

*Full Length Research Paper*

# Internal audit function: Current status and perception of outsourcing

Elmarie Papageorgiou\*, Yaesh Yasseen and Nirupa Padia

University of the Witwatersrand, School of Accountancy, Johannesburg 2001, South Africa.

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Organisations are constantly striving to maximise shareholder wealth by improving effectiveness and efficiency of operations. There has been an emerging trend since the early 1980's to outsource functions which were considered non-core and have now moved into the internal audit sphere, a function which was previously maintained in-house. This paper explores similarities and differences between public and private sector internal auditing in South Africa and the perceptions of the Internal Audit Function (IAF) in both these sectors. The sample selected varied in terms of education and experience of participants that were mainly Chief Audit Executives (CAEs) and Internal Audit Managers (IAMs). Results from statistical analysis suggest that there was no significant difference in the consideration of outsourcing of internal audit function by sector. The private sector was significantly more likely to consider internal audit a core activity when compared to the public sector while the public sector was more uncertain. The value of this research study contributes to the existing body of knowledge by means of bridging the gap between the theory and practice from a developing economy and emerging market perspective, by highlighting the status and perceptions of the IAF.

**Key words:** Chief audit executive, internal audit, internal audit manager, outsourcing, perceptions, private sector, public sector, status, service providers, South Africa.

## INTRODUCTION

Outsourcing of internal auditing is not a new phenomenon; outsourcing practice dates back to eighteenth-century and has been in continuous use in numerous industry sectors since it received impetus in the latter half of the 1980s and 1990s in the emerging service sector (Kakabadse and Kakabadse, 2000:670). According to Jennings (1996:393) adopting a strategic view for sourcing decisions can lead to a number of benefits including reduced costs, increased flexibility, the ability to sustain a wider product portfolio, improved innovation

and technical development.

Furthermore, recent changes in corporate governance in South Africa will affect the strategic directions taken by most organisations. Consequentially, the King Code for corporate governance recommends the establishment of an IAF as a benchmark of best business practise (IOD, 2009). The manner in which a company manages the quality and costs of internal audit services is therefore critical to the fulfilment of its responsibility towards a sound governance system (Carey et al., 2006:12). There can be no doubt that as long as outsourcing initiatives get closer to the organisation's core and to activities which are at the centre of its future success, the risks involved will be greatly increased (Selim and Yiannakas, 2000:1).

The study of Selim and Yiannakas (2000) was adapted to a comparative study within a South African context.

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\*Corresponding author. E-mail: Elmarie.Papageorgiou@wits.ac.za. Tel: +27 82 450 6025. Fax: 086 553 5083.

The aim of this research is to determine the status quo in respect of outsourcing of the IAF within South African private and public organisations. The research will focus on the current status and perceptions of CAEs and IAMs who motivate the decision to outsource the IAF. The study could add value to external and internal auditors, with particular interest when considering the sourcing arrangements of the IAF in organisations in the public and private sectors.

It was not until the 1940s that the practice of internal auditing began to evolve as an important role in organisational strategy and management. The professionalisation of internal auditing has continued steadily since then. Chapters of the Institute of Internal Auditors (IIA) (the Internal Audit profession's recognised authority and principal educator) have been established around the world (Castanheira et al., 2009:79).

Internal Auditing as a profession on a global landscape is thus relatively new. For South Africa in particular the profession had started inaugural in 1984 with the formation of the Institute of Internal Auditors of South Africa (IIASA). The academic and professional research with regards to the practice of Internal Auditing has been fairly sporadic and consequentially most of the research would have been exploratory. This includes the iKkutu Report which was published by the Institute of Internal Auditors (IIA, 2011).

The South African economy faces many challenges over the past two decades, the first being the transition from a racist regime to one where all stakeholders of the economy would equally participate. This in itself posed major challenges and the first King Report for corporate governance (IOD, 1994) aimed to educate these new stakeholders about being a corporate citizen and how to fulfil their new found responsibilities. Secondly the past two decades has seen the fall of large corporations both locally and abroad such as Enron, Lesiurenent and Bearings Bank that have uprooted the corporate world. This called for specialist skills and individuals to assist in the protection of the integrity of information reporting in the economy.

## LITERATURE REVIEW

Internal auditing has undergone dramatic changes that have expanded its scope in a way that allows it to make greater contributions to the organisation it serves (Fadzil et al., 2005:844). As a result of changes in organisational needs, technology and complexity of organisations' activities and systems, the nature of the services sought from the Internal Auditors has been transforming over the years from an emphasis on traditional/compliance audit where independence has been the core paradigm, to a value-adding role where partnering with management is accorded greater significance (Mihret and Woldeyohannis, 2008:567).

Internal auditing as a profession was placed in the spotlight since the King Code for corporate governance (IOD, 1994) called on Internal Auditors to deliver. Over the past few years, internationally and nationally substantial developments in the profession and the corporate environment in general, have led to a revised definition that incorporates the new and changing responsibilities of the Internal Auditor. One of these developments was the Competency Framework for Internal Auditing (CFIA). The study concluded among other things that the then prevailing definition of Internal Auditing was insufficient to articulate the modern Internal Auditing profession (Coetzee and Du Bruyn, 2001:63). Chapman and Anderson (2002) explain that this new definition of internal auditing implies that the IAF as an objective activity does not necessarily have to be established within the organisation as the revised definition permits internal auditing services to be provided by 'outsiders,' who in effect acknowledges that quality internal audit services can now be obtained through outsourcing. Performed by professionals with an in-depth understanding of the business culture, systems, and processes, the IAF provides assurance that internal controls in place are adequate to mitigate the risks, governance processes are effective and efficient, and organisational goals and objectives are met (Sadler et al., 2008:124).

According to the IIA's position paper on sourcing entitled IIA position paper: The role of internal auditing in resourcing the internal audit activity, is that the IIA's principal interest is to promote internal audit activities that provide the maximum overall effectiveness in helping achieve the organisation's strategic objectives. The position adopted by the IIA with regards to outsourcing is that even though oversight and responsibility for the IAF cannot be outsourced, certain organisations might partner with outside service providers to assist management in achieving its strategic objectives. From the IIA's perspective, internal auditing, regardless of who provides the service, should be performed in conformance with the Standards.

Li (2006:6) states that the three different system structures of a typical IAF consist of an in-house function, an outsourced function and co-sourcing. Outsourcing of organisational activities has often been suggested as a means of reducing organisational costs, providing flexibility in dealing with change in the business cycle and capturing innovation (Naidu et al., 2005:235). International practices have indicated that different types of audit institutions all have their own auditing emphases for example; government audit institutions mainly audit enterprises having an important bearing on the national economy (Enyue, 1997:206).

Carcello et al. (2005:70) examined factors associated with U.S. public companies' investment in internal auditing. Total internal audit budgets were found to be negatively related to the percentage of internal auditing that is outsourced. This study is important in the

understanding of internal audit services, and it allows companies to benchmark their outsourcing investment of internal auditing. Rittenberg and Covaleski (1999:227) discussed arguments that internal auditing is a fundamental part of corporate governance and cannot be outsourced, despite evidence that the outsourcing of internal auditing is taking place on an increasing scale. Trends in the research conducted by Rittenberg and Covaleski (1999) predicted that a company providing only audit outsourcing will go public within the next five years and indicated that the outsourcing phenomenon is redefining the nature of Internal Auditing in many organisations.

Allegrini et al. (2006:848) confirmed that 61% of the responding Internal Audit departments do not use outsourcing or co-sourcing, however they expect to increase their external service providers in the future. According to Jenkins and Krawczyk (2002:3), companies currently demand a broad set of non-audit services. "Certified Public Accounting Companies are responding by offering such varied services as investment banking, strategic management planning, human resource planning, computer hardware and software installation, and internal audit outsourcing services." Goodwin and Kent's (2001) study suggested that Australian listed companies do not use internal audit extensively. Size was a dominant driver of whether a company uses Internal Audit, suggesting that smaller companies do not regard it as cost effective (Goodwin and Kent, 2001:85-86).

Goodwin (2004:1), explored similarities and differences between public sector Internal Auditing and its counterpart in the private sector. Results from the study suggested that there were differences in status between Internal Audits in the two sectors, with public sector Internal Auditors generally reporting to a higher level in the organisation. Carey et al. (2006:832) undertook a study and confirmed by Cooper et al. (2006) to investigate the determinants of internal audit outsourcing with perceived cost savings and the technical competence of the provider. Analysis of results differed as observations indicated that 75% of those companies outsourcing did so to their external auditor, which may have implications for perceptions about the independence of the external auditor."

Van Peurse and Jiang (2008:19) explored patterns in and senior managers' reasons for their decisions to outsource or in-source IAFs in New Zealand listed companies. Results of the Van Peurse and Jiang (2008:17) survey indicated that 43% still do not carry out an IAF. What was brought to light here was that New Zealand managers seemed to look for otherwise inaccessible expertise in making their outsourcing choices. Carcello et al. (2005:69) examined the size of internal audit budgets and found that they were positively related to company size; leverage; financial, service, or utility industries inventory; operating flows; and audit committee review of the internal audit budget.

In the South African public sector the division of accountability is evident from the Public Finance Management Act (PFMA), 1999 (Act 1 of 1999). Accountability among public officials/administrators starts with the accounting officer of a government department. The accounting officer mentioned in Section 36 of the Act is assigned accountability requirements by Section 38 of the PFMA, 1999. These include responsibilities to ensure that the department has and maintains a system of financial and risk management and internal control. This system of internal control must be monitored by an IAF under the control and direction of an audit committee (Van der Nest et al., 2008:547). The PFMA explicitly states that the IAF forms part of the framework of control and supports accountability and good governance (Fourie, 2007:740). Carhill and Kincaid (1989) suggest public sector agencies operate in a rigid framework where activities are authorised by legislation.

IIA Standard 2210.C1 recognises that management may decide that the IAF should be outsourced. Cascarino and Van Esch (2007:195) point out that large professional firms of accountants and auditors have recognised the marketing opportunity of rendering internal audit services.

The Companies Act 71 of 2008 (South Africa, 2009) does not prohibit the provision of both internal and external audit services by the same audit firm, however in terms of S94 (7e): "The audit committee of a company has to determine the nature and extent of any non-audit services that the auditor may provide to the company and to pre approve any proposed agreement with the auditor for the provision of non audit services to the company". According to Figg (2000:49) the current global emphasis on the need for sound corporate governance has led to an increasing interest in Internal Audit. The Institute of Internal Auditors (IIA, 2009) survey in late 2003 showed that 80% of the companies with a higher capitalisation companies that were listed on the Fortune 100 already had an IAF. The NASDAQ also supports an IAF as a best practice (Harrington, 2004:45).

The following studies have addressed the Internal Audit outsourcing decisions in South Africa. Mjoli (1997) study concluded that although the outsourcing of Internal Audit may assist to address the problems associated with the need to focus on core business functions, shortage of appropriate skills and cost pressures. It recommended that partial outsourcing would seem to be a better alternative than complete outsourcing as it contributes to better management of the risks inherent in outsourcing contracts (Mjoli, 1997:99).

The iKutu Research Team (2010) provided a broader insight into the Internal Audit outsourcing practices of large listed companies in South Africa and revealed that the participating companies mainly used in-house (53.3%), co-sourced IAFs (33.3%) and complete outsourcing (13.4%) was also present in their IAF structures.

According to the iKutu Brochure (2010) the respondents' perceptions were: the need for specialised technical expertise as being the most important rationale for outsourcing all or certain services of IAFs, the shortage of competent Internal Auditors in South Africa as a very important rationale, the complex business processes of their companies and the superior knowledge of internal staff as being the two most important rationales for using an in-house IAF to perform certain or all Internal Audit services. The iKutu Brochure (2010) recommended that in light of the PFMA more work is needed to gain an understanding of Internal Audit outsourcing practices in the public sector. The upsurge in outsourcing over the last 20 years has been fuelled by arguments from leading academics that an organisation competitive advantage stems from its ability to identify, concentrate on and develop its core competencies and activities and outsource anything which is non-core (Burnes and Anastasiadis, 2003:355).

## RESEARCH PROBLEMS AND RESEARCH METHODOLOGY

This research study identified that there is a gap in the research with respect to status and perception of the internal auditing function in South Africa due to the infancy of the profession. The broad focus of the current study was to look at the practice of outsourcing the IAF in South Africa with a focus on both the private and public sectors. Although other studies such as the iKutu Report (IIA, 2010) had addressed some of the areas of outsourcing it is still incomplete in areas, for example, research with respect to the public sector had not been conducted. This paper furthermore explores similarities and differences between the public and private sector Internal Auditing in South Africa. This study investigates the outsourcing the IAF in South African organisations with respect to:

- (i) Determining the current status of outsourcing the IAF in South African private and public entities.
- (ii) Ascertaining from Finance and Chief Audit Executives, in both the public and the private sector, what are their perceptions of the IAF.

The following hypotheses were formulated to answer the research questions.

$H^{0a}$ : There is no significant difference between outsourcing of the IAF in the public and private sector

$H^{0b}$ : There is no significant difference between the decision to outsource the IAF in the public and private sector

$H^{0c}$ : There is no significant difference between the providers of Internal Audit services in the public and private sector

$H^{0d}$ : There is no significant difference between the interactions of the external auditors in the public and private sector

The study used a mixed method that was a comparative study of a quantitative nature that was conducted in the framework of a descriptive research study. The study drew on existing literature to provide the theoretical and technical base on which to construct questionnaires. Frequency tables with sample sizes and percentages were used to present the information. Cross tabulations were used to assess frequencies by sector and other factors. Analytical analyses were conducted to assess significant differences by sector. Chi-square tests (sample sizes dropped under 5 in cells then the Fisher's exact test) were used to assess

significant differences in proportions of selected covariates by sector. The Wilcoxon Rank Sum test was used to assess significant differences in the distribution of responses scores for ordinal covariates such as factors affecting decision to outsource (0 = not relevant to 5 = extremely important) by sector. Finally a t-test was also performed to assess significant differences in the duration of outsourcing the IAF.

To test the hypotheses, IIASA (2011) distributed an electronic questionnaire via their newsletter to attract a better response rate than distributing the questionnaire to a selected sample of 80 South African organisations from both the public and private sector. Questionnaires were also distributed and individuals were approached at IIASA regional events. Organisations within the public sector included a combination of Government Departments, Government Agencies, and Provincial Departments while organisations within the private sector comprised of companies listed on the Johannesburg Securities Exchange (JSE) as well as influential non-listed private companies. Selim and Yiannakas (2000:13) found this method to be the most effective vehicle for reaching a significant number of respondents.

## RESULTS

All the public and private organisations that participated in the study are located within South Africa and represent a multiplicity of industries and branches of government. The results of the questionnaire are discussed to support the objectives of the study and are divided between two main categories: Basic frequencies and Associations between categorical variables. Basic frequency tables were used to present the results of the questionnaire regarding the organisation size, current provision of IAF, type of provider of Internal Audit services, outsourced functions and factors affecting the decision to outsource. Out of the entire purposive sample approached, 72 organisations responded. Respondents comprised of CAEs, IAMs with the majority of respondents occupying the position of CAE or equivalent.

In Table 1 respondents represented a diverse range of educational qualifications as well as professional skills and qualifications. The majority of respondents had, at a minimum, a degree with seven of the respondents being Chartered Accountants (CA)(SA) and a further eight respondents holding the Certified Internal Auditor (CIA) qualification.

Respondents were grouped according to the position occupied in the organisation, as per Table 2. Although questionnaires were primarily addressed to CAE's and FD's it is interesting to note that in instances the surveys were delegated to Senior Managers/Managers and Internal Auditors to complete.

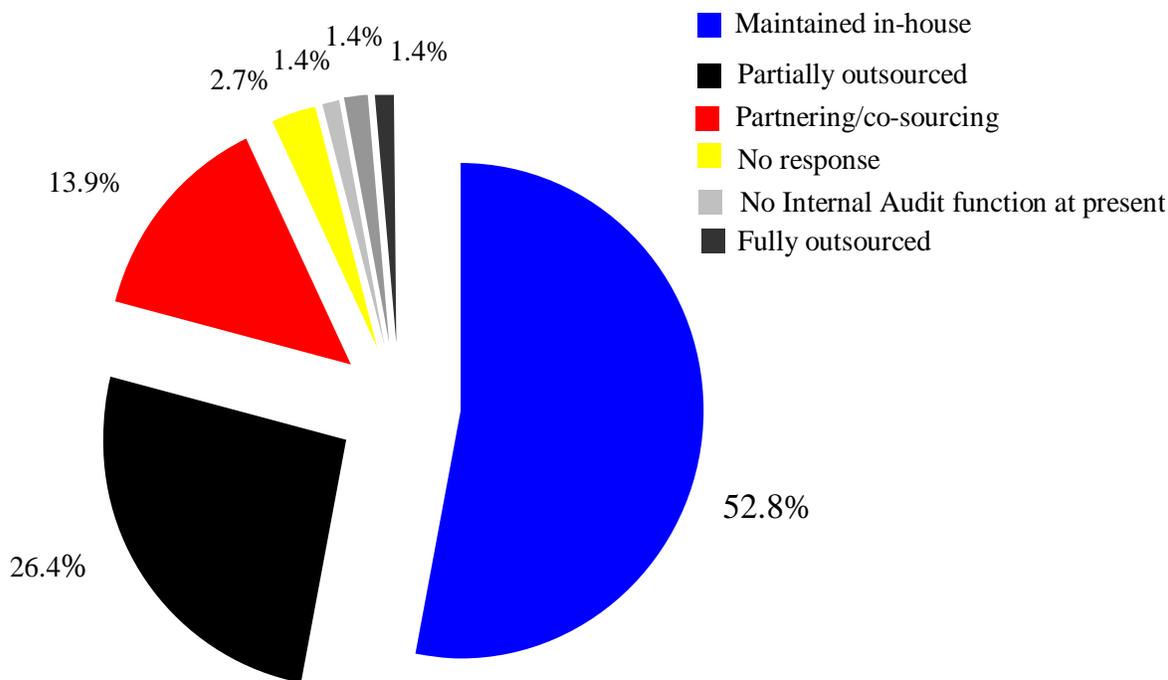
To determine the structure of IAFs within organisations, respondents were asked to indicate whether their organisations IAF was fully outsourced, co-sourced, partially outsourced or maintained in-house. The minority of respondents (40.3%) indicated using outsourced Internal Audit services during the past year, while the majority of the respondents (52.8%) indicated that they currently have an in-house IAF as illustrated in Figure 1.

**Table 1.** Highest level of education.

Highest level of education	Frequency	Valid percent
Masters Degree	7	9.7
Honours	19	26.4
Degree	35	48.6
Other	11	15.3
Total	72	100.0

**Table 2.** Respondents by position in the organisation.

Respondents by position in the organisation	Frequency	Valid percent
CAE	42	58.3
Internal Auditor Manager	26	36.1
Director	2	2.8
FD	1	1.4
Other	1	1.4
Total	72	100.0



**Figure 1.** Current provision of Internal Audit service in South African private and public sector organisations, 2010.

The Selim and Yiannakas (2000) study confirmed that the majority of the respondents (73%) indicated out of 165 United Kingdom organisations in the public and private sectors that they have an in-house IAF, 24% of respondents outsourced IAF and 3% have no IAF. The percentage of organisations outsource in the UK is dramatically higher than SA.

Larger organisations with 1000 or more employees appeared less likely to have outsourced Internal Audit services in the past year when compared to smaller organisations with less than 1000 employees.

$H^{0a}$ : There is no significant difference between outsourcing of the IAF in the public and private sector

**Table 3.** Organisation's consideration of outsourcing the whole or part of their IAF by sector.

	Public		Private		Total	
	Count	% within sector	Count	% within sector	Count	% of Total
Yes	5	17.2	11	26.2	16	22.2
No	18	62.1	25	59.5	43	59.7
N/A	6	20.7	6	14.3	12	16.7
Corrupt data	-	-	-	-	1	1.4
Total	29	100%	42	100%	72	100%

i: Chi-square ( $\chi^2$ ) = 0.552, p-value = 0.458; Fisher's exact p-value = 0.556.

Footnote 1: significance tests does not include missing or N/A.

**Table 4.** Duration of outsourcing the IAF.

	Frequency	Percentage
N/A	41	56.9
Not answered	2	2.8
Corrupt data	2	2.8
Less than 1 year	13	18.1
1-5 years	9	12.5
6-10 years	5	6.9
Total	72	100.0

H<sup>0b</sup>: There is no significant difference between the decision to outsource the IAF in the public and private sector

Even though significance testing revealed that this is not statistically significant (p-value = 0.102), reasons from respondents maintaining an in-housed IAF included the following:

- (i) Taking into account of SAS70/ISAE3402 services to be external audit/other consulting and not outsourced Internal Audit.
- (ii) We don't outsource the Internal Audit, as it is not cost effective.
- (iii) As we operate and have to perform audits in Europe, we consider it less costly to have an IAF based in SA and to travel to foreign offices than to outsource these audits to European audit firms.
- (iv) We have not outsourced our IAF, but rather decided to co-source with a Big 4 (PwC, KPMG, E&Y and Deloitte) firm in order to get the specialist skills we need in many areas and could not afford to employ permanently. We have a very small core team and then the co-sourced provider. This will help us ensure that we have sufficient audit coverage from the right resources in all risk areas of the business under our combined assurance model.

As reflected in Table 3, 22.2% of respondents had considered outsourcing the IAF. Of all respondents, 17.2% of

the public sector and 26.2% of private sector respondents had considered outsourcing their IAF. The Selim and Yiannakas (2000) study in the UK in contradictory stated that a total of 62.5% of respondents had considered outsourcing their IAF, of which 45.8% private and 78.7% public sector. The reasons of why Selim and Yiannakas (2000) to bring the IAF back are; the quality of the provider audit staff deteriorated, due to staff shortages, poor quality of service, dissatisfaction of overall performance and the lack of understanding of the business.

The respondents whose organisations fully, partially, or co-source their IAF were required to provide information as to when the organisation had started doing so. As per Table 4 responses varied with 37.5% of organisations that outsource, indicating that this occurred for the past ten years or less. A further analysis of this statistic reveals that 12.5% of respondents had been outsourcing their IAF for between 1 to 5 years and 6.9% of respondents had been outsourcing for more than 5 years. As per Table 4 it has become evident that the IAF outsourcing is relatively new in SA in comparison with the study of Selim and Yiannakas (2000) The UK study confirmed that 77.5% of respondents outsourcing the IAF 1 to 5 years ago in comparison with a 12.5% in SA.

To determine the main providers of Internal Audit services, organisations that are currently outsourcing their IAF were asked to identify their service provider. As per Table 5, 33.3% of respondents utilised the services of a Big 4 accounting firm while 19.4% utilised a smaller

**Table 5.** Providers of Internal Audit services by sector.

Provider	Public		Private		Total	% of Total
	Count	% within sector	Count	% within sector	Count	
Big 4 accounting firm	6	20.0	18	42.9	24	33.3
Smaller accounting firm	8	26.7	6	14.3	14	19.4
Specialised Internal Audit provider	4	13.3	4	9.5	8	11.1
Other (i)	1	3.3	2	4.8	3	4.2
N/A or not answered	4	13.3	9	21.4	13	18.1
Corrupt data	7	23.3	3	7.1	10	13.9
Total	30	100	42	100	72	100

<sup>(i)</sup> Includes other, local public accounting firm or financial services.

Fisher's exact p-value = 0.215 (note: significance tests does not include missing or N/A).

accounting firm and 11.1% made use of a specialised Internal Audit services provider. Further investigation revealed that due to Black Economic Empowerment (BEE) legislation in South Africa, organisations are required to give preference to individuals from previously disadvantaged backgrounds when seeking service providers. Smaller accounting firms and specialised internal audit service providers usually have a strong BEE employee base.

As evidenced by Table 5, one can deduce that, when comparing the providers of Internal Audit services by sectors, 40% (26.7 added to 13.3%) of public organisations utilise the services of smaller accounting firms and specialised Internal Audit service providers when benchmarked against 23.8 % (14.3% added to 9.5%) of private sector organisations who utilise the above-mentioned service providers. Another deduction could be that private sector organisations operate in a global context and use Big 4 accounting firms to reduce the transaction costs of cross border operations, which is supported by the data in Table 5 where 42.9% of private sector organisations contracted Big 4 accounting firms in contrast to organisations within the public sector, where only 20% of Internal Audit services were provided by Big 4 accounting firms. In comparison with the study of Selim and Yiannakas (2000), 91.7% of the private and 64.3% of the public sectors very clearly exhibit the dominant position the Big 5 accountings firms in the UK for outsourced the internal audit function.

However from a statistical perspective there appears to be no significant difference in the provider of IAF by sector (Table 5, footnote ii). The biggest difference appears to be that private organisations chose a Big 4 accounting firm (42.9%) more often than in the public sector organisations (20%).

H<sup>0c</sup>: There is no significant difference between the providers of Internal Audit services in the public and private sector

Conversely the public sector had a higher frequency of

choosing smaller accounting firms and specialised Internal Audit providers when compared to the private sector, the rationale for this having been explained in the preceding paragraph.

One of the fundamental objectives of this study was to ascertain from Finance and Chief Audit Executives, in both the public and the private sector, what were their perceptions of the IAF. Core competency theory suggests that firms outsource activities that are not considered fundamental to business operations.

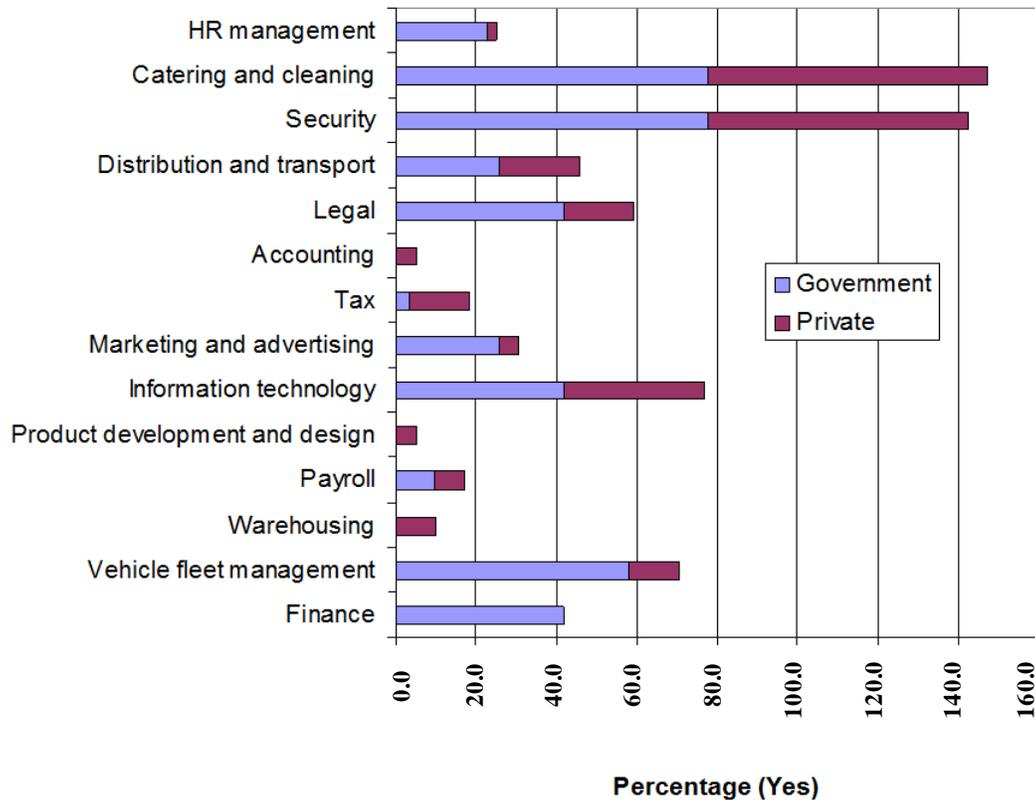
H<sup>0d</sup>: There is no significant difference between the interactions of the external auditors in the public and private sector

It was therefore important to investigate how Internal Audit was perceived. The private sector was significantly (Fishers exact p-value of 0.015) more likely to consider Internal Audit a core activity when compared to the public sector (65.9% vs. 40% whilst the public sector organisations were more uncertain (36.7% vs. 9.8%) when it came to deciding on where the activity was placed.

In the study of Selim and Yiannakas (2000:221), 92.1% of organisations stated that they have used some form of outsourcing and clearly demonstrates the widespread adoption of outsourcing in the UK in both sectors. It is also stated in the study that 90% of organisations have outsource activities such as catering and cleaning, security, information technology, payroll and fleet management and to a lesser extent finance, human resource management and accounting. In contrary this study also shows supports to outsource legal function and less support for the payroll function.

## DISCUSSION

Tables 1 to 5 and Figures 1 and 2 illustrate the results obtained from the statistical analysis addressing the research questions of the study and are discussed as follow. In Table 1 the majority of respondents had a



**Figure 2.** Functions currently being outsourced by organisations

degree (48.6%) and 21.0% of the respondents being Chartered Accountants (CA)(SA) and holding the CIA qualification. This is an interesting finding in the light of the fact that IIA(SA) recommends that CAEs need to have a masters degree and holding a CIA qualification. The question that needs to be raised is whether CAEs would then be suitably skilled to effectively discharge their function.

In Table 2 it is apparent that the majority of survey participants occupied the role of CAE in their respective organisations (58.3%), followed by Senior Managers/Managers and Internal Auditors (36.1%) with respondents occupying the role of Director/ Financial Director (FD) representing 4.2% of total respondents. Although questionnaires were primarily addressed to CAE's and FD's it is interesting to note that in instances the surveys were delegated to Senior Managers/Managers and Internal Auditors to complete. A total of 1.4% of respondents indicated other positions that were not listed in the questionnaire. Executive's positions vary between organisations as in the public sector the reporting lines differ according to title, making it difficult at times to distinguish the designate of the respondent completing the questionnaire.

A further breakdown, as indicated in Figure 1, revealed that 26.4% of respondents have fully outsourced IAFs,

1.4% partially outsourced their IAFs whilst 13.9% indicated co-sourcing agreements with respect to their IAFs were maintained. Collectively 97.2% of organisations have an IAF either maintained in-house or use the expertise of an external service provider to resource their IAF.

In Table 3 organisation's consideration of outsourcing the whole or part of their IAF by sector expressed the opinions of respondents that organisations perceived Internal Audit to add more value when it was maintained in-house. Respondents were also asked whether they had at any stage considered outsourcing the whole or part of their IAF. As reflected in Table 3, there appears to be no significant difference in the consideration of outsourcing of IAF by sector. This can be supported by the use of the Chi-square  $\chi^2 = 0.552$ , p-value = 0.458 and Fisher's exact p-value = 0.556 significance tests (Table 3, footnote 1). This deviated from the Selim and Yiannakas, (2000:219) study which showed that there were significant differences from respondents in the private and public sectors. "This difference between the two sectors can be explained, to a certain extent, by the fact that government departments – in an effort to achieve the best value for money for the taxpayer – market test on a regular basis, among other activities, the IAF" (Selim and Yiannakas, 2000:219) which is not the

case in a South African context.

As per Table 4 it has become evident that the IAF outsourcing is relatively new in a South African context, this is further supported by the 18.1% of respondents who have established outsourcing arrangements for less than a year. The reason for this is the issuance of the revised King III code for corporate governance in SA which strongly recommends the establishment of an IAF in some form or another.

The results discussed in Table 5 are further supported by the fact that in order to secure tenders, providers of Internal Audit services, especially the Big 4 accounting firms partner with the smaller firms and Internal Audit service providers (service providers who often have strong BEE credentials). Due to the interdependence between firms who provide Internal Audit services in South Africa and the limited access to skills within South Africa, one cannot predict with certainty whether there is actually a single provider who in essence captures the outsourcing market.

Figure 2 illustrates the functions currently being outsourced by organisations. In South Africa, the PFMA requires that all government organisations establish an IAF. From this it can be deduced that the public sector did not fully understand the value added approach that Internal Audit offered and hence were uncertain as to whether the function was considered to be a core or non-core activity. In the private sector, the valued added approach has been echoed through various governance reforms and codes which have created the desire to establish an IAF in order to establish best practice. It is therefore not surprising that Internal Audit was considered a core activity within the organisation even though in certain instances it was fully outsourced.

## CONCLUSIONS

This research was undertaken to determine the current status of outsourcing the IAF in South African private and public organisations by: surveying mainly CAEs and IAMs in both the public and the private sectors to determine what their perceptions with regards to outsourcing IAF. This study also identify the similarities and differences of a UK study (Selim and Yiannakas, 2000) that was adapted as a comparative study with South African. This study analyses data collected from a survey which explored similarities as well as differences in the sourcing arrangements of IAFs between organisations in the public sector and those in the private sector. The study was based on a survey of mainly CAE's and IAMs in organisations from South Africa. The results are as follows: overall 52.8% of the respondents indicated that they currently have an in-house IAF while 48.6% indicated that they used outsourced Internal Audit services in the past year.

Larger organisations with 1000 or more employees

appeared less likely to have outsourced Internal Audit services in past year when compared to smaller organisations. Statistical analysis revealed that there appeared to be no significant difference in the consideration of outsourcing of IAF by sector. The biggest difference in results appeared to be that private organisations chose a Big 4 accounting firm (42.9%) more often than in the public sector (20%). Conversely the government sector had a higher frequency of choosing smaller accounting firms and specialised Internal Audit providers than private sector organisations. The private sector was significantly (Fishers exact p-value of 0.015) more likely to consider Internal Audit a core activity than the public sector (65.9% versus 40%) while the public sector were more uncertain (36.7% versus 9.8%). In contrary the study in the UK confirmed that 91.7% of the private and 64.3% of the public sectors very clearly exhibit the dominant position the Big 5 accountings firms in the UK in outsourcing the internal audit function. The driver of this difference is that accounting firms in the UK have been aggressively engaged in promoting their services to new and existing customers. This difference might be extended to the broader range of developing countries due to a lack of funds and expertise.

Generally there were no significant differences in the distribution of importance scores for criteria used in decision to outsource by sector for the criteria listed. However a marginally significant (p-value = 0.057) difference was identified for reduction of total audit cost, with the public sector generally ranking this more importantly as a deciding factor for outsourcing than the private sector (mean of 2.31 and 1.89 respectively). The majority of companies indicated that they did not view Internal Audit as a training ground. There was also no significant difference in response to this question between public and private sector.

The time spent on different Internal Audit activities varied across both sectors. Private organisations were significantly more likely to have longer hours provided by internal service providers relative to outside providers than the public sector with the largest percentage of hours of outsourced Internal Audit by activity attributed to internal control evaluation followed by routine IAF and EDP auditing.

Interactions with the external auditor also do not differ significantly between the two sectors. No significant differences were observed between sectors with regards to interaction with external auditors in terms of co-ordination of areas of audit coverage and work schedule. The majority of organisations for which data were available indicated that external auditors had access to work papers and a hundred percent indicated access to reports.

The overall results provide insight into the dynamics of outsourcing arrangements in South Africa's private and public sector organisations. The study provides a good comparative to the Selim and Yiannakas (2000) study in

the UK and brings to light how developing economies strategise to provide world class services with a limited pool of skills.

## LIMITATIONS AND RECOMMENDATIONS

The findings of the current study, however, need to be interpreted in light of some limitations. The sample size is relatively small, particularly with regard to the private sector and public sector when viewed in isolation. Due to the nature of surveys, an inherent limitation is that the results are based on the perceptions of respondents and therefore misinterpretation of the questions as well as the objectivity in the responses may be questioned. Collaboration via interviews would have been useful in supporting the conclusions drawn. Despite the limitations, the study makes a valuable contribution to the understanding of the dynamics of Internal Audit in both sectors of the South African environment.

Future academic research in South Africa could extend to examine the demand for CIA's versus the CA(SA) in South Africa, who as per the proposed South African Institute of Chartered Accountants (SAICA) competency framework is now also being trained to develop Internal Audit as a residual skill. Other aspects of Internal Audit such as the extent of consulting work compared to assurance activities could be explored further, or conducting the same research on a much broader scale. Lastly, academic research could focus on developing a core curriculum to address the spectrum in which the Internal Auditor is expected to execute their duties in South Africa. This is a contribution to an important learning curve in developing the skills needed to resource the South African economy.

The value of this research study contributes to the existing body of knowledge by means of bridging the gap between the theory and practice from a developing economy and emerging market perspective, by highlighting the status and perceptions of the IAF.

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