elements are provided, with level 1 being the lowest and level 5 the highest. The average (*M*) of each element as well as the overall average is also calculated.

**Table 7: Summary of analysis of capability levels as reflected in various legislation and guidance**

| Legislation & Guidance | Services & Role | | People Management | | Professional Practices | | Performance Management & Accountability | | Organisation Relations & Culture | | Governance Structures | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **L** | **G** | **L** | **G** | **L** | **G** | **L** | **G** | **L** | **G** | **L** | **G** |
| PFMA | 1 | | 1 | | 1 | | 1 | | 1 | | 2 | |
| Treasury Regulations | 4 | | 2 | | 4 | | 3 | | 3 | | 5 | |
| MFMA | 4 | | 1 | | 3 | | 1 | | 2 | | 2 | |
| King III | | 4 | | 3 | | 5 | | 3 | | 5 | | 5 |
| Protocol on Corporate Governance | | 4 | | 3 | | 2 | | 1 | | 3 | | 4 |
| IIA *Standards (\*)* | 4 | 4 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 2 | 2 |
| National Treasury Framework | | 4 | | 3 | | 5 | | 2 | | 3 | | 5 |
| **2.93** | | | **3.57** | | **2.29** | | **3.28** | | **2.0** | | **2.86** | **3.57** |

*(\*) The IIA* Standards *are interpreted as both guidance and legislation under the PFMA*
*Key: L = Legislation*
  *G = Guidance*

A general conclusion is that although reference is made in various documents to the IIA *Standards*, the Code of Ethics and the IIA's internal audit definition, no reference is made to the IIA's additional guidance. Specifically, the practice advisories that enhance the *Standards* are not referred to. A solution to this problem would be to change the references to the IIA *Standards* in the PFMA to the International Professional Practices Framework (IPPF). The IPPF contains detailed IIA guidance, which would then also be legislated for the South African public sector.

With reference to table 7 above, the element 'Performance management and accountability' is the weakest. Accountability is one of the cornerstones of the public sector environment (refer to section 2.1). The performance of the IAF, being a service-orientated function, should be a priority for government organisations. However, neither of these aspects are addressed properly in legislation and guidance (average of 2.0 in table 7). The second weakest element is 'People management' (refer to table 7 with an average of 2.29), referring to the staff component of the IAF. The IAF is a service-orientated function within the organisation and its internal auditors obtain most of their information and evidence from individuals, and as such it is important to have a well-balanced and competent IAF staff complement. However, many shortcomings exist in the legislation and guidance. For example, team building, a very important aspect of any internal audit team, is not addressed at all.

The element 'Governance structures' is fairly well addressed in the legislation and guidance (refer to table 7 with an average of 3.57). This indicates, *inter alia,* to whom the IAF should report. The element 'Organisational relationships and culture' (refer to table 7 with an average of 2.86), also refers to relationships with top management, but on a less measurable level. It is not, however, properly addressed in the legislation and guidance. This is most probably due to the fact that it is difficult to legislate culture.

Although element 1, 'Services and role of internal audit', is well addressed overall, one specific area that needs to be developed within South African legislation and guidance is performance auditing (level 3). The reason for this is that the elements of performance measurement, namely economy, effectiveness and efficiency are addressed in the legislation (South Africa 1999), but the audit thereof is not. The element 'Professional practices' could be linked to element 1, as it reflects on the IAF's planning and scope of services, including the type of audits that should be performed. This element is also well addressed, with the exception of the key process area 'continuous improvement and professional practices' on capability level 5.

An assumption can be made that a level 5 capability is not necessarily the preferred capability level for all organisations. This could be expensive to achieve and the cost may not justify the benefit. Therefore, it

is understandable that legislation in particular does not enforce all these KPAs. However, a total capability average of 2.93 indicates that just above 50% of the KPAs in the IACM are covered in the most prominent South African legislation and guidance for the public sector IAF. Should applicable legislation be revised in the future, this could be an ideal opportunity to address the above shortcomings.

Although one of the limitations of this study (as discussed in section 3) is that the methodology followed could result in biased opinions, the overall conclusion identifies the main weak areas within South African legislation and guidance. It is suggested that a follow-up investigation should be performed to identify shortcomings more comprehensively.

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**ANNEXURE A**

| Internal Audit Capability Model Matrix | | | | | | |
|---|---|---|---|---|---|---|
| | **Services and Role of IA** | **People Management** | **Professional Practices** | **Performance Management and Accountability** | **Organisational Relationships and Culture** | **Governance Structures** |
| **Level 5: Optimising** | IA Recognised as Key Agent of Change | Leadership Involvement with Professional Bodies<br><br>Workforce Projection | Continuous Improvement in Professional Practices<br><br>Strategic IA Planning | Public Reporting of IA Effectiveness | Effective and Ongoing Relationships | Independence, Power, and Authority of the IA Activity |
| **Level 4: Managed** | Overall Assurance on Governance, Risk Management and Control | IA Contributes to Management Development<br><br>IA Activity Supports Professional Bodies<br><br>Workforce Planning | Audit Strategy Leverages Organisation's Management of Risk | Integration of Qualitative and Quantitative Performance Measures | CAE Advises and Influences Top-level Management | Independent Oversight of the IA Activity<br><br>CAE Reports to Top-level Authority |
| **Level 3: Integrated** | Advisory Services<br><br>Performance/ Value-for-Money Audits | Team Building and Competency<br><br>Professionally Qualified Staff<br><br>Workforce Coordination | Quality Management Framework<br><br>Risk-based Audit Plans | Performance Measures<br><br>Cost Information<br><br>IA Management Reports | Coordination with Other Review Groups<br><br>Integral Component of Management Team | Management Oversight of the IA Activity<br><br>Funding Mechanisms |
| **Level 2: Infrastructure** | Compliance Auditing | Individual Professional Development<br><br>Skilled People Identified and Recruited | Professional Practices and Processes Framework<br><br>Audit Plan Based on Management/ Stakeholder Priorities | IA Operating Budget<br><br>IA Business Plan | Managing within the IA Activity | Full Access to the Organisation's Information, Assets, and People<br><br>Reporting Relationships Established |
| **Level 1: Initial** | Ad hoc and unstructured; isolated single audits or reviews of documents and transactions for accuracy and compliance; outputs dependent on the skills of specific individuals holding the position; no specific professional practices established other than those provided by professional associations; funding approved by management, as needed; absence of infrastructure; auditors likely part of a larger organisational unit; no established capabilities; therefore, no specific key process areas. | | | | | |