

Review

Internal audit outsourcing practices in South Africa

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Accepted 11 January, 2010

This study explores internal audit outsourcing practices in South Africa, an area that has not been researched over the past decade. The extent of internal audit outsourcing practices within 30 large listed South African companies, the rationales behind their outsourcing decisions were determined and their preferred external internal audit function providers, as well as the perceived status of in-house and outsourced internal audit functions. Statistical analysis was conducted on data obtained from questionnaires submitted to all the major stakeholders in the internal audit environment. The study reveals that due to a lack of appropriate skills, cost implications, company policies and the perceived objectivity of external parties internal audit functions are outsourced within selected companies, to mainly Big 4 public accounting firms. The status of both in-house and outsourced internal audit functions was perceived to be high. These results enable the Institute of Internal Auditors to assess its outsourcing standards, allow external providers to identify internal audit outsourcing opportunities, and give companies the opportunity to compare their own outsourcing practices with those reported on.

Key words: Internal audit, internal auditing, outsourcing, co-sourcing, internal audit functions, internal audit skills, internal audit function status.

INTRODUCTION

Outsourcing is a management strategy by which an organisation delegates functions or activities formerly per-formed inside the organisation to specialised and efficient service providers (Elmuti and Kathawala, 2000: 112). Although this practice has been well established in the accounting environment for many years, for example using service organisations to maintain an organisation's derivative records (Billing, 2002: 26), conducting inventory management and distribution (Gavin and Matherly, 1997: 118), performing information technology (IT) functions (Selim and Yiannakas, 2000: 214) and complying with accounting and tax requirements (Selim and Yiannakas, 2000: 214; Frost, 2000: 34; Gavin and Matherly, 1997: 118), the outsourcing of the internal audit function (IAF) only became popular during the 1980s (Moeller, 2004: 42).

Outsourcing has often been suggested as a means of

reducing organisational costs, providing flexibility and 'capturing' innovation (Naidu et al., 2005: 235). Due to the close scrutiny of internal audit costs (Moeller, 2004: 42; Spira and Page, 2003:653; Sawyer et al., 2003: 1305) and the increased demands placed on the skills and competencies of internal auditors (Specklé et al., 2007:103) during the 1980s, the practice of outsourcing internal auditing (Caplan and Kirschenheiter, 2000: 392) to especially public accounting firms (Carey et al., 2006: 27) has gained momentum.

Over the last decade, much interest has been expressed in the literature on the rapidly growing phenomenon of outsourcing internal auditing, the preferred providers and the rationales behind such outsourcing decisions. In contrast with international research, it seems that only one study addressed internal audit outsourcing practices in South Africa. This was the study/research report by Mjoli (1997: 7), which was conducted more than a decade ago, to determine the role of internal auditing and to establish the reasons for outsourcing the internal audit function. The study concluded that internal audit outsourcing practices may mitigate the problems

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associated with the need to focus on core business services, shortage of appropriate skills and cost pressures (Mjoli, 1997: p97, 99).

OBJECTIVES, MOTIVATION AND LIMITATIONS OF THE STUDY

This study explores internal audit outsourcing practices in South Africa to fill the gap which originated because for the past decade this area has not been researched. For the purposes of this study, outsourcing could be regarded as complete outsourcing, where all services of an IAF are delegated to an external provider, or partial outsourcing, where certain services of an IAF are delegated to an external provider.

The study builds on the current body of knowledge by attempting to determine the extent of internal audit outsourcing practices within 30 large listed South African companies, the rationales behind such outsourcing decisions and the preferred external IAF providers that are contracted to perform such services. The study also explores new horizons by determining the perceived status of in-house and outsourced IAFs in the selected companies.

The latter entails obtaining the views of all the major stakeholders in internal auditing, including the views of the chief audit executives (CAEs), chairpersons of the audit committees (CACs) and senior management represented by either the chief executive officers (CEOs), the chief operating officers (COOs) or the chief financial officers (CFOs) of these companies. The findings are important from a theoretical perspective because internal audit outsourcing practices in the South African context are a relatively unexplored area, for which limited literature exists.

The study could benefit the Institute of Internal Auditors (IIA) by providing information on internal audit outsourcing practices, and the IIA could use such information to develop its standards. In addition, the study could be useful to service providers of outsourced internal audit services when identifying outsourcing opportunities, and to companies when comparing their own internal audit outsourcing practices with those reported on.

As set out in the foreword to this journal, the IKUTU study is not without limitations, because it is limited to 30 large listed South African companies. This article is based on the IKUTU study and its exploration of internal audit outsourcing practices in South Africa; it is therefore also limited to the participating companies. The small sample size may have influenced the results and its generalisation may therefore be limited. As regards the structure of this article, the next section discusses prior research on internal audit outsourcing. This is followed by discussions on the research method, findings of the study, conclusions, recommendations and areas identified for future research.

LITERATURE REVIEW

Extent of IAF outsourcing

Over the past years the traditional role of the IAF to help ensure reliable accounting information and to safeguard organisation assets (Nordin van Gansberghe, 2005:69) evolved as part of an organisation's management control structure. This could be attributed *inter alia* to the increased status of the internal audit profession (O'Regan, 2001: 224; Bou-Raad, 2000: 183), larger and more complex systems requiring technological advancements (Nordin van Gansberghe, 2005:69), legislative reforms and corporate governance developments (Paape et al., 2003: 252; Thompson, 2003: 17; Spira and Page, 2003: 653; O'Regan, 2001:220). This in turn led to an increased demand for IAFs with appropriate skills and competencies (Sawyer et al., 2003: 864).

Outsourcing of internal auditing is a rapid growing phenomenon (Caplan and Kirschenheiter, 2000: 394). Selim and Yiannakas (2000: 219) for example found that 78.7% of public sector and 45.8% of private sector organisations that participated in their United Kingdom (UK) study, considered outsourcing or co-sourcing of IAFs. Co-sourcing, a partnership between an organisation and its external provider, allows the in-house IAF to retain responsibility for the internal audit process, while relying on the external provider for specialised technical skills and personnel (Thomas and Parish, 1999:85). It enables an organisation to be cost-effective and derive external expertise, while retaining the advantage of direct control over internal audit (Subramaniam et al., 2004:87). In their study, performed in Australia, Subramaniam et al. (2004: 91) found that organisations that co-sourced internal audit used the external providers to supplement areas in which the in-house IAF lacked technical expertise, while those that made use of full outsourcing ascribed it to the improved quality of service provided by external providers.

Although the appropriateness of outsourcing IAFs is questioned in the literature (Caplan and Kirschenheiter, 2000: 392; Selim and Yiannakas, 2000: 215), Rittenberg and Covaleski (1999: 227) believe that an IAF lends itself to outsourcing because it is viewed as a stand-alone function for which a readily identifiable external provider is present. In the event that an IAF is regarded as a core function of an organisation (Selim and Yiannakas, 2000: 214), the outsourcing thereof could be questionable because not being regarded as a peripheral activity (Frost, 2000: 35), it could impact on the organisation's operations. If an opposite view is taken and an IAF is perceived to be a non-core function which does not directly contribute to revenue (Gavin and Matherly, 1997:121), the outsourcing thereof poses minimal risks of business disruption or operational discontinuity and such practice appears to be justifiable.

The only South African study that addressed internal audit outsourcing practices found that internal audit was

considered by management to be a non-core function (Mjoli, 1997: 67), thus justifiable for outsourcing. This narrow viewpoint has thereafter been replaced by the notion that the distinction between core and non-core services for outsourcing purposes has become irrelevant, because such practices are increasingly applied for all services and are driven by other rationales (Burnes and Anastasiadis, 2003: 356).

Rationales for outsourcing

Rationales for the outsourcing of IAFs have been well researched. Cost and flexibility were identified as the key benefits which accrue from outsourcing (Rajabzadeh et al., 2008: 524; Van Peurseem and Jiang, 2008: 220; Galanis and Woodward, 2006: 9; Rittenberg and Covaleski, 2001: pp 621, 622; Selim and Yiannakas, 2000: 225), especially when required by fast-changing market demands. In addition outsourcing IAFs relieves the organisation of the need to maintain in-house capabilities that require a high degree of specialisation by providing access to technical expertise and enabling management to focus on core business activities/services (Van Peurseem and Jiang, 2008: 220; Galanis and Woodward, 2006: 9; Subramaniam et al., 2004: 91; Frost, 2000:34; Selim and Yiannakas, 2000:225). An in-house IAF could also be used as a training ground or a stepping stone to management positions (Goodwin and Yeo, 2001: 111).

The scarcity of internal auditing skills and competencies further necessitates that organisations consider outsourcing as an alternative (Van Peurseem and Jiang, 2008: 234; Specklé et al., 2007: 103; Selim and Yiannakas, 2000: 214). In its Scarce Skills Guide for 2009/2010, Fasset (2009: pp 10, 11) identifies internal audit as a scarce skill in South Africa; and it is thus not surprising that the study by Mjoli (1997: 68) identified the scarcity of skills as a key driver for outsourcing internal auditing in South Africa.

Many arguments are found in the literature against outsourcing IAFs which include: the quality of services performed by external providers may not meet expectations, external providers' limited understanding of an organisation's business hampers their constructive assistance, the inability to exercise control over an outsourced IAF and the loss of internal auditing expertise within an organisation (Van Peurseem and Jiang, 2008: 220; Galanis and Woodward, 2006: 10).

Further arguments against outsourcing relate to the enhanced profile and increased responsibilities of internal auditors owing to the worldwide proliferation of corporate governance guidelines and codes (Aguilera and Cuervo-Cazurra, 2004: pp 416, 428). Due to the role that IAF plays in an organisation's internal control environment, Selim and Yiannakas (2000:216) are reluctant to support the outsourcing of an IAF because outsourcing could impact on the scope and quantity of information provided

to the board. An IAF is thus perceived to be a fundamental part of corporate governance which cannot be outsourced. As internal auditors become more involved in the core activities of risk management and strategy, outsourcing IAFs will involve risks relating to exposing providers to important organisation information and limiting the continuous accessibility to internal auditors (Van Peurseem and Jiang, 2008: pp 220, 224, 235; Carey et al., 2006: 12).

Preferred external IAF providers

External providers used by organisations to perform outsourced internal audit services received much attention in the literature. Various studies identified public accounting firms as preferred providers (Van Peurseem and Jiang, 2008: 233; Carey et al., 2006: 27; Caplan and Kirschenheiter, 2000:394; Selim and Yiannakas, 2000: 220). Large public accounting firms view internal audit services as an important growth opportunity which they should explore because of the high quality of their services, sophisticated expertise and the audit resources at their disposal (Specklé et al., 2007: 103; Caplan and Kirschenheiter, 2000: 394). Their claim to perform outsourced internal audit services sparked much debate, in particular on the issue of whether an organisation's external auditors could maintain their independence and objectivity if they were used as outsourced IAFs (James, 2003: pp 322, 323; Gavin and Matherly, 1997: 120).

This argument has been resolved for companies listed in the United States of America by increased regulatory requirements, such as the Sarbanes-Oxley Act of 2002 and the Security and Exchange Commission rules, now prohibiting outsourcing IAFs to a company's external auditors, while it allows for outsourcing of such activities to a different public accounting firm (Carcello et al., 2005: 74; Moeller, 2004: 42; James, 2003: 316). The South African Companies Act 61 of 1973 (South Africa, 1973: section 275A) provides that an external auditor for a widely held company may not, for the duration of the appointment, perform for that company services prohibited under the Code of Professional Conduct (referred to as the code of the Independent Regulatory Board of Auditors (IRBA Code)) mentioned in section 21(2)(a) of the Auditing Profession Act 26 of 2005 (South Africa, 2005). The newly introduced Companies Act 71 of 2008 (South Africa, 2008) (to be promulgated in 2010) supports the same principle by requiring that non-audit services performed by external auditors should not prejudice their independence or create a conflict of interest in terms of the Auditing Profession Act or as may be determined by such a company's audit committee (South Africa, 2005: sections 94(8)(b) and (c)). In terms of the IRBA Code (IRBA, 2008: pp 4-10) external auditors should be free from any influence, interest or relationship, whether direct or indirect, that might be regarded as incompatible with integrity, independence and objectivity.

In the preamble to the IRBA Code (IRBA, 2008: pp 4-10) external auditors are cautioned before retaining or accepting assurance engagements where there are fundamental threats to independence that require to be overcome by the application of safeguards. Particulars of such threats and safeguards are provided in the Code of Professional Conduct of the South African Institute of Chartered Accountants (SAICA) (referred to as the SAICA Code) which stipulates that outsourcing of IAFs to a company's external auditor may result in a self-review threat (SAICA, 2008, 290: pp 181-186). Although such a self-review threat may be reduced to an acceptable level by ensuring that there is a clear separation between the management and control of the internal audit by client management and the internal audit services themselves, the SAICA Code nevertheless urges external auditors to proceed with caution before taking on such activities (SAICA, 2008, 290: p184).

Initially the IIA maintained a preference for in-house IAFs (Goodwin and Yeo, 2001: 108; Caplan and Kirschenheiter, 2000:395; Selim and Yiannakas, 2000:216), but since 2005 has changed its view by welcoming public accounting firms as fellow internal audit practitioners (Rittenberg and Covaleski, 2001: 637). In 2005 the IIA issued a position paper on resourcing alternatives for the IAF. In this document the IIA expressed its support for the fact that a fully resourced and professionally competent staff that is an integral part of the organisation, whether in-house or outsourced, best performs the IAF (IIA, 2005). According to Caplan and Kirschenheiter (2000: 397), external providers justify their presence in the market for internal audit services by emphasising their cost-effectiveness. Selim and Yiannakas (2000: 216) are more sceptical and warn that outside service providers may initially go for low-balling (where services are tendered at a price unrelated to the amount of work done in an attempt to secure the appointment (Odendaal and De Jager, 2005: 29)) in order to obtain outsourced internal audit services, but such low fees may not be sustainable eventually costing an organisation more than to retain an in-house IAF. Their view is supported by Rajabzadeh et al. (2008: 524) who argue that once an in-house IAF is abandoned, an organisation will have no choice but to pay the inflated fees. Not only were the desirability of, rationales for and preferred service providers for outsourced IAFs debated in the literature (as discussed above), various researchers also explored such practices. There are studies on the types of internal audit services being outsourced (Galanis and Woodward, 2006: 43; Carey et al., 2006: 26; Subramaniam et al., 2004: pp 90, 91), reporting lines of in-house and outsourced IAFs (James, 2003: 323; Paape et al., 2003: 259), and the differences in outsourcing practices followed by private and public sector organisations (Burnes and Anastasiadis, 2003: 364; Selim and Yiannakas, 2000: 224). In addition, Selim and Yiannakas (2000:224) determined the level of satisfaction with the quality of services performed by an out-

outsourced IAF and found that both private sector and public sector respondents are satisfied with such services.

Status of in-house and outsourced IAFs

Very limited research has been conducted on the status of in-house and outsourced IAFs. Selim and Yiannakas (2000: 224), for example, determined the level of satisfaction with the quality of services performed by an outsourced IAF using a five-point Likert scale ranging from very satisfied to very dissatisfied. They limited their study to a single test on the general perception of the quality of services performed by an outsourced IAF.

RESEARCH METHOD

An overview of the research method used during the IKUTU study is included in the foreword to this special edition of the journal. As this article is based on the IKUTU study, the described methodology was used.

This article aims to assess preferences (relating to the extent of outsourcing practices, rationales, preferred external IAF providers and the status of in-house and outsourced IAFs) in terms of levels of measurement for data on ordinal scales (Likert-type scales were used); therefore additional non-parametric statistics were performed on the IKUTU results. Details follow in the discussion below.

References made to outsourcing in the remainder of the article include complete outsourcing as well as partial outsourcing, except where otherwise indicated. Similarly reference made to an outsourced IAF includes instances where certain or all internal auditing services were delegated to an external party.

RESULTS AND DISCUSSIONS

Extent of IAF outsourcing

Respondents were required to indicate the structure of their IAFs. In particular respondents had to indicate whether their IAFs were completely outsourced, co-sourced or in-house services. 47.6% of CEO/CFO/COO respondents indicated their IAFs were in-house, while for 13.4% of these respondents' IAFs were completely outsourced and 39.0% of them indicated their IAFs were co-sourced. For CAC respondents these percentages were 46.2, 6.7 and 47.1%, respectively. More than 60% of CAE respondents (64.0%) indicated that their IAFs were in-house, while according to 36.0% of these respondents their IAFs were either completely outsourced or co-sourced. The non-parametric Kruskal-Wallis test, as an alternative to the parametric one-way analysis of variance, was used to test differences in the ranks for the three groups of respondents. The Kruskal-Wallis test on the ranks revealed no significant differences between the responses of the three groups.

Rationales for outsourcing and in-house IAFs

Based on the literature, five rationales (cost implications

Table 1. Rationales for outsourcing IAFs.

	Cost	Skill shortage	Objectivity	Specialised technical expertise	Company strategy
CAC					
<i>M</i>	2.1	2.9	2.6	3.7	2.1
<i>N</i>	11	14	10	18	9
<i>s</i>	1.375	1.492	1.647	1.602	1.364
CEO/CFO/COO					
<i>M</i>	2.2	3.7	2.5	4.0	2.6
<i>N</i>	14	15	15	17	14
<i>s</i>	1.311	1.633	1.356	1.144	1.646
Total					
<i>M</i>	2.2	3.3	2.52	3.9	2.4
<i>N</i>	25	29	25	35	23
<i>s</i>	1.313	1.583	1.447	1.388	1.532

Key: *M* = mean; *N* = number of respondents; *s* = standard deviation. Marginal mean interpretation: Extremely important = ($M \geq 4.0$); very important = ($3.5 \leq M < 4.0$); important = ($3.0 \leq M < 3.5$); reasonably important = ($2.5 \leq M < 3.0$); not important = ($M < 2.5$).

where an outsource IAF is regarded as more cost-effective than an in-house IAF, the shortage of competent internal auditors, where outsourced internal auditors are perceived to be more objective than the in-house internal auditors, the need for specialised technical expertise or where a deliberate strategy is followed by the organisation to outsource the IAF) for outsourcing the services of IAFs and six rationales for maintaining in-house IAFs were formulated. The latter include cost implications where and in-house IAF is regarded as cheaper, complex business processes in the organisation hinder outsourcing, internal staff are perceived to have superior knowledge of the organisation, the in-house IAF serves as a training ground for management, internal audit is perceived to be part of corporate governance which is a management function and confidentiality remain intact where internal staff are utilised rather than external staff.

Respondents were required to rate the importance of rationales for outsourcing the services of their IAFs (Table 1) and for the use of in-house IAFs (Table 2). These were measured on a five-point scale ranging from 1 (not important) to 5 (extremely important). A response of "3" was taken to indicate an importance higher than "2" and lower than "4", rather than being an indication of the "central tendency bias".

In both instances respondents had the option not to rate a rationale if they regarded it as not applicable. In addition, if a respondent's company did not follow an outsourcing practice (not even for certain IAF services), such a respondent would not have responded to the five rationales for outsourcing IAFs which would have reduced

the number of responses. This resulted in the varied number of responses as indicated in Tables 1 and 2.

Rationales for outsourcing certain or all services performed by IAFs

The CEO/CFO/COO respondents perceived the need for specialised technical expertise as an extremely important rationale ($M = 4.0$) for the outsourcing of services of IAFs, while it was the only rationale perceived by CAC respondents to be very important ($M = 3.7$). CEO/CFO/COO respondents perceived the shortage of competent internal auditors as a very important rationale ($M = 3.7$) that contributed to the outsourcing decision, while CAC respondents perceived this as a reasonably important rationale ($M = 2.9$). Both CEO/CFO/COO and CAC respondents perceived cost implications ($M = 2.2$ and 2.1) as not being an important rationale in the outsourcing decision. The non-parametric Mann-Whitney *U*-test was performed with one independent variable, namely the type of respondent (CEO/CFO/COO and CAC), and five dependent variables, namely the identified rationales (Table 1). It revealed no significant differences between the responses of the CEO/CFO/COO and CAC groups.

Rationales for maintaining in-house IAFs

The three rationales perceived by CEO/CFO/COO respondents as extremely important in motivating the decision to use an in-house IAF were complex business

Table 2. Rationales for in-house IAFs.

	Cost	Business complexities	Knowledge of business	Training ground	Corporate governance	Confidentiality
CAC						
<i>M</i>	2.6	3.5	3.7	2.7	3.1	3.0
<i>N</i>	22	26	27	25	24	21
<i>s</i>	1.293	1.606	1.583	1.402	1.558	1.261
CEO/CFO/COO						
<i>M</i>	3.5	4.2	4.2	3.5	4.2	2.8
<i>N</i>	25	24	25	24	22	24
<i>s</i>	1.122	.761	.970	.977	.922	1.189
Total						
<i>M</i>	3.1	3.8	4.0	3.1	3.6	2.8
<i>N</i>	47	50	52	50	46	45
<i>s</i>	1.265	1.309	1.336	1.272	1.404	1.211

Key: *M* = mean; *N* = number of respondents; *s* = standard deviation. Marginal mean interpretation: Extremely important = ($M \geq 4.0$); very important = ($3.5 \leq M < 4.0$); important = ($3.0 \leq M < 3.5$); reasonably important = ($2.5 \leq M < 3.0$); not important = ($M < 2.5$).

processes in the company ($M = 4.2$), the superior knowledge of internal staff of the company ($M = 4.2$) and the fact that internal audit was perceived to be part of corporate governance ($M = 4.2$). The first two of the aforementioned rationales were perceived by the CAC respondents to be very important ($M = 3.5$ and 3.7), while the third rationale, namely that internal audit was perceived to be part of corporate governance, was only perceived by the CAC respondents to be important ($M = 3.1$).

Cost implications ($M = 3.5$) and the fact that the internal audit function serves as a training ground for management ($M = 3.5$) were perceived as very important by the CEO/CFO/COO respondents, while these rationales were perceived by CAC respondents to be reasonably important ($2.5 \leq M < 3.00$). The non-parametric Mann-Whitney *U*-test was performed with one independent variable, the type of respondent (CEO/CFO/COO and CAC), and six dependent variables, the identified rationales (Table 2). Three of the identified rationales for in-house IAFs showed significant differences on the ten percent (or better) level of significance: cost implications ($U = 174.5$, $Z = -2.236$, $p = 0.025$), in-house IAF serves as training ground ($U = 293.5$, $Z = -2.152$, $p = 0.031$) and IAF is part of corporate governance ($U = 151.5$, $Z = -2.592$, $p = 0.010$) were significantly affected by the category of respondents. In all three instances CEO/CFO/COO respondents attributed a higher degree of importance to these rationales than did the CAC respondents.

Preferred external IAF providers

CEO/CFO/COO respondents were required to identify the

external parties who performed the outsourced services of their IAFs. The majority of them (68.6%) indicated that such services of IAFs were mostly outsourced to one of the Big 4 public accounting firms. Public accounting firms other than the Big 4 firms (14.3%) were also used. CEO/CFO/COO respondents indicated that their company's own external auditors (5.7%), or individuals providing internal audit services (5.7%), or internal audit consulting firms (5.7%) were the least explored alternatives.

Status of in-house and outsourced IAFs

To determine the status of both the in-house and outsourced IAFs in this study three indicators were investigated: attributes of IAFs, value added by IAFs to different activities, and whether recommendations made by IAFs were implemented.

The research team identified IAFs' competence, commitment, effective service delivery, flexibility, added value and whether they meet expectations as attributes of both in-house and outsourced IAFs. These attributes served as the first indicator used to determine the status of both the in-house and outsourced IAFs. Respondents were required to rate their level of satisfaction with the current state of their outsourced IAFs and their in-house IAFs (Table 3), which were measured on a five-point scale ranging from 1 (extremely dissatisfied) to 5 (extremely satisfied). A response of "3" was taken to indicate an importance higher than "2" and lower than "4", rather than being an indication of the "central tendency bias".

To cover the second indicator in identifying the status of outsourced and in-house IAFs, respondents were requested to rate the current value added by their IAFs

Table 3. Attributes of in-house and outsourced IAFs.

	Competence	Commitment	Effective service delivery	Flexibility to accommodate management needs	Value added	Meet expectations
In-House IAFs						
CAC						
<i>M</i>	4.4	4.6	4.3	4.2	4.2	4.2
<i>N</i>	27	27	27	27	27	27
<i>s</i>	.565	.577	.679	.801	.662	.641
CEO/CFO/COO						
<i>M</i>	4.1	4.8	4.3	4.0	4.0	4.3
<i>N</i>	26	26	26	26	26	25
<i>s</i>	.864	.430	.667	.999	.894	.678
Total						
<i>M</i>	4.3	4.7	4.3	4.1	4.1	4.3
<i>N</i>	53	53	53	53	53	52
<i>s</i>	.731	.517	.668	.900	.781	.653
Outsourced IAFs						
CAC						
<i>M</i>	4.2	3.9	3.7	3.6	3.7	3.8
<i>N</i>	14	14	14	14	14	14
<i>s</i>	.802	.829	.825	.745	.726	.699
CEO/CFO/COO						
<i>M</i>	4.0	4.0	3.9	4.2	3.5	3.6
<i>N</i>	12	12	12	12	12	11
<i>s</i>	.739	.669	.996	.937	1.000	.688
Total						
<i>M</i>	4.1	4.0	3.8	3.9	3.6	3.7
<i>N</i>	26	26	26	26	26	25
<i>s</i>	.766	.748	.895	.864	.852	.690

Key: *M* = mean; *N* = number of respondents; *s* = standard deviation. Marginal mean interpretation: Extremely satisfied = ($M \geq 4.0$); satisfied = ($3.5 \leq M < 4.0$); neutral = ($3.0 \leq M < 3.5$); dissatisfied = ($2.5 \leq M < 3.0$); extremely dissatisfied = ($M < 2.5$)

with regard to eight identified activities; namely activities with regard to corporate governance, enterprise risk management, the control environment, operational effectiveness, the reputation of the company, independence assurance provided; mergers and acquisitions and forensic investigations (Table 4). The ratings were measured on a four-point scale providing for significant value added (H), moderate value added (M), limited value added (L) and no value added (N).

The third indicator required of the respondents to indicate the frequency (always, frequently, sometimes, occasionally and never) with which their companies implemented the recommendations made by both outsourced and in-house IAFs.

In all the above instances, respondents had the option not to rate the importance of an attribute, or not to rate the value added by a specific activity, or not to indicate the implementation frequency, if they regarded it as not applicable. It resulted in the varied number of responses as indicated in Tables 3 and 4.

Attributes of IAFs

The perceptions of CEO/CFO/COO respondents revealed that these respondents were extremely satisfied ($M \geq 4.0$) that their in-house IAF demonstrated compliance with each of the six attributes listed (Table 3), as well as with the competence ($M = 4.0$), commitment ($M = 4.0$) and flexibility ($M = 4.2$) displayed by the outsourced IAF. With regard to the effectiveness of services and value added by the outsourced IAF, the CEO/CFO/COO respondents were deemed to be satisfied ($3.5 \leq M < 4.0$). The latter was also the case with regard to the outsourced IAF meeting of expectations ($M = 3.6$).

Similar responses were obtained from the CAC respondents' perceptions (Table 3). The perceptions of CAC respondents revealed extreme satisfaction that their in-house IAF demonstrated compliance with each of the six attributes listed, as well as with the competence displayed by the outsourced IAF. With regard to the other attributes of the outsourced IAF, the CAC respondents

Table 4. Value added by in-house and outsourced IAFs.

	Corporate governance	Enterprise risk management	Control environment	Operational effectiveness	Reputation of company	Independent assurance	Mergers and acquisitions	Forensic investigations
In-House IAFs								
CAC								
<i>M</i>	3.4	3.4	3.8	3.3	3.3	3.6	2.3	3.2
<i>N</i>	26	27	26	27	27	27	24	25
<i>s</i>	.892	.747	.402	.724	.764	.698	.794	.866
CEO/CFO/COO								
<i>M</i>	3.5	3.2	3.6	3.1	3.1	3.6	2.5	3.2
<i>N</i>	23	24	24	24	22	23	14	18
<i>s</i>	.593	.816	.576	.797	.834	.783	.855	.943
Total								
<i>M</i>	3.4	3.3	3.7	3.2	3.2	3.6	2.3	3.2
<i>N</i>	49	51	50	51	49	50	38	43
<i>s</i>	.762	.782	.497	.757	.790	.731	.815	.888
Outsourced IAFs								
CAC								
<i>M</i>	2.7	2.6	3.0	2.6	2.3	2.8	1.8	1.9
<i>N</i>	11	11	11	11	11	11	5	7
<i>s</i>	.905	1.027	.894	.522	.647	.874	.447	.690
CEO/CFO/COO								
<i>M</i>	2.6	2.9	3.4	2.5	2.5	3.5	1.9	2.6
<i>N</i>	12	14	14	14	13	13	7	10
<i>s</i>	.669	.663	.633	.760	.877	.519	.900	.843
Total								
<i>M</i>	2.7	2.8	3.2	2.5	2.4	3.2	1.8	2.3
<i>N</i>	23	25	25	25	24	24	12	17
<i>s</i>	.775	.831	.764	.653	.770	.761	.718	.849

Key: *M* = mean; *N* = number of respondents; *s* = standard deviation. Marginal mean interpretation: No value added = ($1.0 \leq M < 2.0$); limited value added = ($2.0 \leq M < 3.0$); moderate value added = ($3.0 \leq M < 4.0$); significant value added = ($M \geq 4.0$).

were deemed to be satisfied ($3.5 \leq M < 4.0$).

The non-parametric Mann-Whitney *U*-test was performed with one independent variable, the type of respondent (CEO/CFO/COO and CAC), and six dependent variables, the identified attributes (Table 3) of IAFs. The attribute of flexibility to accommodate management needs by outsourced IAFs, on a ten percent level of significance, was significantly affected by the category of CEO/CFO/COO respondents ($U = 52.0$, $Z = -1.779$, $p = 0.075$). CEO/CFO/COO respondents attributed a higher degree of satisfaction to this attribute than did the CAC respondents.

Value added by IAFs

Both the CEO/CFO/COO and CAC respondents perceived that their in-house IAFs added moderate value ($3.0 < M \leq 4.0$) to all identified activities (listed in Table 4), except for mergers and acquisitions where they perceived

only limited value ($M = 2.5$ & $M = 2.3$) to be added. Both groups of respondents perceived the value added by their outsourced IAFs to be at a lower level. CEO/CFO/COO and CAC respondents perceived that their outsourced IAFs never added significant value and that only moderate value ($M = 3.4$ and 3.0) was added for its part of the control environment; and for independent assurance provided CEO/CFO/COO respondents perceived also moderate value ($M = 3.5$), while CAC respondents perceived only limited value ($M = 2.8$) to be added. For the majority of activities performed by outsourced IAFs, CEO/CFO/COO and CAC respondents perceived that limited value was added ($2.0 \leq M < 3.0$) and for mergers and acquisitions these respondents perceived no value to be added ($M = 1.9$ & $M = 1.8$). The CAC respondents also perceived that no value ($M = 1.9$) was added by the outsourced IAF for forensic investigations, while CEO/CFO/COO respondents perceived such value to be limited ($M = 2.6$).

The non-parametric Mann-Whitney *U*-test was per-

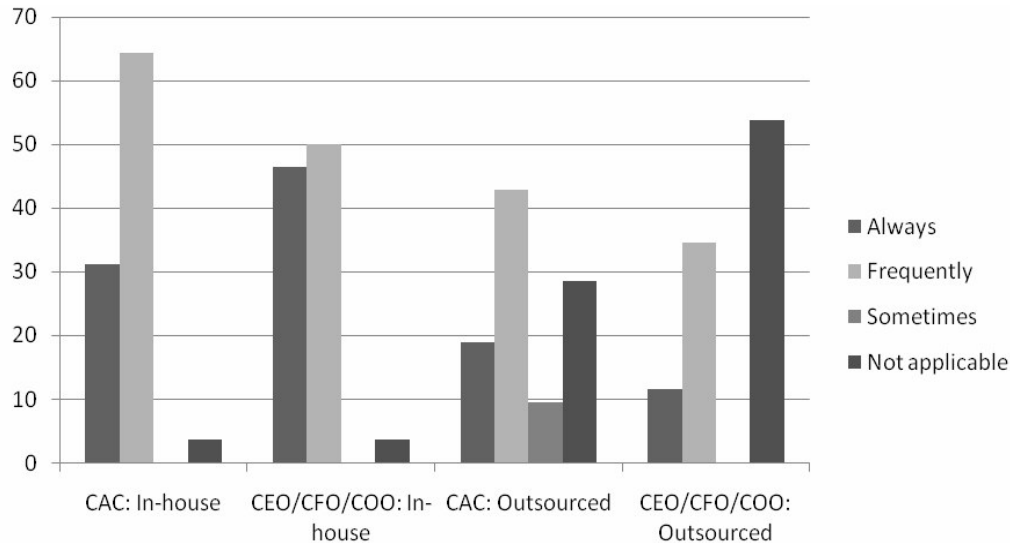


Figure 1. Frequency of implementation of IAF recommendations.

performed with one independent variable, the type of respondent (CEO/CFO/COO and CAC), and eight dependent variables, the identified activities (Table 4). Two activities of outsourced IAFs, independence assurance ($U = 40.5$, $Z = -1.928$, $p = 0.054$) and forensic investigations ($U = 17.5$, $Z = -1.817$, $p = 0.069$), were significantly affected by the category of respondents. CEO/CFO/COO respondents perceived more value to be added by their outsourced IAFs than did the CAC respondents.

Implementation of recommendations made by IAFs

Respondents were required to indicate the frequency with which their companies implemented the recommendations made by outsourced and in-house IAFs. Figure 1 depicts the perceptions of both CEO/CFO/COO and CAC respondents. CAC respondents perceived that approximately a third (32.1%) of their companies always implemented the recommendations made by in-house IAFs and that this practice is followed by 64.3% of their companies on a frequent basis. For outsourced IAFs these perceptions of CAC respondents reported a much lower percentage of their companies that implement recommendations (19.0 and 42.9%, respectively). They also perceived that 9.5% of their companies sometimes implement the recommendations made by their outsourced IAFs.

From Figure 1 it is clear that CEO/CFO/COO respondents perceived the frequency of the implementation of their outsourced IAFs' recommendations (11.5%) at a much lower percentage than that of their in-house IAFs (46.4%). The majority of CEO/CFO/COO respondents (53.8%) perceived recommendations from their outsourced IAF as not applicable. Such a response is

concerning if the respondents viewed recommendations made by outsourced IAFs as irrelevant, especially since these respondents perceived that a high percentage of IAF activities were completely outsourced or co-sourced (13.4 and 39.0%). It could also be that some of the respondents chose the not applicable option because their companies are not involved in the outsourcing of internal audit. This finding represents an area which should be explored in more detail.

Conclusion and future directions

The results of this study provide insights into the internal audit outsourcing practices of large listed companies in South Africa. It was found that the participating companies mainly used in-house and co-sourced IAFs, but complete outsourcing was also present in their IAF structures.

The findings showed that both CAC and CEO/CFO/COO respondents perceived the need for specialised technical expertise as being the most important rationale for outsourcing all or certain services of IAFs. CEO/CFO/COO respondents perceived the shortage of competent internal auditors in South Africa as a very important rationale. These findings align with the Australian Subramaniam et al. (2004: 93) study and the UK respondents' views in the Selim and Yiannakas (2000: 223) study who viewed their inability to retain and recruit people with necessary skills as the main reason for outsourcing internal audit. More than a decade ago the Mjoli study (1997:68) also identified the scarcity of skills as a key driver for outsourcing internal auditing in South Africa and since then Fasset (2009: pp 10, 11) has identified internal audit as a scarce skill in South Africa. It affords an opportunity for further research investigating

the competencies (knowledge, skills and attitudes) required of internal auditors at specific levels and to determine the current and expected shortfall in the supply of competent internal audit managers, seniors, assistants and trainees.

The study furthermore revealed that both CAC and CEO/CFO/COO respondents perceived 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 results indicate that the CAC and CEO/CFO/COO respondents disagree significantly on the importance of three rationales for using an in-house IAF to perform certain or all internal audit services: namely cost implications, an in-house IAF serves as training ground or a stepping stone to management positions and an IAF forms part of corporate governance. On all counts the CEO/CFO/COO respondents consider these rationales to be more important than did the CAC respondents.

The study found that certain or all services of participating companies' IAFs were mostly outsourced to one of the Big 4 public accounting firms. This finding concurs with past research such as the Van Peurse and Jiang (2008: 233) study in New Zealand and the UK study of Selim and Yiannakas (2000: 220). Factors contributing to the Big 4 public accounting firms as being preferred outsourced parties represent an area for further exploration. In particular the finding of Caplan and Kirschenheiter (2000: 411) that public accountants provide the same or higher levels of testing than in-house internal auditors which may result in a higher fee, warrants further investigation. To determine the perceived status of both in-house and outsourced IAFs, the importance of certain attributes (IAFs' competence, commitment, effective service delivery, flexibility, added value and whether they meet expectations) was determined, the value added by IAFs in various activities was investigated and the frequency at which IAFs' recommendations were implemented by the participating companies was determined. The results revealed that CEO/CFO/COO respondents were extremely satisfied that their in-house IAFs demonstrated compliance with each of the identified six attributes, as well as being extremely satisfied with the competence, commitment and flexibility to accommodate managements' needs displayed by their outsourced IAFs. CAC respondents' perceptions on their in-house IAFs were similar to the perceptions of the CEO/CFO/COO respondents, but for their outsourced IAFs they only perceived extreme satisfaction with regard to the competence attribute. Significant disagreement existed between the satisfaction perceived by the two groups of respondents relating to the flexibility of the IAFs to whom certain or all internal audit services were outsourced. The CAC respondents expressed significantly less satisfaction with this attribute than did the CEO/CFO/COO respondents.

Both groups of respondents perceived the value added

by their in-house IAFs to be more than the value added by their outsourced IAFs. Further statistical analysis revealed that perceptions of CEO/CFO/COO and CAC respondents on two activities of their outsourced IAFs, namely independent assurance and forensic investigations, were significantly affected by the category of respondents. The findings of the study furthermore revealed that recommendations made by in-house IAFs are implemented more frequently than those of the IAFs to whom certain or all internal audit services were outsourced. CEO/CFO/COO respondents perceived more value to be added by their outsourced IAFs than did the CAC respondents. The results of the study also showed that the majority of CEO/CFO/COO respondents perceived recommendations from their outsourced IAF as not applicable. This finding represents an area which should be further explored, because it contradicts their perceived satisfaction with the attributes of their outsourced IAFs and the value added by them. An investigation should be conducted to determine whether recommendations from outsourced IAFs are considered relevant and possible causes of this contradiction.

Although the study was limited to 30 large listed companies in South Africa, it makes a valid contribution to internal audit outsourcing practices in South Africa. Goodwin-Stewart and Kent (2006:95) found a strong correlation between internal audit and the size of an organisation in Australia, suggesting that smaller organisations do not regard internal audit as being cost-effective. The incidence of IAFs in smaller South African organisations could be investigated. The latter could be expanded to determine the financial viability of internal audit outsourcing for small organisations, which according to Duck (2006: 67) makes financial sense.

The final research area to be explored emanates from the fact that this research was limited to the private sector. Taking into account the public sector legislation, the Public Finance Management Act (South Africa, 1999: section 38(1)(a)(i)(ii)) and the Municipal Finance Management Act (South Africa, 2003: section 165(1)), which require national and provincial departments and municipalities to have IAFs, and the known shortage of skills in South Africa, more work is needed to gain an understanding of internal audit outsourcing practices in the public sector.

The findings of the study enable the IIA to assess its standards on outsourcing IAFs. External providers can use these findings to identify future opportunities and companies may compare their own internal audit outsourcing practices with those revealed by the study.

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