

# INVESTIGATING INTERNAL CONTROL FACTORS ON CLEAN AUDIT OUTCOMES: A CASE OF SELECTED DEPARTMENTS IN THE MPUMALANGA PROVINCE IN SOUTH AFRICA

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## ABSTRACT

Among the academic, there is a general agreement that the system of internal monitoring plays an important role in managing business either private or government as far as the audit outcomes are concerned. The article examines the internal control factors that affect the achievement of a clean audit outcomes. Primary data was collected from self-administered questionnaires from 269 research participants who were permanent employed by the three Mpumalanga provincial departments namely Department of Health, Department of Education and Department of Community Safety and Liaison. Research results showed that internal control system factors such as leadership visibility and accountability, corporate governance and financial performance and management were positively related to the audit outcomes with a R square coefficient of .981. Additionally, all three factors were significant with a P-value of .000 less than .01. An effective leadership visibility and accountability should include appropriate management, verification process, performance agreement, early audits plan together with the transgression measures and the compliance to the legislation. The corporate governance dimension should involve management responsibility, risk management strategies, portfolio of evidence, solid internal control system, compliance monitoring as well as the update based on the Auditor General. The financial performance and management dimension should focus on the management controls, review of contracts, certified financial statements, expenditure monitoring while following the Public Finance Management Act. As part of the recommendations, policymakers should ensure execution of the laws and regulations in relation to a clean audit outcome. They should equally organise training sessions to advise companies, organisations and institutions about compliance to the legislation as well as the applicable transgression measures. The execution the audit action plans are to be implemented early during the financial year and review of contracts should be done periodically.

## ARTICLE INFO

### Keywords:

Audit outcomes, internal control factors, leadership, corporate governance, financial performance and management, Mpumalanga Province.

### Article History:

Received: 11 Jun 2021

Revised: 15 Aug 2021

Accepted: 19 Oct 2021

Available Online: 15 Nov 2021

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## 1. INTRODUCTION AND BACKGROUND

### 1.1 Introduction

Auditing is a global phenomenon that is performed by the independent auditors in various business landscape around the world. The auditing main objective is to scrutinise the financial statements and various annual reports setup by businesses and institutions. Auditor provides an independent opinion after auditing companies and organisation. The auditing is significant as it provides credibility that the statements and accounts are free of error and are fair. Therefore, owners and depositors are provided with the certainty. The reputation of the business can be overemphasised. The accounting officers are required to manage and safeguards all the assets under their jurisdiction. The internal control systems are everybody's responsibility. Therefore, it requires team efforts for the entity to succeed. South Africa has laws and legislation that people and businesses within the borders of the country should abide to. The establishment of Auditor General South Africa (AGSA) was to support the constitutional democracy in the country and to perform its function and mandate without fear and favour. Previously, the Auditor General was more optimistic than in the relation to the Public Protector (PP). The Auditor General South Africa independent conducts performance audits across all the spheres of government including State Owned Enterprises (SOEs). To enable public accountability and transparency and thus enhance the good financial practices of the taxpayer's money. It is therefore important for all levels of government to be scrutinised by Auditor General South Africa. In

this way, all accounting officers, public entities and officials are hold accountable by the executives. Irrespective of various initiatives issued by the National Treasury (NT), departments continue with the failure to curb undesirable results. This situation promoted the Auditor General South Africa to develop effective business strategies before the execution phase of performance audit.

## 1.2 Background

Every year, the provincial departments are audited by the Auditor General to assess if the financial statement submitted are free of errors and in compliance with the legislation. The Auditor-General South Africa is the premier auditing firm established in terms of the Constitution (Nsingo, 2014:50). The Auditor General South Africa is also called “*Chapter 9 institution*”. The two best performing provinces namely the Gauteng and the Western Cape Province have obtained the clean bill of health from AGSA. These provinces have sustained the best performance while other seven provinces are dropping the ball. The Mpumalanga Province is no exception. The fruitless and wasteful expenditure, irregular expenditure and authorised expenditure are regular phenomenon in Mpumalanga Province. The former Premier Mr. David Mabuza launched on 16 July 2019 “Operation Clean Audit 2014” with the key objective to guarantee that by 2014 all the provincial departments and municipalities must obtain the clean audit. There is obviously a poor culture of accountability and a lack of corporate governance. According to van Niekerk and Dalton-Brits (2016:117), public accountability has become the key factor of the sound corporate governance across all state departments.

The provincial leadership have consistently failed to deliver on improvement with respect to clean audit outcomes contributing to the Mpumalanga Province receiving poor audit outcomes. The internal control mechanism is fundamentally important if the province leadership intent towards obtaining the clean audit outcomes. In addition, the clean audit outcome is good indicator that entity complies with relevant laws and guidelines and that there are no misstatements of the financial statements and annual performance reports. The audit context began in response to the changes in the business landscape. The principles of financial reporting, auditing and regulations were consequently improved. Primarily, an audit is the inspection of business entity accounts. The adventure for evaluation issue abides along these lines as a consignment with a conclusion (International Federation of Accountants, 2014:6).

Clean audit outcome is a problem that continues to persist around the globe. In some private business practices, it is reported while others are not. It worth noting that this article gives a historical background with respect to the internal control systems. The King Report I was published in 1994 and the key code philosophy consist of leadership, good corporate governance and sustainability. It was upgraded to the King Report II, Report III and recently to the King Report IV. The prime purpose of King Report is creating the business environment of accountability, trust and transparency in either private business or government including parastatals. For Ngcobo and Malefane (2017: 74-75), internal controls are essential in directing administrators and their workforces on how the obligations must be carried out and how approaches and strategies have to be executed. It calls for state of readiness of the leadership and support in various control features such as financial reporting good governance through the uses of the entity audit and risk committees. The main key stakeholder is the internal auditors who assist with strengthening internal control in the organisation. Furthermore, the provisions of the Public Audit Act give Auditor General South Africa more powers and its intention is to foster clean audit in government departments. Again, section 38 of Public Finance Management Act (PFMA) spells out responsibilities of the accounting officers while section 48 of the Public Finance Management Act spells out the responsibilities of other public officials in public sector. These two pieces of legislation cannot be ignored at any given time. Well, chapter 10 of the Public Finance Management Act addresses financial misconduct for any transgressors.

## 2. LITERATURE REVIEW

The internal control systems are machines that help with the management control through objectivity of an independent facilitator to assist and monitor the internal control effectiveness of the organisation. The objectives of the internal control systems are to foster efficiency of the business activities. It supports the main focus points mainly operations, reporting and compliance in all the business aspects. For Graham (2015:5), the pillars include control environment, information and communication, control activities, risk assessment, monitoring as well as control activities. Morehead (2007:4) further argued that internal controls are the instruments to strengthen and enforce the culture of accountability. The development of unfailing financial performance and reporting enhances full compliance with laws of the land (Arens, Elder & Beasley 2008:290). The types of the internal control activities are outlined below.

### 2.1 Internal Control Activities

Coetzee, du Bruyn, Fourie and Plant (2017:99) outlined that internal control activities can be done through segregation of duties, proper management of business authorisation and the safeguarding of assets and information. Rittenberg, Schwieger and Johnstone (2008:209) together with Spencer-Pickett (2007:99) argued that the principle behind the segregation of duties indicates that people should not perpetrate fraudulent interest by manipulating accounting statistics. Effective segregation of responsibilities demands that at least three officials partake during the transaction processing. For Coetzee *et al.* (2017:19), staff responsible for recording transactions should also be responsible for authorising of the transaction. Puttick and van Esch (2007:401) indicated that it is important for each transaction to be documented properly. Elder, Beasley and Arens (2010:298) contended that internal controls should be put into place in such

a way that all the business activities are appropriately processed with a distinctive authorisation process. This statement is embraced by Rittenberg *et al.* (2008:209-210) who ascertained that internal controls must be defined to ensure that only duty approved transactions occur. Rittenberg *et al.* (2008:209-210) and Puttick *et al.* (2007:416) claimed that physical management is important for preserving and protecting from accidental damage and theft. Cosserat and Rodda (2009:237) stated that restriction of physical controls gets access to information management. Direct controls include the initiation of safeguarding measures for facts and files. Again, Coetzee *et al.* (2017:101) contended that bookkeeping and other business documentation should be physically secured and restricted since files are the business entity's statistics that can be expensive or even difficult to rebuild if destroyed (Elder *et al.*, 2010:300).

## 2.2 Leadership Visibility and Accountability

Van der Nest, Thornhill and de Jager (2008:546) comprehensively argued that there might have been increasing pressure on public officials to illustrate an excessive stage of responsibility regarding the use of public finances. Those responsibilities and the requirement for sound financial controls have introduced public sector managers with the responsibility of inclusive inner audit together with the audit committee of the group. The charter of the Republic of South Africa of 1996 accommodated distinctive components of cultivating open obligations. It was far critical that a few current responsibilities gave the look to be assessed and to be able to prescribe powerful methodologies and thus improve their functionalities. According to van Niekerk, van der Walldt and Jonker (2001:125), politicians and public servants had to be chargeable for their moves to constituencies and supervisors respectively and to the general public. Accountability ought to cognisance both at the compliance with guidelines, moral standards and on the fulfilment of the effects. The redefinition rested on the knowledge that if the legislatures' oversight role was exercised in pursuit of right authorities, then the legislatures too bear some obligation for typical authorities' overall performance (Gauteng Legislature, 2014:12). According to Plaatjes (2013:46), a constitutional democracy-imposed limitation on the powers of the executive and mandated parliament to oversee the executives and held them accountable. As per the Auditor-General South Africa (2013:47), the absence of the responsibility and shortage of ramifications for negative execution together with the misbehaviours of using the officials were frequently the cause for terrible audit outcomes. For Moeti (2015:122), the Special Investigating Unit (SIU) and the Special Tribunals Act (Act 74 of 1996) offer the mandate for the capabilities of the unit.

## 2.3 Corporate Governance

Corporate governance goes in hand with the compliance to the Constitutional functions, Public finance management act of 1999, the Public audit act 25 of 2004, mechanisms for oversight and accountability, Auditor general South Africa, Public protector and the standing committee of public accounts. As indicated by van der Nest, Thornhill and de Jager (2008:546), there might be expanding pressure on accounting officers to represent a reasonable phase of obligation with respect to the utilisation of public funds. Oversight and accountability in the South African perspective are constitutionally mandated structures to investigate and police various departments with respect to promoting transparency and accountability. With new development and reform in the office of the Auditor General, the AGSA as supreme auditing entity in the land, has been given more power by the Parliament. The abovementioned legislation instruments oversee the general financial management and internal control systems at all spheres of government. According to the Auditor General South Africa (2013:47), the nonattendance of duty and deficiency of repercussions for negative execution are oftentimes the reason for awful review results. Munzhedzi (2013:282) showed that lacking cash related capabilities and nonattendance of obligation contribute to a helpless condition of monetary inconveniences. Moeti (2015:122) suggested that the Public Protector has the capacity to investigate any conduct in all the spheres of the government including State Owned Enterprises (SOEs) without fear and favour. The Public Protector's recommendations reports are biding and should be available to the overall population at public domain (Van Niekerk, van Der Walldt & Jonker, 2001:127). The main function of Standing Committee of Public Accounts (SCOPA) is to practice oversight over government for the benefit of the Parliament to guarantee responsible usage of assets and judicious monetary administration and to make proposals to the Parliament. This job is supplemented by the Auditor-General whose order is to lead reviews of national and provincial departments and other public part bodies, and to submit reports to the Legislature in accordance to the necessities of the Public Audit Act, 2004 (Act No. 25 of 2004) and the Constitution of RSA (Gauteng Legislature, 2012:4).

## 2.4 Financial and Performance Management

The Constitutional function is the highest and supreme piece of legislation in the land. Section 215 of the Constitution of Republic of South Africa expresses the fundamental importance of sound financial management. It also advocates for effective and efficient management of state funds. The Public Finance Management Act is delineating as the public sector financial management regulator policy framework which is applicable to national and provincial departments in the South African context. It enables the accounting officers to stabilise the public funds while holding them accountable and answerable for state assets under their guide. Section 38(1)(a) of the PFMA requires that "The accounting officer has and maintains effective, efficient and transparent systems of financial and risk management and internal control." Elder *et al.* (2010:300) established that the need for objective evaluations exists due to the fact that internal controls usually appear to evolve over time. According to Coetzee *et al.* (2017:101), the internal auditors and operation monitoring should be cautious and provide ongoing overview of management activities. In simple phrases, Rittenberg *et al.* (2008:210) claimed that provision proof of documentation is pivotal important as it provides with the records. The commitments of finances made by the organisation

also become vital for recording purposes. In addition, Coetzee *et al.* (2017:100) argued that documentation serves as mechanisms to transfer important information within the organisation (Elder *et al.*, 2010:299).

## 2.5 Contribution of the study

Every year, the Minister of Finance tables on the financial year budget for all government departments at the parastatals, national, provincial and municipalities levels. It is important that government combats corruption and reduces wasteful expenditure at all cost and thus restores public confidence. A clean audit outcome is regarded as the best and most awesome performance score that the independent auditor particularly external auditor gives to entities where all the books are in order in all aspects. The South Africa economic growth outlook is bleak. Auditor General called upon all accounting officers to “act now” and stop the “disappointing” audit results to ensure the prevention of mismanagement of public funds and the restoration of culture of accountability. The rising trends of high fruitless and wasteful expenditure, irregular expenditure, unauthorised expenditure and the audit outcomes regression in Mpumalanga provincial departments is the cause of concern. The weakness in financial management, financial health of the provincial department continues to deteriorate creating emerging risks such as the litigation. Of concern, the state of affairs is deteriorating over time and audit outcomes are depressing. Mpumalanga Provincial Government has the high irregular expenditure and has passed the R1 billion-rand mark during 2013/2014 financial year. The culprits are the Department of Health (DOH) with R818 million, the Office of the Premier with R68 million, the Department of Education (DOE) with R56 million. The trends of disregarding and violating laws and regulations remains a big concern. Irregular expenditure exceeded R2 billion mark in 2014/15. The government adopted the concept “Back to Basics” which substituted the “Operation clean audit” with a start in the internal control system to easily detect relevant factors. The province financial statements outlook is depressing and could leave key departments being under administration if left unattended. The main mandate of the state is to foster good governance and act in a manner that is sound to safeguard assets. The non-identification of the critical factors that block the clean audit process is often cited as a cause of concern for the Auditor General South Africa (AGSA, 2016:112). This article reports on the internal control factors that cause poor audit outcomes challenges that have become norms particularly in the Mpumalanga Province in South Africa.

## 3. DESIGN AND METHODOLOGY

This research paper follows the quantitative design method. Data used in this research were collected from the primary sources through self-administered questionnaire distributed across all three departments in the Mpumalanga province namely Department of Health, Department of Education and Department of Community Safety and Liaison. The consent was obtained from the participants once the researcher guaranteed privacy and anonymity. A demographic profile will be run to determine the frequency of respondents per department. This study considers the financial years from 2008 to 2010 to investigate internal controls factors that impact the process of a clean audit. Statistical analysis will be done using descriptive statistics, correlation and regression analysis. The Cronbach’s Alpha test will be run to ensure reliability and validity of the research instruments used as well as the research variables as displayed on table 1 below.

**Table 1**

Research variables

Dependent Variable		Independent Variable	
LA	Leadership and Accountability	CAO	Clean Audit Outcomes
CG	Corporate Governance		
FPM	Financial and Performance Management		

Source: Own Compilation

The following linear equation form is defined according to the research variables considered in this study:

$$CAO = \beta_0 + \beta_1 LA + \beta_2 CG + \beta_3 FPM + \epsilon$$

Where  $\epsilon$  represents the error term ;  $\beta_1, \beta_2, \beta_3, \beta_4$  the estimation parameters and  $\beta_0$  the constant term.

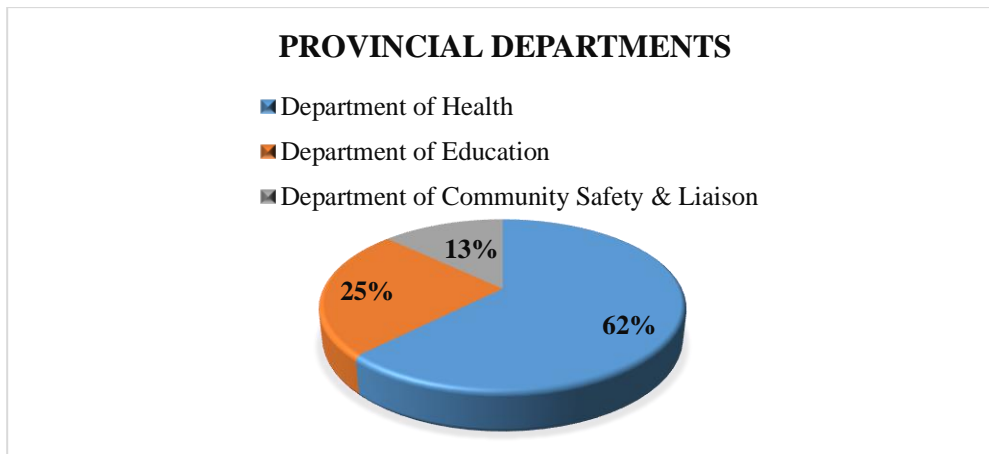
## 4. DATA ANALYSIS AND DISCUSSION

### 4.1 Data Analysis

The data analysis section covers the demographic profile and the statistical analysis of research variables.

#### 4.1.1 Demographic Profile

Figure 1 shows that there are 62.5% of the respondents from the Department of Health, 24.5% from the Department of Education and 13% of them were from the Department of Community Safety and Liaison. The Department of Health and the Department of Education are labour intensity departments.



**Figure 1**  
Provincial Departments  
Source: Own Compilation

#### 4.1.2 Validity and reliability

Table 2 below indicates that the Cronbach's Alpha coefficient is .983. This means that the instrument and the variables used in this research are valid and reliable.

**Table 2**  
Reliability statistics

Reliability Statistics		
Cronbach's Alpha	Cronbach's Alpha Based on Standardized Items	N of Items
.983	.983	4

Source: Own Compilation

#### 4.1.3 Descriptive statistics

Table 3 represents the descriptive statistics of the research variables. The annual average of the LA, CG, FPM and the CAO are respectively 3.66, 3.75, 3.61 and 3.61. The standard deviation indicates how close the sample mean is to the population. Table 3 displays that standard deviation of LA, CG, FPM and the CAO are respectively 1.417, 1.356, 1.318 and 1.267.

**Table 3**  
Descriptive statistics

	N	Range	Minimum	Maximum	Sum	Mean	Std. Deviation	Variance
Leadership and Accountability	269	4	1	5	985	3.66	1.417	2.008
Corporate Governance	269	4	1	5	1008	3.75	1.356	1.839
Financial and Performance Mgt	269	4	1	5	972	3.61	1.318	1.738
Clean Audit Outcomes	269	4	1	5	970	3.61	1.267	1.605
Valid N (listwise)	269							

Source: Own Compilation



#### 4.1.4 Correlation Analysis

**Table 4**

Correlation analysis

		Leadership and Accountability	Corporate Governance	Financial and Performance Mgt	Clean Audit Outcomes
Leadership and Accountability	Pearson Correlation	1	.938**	.940**	.898**
	Sig. (2-tailed)		.000	.000	.000
	N	269	269	269	269
Corporate Governance	Pearson Correlation	.938**	1	.922**	.967**
	Sig. (2-tailed)	.000		.000	.000
	N	269	269	269	269
Financial and Performance Mgt	Pearson Correlation	.940**	.922**	1	.954**
	Sig. (2-tailed)	.000	.000		.000
	N	269	269	269	269
Clean Audit Outcomes	Pearson Correlation	.898**	.967**	.954**	1
	Sig. (2-tailed)	.000	.000	.000	
	N	269	269	269	269

\*\* Correlation is significant at the 0.01 level (2-tailed).

Source: Own Compilation

Table 4 indicates that there is a strong and positive relationship between the CAO and the LA, CG and FPM variables with respectively .898, .967 and .954 as coefficient at a significance level of 1%. Additionally, the correlation is equally very strong and positive in-between the LA, CG and FPM variables with the correlation coefficient more than .80.

#### 4.1.5 Regression Analysis

Table 5 below displays the model summary indicating that the relationship between the CAO and the LA, CG and FPM variables is positive and solid with the R Square coefficient equals to .981. This result equally means that 98.1% of the Clean Audit Outcomes' behaviour is explained by behaviour of the LA, CG and the FPM variables.

**Table 5**

Model summary

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.990 <sup>a</sup>	.981	.980	.178
a. Predictors: (Constant), Financial and Performance Mgt, Corporate Governance, Leadership and Accountability				

Source: Own Compilation

The ANOVA table shows that the Significance F is .000 which is less than 1% at a significance level. This entails that the regression model is reliable since there is a significant relationship between Clean Audit Outcomes and the LA, CG and FPM research variables.

**Table 6**

ANOVA Table

ANOVA <sup>a</sup>						
Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	421.874	3	140.625	4459.439	.000 <sup>b</sup>
	Residual	8.357	265	.032		
	Total	430.230	268			
a. Dependent Variable: Clean Audit Outcomes						
b. Predictors: (Constant), Financial and Performance Mgt, Corporate Governance, Leadership and Accountability						

Source: Own Compilation

## 4.2 Regression model

Table 7 shows the P-value as well as the coefficients of each variable in the regression equation. Since the P-value is less than .001, it implies that the LA, CG and FPM are significant in affecting the progression of a clean audit outcome in the provincial departments in Mpumalanga.

**Table 7**

Regression coefficients

		Coefficients <sup>a</sup>			
		Unstandardized Coefficients		Standardized Coefficients	
Model		B	Std. Error	Beta	t
1	(Constant)	.054	.033		1.644
	Leadership and Accountability	-.438	.027	-.489	-16.394
	Corporate Governance	.761	.024	.814	31.047
	Financial and Performance Mgt	.638	.026	.663	24.807

a. Dependent Variable: Clean Audit Outcomes

Source: Own Compilation

From this equation:

$$CAO = \beta_0 + \beta_1 LA + \beta_2 CG + \beta_3 FPM + \epsilon \quad (1)$$

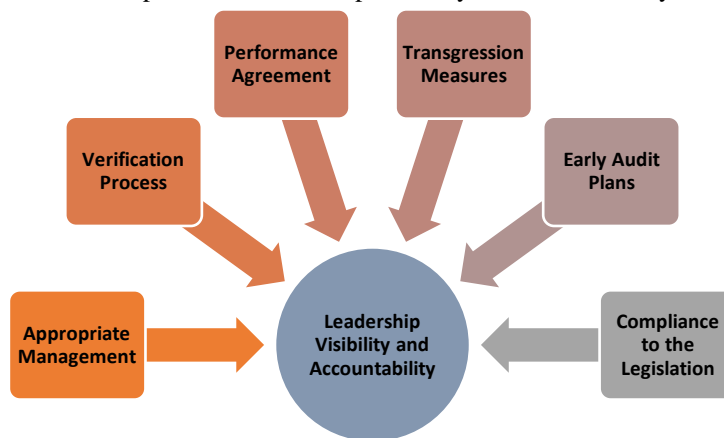
The regression equation becomes as follow:

$$CAO = 0.054 - 0.438 LA + 0.761 CG + 0.638 FPM + \epsilon \quad (2)$$

## 4.3 Data Findings

### 4.3.1 Leadership visibility and accountability

Based on the above statistical analysis and the responses collected from research participants, the leadership visibility and accountability should ensure an appropriate management including suitable verification process that comes with the performance agreement signed by workers. Additionally, transgression measures should be executed to limit fraud and corruption while ensuring early audit plans and the compliance to the Government regulations. Figure 2 represents a summary of components that form part of the leadership visibility and accountability.



**Figure 2.**

Leadership visibility and accountability

Source: Own Compilation

### 4.3.2 Corporate governance

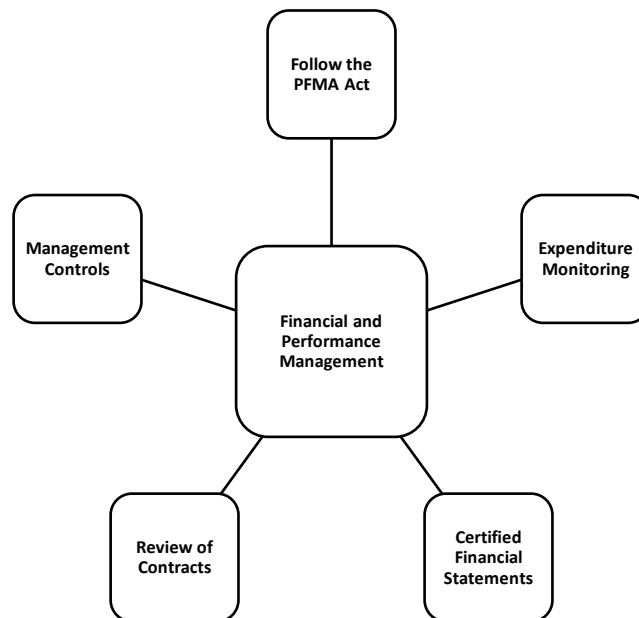
Figure 3 below shows that corporate governance is critical when it comes to the application of clean audit outcomes. Research results highlight that management should be accountable for effective internal control system following the portfolio of evidence. Furthermore, the top management should define the risk management strategies appropriate to their core ethical values. As part of the code of conducts, compliance monitoring and the updates suggested by the Auditor General have to be executed for continuous amelioration over financial years.



**Figure 3.**  
Corporate governance elements  
*Source: Own Compilation*

#### 4.3.3 Financial and performance management

Figure 4 indicates the constituents that guide the efficacy of the financial and performance management. A proper financial management technique follows the PFMA Act and the certification of financial statements in addition to their publication on the public domain. On the other side, performance management evolves with expenditure monitoring, review of contracts and incessant management controls.

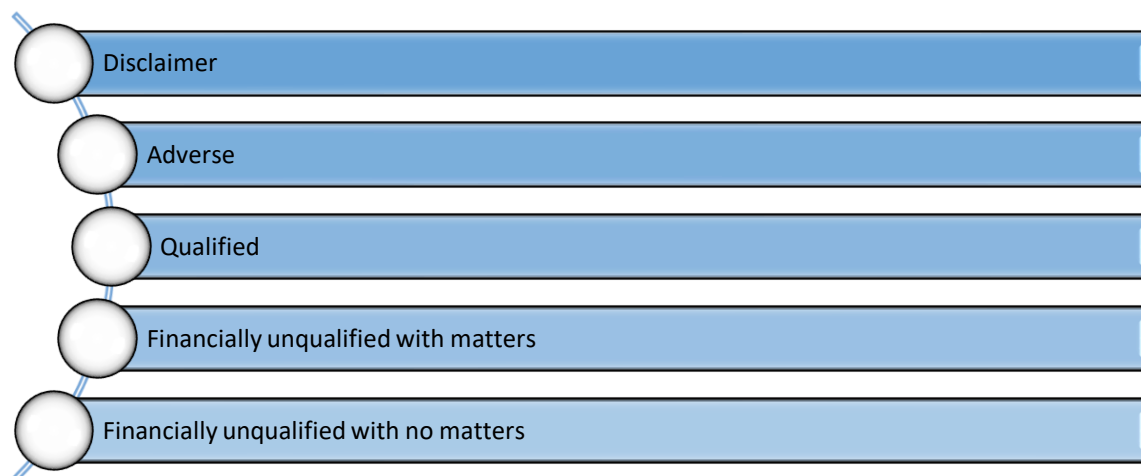


**Figure 4.**  
Financial and performance management  
*Source: Own Compilation*



#### 4.3.4 Clean Audit Outcomes

Figure 5 shows the different type of clean audit outcomes namely disclaimer, adverse, qualified, financially unqualified with matters and the financially unqualified with no matters.



**Figure 5.**

Type of audits

Source: Own Compilation

In the new dispensation, the public sector had a mix results in as far as the audit outcomes are concerned. It concludes that there is a connection between internal controls and the results of the audits. The inadequate management control and all previous results have not been fixed by AGSA. Moreover, the non-obedience to Supply Chain Management and the late development of the audit action programmes have compromised successful achievement of the clean audit outcomes. There is a strong association between the audit outcomes and the internal control. It can be widely argued that achieving clean audit results depends primarily on internal control. Without a shadow of doubt, for the clean audit outcomes to be realised, it required the robust intervention and implementation of an effective internal control systems following the above-mentioned factors. The biggest basis of managing these problems, is culture of corporate governance supported by the proactiveness of mitigation actions.

### 5. CONCLUSION

Based on the statistical analysis and the research findings, an effective leadership visibility and accountability should include appropriate management, verification process, performance agreement, early audits plan together with the transgression measures and the compliance to the legislation. The corporate governance dimension should involve management responsibility, risk management strategies, portfolio of evidence, solid internal control system, compliance monitoring as well as the update based on the Auditor General. The financial performance and management dimension should focus on the management controls, review of contracts, certified financial statements, expenditure monitoring while following the Public Finance Management Act (PFMA). The investigation conducted shows that stability in leadership, compliance with the laws and evaluation of contracts should be performed regularly. From the principle point of view, leadership visibility and accountability should set the tone of professionalism in the midst of challenges. A strong leadership should protect the institution, save people, manage fiscal and ensure the institution finance to remain sustainable and viable. According to Munzhedzi (2016:6), South Africa as the country is facing many demanding conditions regarding clean audits due to the loss of liability. The filling of critical vacant funded posts should be accelerated to strengthen the culture of accountability. To circumvent, limitation of scope by the external auditor, proper record keeping should prioritised. Therefore, the audit committee chairperson should hold the accounting officers answerable for their actions and omissions. As part of the recommendations, policymakers should ensure execution of the laws and regulations in relation to a clean audit outcome. They should equally organise training sessions to advise companies, organisations and institutions about compliance to the legislation as well as the applicable transgression measures. The execution the audit action plans are to be implemented early during the financial year and review of contracts should be done periodically.

### 6. LIMITATIONS OF THE STUDY

The present study provides internal control factors that influence achievement of a clean audit outcomes for the financial years 2008 to 2010. An analysis over 5 years or 10 years could provide better comprehension on the evolution of the audit process considering the fact that internal control factors can vary from one year to another.

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