

*Review*

# The standing of the internal audit function within South African companies

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Accepted 09 March, 2010

This study examined the standing of the internal audit function in 30 of South Africa's large listed companies as perceived by the chairs of their audit committees, their chief executive officers, chief financial officers, and chief operating officers, as well as the chief audit executives. The standing of the internal audit function in these 30 companies was based on the academic and professional qualifications profiles of the chief audit executives, the composition and qualifications of the internal audit staff complement, the independence of the function and the expectations that various stakeholders have of the function. The study reveals that the overall standing of the internal audit function in these 30 companies was perceived to be high. However, there are a number of concerning aspects that include the fact that most of the chief audit executives are qualified and registered South African Chartered Accountants (CA(SA)) and not holders of the Certified Internal Auditor (CIA) qualification. Additional concerns are that the chief audit executives' reporting lines are not necessarily in line with currently perceived best practices; the stakeholders surveyed for this study held diverse views of the internal audit function; and in-house internal audit functions were viewed to be of a higher standing than those of outsourced functions. This study provides the internal audit profession with a scientifically researched benchmark of their status or standing in the eyes of their stakeholders and will enable them to measure changes to their status and effectiveness within their companies.

**Key words:** Internal audit function, chief audit executive, independence, internal audit standing.

## INTRODUCTION AND RESEARCH PROBLEM

Many stakeholders (Spencer Pickett, 2003: 47-59; Green and Gregory, 2005: 50-54; Jackson, 2005: 345-350; Lewis, 2007; Marx, 2008:97- 205) in the business environment recognise that internal auditing is a key component of corporate governance. This is supported by the fact that internal auditing is a specified business component required in prominent corporate governance guidelines

and legislation (CACG, 1999; IOD, 2002; Crowe Chizek, 2006; IOD, 2009; IIA n.d.(a)). However, the question is not whether organisations adhere to these guidelines or not, but rather, what is the company's attitude towards the internal audit function and its implementation, or more specifically, what is the standing or status of the internal audit function within the organisation. Is adherence merely a check list "tick off" item, or is it implemented to genuinely improve governance? Studies (Mardjono, 2005: 282; Markham, 2006: 596) and other literature (Spencer Pickett 2003: 45; Williams, 2008: 472) indicate that most of the organisations linked to corporate scandals have practiced sound governance principles, including the establishment of an internal audit function (IAF).

In two of the world's well-known corporate scandals, namely Enron and WorldCom, the IAF played an important part in the companies' collapse. Arthur Andersen was

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**Abbreviations:** CAE; Chief audit executive (Head of the internal audit function), CAC; chairperson of the audit committee, CE; chief executive, CEO; chief executive officer, CFO; chief financial officer, COO; Chief Operating Officer; CIA; certified internal auditor, IAF; internal audit function, IIA; institute of internal auditors.

**Table 1.** Summary of IIA membership and CIAs globally and in South Africa.

|          | 2000  |       | 2002  |       | 2004  |       | 2006   |       | 2008   |       |
|----------|-------|-------|-------|-------|-------|-------|--------|-------|--------|-------|
|          | M(*)  | CIA   | M     | CIA   | M     | CIA   | M      | CIA   | M      | CIA   |
| IIA Inc  | 70993 | 33207 | 82147 | 40212 | 99433 | 50816 | 135500 | 64453 | 164896 | 74305 |
| %growth  | -     | -     | 16%   | 21%   | 21%   | 26%   | 36%    | 27%   | 22%    | 15%   |
| IIA (SA) | 1305  | 154   | 2117  | 248   | 2725  | 447   | 4622   | 739   | 5819   | 935   |
| %growth  | -     | -     | 62%   | 61%   | 29%   | 80%   | 70%    | 65%   | 26%    | 27%   |

\*M – membership of IIA

both the external and the internal auditor for Enron. In 2000 they earned \$52 million in fees from Enron, of which \$27 million was for internal audit and the balance (\$25million) was for external audit (Markham, 2006: 205) - an income that probably compromised the firm's independence. As the external auditors, they gave an unqualified audit opinion on Enron's annual financial report of 31 December 2000, the financial year in which the scandal was revealed (Markham, 2006: 197). After the whole Enron debacle had been unravelled, it was argued that the external auditors could not have been in a position to issue an unqualified audit report, and that the internal auditors were in the perfect position to identify the problems and risks that led to the scandal. The problem appears to have rested on the standing of the IAF in the organisation. Was the IAF believed/respected enough to have their warnings taken seriously?

With the WorldCom scandal (Spencer Pickett, 2003: 43; Markham, 2006: 311-376; Cooper, 2008), again it was the internal auditors that shouldered the responsibility for uncovering the problem, but in contrast to the Enron debacle, Cynthia Cooper, the chief audit executive (CAE) of WorldCom, uncovered the fraud, thus suggesting that her standing within the organisation was of sufficient stature that her voice was finally heard.

Studies indicate that despite the huge effort to provide proper guidance to those involved in the management of an organisation, the truth is that for many organisations it remains "business as usual", with barely any discernible improvement in governance (Waring, 2006: 36; Alexakis, Balios, Papagelis and Xanthakis, 2006: 682; Aluchna, 2009: 195). It is therefore important for the internal auditors to ensure that they *do* impress the business environment with what they can contribute. This is likely to mean the difference between implementing an IAF for the sake of adherence to corporate governance principles, or the implementation of an effective IAF that is truly independent and has a positive and respected standing within the organisation.

With the above in mind, this paper examines some of the most prominent issues recorded in the literature that affect the standing of the IAF. This paper's research examined the perceptions of the audit committee chairs (CAC) and the chief executives (CE), (specifically the

chief executive officer (CEO), chief financial officer (CFO) and chief operating officer (COO), and compared them with the views of the CAE. The result identifies the extent of management's current knowledge of the IAF. Secondly, it should assist the CAE to identify weaknesses within the function that should be addressed in order to enhance the standing of the function within the organisation, *and* to ensure that internal auditing is not implemented as a mere "tick-box" nod to corporate governance compliance.

## LITERATURE REVIEW

The standing of the IAF within an organisation depends on it effectively fulfilling a variety of requirements, some admittedly more important than others. Furthermore, the greater the extent to which stakeholders recognise the value of the IAF the more the IAF will be used. This will in turn influence the investment that management and the board is prepared to make in the function, further influencing the quality of the function. This section investigates current literature on three of the issues that most strongly influence the standing of the IAF within larger businesses.

### The skills profile of the CAE and the composition of the internal audit staff complement

The internal audit profession has seen an enormous growth both in membership and in certification over the past years, as reflected in the statistics in Table 1 (Erasmus, 2009; Ttappous, 2009; IIA n.d. (c); Johnson, 2009). This growth may be attributed to the increased importance of internal audit activities within organisations, because of the promulgation and adoption of various codes of corporate governance internationally, and the associated improvement of the function's status.

The Institute of Internal Auditors (IIA) is the governing body of the profession, but not all individuals practicing as internal auditors are registered with the IIA (IIA n.d.(e)). It could be argued that most internal auditors who qualify for membership would want to register as this brings many advantages, such as joining a worldwide

network of professionals, increased knowledge and professional guidance amongst others (IIA n.d.(e); IIA(SA) n.d.(b)). The criteria for membership differ from country to country, but in short, the minimum requirement for membership of the IIA is a bachelor's degree or equivalent from a recognised institution of higher education, combined with suitable work experience (IIA n.d.(e)). Secondly, the only officially recognised internal audit certification is the Certified Internal Auditor (CIA) designation, owned and managed by the IIA (Inc), and this remains the only official standard by which individuals unambiguously demonstrate their competency and professionalism in the internal audit field (IIA n.d.(d)).

However, a few questions remain unanswered. Why are fewer than 50% of IIA members across the globe holders of the CIA qualification (and even fewer in South Africa)? A fair statement would be to conclude that the CIA designation is a reflection of the perceived competence of internal auditors; this again reflects on the quality of activities performed by internal auditors, directly influencing the standing of the IAF. In other words, there is little perceived benefit to be derived from obtaining the CIA qualification.

Although the statistics in Table 1 indicate that there is a steady growth in membership, it also shows that there is an almost negligible increase in the proportion of South African members gaining their CIA certification. Why then is there still a shortage of certain competencies and skills to perform the duties expected by management? It seems that organisations struggle to attract the right mix of talents to be able to meet the needs of all the stakeholders and to add value to the organisation. The scarcity of competent and skilled internal auditors is highlighted by many global studies that address issues such as:

- The technical and soft skills and competencies that are required of internal auditor (McCaul, 2006: 19; IIA Research Foundation, 2007: 282-325; Ernst and Young, 2007: 8; Roffia 2007: 14; Deloitte and IIA (UK and Ireland) 2008: 6-7; PWC, 2008a: 28-30 and 2008b: 39; Ernst and Young, 2008: 17).
- The appointment of the CAE, including the parties involved in the appointment process, suitable qualifications and experience, the ability to earn the respect of *inter alia* senior management and the audit committee, *et cetera* (Boyle, 2003:1; Gray, 2004: 19-23).
- Internationalisation of the profession and the resource needs that accompanies it (Ernst and Young, 2007:9 and 2008:14-15; PWC, 2008b:13-20).
- The current salary war and related vacancies in key positions (Robert Half International, 2007: 7; Roffia, 2007: 13; PWC, 2008a: 30; Harrington, 2008: 47).
- The recruiting and retaining of staff, including staff turnover (Ernst and Young, 2007: 6-7, 9; PWC, 2007: 30; Singer, 2008: 7).
- The use of internal auditing as a stepping stone to pre-

pare individuals for managerial positions (Oxner and Oxner, 2006: 56; Christopher, Sarens and Leung, 2009: 209).

- The training and development required (Spencer Pickett, 2000: 266-268; Siegel and O'Shaughnessy, 2008: 27; Singer 2008: 8).
- The importance of succession planning, especially for the CAE position (McCaul, 2006: 18-21).
- The use of staff rotation or the outsourcing of certain activities to provide for the needs of the IAF (PWC, 2007: 32-33; IIA Research Foundation, 2007: 256,258).

Although the profession is growing at a tremendous rate, whether this is enhancing the standing of the IAF as perceived by the stakeholders is debatable as it seems that the skills and competencies of internal auditors are continually being questioned. Due to the shortage of competent internal auditors there is a high staff turnover within the IAF which in turn compromises the IAF's ability to make a significant contribution to the organisation.

### **Independence of the function**

Internal auditing will always operate within the dynamic contradiction of, on the one hand being a part of the organisation, and on the other hand trying to remain independent and objective (KPMG, 2003: 2-3; Crowe Chizek, 2006: 3). The independence of the IAF and the objectivity of the internal auditor can be enhanced by various factors, the most important being the reporting lines. According to the IIA (IIA, 2006:41-44) and reports issued by other major role players (IOD, 2002: 186; KPMG, 2005: 26-32; ECIIA, 2005: 28; Crowe Chizek, 2006: 2; Marx, 2008: 291; IOD, 2009: 96), operationally or functionally the CAE should report to the audit committee, while administrative reporting should be to the CEO. Legislation, codes and other standards (IIA 2006:100-101; Companies Act 2008: S94; IOD 2009: 56) highlight the independence of the audit committee, making this line of reporting the ideal route to follow for internal auditing. According to the third King Report on Governance (IOD 2009: 97), internal auditing must be strategically positioned to accomplish their objectives:

Companies should have an effective IAF that is independent and objective. Internal audit should report functionally to the audit committee to assure this and should have the respect and cooperation of both the board and management.

The statistics available on the reporting structures in the private sector are contradictory. In an Australian study conducted amongst CAEs (Christopher et al., 2009: 211), only 38.24% of the respondents report functionally to the audit committee, and only 32.35% report administratively to the CEO, the reporting channels that currently define

independence. A further concerning result is that 26.47% report to the chief financial officer (CFO). That these reporting lines are commonplace is a fact supported by a study conducted by Green and Gregory (2005: 59), amongst USA organisations. Although displaying a clear trend that CAEs are increasingly reporting to the audit committees, many CAEs still report directly and exclusively to their CFOs.

Other studies indicate a higher incidence of appropriate reporting lines. According to studies performed by PWC (2007, 2008a) on the latest trends in internal auditing, 81% (2007: 42) and 89% (2008a: 7) of the respondents indicated that the IAF does report functionally to the audit committee, and 88% reported that the function reports administratively to the CEO. The IIA's Common Body of Knowledge (CBOK) study (IIA Research Foundation 2007:185), while not as optimistic as PWC's, 2007 research, is more positive than the Australian situation (Christopher et al., 2009), where 54% of the respondents report to the CEO and 51% to the audit committee.

In South Africa, a study performed by Marx (2008: 433) on audit committees in larger private sector companies concluded that "all audit committees review the finding of the IAF", a statement that probably refers to functional reporting lines. On the other hand, only 94% of the respondents indicated that the internal auditors have unrestricted access to the CAC, tempering the rosy picture created by the previous assumption.

By structuring the IAF as an independent function within the organisation, achieved by reporting directly to the highest level of management, namely the board via the audit committee, and the CEO representing senior management, may be deemed indicative of the high standing of the IAF within the organisation, while more vulnerable reporting lines would suggest a lower respect for and standing of the IAF in the company.

### **Expectations of various stakeholders**

The business functions that have the closest links with internal auditing are the board of directors and its committees, and top management including line management (Guner, 2008: 25-27). For the board of directors internal auditing's main function is to provide them with assurance on organisational activities *via* its board committees, especially the audit committee. In an ideal scenario, the management team is side-stepped, and are only reported to on a need-to-know basis. Internal auditing can thus, if needed, report effectively on management's fraudulent activities or if management is not running the organisation according to the board's mandate. The independence and status of the IAF will ultimately affect its relationship with the board and the audit committee, and if their reporting lines are short and direct internal auditors will have greater boldness in reporting wrong-doings to them. Zain and Subramaniam's (2007: 899) study indicated that 91% of the CAEs inter-

viewed declared that the audit committee had protected their IAFs in instances when they were frank and open about problems.

Although internal auditing should be directly responsible and accountable to the board and its audit committee (IOD 2009: 93), day-to-day activities are performed in conjunction with the management team. Senior management expects internal auditing to fulfil certain tasks, ranging from assurance to consulting activities. In global studies (Sarens and De Beelde, 2006: 219-241; Carcello, Hermanson and Raghunandan, 2005: 69-84), management has indicated that they are satisfied that the IAF is meeting these expectations.

With regard to external parties, studies indicate that external auditors are increasingly inclined to use the work performed by the internal auditors (Apostolou, Harper and Strawser, 1990: 309; Gramling, 1999: 124; Morrill and Morrill, 2003: 495-501; Gramling, Maletta, Scneider and Church, 2004: 233; Haron, Chambers, Ramsi, and Ismail, 2004: 1156), indicating that there has been an improvement in the quality of the internal auditors' work, (a result of improved training programmes, be it in-house, external or formal academic courses). Areas gaining external auditor approval include satisfactory follow-up procedures on issues arising from prior audit engagements, the quality of the work performed by the IAFs and the depth of audit-specific knowledge.

With internal auditing being a service function within the organisation, the greater the function's ability to meet stakeholder expectations the higher the expectations of stakeholders become and the more the IAF will be utilised: enhanced standing within the organisation is the result.

### **RESEARCH METHODOLOGY**

This journal is a special edition focusing on a study conducted into the standing of and demand for internal auditing services within South African companies. The comprehensive research methodology is explained in the foreword of this journal. Additional statistical analysis has been performed to address the specific research problems addressed in this paper. The research findings are presented by means of tabulated representations and interpretation.

### **DATA ANALYSIS AND FINDINGS**

The analysis of the data and the discussion of the findings follow the same sub-sections that have been used in the literature study. An additional sub-section presents the perceptions of the CAE on the standing of the IAF.

#### **The profile of the skills CAE and the composition of the internal audit staff complement**

In assessing the standing of the IAF within South African companies, as reflected in the literature, the academic

**Table 2.** CAE – The IAF staff complement by highest academic qualification and professional designation.

| <b>Academic qualification level *</b> | <b>Average number of staff</b> |
|---------------------------------------|--------------------------------|
| Lower than senior certificate         | 12.0                           |
| Senior certificate                    | 11.9                           |
| National diploma                      | 10.7                           |
| National higher diploma               | 4.8                            |
| Degree                                | 8.8                            |
| Degree with articles (external audit) | 7.5                            |
| Degree with articles (internal audit) | 3.1                            |
| Honours degree                        | 9.7                            |
| Master's degree/doctorate             | 1.8                            |
| MBA/MBL                               | 2.6                            |
| <b>Professional designation *</b>     |                                |
| CIA                                   | 4.9                            |
| CA(SA)/RA                             | 3.5                            |
| CISA                                  | 9.4                            |
| CFE                                   | 2.4                            |
| ACCA                                  | 1.5                            |
| CCSA                                  | 3.4                            |
| CGAP                                  | 1.0                            |
| CMA                                   | 1.2                            |
| Professional Accountant (SA)          | 2.3                            |

\*Respondents were allowed to choose more than one option.

and professional qualifications profile of the CAE could be a useful indicator of the IAF's standing within the company. From the data gathered on the formal qualifications of the CAEs, two-thirds of them hold either a bachelor's degree or an honours degree, while only 5 (16.7%) hold a Master's degree and only 1 (3.3%) has obtained a doctorate. The reason for the majority not continuing their academic education beyond honours level may be due to the higher value placed on professional qualifications in the private sector as opposed to academic qualifications. Almost half of the CAE respondents (14 (46.7%)) are qualified chartered accountants (CA(SA)) and/or registered auditors (RAA). As external auditing represents the main field of specialisation of 18 (60%) of the CAE respondents, the high percentages of chartered accountants and registered auditors is understandable. An interesting finding was that only 9 (30%) of the CAE respondents are CIAs. From the data it was not possible to determine whether any specific individual holds both the CA(SA) and CIA auditing profession designations. However, if it were assumed that this is not the case, at least 7 (23.3%) of respondents do not hold either of these recognised audit profession designations.

Response data indicated that 27 (90%) of the CEs were aware of the existence of the IIA(SA), 24 (80%) that the IIA(SA) grants a CIA certification, and 23 (77%) that they were aware of the IIA Standards. 29 (97%) of the CACs indicated that they were aware of the existence of the

IIA(SA), 22 (73%) that the IIA(SA) grants a CIA certification and 23 (77%) that they were aware of the IIA Standards. All companies listed on the JSE Limited, the South African stock exchange, are required to adhere to the stipulations in the second King Report (Baue 2003), which includes the requirement to adhere to the IIA Standards (IOD 2002:88). It is therefore concerning that 7 (23%) of the CACs, who are the overseers of the IAF, were not aware of the IIA Standards.

From the above it can be deduced that the private sector companies in South Africa place a higher value on the CA qualification than on the CIA qualification when it comes to appointing a professional to head their IAF. Due to the professional status attached to their qualifications, approximately half of the CAE respondents earn more than R1 million per year while 5 (16.7%) chose not to disclose their remuneration packages. As a result, it is fair to say that the majority of the CAE respondents are well qualified and well remunerated albeit in the field of external auditing rather than internal auditing. It can thus be accepted that they hold positions of high standing within their organisations.

With regard to the composition of the staff complement of the IAF an analysis of the perceptions reported by the CAE respondents provided the following findings (summarised in Table 2):

- The average IAF of a large listed South African com-

**Table 3.** CAE – Total number of filled positions and staff turnover over a 12 month period (averages).

|                            | Total number of filled positions excl. CAE * | New appointments * | Resignations * | Minimum qualification requirements on average for post level |
|----------------------------|--|--------------------|----------------|--|
| <b>CAE</b>                 | N/A  | 1.0                | 1.0            |  |
| <b>Audit manager</b>       | 7.2  | 1.8                | 2.5            | Hons degree (CA/CIA)   |
| <b>Senior auditor</b>      | 18.4   | 2.9                | 4.7            | B degree (CIA)   |
| <b>Auditor / assistant</b> | 11.3   | 4.6                | 2.2            | B degree (CIA in progress)                                   |
| <b>Trainee</b>             | 2.4  | 2.4                | 1.0            | B degree (CIA in progress)                                   |
| <b>Total</b>               | 39.3   | 12.7               | 11.4           |  |

\*The above is based on year averages, which explains the disparities

**Table 4.** CAE reporting lines.

| Reporting line               | Functionally / Operationally(*) |           | Administratively(*) |           |
|------------------------------|---------------------------------|-----------|---------------------|-----------|
|                              | CE                              | CAC       | CE                  | CAC       |
| Chair of the Audit Committee | 17                              | 25        | 8                   | 4         |
| Chair of the Board           | 0                               | 0         | 0                   | 0         |
| CEO                          | 3                               | 2         | 5                   | 5         |
| CFO                          | 6                               | 4         |                     | 10        |
| COO                          | 0                               | 0         | 0                   | 1         |
| Other                        | 3                               | 4         | 4                   | 6         |
| <b>Total</b>                 | <b>29</b>                       | <b>35</b> | <b>30</b>           | <b>26</b> |

\*A total of 30 CAC's and 30 CEs participated in the survey. Respondents were allowed to choose more than one option.

pany comprises 45.2 permanent employees and 2.4 temporary or contract employees, totalling 47.6 employees.

- The majority of the employees have lower-level academic qualifications – Bachelors degrees and/or professional certificates and diplomas.
- Approximately 20% of the employees are graduates.
- A very low percentage of the employees hold professional qualifications.

It is clear that the majority of employees in the IAFs of the companies that participated in this investigation (according to their CAEs' responses) hold lower-level academic qualifications and are not professionally qualified. This is in line with information obtained from the literature study and reflects pointedly on the need for more competent and skilled internal auditors.

With regard to the retention of internal audit staff, as well as the educational and professional qualifications required by the positions, the following summary refers to the data in Table 3 (the data reflects the positions filled over a twelve-month period, and expressed as an average, namely 39.3 employees).

- Only 18.3% hold positions at the audit manager level.
- Almost half, 46.8% hold positions at the audit senior level.
- Approximately one-quarter, 28.8% hold positions at the

auditor/assistant level.

- Only 6.1% are trainees.
- A decline was experienced at the audit manager and the senior auditor levels, as more employees resigned than were appointed in the period concerned;
- CAEs who resigned were replaced within the period under review. This prompt action suggests that companies believe that such a strategic position should be filled at all times.

The data illustrated that a decline was experienced at the senior staff level, which may be indicative of the shortage of individuals who have appropriate internal auditing skills. This is again substantiates the evidence discussed in the literature study.

### Independence of the function

As summarised in Table 4, the CACs and CEs could respond to several alternatives and had to indicate the CAE's functional and administrative reporting lines. The significant majority of CAC respondents (83.3%) and the majority of the CE respondents (56.7%) indicated that the CAE reports to the audit committee on all functional matters. Twenty percent of the CE respondents indicated that the CAE reports to the CFO.

A total of 13 (43.3%) of the CEs indicated that, for ad-

**Table 5.** Organisational satisfaction with performance of IAF.

| Attributes                                  | In-house (*) |      | Outsourced (*) |      |
|---|--------------|------|----------------|------|
|   | CE           | CAC  | CE             | CAC  |
| Competence                                  | 4.11         | 37   | 4.00           | 4.21 |
| Effectiveness of services                   | 4.26         | 4.33 | 3.91           | 3.71 |
| Flexibility to accommodate management needs | 4.03         | 4.22 | 4.16           | 3.64 |
| Meets your expectations                     | 4.28         | 4.22 | 3.54           | 3.78 |

\*Table provides the mean from a response range 1 - 5. 1 = extremely dissatisfied. 5 = extremely satisfied

**Table 6.** Implementation of recommendations made by the IAF.

| Frequency  | In-house (*) |     | Outsourced (*) |     |
|------------|--------------|-----|----------------|-----|
|            | CE           | CAC | CE             | CAC |
| Always     | 13           | 9   | 3              | 4   |
| Frequently | 14           | 18  | 9              | 9   |
| Sometimes  | 0            | 0   | 0              | 2   |
| Never      | 0            | 0   | 0              | 0   |

\*A total of 30 CAC's and 30 CEOs participated in the survey. The table indicates the number of respondents to the question. The totals do not tally as a result of possible co-sourcing.

ministrative purposes, the CAE reports to the CFO, while 8 (26.7%) indicated that the CAE reports to the audit committee. A third of the CAC respondents indicated that the CAE reports administratively to the CFO, while 5 (16.7%) of these respondents indicated that the CAE reports to the CEO.

It is clear from the findings that there is a difference between the information provided by the CE respondents and that provided by the CAC respondents. This anomaly indicates that uncertainty exists among the members of board (CAC) and senior management (CE). This uncertainty could be removed by engaging in more effective communication. A second concern is that in the functional reporting line as perceived by the CE and in the administrative reporting line as perceived by the CAC there were fewer than 30 responses. This highlights the uncertainty surrounding IAF reporting lines.

### Expectations of various stakeholders

Various attributes of the IAFs were investigated and summarised in Table 5. These attributes included their competency, service, flexibility and performance. Both the CAC and the CE respondents expressed their extreme satisfaction with the in-house IAF's performance against these attributes. While they also expressed extreme satisfaction with the *competence* of their outsourced IAF, they were less satisfied with the performance of the remaining attributes. It should be added that the CE respondents expressed their extreme satisfaction with the flexibility of their outsourced IAFs.

One of the perceptions used to assess the status of an IAF is to determine the extent to which its recommenda-

tions are implemented by the host company (Table 6). The CAE respondents believed that their recommendations *are* implemented by management. Nearly all the CAC and CE respondents agreed that the recommendations that are made by an in-house IAF are *always*, or *frequently*, implemented. In the opinion of the respondents there is a lesser tendency to implement the recommendations made by an outsourced IAF.

The majority (53% (16)) of the CAC respondents are of the opinion that the external auditors of a company place a high reliance on the work done by an in-house IAF, while only a few (23.3% (7)) of these respondents shared a similar view with regard to an outsourced IAF, as summarised in Table 7. It is a concern for in-house and even more so for the outsourced IAF that some CACs are of the opinion that external auditors place limited reliance or even no reliance on the work performed by the IAF. This could possibly be as a result of internal auditing being required to focus on areas other than finance.

The above findings indicate that IAFs meet the expectations of their respective organisations. The respondents expressed much satisfaction with the contributions made by their IAFs. However, in many instances the contribution that is made by an in-house IAF was considered to be of slightly greater value than that made by an outsourced IAF.

### The CAE's opinion of the standing of the IAF

Table 8 reflects the opinions of the responding CAEs on the standing of their IAFs. The level of agreement was measured by means of a five- point scale that ranges from 5 (strongly agree) to 1 (do not agree). A response of '3'

**Table 7.** The CAC opinion of the reliance placed by the external auditors on the work of the IAF.

| <b>Level of reliance</b> | <b>In-house (*)</b> | <b>Outsourced (*)</b> |
|--------------------------|---------------------|-----------------------|
| High reliance            | 16                  | 7                     |
| Moderate reliance        | 7                   | 2                     |
| Limited reliance         | 3                   | 3                     |
| No Reliance              |                     | 1                     |
| Not Applicable           |                     | 4                     |

\*A total of 30 CAC's participated in the survey. The table indicates the number of respondents to the question. The totals do not tally as a result of possible co-sourcing.

**Table 8.** The CAE's opinion on the standing of the IAF in their respective organisations.

| <b>Top 5 rating</b>   | <b>Mean</b> |
|---|-------------|
| Recommendations made by the IAF are implemented by management   | 4.58621     |
| The IAF is held by the board and top management to have a significant role in enhancing good corporate governance | 4.48276     |
| The status of the IAF is positively supportive of the long-term interests of the organisation                     | 4.31034     |
| The IAF is not used to place non-performing staff from other functions  | 4.31034     |
| The IAF is an aid to management   | 4.20690     |
| <b>Bottom 5 rating</b>  | <b>Mean</b> |
| The IAF provides resources to other departments   | 2.31034     |
| The IAF is performed in order to reduce external audit fees   | 2.51724     |
| The IAF is regarded as a safe department in which to develop inexperienced staff                                  | 2.58621     |
| The IAF is included in board meetings   | 2.64286     |
| The IAF is regarded as a training ground for operational managers   | 3.00000     |

\*Table provides the mean from a response range 1-5. 1 = Strongly disagree. 5 = Strongly agree.

is taken to indicate a level of agreement that is higher than '2' and lower than '4' rather than being an indication of "central tendency bias". The findings are discussed in the context of the rest of the data in the conclusion.

## CONCLUSION

The results of the study are evidence of the perceived standing of the IAF within its organisation by its stakeholders. As discussed in the literature review, the IIA is the governing body of the internal audit profession and its CIA designation the only certified internal audit designation. As a result, the CIA designation remains the standard by which internal auditors demonstrate their competency and professionalism in the internal audit field. However, it is clear from the data gathered, that for the CAE position in South African companies, the Chartered Accountant (CA) professional designation is favoured above that of the CIA, and that the CIA qualification is reserved for the lower audit manager levels (Table 2).

This phenomenon may be due to the excellent reputation the CA designation enjoys within South Africa, and perhaps a legacy of the fact that the internal audit profession has developed from the external audit profession. Furthermore, the CA qualification requires a higher educational level than the CIA qualification, and thus may be interpreted by many as indicative of a higher level of knowledge and competence. This statement may also indicate a poor knowledge of internal audit practice amongst top management of South African companies. According to responses from the CEs and the CACs, 23% of them were not aware of the IIA Standards, in spite of compliance with them being a requirement for their listing on the JSE Limited. A few respondents were also not aware of the IIA or its CIA certification. Modern internal auditing, as a management tool, (as highlighted by the current definition of internal auditing (IIA 2006)) has undergone a transformation in its purpose, which has separated the training of the internal auditor, and the acquisition of skills unique to internal audit, from that of the financial accountant and external auditor.

Another reason for CAs being appointed to the CAE

position may be deduced from Table 3's data that appears to indicate a shortage of individuals who have high level internal auditing skills. This substantiates the evidence discussed in the literature study. It appears obvious that the IIA should focus on the marketing of its CIA brand amongst internal auditors and the top management of South African companies.

With regard to the independence of the IAF, the data indicates two concerns. The first is the inconsistency between the responses of the CACs and CEs with regards to the reporting lines of the CAE. Although CACs and CEs of the same companies were targeted, in a number of cases they did not share the same view. This is a concern as these are senior positions and the individuals should have a better understanding of the reporting lines. The second concern is that, although in the minority, a significant number of CEs and CACs indicated that the CAEs' operational reporting lines pointed to office bearers other than the CAC. Furthermore, the CEs and CACs indicated that the CAE reported administratively, in the most cases, to the CFO. In order for the IAF to remain independent the King Report on Governance (IOD 2009: 97) is adamant that the CAE should report operationally or functionally to the CAC. Although the King Report on Governance (IOD, 2009) does not mention that the administrative reporting line of the CAE should be to the CEO, best practice, as discussed in the literature, does support this practice.

From the data presented in Tables 5 - 7 it is evident that an in-house IAF is preferred above an outsourced IAF. It is possible that management holds the opinion that the in-house IAF has a better understanding of the operations of the company and as a result is able to add more value to the management of the company. The CE and CAC respondents were more satisfied with the in-house IAFs than outsourced, with regard to meeting their expectations, which mirrors their responses on the implementation of in-house IAF recommendations and the reliance placed on the work of the IAFs by external auditors. These responses generally showed a higher rating than those of the outsourced IAF.

The CAEs, although much higher ranked employees, (refer to Table 8) shared the opinion held by the CACs and CEs (refer to table 6) that the recommendations of the IAFs are held in high regard. The CAEs were also of the opinion that the board and top management views the IAF as playing a significant role in enhancing good corporate governance. However, this high rating by the CAEs appears in certain instances be contradicted by the responses by CEs and CAC with regard to the CAEs' reporting lines. What is extremely positive is that aspects that normally indicate a low IAF standing (not included in the literature review), and that were traditionally a challenge to IAFs, received the lowest ratings from the CAE. In other words, issues that historically have undermined the status of the IAF were now seen as relatively unimportant by the CAEs.

In general, the data indicated that the IAFs in South African companies enjoy a healthy standing. Apart from a few individual concerns, the majority of CEs and CACs are of the opinion that their IAFs are an asset to their management team. The CAEs were also confident that their IAFs received the necessary respect within their companies to enable them to perform competently. This is in line with the new King Report where internal auditing should have the respect and cooperation of both the board and management (IOD 2009: 97).

The standing of an IAF within its company should not be considered a constant and as a result this study may be repeated in a couple of years in order to compare the results and assess progress after the implementation of the requirements of the third King report on Governance in 2010. The scope of the study may also be expanded in future to include the perceptions of the public sector in South Africa.

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